



CSIS *California School Information Services*

Escondido Union School District

Unification Study

Including the
Escondido Union School District
and the
Escondido Union High School District

March 8, 2011



Joel D. Montero
Chief Executive Officer







CSIS California School Information Services

March 8, 2011

Jennifer Walters, Superintendent
Escondido Union School District
2310 Aldergrove Avenue
Escondido, CA 92029

Dear Superintendent Walters:

In May 2010, the Escondido Union School District and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement to conduct a review of the potential fiscal impact of unifying the Escondido Union School District and the Escondido Union High School District. Specifically, the agreement states that FCMAT will perform the following:

1. Conduct a review of the fiscal impact only of a potential reorganization of the Escondido Union School District and the Escondido Union High School District (The study does not include the evaluation of the state's nine criteria pursuant to Education Code Section 35753).

In accordance with Education Code Section 35735.1, the computation of the base revenue limit for the newly organized school districts will be based on the current information available for each affected school district for the second principal apportionment of the 2009-10 fiscal year and will be used for budgetary estimates of ADA, full-time equivalent employees (FTEs), salaries and benefits. Neither school district is considered Basic Aid for purposes of this calculation.

The attached final report contains the study team's findings and recommendations.

FCMAT appreciates the opportunity to serve you and extends thanks to all the staff of the Escondido Union Elementary School District and the Escondido Union High School District for their cooperation and assistance during fieldwork.

Sincerely,



Joel D. Montero
Chief Executive Officer

FCMAT

Joel D. Montero, Chief Executive Officer

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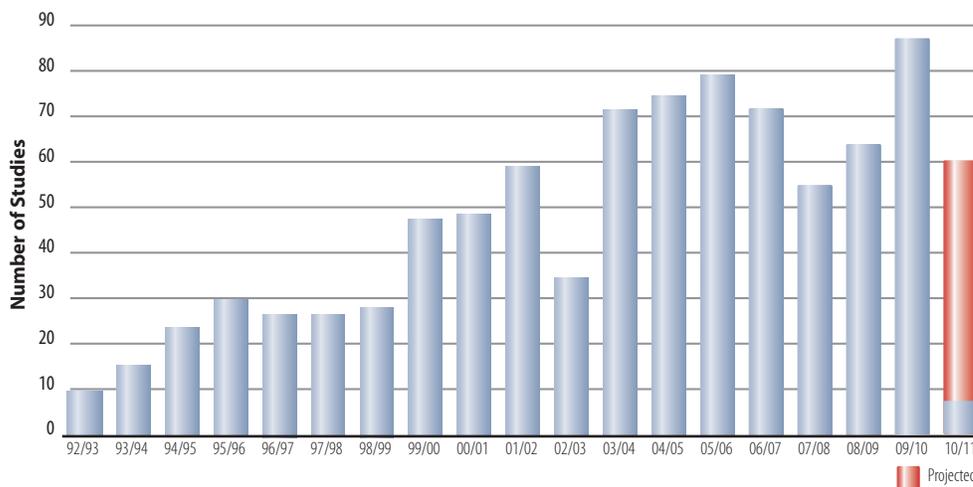
About FCMAT

FCMAT’s primary mission is to assist California’s local K-14 educational agencies to identify, prevent, and resolve financial and data management challenges. FCMAT provides fiscal and data management assistance, professional development training, product development and other related school business and data services. FCMAT’s fiscal and management assistance services are used not just to help avert fiscal crisis, but to promote sound financial practices and efficient operations. FCMAT’s data management services are used to help local educational agencies (LEAs) meet state reporting responsibilities, improve data quality, and share information.

FCMAT may be requested to provide fiscal crisis or management assistance by a school district, charter school, community college, county office of education, the state Superintendent of Public Instruction, or the Legislature.

When a request or assignment is received, FCMAT assembles a study team that works closely with the local education agency to define the scope of work, conduct on-site fieldwork and provide a written report with findings and recommendations to help resolve issues, overcome challenges and plan for the future.

Study Agreements by Fiscal Year



FCMAT also develops and provides numerous publications, software tools, workshops and professional development opportunities to help local educational agencies operate more effectively and fulfill their fiscal oversight and data management responsibilities. The California School Information Services (CSIS) arm of FCMAT assists the California Department of Education with the implementation of the California Longitudinal Pupil Achievement Data System (CALPADS) and also maintains DataGate, the FCMAT/CSIS software LEAs use for CSIS services. FCMAT was created by Assembly Bill 1200 in 1992 to assist LEAs to meet and sustain their financial obligations. Assembly Bill 107 in 1997 charged FCMAT with responsibility for CSIS and its statewide data management work. Assembly Bill 1115 in 1999 codified CSIS’ mission.

AB 1200 is also a statewide plan for county office of education and school districts to work together locally to improve fiscal procedures and accountability standards. Assembly Bill 2756

(2004) provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans.

In January 2006, SB 430 (charter schools) and AB 1366 (community colleges) became law and expanded FCMAT's services to those types of LEAs.

Since 1992, FCMAT has been engaged to perform nearly 850 reviews for LEAs, including school districts, county offices of education, charter schools and community colleges. The Kern County Superintendent of Schools is the administrative agent for FCMAT. The team is led by Joel D. Montero, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

Introduction

Background

Located in northwest San Diego County, the Escondido Union (Elementary) School District and the Escondido Union High School District each have a separate governing board consisting of five elected representatives. Enrollment for each of these districts has declined during the last two years, and further decline is projected for the future.

According to the October 2009 unofficial California Basic Educational Data System (CBEDS) report, the Escondido Union School District serves 18,002 students in grades K-8 in 17 elementary schools, five middle schools and one community day school. The district also operates preschool and First Years programs, which serve an additional 607 students districtwide.

According to the same CBEDS data source, the Escondido Union High School District serves 8,202 students in grades 9-12 in four high schools. The district also operates one adult school and a regional occupational program (ROP).

In May 2010, the Escondido Union Elementary School District requested that FCMAT assist the district by conducting a review of the potential fiscal impact of a reorganization of the Escondido Union School District and the Escondido Union High School District. The study agreement specifies that FCMAT will perform the following.

1. Conduct a review of the fiscal impact only of a potential reorganization of the Escondido Union School District and the Escondido Union High School District (The study does not include the evaluation of the state's nine criteria pursuant to Education Code Section 35753).
2. In accordance with Education Code Section 35735.1, the computation of the base revenue limit for the newly organized school districts will be based on the current information available for each affected school district for the second principal apportionment of the 2009-10 fiscal year and will be used for budgetary estimates of ADA, full-time equivalent employees (FTEs), salaries and benefits. Neither school district is considered Basic Aid for purposes of this calculation.

The San Pasqual Union School District also falls within the boundaries of the Escondido Union High School District but is not part of the proposed unification that is the subject of this report. Unification with the San Pasqual Union School District would be allowed by law but is not required. If such a unification were to be considered, any decision regarding it would be made by the county committee on school district organization, subject to appeal to the State Board of Education.

Study Guidelines

FCMAT visited the Escondido Union School District on September 15, 2010 and the Escondido Union High School District on September 16, 2010 to conduct interviews, collect data and review documents. This report is the result of those activities and is divided into the following sections:

- I. Executive Summary
- II. Education Code Criteria
- III. Revenue Limit
- IV. Projected Salary and Benefit Costs
- V. Consolidation or Division of Assets and Liabilities
- VI. Additional Unification Issues
- VII. Appendices

Study Team

The study team was composed of the following members:

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*As a member of this study team, this consultant was not representing his employer but was working solely as an independent contractor for FCMAT.

Executive Summary

With the continued decline in the State of California's economic position and the resulting reductions in funding for K-12 education, local educational agencies are seeking to identify every possible avenue to address serious fiscal shortfalls by either increasing revenue or reducing expenditures. School district unification is one action that may accomplish both goals by increasing state aide and eliminating duplicate services. State law provides for an increase in total revenue limit funding during unification because it recognizes the need to develop a common salary and benefit structure for all employees of a newly reorganized district.

Unification is the process by which an entire elementary district and high school district or portions of them are reorganized into a unified district serving students in kindergarten through grade 12. In the case of Escondido, unification involves an elementary and a high school district, expanding the number of grades served to K-12. Unification of school districts often provides increased organizational efficiency and economies of scale as well as enabling the districts to reduce expenditures through consolidation of services. Consolidation often results in some staffing redundancies and thus opportunities to reduce costs.

When districts unify, a new revenue limit is calculated in accordance with Education Code Section 35735.1 using a two-step process. The first step is to blend the base revenue limits of the affected districts. This calculation is revenue-neutral. The second step is to raise the districts with the lower average costs for certificated and classified full-time equivalent employees (FTEs) to the level of the district with the higher average costs per FTE. This is done once for the classified and once for the certificated employee groups. This adjustment is then added to the blended base revenue limit. The adjustment to the new revenue limit is based exclusively on the differences in average cost per FTE, not on the actual cost of bringing all employees to a common salary schedule.

Depending on an individual district's particular circumstances, the revenue limit adjustment may or may not be sufficient to cover the actual costs to develop a common salary and benefit structure for all employees of the newly reorganized district. FCMAT calculated the projected revenue limit adjustment for the Escondido Union School District and the Escondido Union High School District based on each district's final financial activity and staffing levels for fiscal year 2009-10. This calculation is a snapshot in time, and the results will change if recalculated based on a subsequent fiscal year. Based on fiscal year 2009-10, FCMAT's adjusted revenue limit calculations for the proposed unified district project an adjustment or increase of approximately \$11.5 million, which equals \$458.70 per average daily attendance (ADA), based on each district's average salaries for certificated and classified employees. This amount reflects the additional dollars the district would receive prior to application of the fiscal year 2009-10 deficit of 18.355%; applying the fiscal year 2009-10 deficit results in net funding of \$9,350,755. The additional funding is provided based on ADA, thus districts with declining enrollment in the years following unification will receive less funding in those years.

When districts unify, every district involved needs to consider numerous areas, many of which have financial impacts and are dependent on multiple variables. The cost of unification is separate from and unrelated to the funding generated through the revenue limit calculation for many of these variables.

Other factors should be considered in addition to the amount of new revenue generated through unification. These include movement to common salary schedules; restructuring staffing to

address redundancies; collective bargain issues; division of assets; and financial obligations, including long-term debt and differing retiree benefit obligations.

Each district has its own unique financial commitments that must be considered when exploring the prospect of unifying. However, typically some of the financial implications are unknown prior to unification. For example, all salary and benefit costs are subject to collective bargaining without regard to current salary schedules, thus the cost projections prepared in advance of board action will be different from what is actually experienced.

Although numerous issues that will have a financial impact are not evaluated in this study, FCMAT prepared an example calculation of the potential costs of moving staff members on the elementary school district's certificated teachers' salary schedule in 2009-10 to the high school district's higher certificated salary schedule. FCMAT also prepared a sample calculation of the cost of providing health benefits for the same certificated staff at the level offered by the high school district. Based on the data provided and the assumptions used for these calculations, the projected annual increase in cost for salaries and benefits is \$4.78 million. This estimate does not include an analysis of the increased costs for other certificated employee groups.

FCMAT also prepared a sample calculation based on total classified salaries and benefits for fiscal year 2009-10 to extrapolate the potential cost related to classified staff. Under the assumptions used for this calculation, estimated costs to adjust classified staff salaries and benefits to create a common salary schedule would be approximately \$2.15 million.

Together, these sample calculations result in a possible total annual cost of \$6.93 million. This would leave a balance of \$2.42 million to address other fiscal implications of unification, including costs related to other certificated positions. To provide some perspective, \$2.42 million is equal to 1.83% of the combined deficit revenue limit calculated for the unified district.

These are only sample calculations based on a snapshot in time and one set of potential assumptions. The board in a newly unified school district would be under no obligation to take this action. Actual costs experienced by a newly unified district will be different.

Outstanding obligations of each district are matters of particular focus, including retiree benefit obligations and the creation of a common benefit structure for employees once a district moves towards unification. Employees whose retirement rights are vested would be protected under California's constitutional prohibition against contract impairment.

Developing a retiree benefit offering for employees of a newly unified district could have a significant effect on the district's resources. Like salaries and benefits, retirement packages are subject to collective bargaining. FCMAT did not assess the potential financial impact of current contractual commitments for retiree benefits. It is reasonable to expect that a decision to extend to elementary staff the same retiree benefit package currently offered to the high school certificated staff would result in an increased future obligation. All unifying districts should acknowledge current liabilities related to post-employment medical benefits in the petition to reorganize.

Both the Escondido Union School District and the Escondido Union High School District have incurred a significant amount of non-voter-approved debt. Any long-term debt that the district must pay out of the unrestricted general fund is considered unfunded because it requires the use of resources typically dedicated to current operating costs, including employees' salaries, administration and supplies. Although most districts are able to fund some long-term debt out of their general fund, caution should be exercised because this depletes funds available for current operations.

At the time of fieldwork, the Escondido Union School District also had a \$9 million unfunded liability in its FBC Health Fund as a result of the dissolution of a self-insured medical insurance plan. Subsequent to fieldwork, the district issued refunding bonds to address the health fund's operational deficit. If unification occurs, any remaining liabilities, including this one, would become the liability of the new unified district. Details regarding long-term debt issued by both the elementary and high school districts after the completion of fieldwork are provided in the Subsequent Events section on page 30 of this report.

In addition to compensation and post-employment benefits, operational differences will also require assessment should the two districts unify. Transportation and food services are among the operational areas that will require further consideration.

This study does not evaluate whether the proposed school district reorganization meets the criteria in Education Code Section 35753; rather, it focused solely on the fiscal impacts of unification.

Findings and Recommendations

Education Code Criteria

Unification of school districts may be initiated either by voter petition or by petitions of the affected districts' governing boards. In either event, the county committee on school district organization and the State Board of Education (SBE) must determine the impact of the unification based on the criteria listed in Education Code Section 35753. This study does not evaluate whether the proposed school district reorganization meets these criteria; rather, it focuses solely on the fiscal impact of unification. However, the criteria are as follows:

- The reorganized districts will be adequate in terms of number of pupils enrolled.
- The districts are each organized on the basis of a substantial community identity.
- The proposal will result in an equitable division of property and facilities of the original district or districts.
- The reorganization of the districts will preserve each affected district's ability to educate students in an integrated environment and will not promote racial or ethnic discrimination or segregation.
- Any increase in costs to the state as a result of the proposed reorganization will be insignificant and otherwise incidental to the reorganization.
- The proposed reorganization will continue to promote sound education performance and will not significantly disrupt the educational programs in the districts affected by the proposed reorganization.
- Any increase in school facilities costs as a result of the proposed reorganization will be insignificant and otherwise incidental to the reorganization.
- The proposed reorganization is primarily designed for purposes other than to significantly increase property values.
- The proposed reorganization will continue to promote sound fiscal management and not cause a substantial negative effect on the fiscal status of the proposed district or any existing district affected by the proposed reorganization.
- Any other criteria as the board may, by regulation, prescribe.

A more thorough understanding of the unification process and the criteria enumerated in the education code can be found in the *District Organization Handbook* published by the California Department of Education and available online at <http://www.cde.ca.gov/re/lr/do/>.

The San Pasqual Union School District also falls within the boundaries of the Escondido Union High School District but is not part of the proposed unification that is the subject of this report. Unification with the San Pasqual Union School District would be allowed by law but is not required. Such a unification would also require a decision from the county committee on school district organization, and be subject to appeal to the State Board of Education.

Recommendations

If the two districts proceed with unification, the districts should:

1. Ensure that the unification meets the nine criteria for reorganization listed in Education Code Section 35753.

Revenue Limit

FCMAT obtained from each district its fiscal year 2009-10 unaudited actuals report, 2009-10 second principal apportionment report, and 2009-10 year-end position control reports for salaries and benefits of certificated and classified full-time equivalent employees (FTEs). The affected school districts are not and will not in the foreseeable future become Basic Aid districts, nor are there any necessary small schools in the unification area. As described in the following section, the computation was made in accordance with Education Code Section 35735.1.

Computing the Unified District's Revenue Limit

Upon unification of school districts, the revenue limit for the new unified district is computed using two steps (Education Code Sections 35735 and following):

1. A blending of the former elementary and high school district revenue limit amounts per average daily attendance (ADA); and,
2. An adjustment made as a revenue limit add-on for the difference between the two districts' average salary and benefit costs.

The first step in the calculation is revenue-neutral because it merely blends the two different revenue limit amounts based on proportional elementary and high school district ADA. The second step adds funding per ADA because a common salary schedule for each bargaining unit must be adopted at the time of unification. This adjustment for the difference in average salaries and benefits accounts for the only additional money that results from unification. The law allows for an adjustment to be made even if common salary schedules are in use at the time of unification.

The new governing board of the unified district retains the right to negotiate all salary costs to higher or lower levels, except those for classified staff, who have a right to two years of continued employment at the rate of pay and benefits in effect at the time of unification, subject to mutual negotiation (Education Code Section 45121). The districts should also consider the provisions of Education Code Section 45028, which requires that the certificated staff be paid on a uniform salary schedule.

Computation Results

An estimated revenue limit has been computed by FCMAT for the proposed Escondido Union School District. A summary of the calculation is provided in Table 1.

Table 1: Summary of Revenue Limit Calculations, Escondido Union School District

District	Base Revenue Limit Before Unification (2009-10)	Estimated Blended Base Unified District Revenue Limit	Estimated Salary & Benefit Adjustment Per ADA	Estimated Unified School District Revenue Limit	Total Estimated Additional Dollars	Total Estimated Additional Percentage
Escondido Union Elementary	\$6,099.60	\$6,493.16	\$458.70	\$6,951.86	\$11,452,942.04	7.06%

Table 2 below shows the details of the new unified district's estimated blended revenue limit.

Table 2: Estimated Blended Revenue Limit for New Unified District
(Base year data: 2009-10 actuals)

District	2009-10 Base Revenue Limit per ADA A	2009-10 Revenue Limit ADA B	Affected ADA C	Percent of District in Reorganization D = C / B	Computed Total Base Revenue Limit E = A x C
Escondido Union Elementary	\$6,099.60	17,248.73	17,248.73	100%	\$105,210,354
Escondido Union High	\$7,372.53	7,719.75	7,719.75	100%	\$56,914,088
Total			24,968.48		\$162,124,442
Total Computed Total Base Revenue Limit			\$162,124,442		
Total Affected ADA			24,968.48		
Blended Base Revenue Limit Per ADA (before add on)			\$6,493.16		

To calculate the revenue limit for the new unified district, FCMAT used the ADA in each district's 2009-10 second interim reporting period (P-2) revised J18/19 attendance reports. The final calculation should be performed after unification using the final P-2 information certified by California Department of Education (CDE).

The revenue limit for the proposed unified school district will be computed based on the second fiscal year prior to the effective date of unification. For example, if the unification is effective July 1, 2011, the base fiscal year for the calculation will be 2009-10. Because of the long time needed to plan, process and approve unifications, it is unlikely that unification could be made effective by July 1, 2011. Therefore these estimates are helpful for planning, but the estimated revenue limit would need to be recalculated based on data from two years prior to the unification date. The calculations provided in Tables 1 and 2 are based on a particular moment in time, so fluctuations in variables such as the number of FTEs, changes in salary and benefit costs, and changes in average daily attendance could increase or decrease these estimates.

Because the base revenue limit for the new district must be calculated using data from the second year prior to the effective date of the reorganization, the law allows the new revenue limit to be adjusted for inflation increases, such as the cost of living adjustment (COLA), that occur between the second fiscal year prior and the effective date of the reorganization. The new base revenue limit also receives any other adjustments for which it would have been eligible had the reorganization been effective two fiscal years earlier.

Calculation of Average Salaries and Benefits per FTE

Although the law provides for a revenue limit adjustment based on the difference in salary and benefit schedules between the districts, the calculation is based on the *average* costs of salaries and benefits for certificated and for classified employees in each district. The calculation is not based on the *actual* cost of moving employees to higher salary and benefit schedules. Therefore, depending on an individual district's particular circumstances, the revenue limit adjustment may or may not be sufficient to cover the actual cost. There is no requirement to move employees to

the higher salary schedule; however, there is often an expectation that this will occur. FCMAT analyzed projected costs for certificated staff based on actual staffing for both districts during fiscal year 2009-10.

FCMAT followed the CDE's *District Organization Handbook* (February 2009) when calculating average salaries and benefits per FTE. There are no state laws or regulations that provide definitive guidance for this calculation. However, state law stipulates that all salaries and benefits for both full- and part-time certificated (or classified) employees be included in the computation.

Table 3 presents the calculation of the new unified district's estimated adjustment for salaries and benefits.

Table 3: Calculation of Certificated and Classified Employee Salaries and Benefits Additional Costs

Calculation for Certificated Employee Salary and Benefits Adjustment

District	Total Salaries & Benefits	Certificated FTE	Average Salaries & Benefits per FTE	% of District in Reorganization	Affected FTE	Affected ADA	25% Test Met?	Salary and Benefit Adjustment	Adjustment to Highest Average Salary
	A	B	C = A / B	D	E = B / D			\$98,480	
Escondido Union Elementary	\$93,790,299	1003.6	\$93,454	100%	1,003.60	17,248.73	YES	\$5,026	\$5,044,491.08
Escondido Union High	\$38,683,046	392.80	\$98,480	100%	392.80	7,719.75	YES	\$ -	\$ -
					1,396.40	24,968.48			\$5,044,491.08

Calculation for Classified Employee Salary and Benefits Adjustment

District	Total Salaries & Benefits	Classified FTE	Average Salaries & Benefits per FTE	% of District in Reorganization	Affected FTE	Affected ADA	25% Test Met?	Salary and Benefit Adjustment	Adjustment to Highest Average Salary
	A	B	C = A / B	D	E = B / D			\$73,540	
Escondido Union Elementary	\$32,236,801	525.50	\$61,345	100%	525.50	17,248.73	YES	\$12,195	\$6,408,450.96
Escondido Union High	\$17,406,175	236.69	\$73,540	100%	236.69	7,719.75	YES	\$ -	\$ -
					762.19	24,968.48			\$6,408,450.96

Certificated Adjustment \$5,044,491.08

Classified Adjustment \$6,408,450.96 09-10 Deficit Net After Deficit

Total Salary Adjustment \$11,452,942.04 -18.3550% \$9,350,754.53

Affected ADA 24,968.48

Total Add-on Per ADA \$458.70

FCMAT used salaries and benefits reported by each district on the Standardized Account Code Structure (SACS) 2009-10 unaudited actuals fund forms to calculate total average salaries and benefits per FTE. Salary and benefit costs reported in each district's deferred maintenance fund were excluded from this calculation because they were deemed immaterial. Also excluded were expenditures for the Escondido Union High School District's adult education fund, because the revenue limit add-on calculation provides general fund income that cannot be used for adult education (E.C. 52501.5).

Expenditures related to board member stipends, related statutory benefits and health premium benefits were removed from each district's 2009-10 expenditures, as were the costs of other post-employment benefits (OPEB) for current retirees. In addition, expenditures for personnel commission members' benefits were deducted from the elementary school district's 2009-10 total expenditures.

FTE calculations were prepared using position control data provided by each district as of June 30, 2010. Staff members who were assigned a partial FTE because of a partial year contract were included. Minor variances in partial FTE were identified for employees with early terminations and late starts, but these were immaterial to the calculations.

The 10% Limit

Education Code section 35735.1(a)(4)(A) limits the increase in base revenue limit for a school district reorganization to no more than 10% more than the blended revenue limit. In addition, state law requires that the new base revenue limit not exceed the amount included in the petition to reorganize.

Using financial information provided by the districts, FCMAT has determined that the base revenue limit increase per ADA for the unification being considered in this study would be \$458.70, which does not exceed the 10% limitation.

Cost of Living Adjustments and Deficits

When all calculations are final, the new base revenue limit of a newly unified school district must be updated to include inflation adjustments and current deficits. Cost of living adjustments (COLAs) that the district would have received had the reorganization taken place during the fiscal year from which the data is extrapolated must be applied. The new base revenue limit is also subject to the deficit factor in effect at that time, and as a result the total adjusted revenue limit per ADA will also be affected by the deficit factor. Because the current economic climate makes deficit factors subject to change, FCMAT applied the final deficit factor from fiscal year 2009-10.

The calculation presented above is based on the most current known inflation and deficit factors as of the date of fieldwork. With the decline of the state's economic climate, some factors previously considered during unifications have become less applicable. Most notable is the assertion included in a previous unification study that the increase to the revenue limit from unification would erode over time in comparison to the COLAs and potential equalization aid the districts would receive if they remained separate. Now that the revenue limit deficit exceeds 17%, those concerns seem unwarranted. These factors, as well as changes in the law and in the districts' financial status, warrant revisiting this issue.

Table 4: Estimated Revenue Limit for the Proposed Unified District

Estimated Blended Unified Base Revenue Limit Per ADA		\$6,493.16
Add-on Dollars per ADA	\$ 458.70	
10% Maximum Increase	\$ 649.32	
Lesser of Add-on or 10% Cap		\$458.70
Total Estimated Unified District Revenue Limit per ADA		\$6,951.86
2009-10 Deficit Factor	18.3550%	\$(1,276.01)
Deficited District Revenue Limit Per ADA		\$5,675.85

Recommendations

If the districts proceed with unification, the districts should:

1. Complete an updated calculation of the unified district's revenue limit using the final P-2 information as certified by CDE.
2. Complete an updated analysis of the unified district's revenue limit and apply appropriate cost of living and deficit factors.

Projected Salary and Benefit Costs

The actual costs incurred by a newly unified school district are separate from and unrelated to the funding generated by the calculation of the revenue limit increase for salaries and benefits.

To assess the financial impact on the newly formed unified school district, an analysis of current salary schedule placement for all affected employees is needed. This helps determine if the funds provided through the calculation of the salary and benefit adjustment (also sometimes known as the level-up calculation) will be sufficient to move all employees to a common salary schedule.

Although additional funding is provided through the revenue limit calculation based on the average cost per FTE in each district, there is no requirement for the newly unified district to raise salaries and benefits to the level of the higher salary schedules. Rather, it is the duty of the newly formed unified school district's governing board to negotiate with its bargaining unit members to develop new salary schedules. A conscientious approach to restructuring salaries and benefits should be taken to avoid opposition to the unification from employees who may fear adverse effects on their salaries and benefits.

The authority of the board is also limited by Education Code Section 45121, which prohibits the district for two years from releasing from employment or reducing the benefits of any classified employee to less than the employee would have had if the unification had not taken place.

If the districts proceed with unification, each district will need to complete a separate independent analysis of its current salary schedule placement for all affected employees to determine if the funds provided through the salary and benefit adjustment calculation will be sufficient to move all employees to a common salary schedule.

To provide an example of the potential salary and benefit costs of unification, FCMAT reviewed each district's staffing and salary schedules for fiscal year 2009-10 and used these as a starting point for cost projection estimates for moving to a common certificated salary schedule. The projection estimates provided are a picture of a moment in time and are built on different assumptions than those that will ultimately be developed by a new board after unification.

FCMAT did not prepare cost estimates for staff members not placed on the certificated salary schedule. The scope of this study did not provide for detailed evaluation of individual job descriptions and duties. A significant number of variables exist for each employee unit because both districts have different salary schedule structures for all other areas of staffing. Further, as stated previously, although a newly unified district receives additional funding based on the *average* cost of salary and benefit differentials of the unifying districts, the calculation is not based on the *actual* cost of moving employees to higher salary and benefit schedules. Indeed, there is no requirement for the district to do so, nor is there an established method for doing so. Any decisions regarding salary schedules will require significant efforts on the part of the board to ensure a smooth and equitable transition. Should the districts proceed with unification, an in-depth assessment of salary schedules and staffing criteria for placement would be needed to assess the potential costs of transitioning to common salary schedules.

The actual costs incurred by a newly unified school district are separate from and unrelated to the funding generated by the calculation of the new revenue limit increase for salaries and benefits.

Common Salary Schedule for Certificated Employees

FCMAT reviewed each district's salary schedules for all employee groups. Clearly defined criteria for salary schedule placement is not evident on the salary schedules alone and would require assessment of each job description to appropriately classify most groups onto common blended schedules. Further, because the responsibility for negotiating salaries and benefits lies with the governing board, a detailed assessment and application of any particular set of assumptions could create an improbable result.

FCMAT assessed each district's 2009-10 salary schedule and position control staffing data for certificated employees.

Comparison of the first three columns of the districts' salary schedules for certificated employees showed that the high school district's schedule offers a higher rate of pay and more steps per column. However the elementary school district offers a higher salary for most steps in the fourth column. The high school district's schedule has a fifth column; the elementary school district's schedule does not.

The high school schedule includes 187 work days while the elementary schedule includes 185 days.

Table 5: Escondido Union High School District Certificated Salary Schedule, 2009-10

STEP	CLASS 1	CLASS 2	CLASS 3	CLASS 4	CLASS 5
1	42,096	42,220	44,021	46,395	48,769
2	42,220	43,657	46,032	48,405	50,780
3	43,294	45,669	48,042	50,417	52,791
4	45,305	47,678	50,053	52,427	54,801
5	47,318	49,690	52,066	54,439	56,814
6	49,327	51,702	54,075	56,450	58,824
7	51,339	53,714	56,087	58,462	60,836
8	53,350	55,723	58,098	60,471	62,846
9	55,362	57,737	60,108	62,482	64,857
10	55,362	59,746	62,119	64,494	66,869
11	57,371	59,746	64,131	66,505	68,879
12	57,371	61,756	64,131	68,516	70,890
13	59,383	61,756	66,142	68,516	72,903
14	59,383	63,767	66,142	70,528	72,903
15	61,396	63,767	68,152	70,528	74,912
16	61,396	65,780	68,152	72,538	74,912
17	61,396	65,780	70,165	72,538	77,148
18	61,396	67,792	70,165	74,551	77,148
19	61,396	67,792	72,176	74,551	79,382
20	61,396	67,792	72,176	76,560	79,382
21	61,396	67,792	74,188	76,560	81,615
22	61,396	67,792	74,188	78,573	81,615
23	61,396	67,792	74,188	78,573	83,851
24	61,396	67,792	74,188	80,584	83,851
25	61,396	67,792	74,188	80,584	86,085
26	61,396	67,792	74,188	82,596	86,085
27	61,396	67,792	74,188	82,596	88,320
28	61,396	67,792	74,188	82,596	88,320
29	61,396	67,792	74,188	82,596	88,320
30	61,396	67,792	74,188	82,596	88,320
31	61,396	67,792	74,188	82,596	88,320
32	61,396	67,792	74,188	82,596	88,320
33	61,396	67,792	74,188	82,596	88,320
34	61,396	67,792	74,188	82,596	88,320
35	61,396	67,792	74,188	82,596	88,320
36	61,396	67,792	74,188	82,596	88,320
37	61,396	67,792	74,188	82,596	88,320
38	61,396	67,792	74,188	82,596	88,320
39	61,396	67,792	74,188	82,596	88,320
40	61,396	67,792	74,188	82,596	88,320
CLASS 1 - BA			Masters Stipend		
CLASS 2 - BA + 30			\$1,006		
CLASS 3 - BA + 45 OR MA			Doctorate (Ph.D./Ed.D.) Stipend		
CLASS 4 - BA/MA +65			\$2,014		
CLASS 5 - MA +80					

Table 6: Escondido Union Elementary School District Certificated Salary Schedule, 2009-10

ESCONDIDO UNION SCHOOL DISTRICT

Approved 09/29/2008

2009-10											
SALARY SCHEDULE											
TRADITIONAL SCHEDULE											
185 DAYS/12 MONTHS - GROUP 18											
Req Cred	12 Months 185 Days	B.A. 0 - 29 Units	12 Months 185 Days	B.A. + 30	12 Months 185 Days	B.A. + 45 or M.A.	12 Months 185 Days	B.A.+60 or 60 incl M.A.+15	12 Months 185 Days	STEP	
STEP	EE ANNUAL	MONTHLY DAILY HOURLY	CLASS I ANNUAL	MONTHLY DAILY HOURLY	CLASS II ANNUAL	MONTHLY DAILY HOURLY	CLASS III ANNUAL	MONTHLY DAILY HOURLY	CLASS IV ANNUAL	MONTHLY DAILY HOURLY	
1	\$36,147.00	\$3,012.25 \$195.39 \$24.42	\$41,229.00	\$3,435.75 \$222.86 \$27.86	\$41,230.00	\$3,435.83 \$222.86 \$27.86	\$42,441.00	\$3,536.75 \$229.41 \$28.68	\$46,058.00	\$3,838.17 \$248.96 \$31.12	1
2	\$38,251.00	\$3,187.58 \$206.76 \$25.85	\$41,230.00	\$3,435.83 \$222.86 \$27.86	\$41,232.00	\$3,436.00 \$222.88 \$27.86	\$44,525.00	\$3,710.42 \$240.68 \$30.08	\$48,152.00	\$4,012.67 \$260.28 \$32.54	2
3	\$40,339.00	\$3,361.58 \$218.05 \$27.26	\$41,232.00	\$3,436.00 \$222.88 \$27.86	\$43,329.00	\$3,610.75 \$234.21 \$29.28	\$46,622.00	\$3,885.17 \$252.01 \$31.50	\$50,240.00	\$4,186.67 \$271.57 \$33.95	3
4	\$42,438.00	\$3,536.50 \$229.39 \$28.67	\$42,438.00	\$3,536.50 \$229.39 \$28.67	\$45,418.00	\$3,784.83 \$245.50 \$30.69	\$48,712.00	\$4,059.33 \$263.31 \$32.91	\$52,323.00	\$4,360.25 \$282.83 \$35.35	4
5	\$44,525.00	\$3,710.42 \$240.68 \$30.08	\$44,525.00	\$3,710.42 \$240.68 \$30.08	\$47,507.00	\$3,958.92 \$256.79 \$32.10	\$50,815.00	\$4,234.58 \$274.68 \$34.33	\$54,426.00	\$4,535.50 \$294.19 \$36.77	5
6	\$46,622.00	\$3,885.17 \$252.01 \$31.50	\$46,622.00	\$3,885.17 \$252.01 \$31.50	\$49,603.00	\$4,133.58 \$268.12 \$33.52	\$52,897.00	\$4,408.08 \$285.93 \$35.74	\$56,514.00	\$4,709.50 \$305.48 \$38.19	6
7	\$48,718.00	\$4,059.83 \$263.34 \$32.92	\$48,718.00	\$4,059.83 \$263.34 \$32.92	\$51,705.00	\$4,308.75 \$279.49 \$34.94	\$54,992.00	\$4,582.67 \$297.25 \$37.16	\$58,610.00	\$4,884.17 \$316.81 \$39.60	7
8					\$53,784.00	\$4,482.00 \$290.72 \$36.34	\$57,087.00	\$4,757.25 \$308.58 \$38.57	\$60,701.00	\$5,058.42 \$328.11 \$41.01	8
9							\$59,175.00	\$4,931.25 \$319.86 \$39.98	\$62,804.00	\$5,233.67 \$339.48 \$42.44	9
10							\$61,268.00	\$5,105.67 \$331.18 \$41.40	\$64,886.00	\$5,407.17 \$350.74 \$43.84	10
11									\$66,992.00	\$5,582.67 \$362.12 \$45.26	11
12									\$68,664.00	\$5,722.00 \$371.16 \$46.39	12
13									\$70,339.00	\$5,861.58 \$380.21 \$47.53	13
16									\$72,711.00	\$6,059.25 \$393.03 \$49.13	16
20									\$75,081.00	\$6,256.75 \$405.84 \$50.73	20
23									\$79,775.00	\$6,647.92 \$431.22 \$53.90	23
25									\$86,303.00	\$7,191.92 \$466.50 \$58.31	25*

All units taken for salary advancement purposes must be reviewed by the immediate supervisor with the exception of the last 15 units taken to meet the B.A.+ 60 program.
Final 15 units must be reviewed by the Personnel Department
NOTE: All units referred to are SEMESTER units.
Initial placement up to a maximum 10 years credit.

BEGINNING TEACHER SALARY CELLS

i\data\salary\[File] 09-10 group 18 185 DAYS

* Longevity increments subject to COLA % effective 7/1/99

* Longevity Compaction effective 10/1/04 from Top step of 29 to step 25.

New Psychologist Salary Schedule 7/01/01
Step 23 increased 3% July 1, 2005
Step 25 increased 5% July 1, 2005

Based on the data provided and the assumptions enumerated below, FCMAT's conservative estimate of the additional annual cost of providing common certificated salaries for the newly formed district is \$3,080,000.

This projection includes the following assumptions:

For columns one through three, the elementary school district's certificated FTE were placed in the same step/column position on the high school district's schedule. The qualifications for each column are the same; however, the high school district's schedule has higher salaries for each column. The projected annual cost of moving the elementary district's positions to the high school schedule for columns one through three is \$580,000.

Column four presents the greatest challenge to comparability because neither district's schedule is consistently higher. Further, the qualifications for this schedule are different: the high school district requires a bachelor's degree or a Master's degree plus 65 units; the elementary district requires a bachelor's degree plus 60 semester units, or Master's degree plus 15 semester units, or a bachelor's degree plus 60 semester units including Master's degree. Column four is also the highest column for elementary school district certificated staff.

For this projection, FCMAT took an approach that would result in the highest projected cost. FCMAT assumed that all elementary school district teachers in column four have a Master's degree plus 80 units and therefore would move to column five of the high school district's salary schedule. This assumption results in an additional annual cost of \$2,500,000. Out of 916 elementary school district FTEs, 778, or 85%, are in column four. Under these assumptions, all high school district certificated employees remain in their present placement on the high school district's salary schedule. The decisions made regarding how to restructure this column will significantly affect the new unified school district's increased salary costs. However, it is likely that the actual additional costs for column four will be lower than FCMAT's projection because it is unlikely that all elementary school district employees in column four have the Master's degree plus 80 units required for advancement.

Another option would be to freeze positions in column four for both districts; however, this type of action would likely result in opposition from affected employees. A more feasible option would be to keep columns one through three and column five, but develop a new fourth column that fits more reasonably into the overall salary schedule.

There are other notable differences in each district's salary schedule. For the 2009-10 fiscal year, both districts' contracts are based on 180 instructional days. However, the elementary school district's contract is based on 185 workdays whereas the high school district's contract is based upon 187 workdays.

Another notable difference between the two districts' contracts is in the area of required employee contributions to retirement programs. A separate trust was established in 2004 to provide health benefits for certificated teachers hired after June 30, 1996 and retiring after January 1, 2004, who were not eligible for district-paid health benefits after the age of 65. The high school district initially funded the trust with a one-time contribution of \$500,000, and the certificated salary schedule was increased by 2.9%. A mandatory payroll deduction, not to exceed 2.9%, was implemented,

deducted and forwarded to the trust for all certificated teacher salaries subject to the contract.

FCMAT did not perform a detailed review of this trust agreement or an assessment of its valuation or fiscal health. If the districts proceed with unification, they will need to thoroughly study the foundation of this trust and work with legal counsel to determine the effects of unification.

Common Health Benefits Cost Projection

The high school district's 2009-10 health and welfare benefit rate structures for certificated employees included a district contribution of \$11,878.40 per employee. In addition, the collective bargaining agreement with certificated employees indicates that employees who work half time or more are covered by the insurance.

The elementary school district's collective bargaining agreement with certificated employees indicates the following:

1. Effective the first full pay period following ratification by the Association, for the duration of this Agreement, the District annual contribution for fully benefited employees shall equal \$10,000 payable tenthly at a rate of \$1,000.
2. For the 2009 plan year, the District will pay the difference between the District annual contribution (set forth above) and the total premium cost for unit members electing the PPO or Kaiser.

Thus the benefit contribution paid on behalf of each qualifying elementary school district employee varied in fiscal year 2009-10. In addition, the elementary school district's collective bargaining agreement with certificated employees indicates that employees who work less than full time receive a straight proration of the contribution for health and welfare benefits. Part-time employees who were employed prior to June 30, 1987 receive the same level of benefits received during fiscal year 1986-87.

The high school district's 2009-10 health and welfare benefit rate structures for classified employees include a district contribution of \$11,525.58 per employee. In addition, the collective bargaining agreement with classified employees indicates that employees must work at least half time to receive benefits; those working half-time or more receive a straight proration of the benefit contribution. The contract also includes grandfather clauses for employees who worked in the district prior to fiscal year 1992-93.

The elementary school district's collective bargaining agreement with classified employees indicates that the maximum contribution for benefits is \$9430.60 per year. However, for the 2009 plan year the rates varied by employee because the district contributed the difference between the maximum contribution and the actual premium cost. Employees who worked five hours per day or more received the full contribution, while employees who worked between four and five hours per day received 50% of the contribution. In addition, the agreement includes grandfather provisions for employees who worked in the district during or before fiscal year 1989-90.

FCMAT analyzed the cost of moving certificated employees to a common benefit schedule. The analysis assumes that elementary school district employees who work at least half time (.50 FTE) will receive the full benefit contribution of \$11,878.40 per fiscal year and that all elementary

school district employees working less than half time would receive a straight proration of benefits.

Using these assumptions, the projected annual cost of moving the elementary school district’s certificated positions to the high school district’s health and welfare benefits schedule is \$1.7 million. This does not include benefits for high school district employees who are less than .50 FTE.

The total projected annual cost of transitioning certificated employee salaries and healthcare benefits using the assumptions described above would be \$4,780,000.

Total Cost of Common Salaries and Benefits for Certificated Employees

The total projected annual cost of transitioning certificated employee salaries and health care benefits using the assumptions described above would be \$4,780,000. FCMAT believes that this cost projection is higher than what the district would actually experience, primarily because of the assumption that all elementary school district staff members in column four of the elementary district’s salary schedule would move to column five of the high school district’s salary schedule.

As noted earlier, the projected additional revenue limit funding for the new unified district, based on fiscal year 2009-10, would be \$11,452,942, which would be reduced to \$9,350,755 after applying the 2009-10 deficit factor of 18.355%. This would leave approximately \$4.6 million to move all remaining staff to a common salary schedule and pay for all other costs related to unification.

Cost of a Common Salary Schedule for all Other District Staff

To estimate the potential cost of moving classified employees to a common salary schedule, FCMAT applied a factor based on the cost of classified employee salaries and benefits as a percentage of total certificated salaries and benefits. This data is presented in Table 7 below.

Table 7: Cost of Classified Employee Salaries and Benefits as Percentage of Certificated Employee Salaries and Benefits

Escondido Union School District	
Certificated	
Total Salaries	\$72,507,140
Total Benefits (Excluding OPEB & Early Retirement, Board & Personnel Commission)	21,283,159
	\$93,790,299
Classified	
Total Salaries (Excluding Governing Board)	\$21,613,438
Total Benefits (Excluding OPEB & Early Retirement, Board & Personnel Commission)	10,623,363
	\$32,236,801
Escondido Union High School District	
Certificated	
Total Salaries (excluding Board and Adult Ed)	\$29,626,208
Total Benefits (excluding OPEB & Board)	9,056,839

	\$38,683,046
Classified	
Total Salaries (excluding Board and Adult Ed)	\$12,303,870
Total Benefits (excluding OPEB & Board)	5,102,304
	\$17,406,175
Total Projected Increase Cost - Certificated Staff	\$4,780,000
	45%
Total Projected Increase Costs - Classified Staff	\$2,150,852

The projected cost for classified salaries is only an estimate; the actual cost of adjusting classified employee salaries to achieve a common salary schedule will be based on each employee's *actual* salary and benefit amounts. If the districts proceed with unification, a complete a review of each employee's job description and classification will be needed to determine the actual cost.

Based on the assumptions applied in this review, it is reasonable to conclude that the additional revenue limit funding would be sufficient to transition remaining salary schedules for all other staff members to a common salary schedule. FCMAT's evaluation is based on the following:

1. The elementary school district has 918 FTE certificated staff on the schedule used in the calculation. The total certificated FTE for the entire elementary school district in all certificated staffing areas is 1003.6. FCMAT's calculations include 91.5% of the district's total certificated FTE. Further, it is reasonable to expect that there will be savings created by eliminating staffing redundancies after the two districts unify, which in theory would make available additional resources.
2. For the elementary school district, salaries and benefits for classified employees constitute 34% of total salary and benefit costs. For the high school district, salaries and benefits for classified employees constitute 45% of total salary and benefit costs. Using the high school district's higher percentage as a basis for estimating the cost of adjusting the salaries and benefits for classified staff to create a common salary schedule results in an estimated annual cost of approximately \$2.15 million.

Because of the numerous variables associated with moving the classified employees to a common benefit schedule, FCMAT's analysis did not include a specific assessment of classified employee costs related to this item.

Recommendations

If the districts proceed with unification, the districts should:

1. Complete an in-depth analysis of health and welfare benefit costs for all affected employees to determine if the funds provided as a result of the salary and benefit adjustment calculation are sufficient to move all employees to a common benefit structure.
2. Use a conscientious approach to restructuring benefits to avoid employee opposition to the unification.

Staffing

When school districts unify, many positions become redundant and are no longer required. Redundant administrative staff positions are the most easily identifiable. For example, two superintendent positions are not needed, nor are two deputy/assistant superintendents for the human resources or business services departments. Elimination of redundant positions can reduce salary and benefit compensation costs and the need for additional facilities as well as provide many other economies of scale.

A thorough assessment of administrative staffing will be needed to help develop an appropriately staffed administrative team for the new unified district. Tables 8a and 8b provide a comparison of each district's certificated and classified staffing.

Table 8a: Certificated Staffing in Each District

Certificated Position	EUSD FTE	EUHSD FTE
Superintendent	1.0	1.0
Deputy Superintendent	1.0	
Assistant Superintendent	2.0	2.0
Certificated Management		
Director of Media Services	1.0	
Director of Community Day	1.0	
Director of Instruction		1.0
Director of Technology		1.0
Director of Special Programs		2.0
Director of Interventions		1.0
Principals	22.0	5.0
Assistant Principals	12.0	10.0
Coordinators		
Teacher/Coordinators		2.0
Coordinator	1.0	
Anytime School	1.0	
Program Evaluations	1.0	
Staff Development	1.0	
Learn Supplemental Services	1.0	
Child Development	1.0	
Safe Schools	1.0	
Program Specialists	4.8	4.0
Content Specialists		2.0
Categorical Specialist	7.0	
Certificated Teachers Traditional		
Teachers	907.3	351.8
Teachers Community Day	3.0	
Teachers-ROTC		2.0
Teachers-AG		4.0
Counselors	5.0	
Nurses	2.7	1.0
Permit Teachers	15.0	
Psychologists - 12 month	8.8	3.0
Psychologist - 185 day 11 month	2.0	
Psychologist - 185 day 12 month	1.0	
Total Certificated FTE	1003.6	392.8

Table 8b: Classified Staffing in Each District

Classified Position	EUSD FTE	EUHSD FTE
Assistant Superintendent	1.0	1.0
Classified Management		
Director of Classified PERS	1.0	
Director of Fiscal Services/Finance	1.0	1.0
Director of Grants/Foundation Development	1.0	
Director of Nutrition	1.0	1.0
Director of Facilities/Planning	1.0	
Director of Maintenance	1.0	1.0
Director of Purchasing	1.0	1.0
Network/Systems Manager	1.0	
Transportation Coordinator	1.0	1.0
Information Systems		1.0
Supervisory and Confidential - Classified		
Executive Assistant to the Superintendent	1.0	1.0
Administrative Secretary/Assistant	3.0	3.0
Personnel Operations Supervisor	2.0	
Personnel Clerk	1.0	
Personnel Analyst	1.0	
Credentials Technician	1.0	
Benefits Technician	0.9375	
Payroll Supervisor	1.0	
Accounting Supervisor	1.0	
Budget Analyst	1.0	1.0
Communications Specialist		0.75
Data Management		1.0
Custodial Supervisor	1.0	
Maintenance Supervisor	1.0	
Stores/Warehouse Supervisor	1.0	
Nutrition Services-Area Supervisor	2.9986	
Classified	496.6	210.9
Classified Bus Drivers		11.0
Classified Other-Career Education		0.07
Professional Expert-Project Manager		1.0
Total Classified FTE	525.5	236.7
Total District FTE	1529.1	629.5

Recommendation

If the districts proceed with unification, the districts should:

1. Complete a thorough assessment of administrative staffing to establish appropriate administrative staffing levels.

Consolidation or Division of Assets and Liabilities

The division of assets and liabilities is normally addressed in the petition for reorganization. However, because the unification of the Escondido Union School District and Escondido Union High School District would result in the consolidation of assets and liabilities rather than their division, the process of reorganization will merely need to acknowledge that any asset or liability of the former districts shall become the asset or liability of the unified district.

Real and Personal Property

Because the unification of the Escondido Union School District and Escondido Union High School District would result in the consolidation of assets and liabilities rather than their division, there is no need to hire a qualified appraiser to establish the fair market value of the property and buildings unless the governing board of the newly unified district desires to complete this process.

Funds from the Sale of Bonds; Bonded Indebtedness; and Bonding Capacity

Funds from the sale of previously issued school bonds may be used only to acquire, construct or improve the school property that was part of the former district, or for such use in that same district. However, pursuant to Education Code section 35561, if the newly formed district accepts the former district's bonded indebtedness, the funds may be used anywhere in the new district and for the same purposes as specified in the bond.

On March 5, 2002, Escondido voters approved Proposition K, a bond measure for the elementary school district that provided \$46.3 million in funding to upgrade, improve, and modernize existing neighborhood schools, and to build two new schools to address increasing enrollment and the resulting overcrowding.

In November 2008, Escondido voters passed Proposition T, a \$98 million bond measure for the high school district to fund critical capital improvements at high school campuses. The purpose of the bond is to modernize campuses and help the district obtain state matching funds to accomplish the following:

- Construction of science and computer laboratories
- Modernization of outdated equipment and facilities
- Reduction of overcrowding on campuses
- Improvements to campus safety, security and energy efficiency
- Replacement of aging portable buildings with permanent classrooms
- Add classrooms and classes to improve students' access to college and high-demand jobs

Education Code section 35573 states, "When any school district is in any manner merged with one or more school districts so as to form a single district by any procedure, the district so formed is liable for all of the outstanding bonded indebtedness of the districts united or merged". However, Education Code section 35578 states, "Any unsold bonds of an elementary, high, or unified school district which is included as a whole in a new school district through any kind of reorganization may be issued by the board of supervisors in the name of the new district and

the proceeds derived upon the sale thereof shall be the funds of the new district. However, the proceeds derived upon the sale thereof shall be expended only for the purpose, or purposes, for which such bonds were authorized.”

Unification in and of itself may not result in a significant increase in the new district's bonding capacity.

As of October 2010, the Escondido Union School District and Escondido Union High School District had estimated outstanding general obligation bond debts of \$49,439,622 and \$85,751,274, respectively. The outstanding bonded indebtedness should be considered in relation to the *net* bonding capacities of \$126,165,974 for the Escondido Union School District and \$96,008,918, for the Escondido Union High School District. A unified school district's bonding capacity is based on 2.5% of the taxable property within district's boundaries, rather than the 1.25% rate used for elementary and high school districts (Education Code Section 15268). However, unification in and of itself may not result in a significant increase in the new district's bonding capacity. This is the case for the Escondido Union School District and the Escondido Union High School District, largely because a large portion of the two districts' boundaries are coterminous, resulting in only a small difference in bonding capacity when the two districts are combined and the 2.5% applied. In addition, both districts experienced a decline in assessed valuation during the last fiscal year. Table 9 illustrates this point.

Table 9: Outstanding Bond Debt, Total Assessed Valuation, and Net Bonding Capacity

Escondido Union High School District	
Outstanding GO Principal Debt as of 10-11-10	
1998 GO Refunding Bonds:	\$24,537,978.30
2008 Election Series A GO Bonds:	\$34,216,904.50
2008 Election Series B GO Bonds:	\$26,996,392.00
Total:	\$85,751,274.80
2010-2011 Total Assessed Value	\$14,540,815,458.00
Bonding Capacity (AV X 1.25%)	\$181,760,193.23
Net Bonding Capacity	\$96,008,918.43
Escondido Union School District	
Outstanding GO Principal as of 10-11-10	
2002 Election Series A GO Bonds:	\$3,349,622.30
2007 GO Refunding Bonds (Series A):	\$7,775,000.00
2007 GO Refunding Bonds (Series B):	\$38,315,000.00
Total:	\$49,439,622.30
2010-2011 Total Assessed Value	\$14,048,447,718.00
Bonding Capacity (AV X 1.25%)	\$175,605,596.48
Net Bonding Capacity	\$126,165,974.18
Current Combined Escondido School Districts' Information	
Grand Total Outstanding GO Principal	\$135,190,897.10
Grand Total Gross Bonding Capacity	\$357,365,789.70

Grand Total Net Bonding Capacity	\$222,174,892.60
Proposed Unified School District	
Combined Outstanding GO Principal as of 10-11-10	
Escondido Union High School District	\$85,751,274.80
Escondido Union School District	\$49,439,622.30
Total:	\$135,190,897.10
New Assessed Value (Current EUHSD District Boundary)	
	\$14,540,815,458.00
New Bonding Capacity (AV X 2.50%)	
	\$363,520,386.45
New Net Bonding Capacity	
	\$228,329,489.35
Change in Net Bonding Capacity from Current	
	\$6,154,596.75

Source: Municipal Statistics

Pensions, Post-Employment Benefits, and Retirement Incentives

Apportioning the payment of medical benefits for retirees may be an issue after reorganization. For current employees, a district could logically agree to achieve equity by paying the premiums for its employees. For retirees, an equitable distribution of these obligations on the basis of FTEs in each district seems to be appropriate.

Similarly, it is reasonable to assume that both retirees and current employees whose retirement rights are vested would be protected under the constitutional prohibition against impairment of contracts (Article I, Section 10 of the U.S. Constitution states, “No state shall . . . pass any . . . Law impairing the Obligation of Contracts.” The California Constitution has a similar provision, protecting contractual rights from being impaired at a subsequent time). Issues related to the division of responsibilities in an equitable manner are still likely to arise. For example, in a multidistrict unification, all the new districts will be expected to share financial responsibility for employees’ prospective retirement income.

Another issue that must be addressed is the Escondido Union School District’s FBC Health Fund’s unfunded liability of \$9,001,534 as of June 30, 2010, which resulted from the dissolution of the district’s self-insured medical insurance plan. Because the Escondido Union School District does not yet have plans to fund the \$9,001,534, this liability will become the liability of the new unified district. Further detail regarding this issue is provided in the Subsequent Events section on page 30 of this report.

Non-Voter-Approved Debt and Compensated Absences

Issuing long-term debt allows school districts to obtain funds for the acquisition or construction of buildings and equipment and to spread the repayment over a period of years. It also allows school districts to obtain buildings or equipment that might not be possible using existing resources. Problems can develop if a school district issues too much debt without a dedicated revenue source, such as tax levies, to service that debt; in such cases annual debt service payments must be made from the district’s unrestricted general fund, at the expense of current operations.

Both the Escondido Union School District and the Escondido Union High School District have incurred a significant amount of non-voter-approved debt. Any long-term debt that the district

must repay from the unrestricted general fund is considered unfunded because it requires the use of resources typically dedicated to the current costs of education, such as employees' salaries, administration and general operating supplies. Although most districts are able to fund some long-term debt (e.g., accrued vacation) out of their general fund, districts should exercise caution in using general fund revenues for debt service payments because this depletes funds available for current operations. Moreover, debt service payments are one of the few line item expenditures that cannot easily be eliminated from a budget and thus place additional pressure on the unrestricted general fund during times of fiscal austerity.

FCMAT analyzed each district's total long-term debt to determine how much debt will be serviced using the unrestricted general fund and how much debt has a dedicated funding source other than the unrestricted general fund. Based on the combined Escondido Union and Escondido Union High school districts' unaudited actuals of June 30, 2010, the districts had a combined total of \$44,299,119 in long-term unfunded debt, as shown in Table 10:

Table 10: Debt Funded from the Unrestricted General Fund (Unfunded)

Type of Debt	Escondido Union School District	Escondido Union High School District	Total
Compensated Absences	\$565,593	\$466,811	\$1,032,404
Capital Lease Obligations	325,000	977,621	1,302,621
COPs	23,104,815	9,690,000	32,794,815
Early Retirement Incentives	167,745	-	167,745
Unfunded Self Insured Medical	9,001,534	-	9,001,534
Total	\$33,164,687	\$11,134,432	\$44,299,119

Compensated absences include the amount of vacation that employees had earned as of June 30, 2010. Although the district is required to pay an employee for accrued vacation in some instances, such as when the employee separates from the district, employees usually take their earned vacation days off in subsequent years rather than taking a cash payment. Because the debt for accrued vacation does not usually require a cash payment; it is not included in the calculation of debt service payments from the unrestricted general fund revenues. Although the district has access to other funds that can be used to make a portion of its debt payments (e.g., developer fees in the capital facilities fund), most are not reliable long-term funding sources.

To determine whether a school district has too much unfunded long-term debt, the amount of the annual long-term unfunded debt payments is compared to the district's total unrestricted general fund revenues. Table 11 shows the unfunded long-term debt payments for both districts for the fiscal year 2010-11.

Table 11: Annual Debt Service Payments Funded from the Unrestricted General Fund (Unfunded)

Type of Debt	Escondido Union School District	Escondido Union High School District	Total
COPs	1,728,839	185,000	1,913,839
Capital Lease Obligations	543,350	244,405	787,755
Early Retirement Incentives	98,446		98,446
	\$2,370,635	\$429,405	\$2,800,040

The total unfunded debt reflects the July 1, 2010 principal payment only (not total outstanding principal obligation).

The unrestricted general fund revenues for the proposed new Escondido Unified School District for fiscal year 2011-12 are projected to be \$146,074,277. Thus the total debt payment amount above is equal to 1.9% of unrestricted general fund revenues. Although there are no standards for the amount of unfunded debt that is considered prudent for California school districts, FCMAT believes that debt service payments of one to two percent of the unrestricted general fund revenues are reasonable.

In many state and local governments, it is standard practice for the governing board to adopt a comprehensive policy that creates standards for issuing and managing debt. In addition, the Government Finance Officers Association recommends that all forms of government adopt a comprehensive debt policy. This helps ensure that underwriters and financial advisers provide the district with adequate information to use when analyzing future debt, enabling the district to make sound business decisions. A sample debt management policy is included in Appendix A.

Subsequent Events

Since FCMAT’s fieldwork, subsequent events in both districts have changed both the outstanding amount of non-voter-approved debt issued in each district and the payments required to service this debt. In the Escondido School District, \$15,000,000 in taxable health insurance obligation refunding bonds were issued, presumably to address the operational deficit in the district’s FBC Health Fund. Annual debt service payments have a 25-year term beginning December 15, 2011 and range from \$940,283 on that date to a final payment of \$892,852 on December 15, 2036. Total principal and interest over the full term will be \$23,864,246.

Similarly, the Escondido Union High School District has issued certificates of participation (COPs) in the amounts of \$33,715,000 (Series A tax-exempt) and \$17,735,000 (Series B non-tax-exempt) to implement building projects included in the district’s facilities master plan. The Series A COPs will require annual interest-only debt service payments of roughly \$1.6 million until May 15, 2028 when principal payments will be made from a mandatory sinking fund through May 15, 2037. Similarly, the Series B COPs will require annual interest-only debt service payments of \$1.2 million per year with principal payments being made from a mandatory sinking fund starting on May 15, 2013 and continuing through May 15, 2027.

As indicated previously, there is no officially established prudent level of unfunded debt for a school district, but FCMAT believes that debt totaling one to two percent of a district’s unrestricted revenues is reasonable. The two districts’ outstanding obligations prior to the debt agreements described above were equal to 1.6% of their combined unrestricted general fund revenues. The additional unfunded debt obligations entered into subsequent to FCMAT’s fieldwork have increased debt payments to more than the maximum of two percent of unrestricted general fund revenues that FCMAT believes reasonable. If the two district proceed with unification, the outstanding unfunded liabilities of both districts be thoroughly analyzed.

Medicare and Single Employer Status

There is some question regarding whether or not school district reorganization constitutes a shift to a new employer, thereby making wages subject to the Federal Insurance Contributions Act (FICA) tax, which is 1.45% of payroll for both employee and employer. Although some or all employees will have a new employer after reorganization, the education code protects employees with respect to their classification and status.

The total debt payment amount above is equal to 1.9% of unrestricted general fund revenues. FCMAT believes that debt service payments of one to two percent of the unrestricted general fund revenues are reasonable.

In a private letter ruling to the Eureka City Elementary and High School districts, the Internal Revenue Service (IRS) concluded that the consolidation of the two districts did not violate the continuing employment exemption for public employees hired prior to April 1, 1986. This exemption allowed the wages of any employee hired before April 1, 1986 to be paid free of FICA tax, so long as the employee remained in continuous employment with the public agency. In making its decision, the IRS cited the case of Board of Education of Muhlenberg County v. U.S. (ref. 920 F.2d 370, 91-1 USTC 50, 125, 6th Cir. 1990). In that case, the court decided that the consolidation of school districts “is not a new employer for purposes of the continuing employment exception.” The court found that the legislative intent of exempting employees hired before April 1, 1986 was to avoid a sudden increase in Medicare taxes to the employer. The court noted that a consolidation of districts would create “the same sudden financial burden ... and ... deter consolidation of local government entities for purposes of enhancing efficiency.” An example of a private ruling from the Internal Revenue on this subject is included in Appendix B.

Recommendations

If the districts proceed with unification, the districts should:

1. Ensure that the petition to reorganize acknowledges all current liabilities for post-employment medical benefits, compensated absences and retirement incentive annuities.
2. Adopt a debt management policy substantially similar to the policy included in Appendix A to guide the board in making decisions regarding non-voter-approved debt.
3. Request a private ruling from the Internal Revenue Service regarding whether the new unified district will be considered a new employer for Medicare tax purposes.
4. Thoroughly analyze the outstanding unfunded liabilities of both districts if the decision is made to proceed with unification.

Additional Unification Issues

If the districts decide to proceed with unification, many logistical and legal issues will be addressed either by Education Code or through the districts' petition. However, following are additional issues the districts will need to consider before unification begins.

State School Facilities Program

Education Code section 17071.10 specifies that a district affected by reorganization election on or after November 4, 1998 may not file an application for new construction funding after notification of the reorganization election. This prohibition remains in effect until a new calculation of the district's baseline eligibility has been determined on Form SAB 50-03, or until the district certifies that the reorganization election will not result in a loss of eligibility for the project for which the district is requesting new construction grants.

A district that is newly created as a result of reorganization may file an application for funding after the State Board of Education has approved the reorganization election.

Adequate Facilities

Education Code section 35735.2 states that if there are no suitable facilities for all students in a newly organized district, its base revenue limit initially will be blended rather than adjusted for the differential in salary and benefits, then increased as the district obtains suitable facilities. However, there is no issue of adequate facilities in the case of the unification being considered in this study because each district would be included in its entirety and there are sufficient facilities for all programs in both districts.

Enrollment

During the last two school years, enrollment declined in both the Escondido Union School District and the Escondido Union High School District. Education Code Section 42238.5 allows districts to be funded based on either current year or prior year P-2 ADA, whichever is greater. Separate districts experience the effects of growth and decline independent of one another; however, once unified, enrollment increases in one district will help offset enrollment declines in the other. If attendance in both districts increases or declines in the same year, neither district will be affected differently than would have been the case had each remained independent.

The Escondido Union Elementary School District's enrollment has declined at an average rate of 1.15% per year for the last six years. The district projects that this trend will continue into the current and two subsequent fiscal years at a rate of 1.13%. The Escondido Union High School District's enrollment has increased at an average annual rate of 1.25% over the past six years. However, this average includes enrollment declines of 0.25% and 0.93% during the last two years.

Further, the high school district projects an average enrollment decline of 0.97% per year over the next three fiscal years.

Based on the projections provided by both districts, funding based on prior year P-2 ADA would not be lost because both districts project continued declines in ADA. However, if the projected declines do not occur and the enrollment of one of the former districts increases, the

Based on the projections provided by both districts, funding based on prior year P-2 ADA would not be lost because both districts project continued declines in ADA.

unified district would lose the additional funding that the growing district would otherwise have received, reducing the benefit of unification.

Table 12 shows enrollment history and projections provided by both districts.

Table 12: Enrollment History and Projections

Fiscal Year	EUSD			EUHSD		
	Enrollment	Inc/(Dec)	%	Enrollment	Inc/(Dec)	%
2003-04	19344			7604		
2004-05	19328	-16	-0.08%	7969	365	4.80%
2005-06	18747	-581	-3.01%	8113	144	1.81%
2006-07	18474	-273	-1.46%	8241	128	1.58%
2007-08	18373	-101	-0.55%	8300	59	0.72%
2008-09	18050	-323	-1.76%	8279	-21	-0.25%
2009-10 Estimated	18011	-39	-0.22%	8202	-77	-0.93%
		-1333			598	
			-1.15%			1.25%
2010-11 Projected	17753	-258	-1.43%	8093	-109	-1.33%
2011-12 Projected	17577	-176	-0.99%	8043	-50	-0.62%
2012-13 Projected	17403	-174	-0.99%	7963	-80	-0.99%
		-608			-239	
Projected 3 year average			-1.13%			-0.97%

Sources: Escondido Union School District 2012-13 enrollment projections – EA 2; Escondido Union High School District enrollment projections.

Protection of Classified Employees

As mentioned earlier under the discussion of revenue limit calculations, the governing board of the new unified district retains the right to negotiate higher or lower salaries and benefits, except in the case of classified staff, who have a right to two years of continued employment at the pay rate and benefit levels in effect at the time of unification (Education Code Section 45121).

Merit System

The Escondido Union School District operates on a merit system, while the Escondido Union High School District does not. Merit systems are governed by numerous provisions in the education code and require that a personnel commission be established to oversee processes and procedures for classified employees.

Education Code Section 45120 states, in part:

If all or any part of any district or districts which is unified with all or any part of a district, has, or have, the merit system prior to the date of the reorganization election, all employees not legally requiring certification qualifications of the reorganized district shall be employed in accordance with Article 6 (commencing with Section 45240) of

this chapter if a simple majority of the classified employees of the reorganized district voting on the adoption of a merit system approve its adoption pursuant to Section 45221. If no such election is requested by the classified employees of the reorganized district pursuant to Section 45221, adoption of a merit system shall be effective only if the number of classified employees from the merit system district who are to become employees of the acquiring district equals or exceeds the number of classified employees of the acquiring nonmerit system district.

FCMAT sought interpretation of this code section from the CDE, whose staff indicated that their interpretation of this code section is that if the number of classified staff in the district that has merit system exceeds the number of classified staff in the district that does not have a merit system, then the newly unified district would have a merit system. However, because the reorganization of a merit system district does not occur frequently, the CDE recommends that the districts seek legal counsel regarding this issue.

The CDE's 2009-10 staffing data for the districts indicates that the Escondido Union School District has 805 classified staff members and the Escondido Union High School District has 330. Thus it appears that the unified district would revert to a merit system unless the merit system is terminated using one of the methods described in Education Code Section 45319.

Retiree Benefit Plans

Both districts provide benefits for retirees, but the districts' contract terms for certificated retirees differ significantly. The elementary district's collective bargaining agreement with certificated employees indicates that medical benefits are provided up to age 65 for retirees who have 20 years or more of service. A prorated amount is provided for retirees who have at least 10 years of service. The collective bargaining agreement states that the district will continue "the least costly basic medical insurance plan that is offered to employees."

During fiscal year 2009-10 the maximum district premium per retiree provided by the Escondido Union School District was \$4,562.52.

The high school district's collective bargaining agreement with certificated employees indicates that employees who were hired prior to June 30, 1996 and retired prior to January 1, 2004 receive lifetime medical benefits. Employees hired after June 30, 1996 or who retire after January 1, 2004 receive \$7,700 per fiscal year to age 65. Retirees with 20 years of service or more receive 100% of the benefit until age 65, and those with between 10 and 20 years of service receive a prorated contribution. In addition, an employee trust was created for payment of benefits after age 65 for employees who retire after January 1, 2004. The trust was initially funded with a one-time district contribution of \$500,000. On July 1, 2004, the certificated employee salary schedule was increased by 2.9% and a mandatory payroll deduction not to exceed 2.9% was implemented and the deducted amount forwarded to the trust.

Government Accounting Standards Board (GASB) Statement 45, released in June 2004, established standards for employers to measure and report their costs and obligations relating to other post-employment benefits (OPEB). The valuation completed for the elementary district as of July 1, 2008 indicates that its actuarial liability (AL) for current and future retirees is \$33,646,156 while its unfunded actuarial accrued liability (UAAL) for past service is \$22,038,093. The valuation completed for the high school district as of July 1, 2009 indicates that its AL is \$22,939,790 and its UAAL is \$21,026,441. The actuarial reports indicate that neither district has established an irrevocable trust to fund the OPEB.

AB 174

Unification may be initiated either by voter petition or by petitions of the affected districts' governing boards. In either case, the county committee on school district organization must determine the effect of the unification based on the criteria enumerated in Education Code section 35753. This study does not include evaluation of these criteria.

Assembly Bill (AB) 174, which became effective in 2009, enables the county committee on school district organization to approve unification if it deems that the petition meets the requirements specified in Education Code Section 35753. AB 174 modified the California Education Code as follows:

35710. (a) For all other petitions to transfer territory, if the county committee finds that the conditions enumerated in paragraphs (1) to (10), inclusive, of subdivision (a) of Section 35753 substantially are met, the county committee may approve the petition and, if approved, shall notify the county superintendent of schools who shall call an election in the territory of the districts as determined by the county committee, to be conducted at the next election of any kind in accordance with either of the following:

(1) Section 1002 of the Elections Code and Part 4 (commencing with Section 5000) of Division 1 of Title 1.

(2) Division 4 (commencing with Section 4000) of the Elections Code.

b) A county committee also may approve a petition to form one or more school districts if the requirements of subdivision (a), and the following conditions, are met:

(1) Each county superintendent of schools with jurisdiction over an affected school district elects to grant approval authority to the county committee on school district organization for which he or she is secretary pursuant to Section 4012, and that county committee chooses to accept that authority.

(2) The governing board of each of the affected school districts consents to the petition.

(3) The secretary of the county committee designated as the lead agency pursuant to Section 35710.3 or subdivision (a) of Section 35520.5 enters into an agreement on behalf of the county committee for any or all affected school districts to share among those districts the costs of complying with the requirements of the California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code).

c) A petition to form one or more school districts that meets the conditions described in subdivision (b), but is not approved by the county committee, shall be transmitted to the state board pursuant to subdivision (a) of Section 35707 and heard by the state board pursuant to Section 35708. The state board, rather than the county committee, shall be the lead agency, as defined in Section 21067 of the Public Resources Code, for purposes of the California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code) for each petition transmitted pursuant to this subdivision, including a petition disapproved by the county committee after determining the project is exempt from the California Environmental Quality Act pursuant to paragraph (5) of subdivision (b) of Section 21080 of the Public Resources Code.

The passage of AB 174 is significant because it allows the county committee on school district organization to call for an election if the school districts' petition is deemed sufficient. However, this legislation, along with the use of State Board of Education waivers, can allow school districts to accelerate the unification process. The following sections of the California Education Code would need to be waived to proceed with unification under AB 174:

- Unification of school districts: E.C. 35706, 35708, 35710
- Election and effective date for unification of school districts: E.C. 35534, 35709, 35710
- Appointment of interim board: portions of E.C. 35100 and all of 35101

Collectively, these waivers allow the State Board of Education to waive the requirement for an election and the appointment of an interim board.

Transportation

Transportation services in the two districts differ. The Escondido Union School District does not provide home-to-school transportation services and contracts with an outside provider for special education transportation. The Escondido Union High School District uses its own employees to provide limited home-to-school and special education transportation for its students.

Concern was expressed regarding the differences in transportation services and the potential pressure to provide more transportation services to students in a unified school district. Because unification provides no additional funding for home-to-school transportation, any increased costs resulting from modified or increased transportation services would come from the newly unified district's general fund.

The new governing board has a few options when considering transportation services, including changing walking distances or service areas and/or charging legally allowable fees. If the districts proceed with unification, the issue of home-to-school transportation and any related financial effects will require consideration.

Recommendations

If the districts proceed with unification, the districts should:

1. Seek legal counsel regarding issues related to the merit system.
2. Complete an in-depth analysis of retiree benefit costs based on a common benefit structure.

Appendices

Appendix A

Sample Debt Management Policy

Appendix B

IRS Private Letter Ruling Regarding Continuing Employment
Exception to FICA Tax

Appendix C

Study Agreement

Appendix A

Sample Debt Management Policy

SAN LUIS OBISPO COUNTY OFFICE OF EDUCATION
P.O. Box 8105, San Luis Obispo, CA 93403-8105

(P) #3266 DEBT MANAGEMENT POLICY

Purpose

The County Office of Education recognizes that the foundation of a well-managed debt program is a comprehensive debt policy.

This debt policy sets forth a set of comprehensive guidelines for the financing of capital expenditures. It is the objective of this policy that: 1) the County Office of Education obtain financing only when necessary, 2) the County Office of Education will use a process for identifying the timing and amount of debt or other financing that is efficient, and 3) the County Office of Education will obtain the most favorable interest and other costs in issuing the debt.

This policy will be reviewed by the County Board of Education at least annually and updated as necessary.

Responsibilities

County Superintendent & Deputy Superintendent

Under the general direction of the Superintendent, the Deputy Superintendent will have the primary responsibility for developing financing recommendations and ensuring the implementation of the debt policy. In developing the recommendations, the Deputy Superintendent will be assisted by the Director of Internal Fiscal Services and the County Superintendent. These individuals will comprise the Debt Management Committee. The responsibilities of the committee will be to:

- Meet at least quarterly to review the County Office's capital improvement program and consider the need for financing to maintain the progress on the capital improvement program.
- Develop a Request for Proposal (RFP) that will be used in the selection of bond counsel, financial advisor and/or underwriter beginning in the Spring of 2002 if necessary.
- Select the financing participants for each debt issue, ensure the debt issue is integrated with the County Office's overall financing program, approve the structure of each debt issue, and review and approve all documentation for each issue.
- Oversee the preparation of the information for the official statement for debt issues.

- Meet as necessary in preparation for a financing or to review changes in state or federal laws or regulations.
- Prepare all information for the bond rating agencies and make presentations as necessary.
- Meet annually to review the County Office of Education's compliance with the existing debt agreements.
- A Meet annually to review the services provided by the financial advisor, bond counsel, paying agents and other service providers to evaluate the extent and the effectiveness of the services provided.
- Administer the investment and expenditure of the debt proceeds and ensure that the debt payments are made on time.
- Ensure that the arbitrage requirements are monitored and that the appropriate reports are filed with the federal government.

Bond Counsel

The bond counsel will issue an opinion as to the legality and tax exempt status of any obligations. The County Office will also seek the advice of the bond counsel on questions involving the state or federal law or arbitrage. The bond counsel is also responsible for the preparation of the bond documents (including the authorizing resolutions that the County Board of Education will adopt) and most of the closing documents. The bond counsel will ensure that all legal requirements for the debt issue are met. The bond counsel will perform other services as defined by the contract approved by the County Superintendent of Schools.

Financial Advisor/Underwriter

The County Office staff will seek the advice of the financial advisor and/or underwriter when necessary. The financial advisor will advise on the structuring of the debt obligations that will be issued, inform the County Office of the options available for each issue, advise the County Office of Education as to how choices will impact the marketability of the County Office of Education's obligations, and will provide other services as defined by the contract approved by the County Superintendent of Schools.

County Office Auditors

The County Office of Education will include a review of any official statements issued in connection with a debt issue in its contract for services with the County Office of Education's independent auditors.

Short-Term Operating Debt Policy

The expenditures associated with the day-to-day operations of the County Office of Education will be covered by current revenues. However, because the County Office of Education does not receive its revenues in equal installments each month and the largest expenditures occur in equal amounts, the County Office of Education may experience temporary cash shortfalls. To finance these temporary cash shortfalls, the County Office of Education may incur short-term operating

debt, typically, tax and revenue anticipation notes (TRANS). The County Office of Education will base the amount of the short-term operating debt on cash flow projections for the fiscal year and will comply with applicable federal and state regulations. The County Office of Education will pledge operating revenues to repay the debt, which will be repaid in one year or less. The County Office of Education will minimize the cost of the short-term borrowings to the greatest extent possible and may participate in pooled TRANS to meet this goal.

Long-term Capital Debt Policy

The following will apply to the issuance of long-term debt:

- The County Office of Education will not use long-term obligations for operating purposes.
- The life of the long-term obligations will not exceed the useful life of the projects financed.
- The County Office of Education will strive to maintain level debt service payments.
- The County Office of Education will not issue unfunded long-term debt in excess of 3% of annual general fund revenues, unless there is a dedicated tax levy, surplus property sale, fixed lease payments from another public agency or redevelopment revenue stream committed to service the debt.

Bonds

The County Office of Education, upon approval of the County Board of Education, may issue general obligation bonds to finance significant capital improvements for the purposes set forth by the voters in the bond election. The County Office of Education may also issue revenue bonds to finance significant capital improvements without voter authorization, through Certificates of Participation (COPs) or through Qualified Zone Academy Bonds (QZABs).

The County Office of Education staff will prepare a resolution authorizing the issuance of Certificates of Participation, Qualified Zone Academy Bonds, and General Obligation Bonds for presentation to the County Board of Education at least 45 days prior to the issuance.

Negotiated Versus Competitive Sale Versus Private Placement

When feasible and economical, the County Office may issue bonds either by competitive or negotiated sale. The County Office of Education will issue by negotiated sale when the issue is predominantly a refunding issue or in other non-routine situations that require more flexibility than a competitive sale allows. Whenever the option exists to offer an issue either for competition or negotiation, the Debt Management Committee will undertake an analysis of the options to aid in the decision making process.

Refunding

The County Office of Education will consider refunding debt whenever an analysis indicates the

potential for present value savings of approximately 5% of the principal being refunded or at least \$200,000. The financial advisor will compute the economic gain or loss on the refunding and the members of the Debt Management Committee will verify the computation. The County Office of Education will not refund less than 5% of its outstanding debt at one time except in unusual circumstances such as when it intends to change bond covenants.

Capital Leases

Capital leasing is an option for the acquisition of equipment or other assets with a cost of less than \$500,000.

The County Office of Education will not consider leasing when there are available funds on hand for the acquisition unless the interest expense associated with the lease is less than the interest that can be earned by investing the funds on hand or when other factors such as budget constraints override the economic consideration.

When a lease is arranged with a private sector entity, the County Office of Education will seek a tax-exempt rate. When a lease is arranged with a government or other tax-exempt entity, the County Office of Education will try to obtain an explicitly defined taxable rate so that the lease will not be counted in the County Office of Education's total annual borrowings subject to arbitrage rebate.

The lease agreement will permit the County Office of Education to refinance the lease at no more than reasonable cost. A lease that can be called at will is preferable to one that can merely be accelerated.

The County Office of Education staff may obtain at least three competitive proposals for any major lease financing. In evaluating the proposals, the net present value of the competitive bids will be compared, taking into account how and when the payments are made. If required by statute, the purchase price of equipment will be competitively bid.

Bond Rating

The County Office of Education's goal is to maintain or improve its bond ratings. The County Office of Education's staff will make a full disclosure to the bond rating agencies when necessary.

Arbitrage Liability Management

The County Office of Education will make every effort to minimize the cost of the arbitrage rebate and yield restriction while strictly complying with the law. The federal arbitrage law is intended to discourage entities from issuing tax exempt obligations unnecessarily. In complying with the spirit of the law, the County Office of Education will not issue obligations except for identifiable projects with very good prospects of timely initiation. Obligations will be issued as closely in time as feasible to the time contracts are awarded so as to minimize the time the debt proceeds are unspent.

The County Office of Education's bond counsel and financial advisor will review, in advance, all

arbitrage rebate payments and forms sent to the IRS.

Internal Interim Financing

In order to defer the issuance of debt obligations, when sufficient non-restricted funds are on hand, consideration will be given to appropriating them to provide interim financing for large construction projects. When the debt obligation is subsequently issued, the non-restricted funds will be repaid.

REVIEWED BY SCHOOLS LEGAL SERVICE DC 7/19/01

APPROVED BY COUNTY BOARD OF EDUCATION 10/4/01

Appendix B

IRS Private Letter Ruling Regarding Continuing Employment Exception to FICA tax

Internal Revenue Service

Department of the Treasury

Number: **200318027**
Release Date: 5/2/2003
Index Number: 3121.02-08

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EOEG:ET2-PLR-151740-02

Date:

January 14, 2003

Legend

Taxpayer:
Former School District:
State:
County:
Plan:
Date 1:

Dear _____ :

This letter is written in response to the Taxpayer's request for a ruling on the application of the continuing employment exception to the hospital insurance portion (also known as Medicare tax) of the Federal Insurance Contributions Act (FICA) tax as set forth in Internal Revenue Code (Code) § 3121(u)(2)(C). The specific request includes the following rulings:

1. The Taxpayer is the same employer as the Former School District for purposes of Code § 3121(u)(2)(C).
2. The services of the eleven teachers who were continuously employed prior to April 1, 1986 qualify for the exception to Medicare tax as set forth in Code § 3121(u)(2)(C), which tax is imposed under Code §§ 3101(b) and 3111(b).

FACTS:

Prior to 1990, the Taxpayer was the Former School District and provided education for children from kindergarten through the eighth grade. The Former School District provided no high school classes for children residing within the boundaries of the school district. Following the passage of a referendum in 1990, the Former School District

PLR-151740-02

became unified under State law and established two high schools within the boundaries of the Former School District. The Taxpayer's borders are the same as the Former School District's borders. The assets and liabilities of the Former School District were transferred to the Taxpayer upon unification.

The County in which the Taxpayer is located remains responsible for the withholding of all federal income and employment taxes for the employees of the Taxpayer as it was for the employees of the Former School District.

Pursuant to a division of the Plan that became effective on Date 1, employees of the Taxpayer who were hired before April 1, 1986, were permitted to elect Medicare insurance coverage provided that they (a) were members of the Plan; (b) were employed in a position covered by the Plan on March 31, 1986; (c) did not have mandatory Medicare coverage under the Consolidated Omnibus Reconciliation Act of 1985; and (d) were members of the Plan or eligible for membership in the Plan on the date of the division. Employees who meet these criteria have the option of being covered under a voluntary agreement pursuant to section 218(d) of the Social Security Act (Section 218 Agreement) for Medicare insurance only.

Generally, a teacher is employed by the Taxpayer for a one-year term that is automatically renewed unless the teacher is terminated. Except for eleven teachers, all employees of the Taxpayer were hired after April 1, 1986. The eleven teachers, who were hired before April 1, 1986, were all eligible to elect voluntary Medicare insurance coverage and four of the eleven teachers elected to be covered for Medicare insurance under the Section 218 Agreement. Seven of the eleven employees remain employed by the Taxpayer after the unification with no break in service. Four of the eleven teachers terminated their employment with the Taxpayer, but were continuously employed with the Taxpayer until their termination.

LAW AND ANALYSIS:

FICA taxes consist of the old-age, survivors, and disability (OASDI) portion and the Medicare tax portion and are computed as a percentage of wages paid by the employer and received by the employee for employment. Code §§ 3101, 3111, 3121. Generally, all remuneration paid by an employer for services performed by an employee is subject to FICA unless the remuneration is specifically excepted from the term "wages" or the services are specifically excepted from the term "employment." Code §§ 3102, 3111, 3121.

Service performed by an employee of a state, political subdivision, or wholly owned instrumentality not covered by a Section 218 Agreement is exempt from employment for purposes of the OASDI portion of FICA only if the employee is a member of a retirement system of such state, political subdivision, or wholly owned instrumentality in connection with the employee's employment. Code § 3121(b)(7)(F). Service

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performed by an employee of a state, political subdivision, or wholly owned instrumentality who is hired after March 31, 1986, is considered to be employment for purposes of applying Medicare tax. Code § 3121(u)(2). Service covered by a Section 218 Agreement is specifically excluded from employment for purposes of Medicare tax as set forth under Code § 3121(u)(2)(A), but is subject to Medicare tax under the terms of such Section 218 Agreement. Code § 3121(u)(2)(B). The Internal Revenue Code, however, provides a narrow exception for services subject to Medicare tax pursuant to Code § 3121(u)(2)(A), known as the continuing employment exception, if specific requirements are met. Code § 3121(u)(2)(C).

For employment to qualify for the continuing employment exception under Code § 3121(u)(2)(C), an employee's service performed for a state, political subdivision, or wholly owned instrumentality must meet the following requirements:

1. The employee's service must be excluded from the term "employment" as determined in Code § 3121(b)(7)(F), which exclusion applies only to an employee who is a member of a retirement system of such state, political subdivision, or wholly owned instrumentality. Code § 3121(u)(2)(C)(i) (cross-reference to subparagraph (A) of Code § 3121(u)(2) with cross-reference to Code § 3121(b)(7)).
2. The employee performed substantial and regular service for compensation for that employer before April 1, 1986.
3. The employee was a bona fide employee of that employer on March 31, 1986.
4. The employee's employment relationship with that employer was not entered into for purposes of meeting the requirements of Code § 3121(u)(2)(C).
5. The employee's relationship with that employer has not been terminated after March 31, 1986.

Section 3121(u)(2)(D)(ii) of the Internal Revenue Code provides that a political subdivision, as defined in section 218(b) of the Social Security Act, 42 U.S.C. § 418(b)(2), includes all agencies and instrumentalities of a political subdivision and shall be treated as a single employer for purposes of applying the continuing employment exception.

Revenue Ruling 86-88, 1986-2 C.B. 172, which provides guidelines for applying the continuing employment exception, refers to section 218(b)(2) of the Social Security Act to define the term "political subdivision" to include a county, city, town, village, or school district. The term "political subdivision employer" is defined as a political

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subdivision and any agency or instrumentality of that political subdivision that is a separate employer for purposes of withholding, reporting, and paying the federal income taxes of employees.

In the instant case, we assume that: (1) the Plan is a retirement system pursuant to Code § 3121(b)(7)(F); (2) the employment of the eleven teachers of the Former School District consisted of substantial and regular services performed for compensation for the Former School District prior to April 1, 1986; (3) such teachers were bona fide employees of the Former School District on March 31, 1986; and (4) the teachers' services were not entered into for purposes of avoiding Medicare tax. Thus, the application of the continuing employment exception turns on whether or not the eleven teachers' employment was terminated upon the unification of the Former School District as the Taxpayer.

Based on the facts presented and assumptions made, we conclude that the Former School District and the Taxpayer are considered to be the same employer for purposes of applying the continuing employment exception to Medicare tax. As we understand the facts, the Former School District expanded in 1990 by opening two high schools within district boundaries that did not previously exist. This expansion of the Former School District did not create a new employer. Employees of the Former School District who subsequently became employees of the Taxpayer remained employed by the same employer, and, therefore, such employees' employment did not terminate for purposes of the continuing employment exception.

To conclude, the continuing employment exception applies to the services of the eleven teachers who were hired before April 1, 1986. The continuing employment exception ceased to be applicable with respect to the four teachers who elected voluntary Medicare insurance coverage under the Section 218 Agreement (and, therefore, application of Medicare tax to their wages) as of the effective date of such election. The teachers whose employment terminated and who had not previously elected voluntary coverage under the Section 218 Agreement ceased to be eligible for the continuing employment exception as of the date of termination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lynne Camillo
Chief, Employment Tax Branch 2
Office of Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

cc:

Appendix C

Study Agreement



CSIS California School Information Services

**FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
STUDY AGREEMENT
May 10, 2010**

The FISCAL CRISIS AND MANAGEMENT ASSISTANCE TEAM (FCMAT), hereinafter referred to as the Team, and the Escondido Union School District, hereinafter referred to as the District, mutually agree as follows:

1. BASIS OF AGREEMENT

The Team provides a variety of services to school districts and county offices of education upon request. The District has requested that the Team provide for the assignment of professionals to study specific aspects of the Escondido Union School District operations. These professionals may include staff of the Team, County Offices of Education, the California State Department of Education, school districts, or private contractors. All work shall be performed in accordance with the terms and conditions of this Agreement.

2. SCOPE OF THE WORK

A. Scope and Objectives of the Study

The scope and objectives of this study are to:

1. Conduct a review of the fiscal impact only of a potential reorganization of the Escondido Union School District and the Escondido Union High School District (The study does not include the evaluation of the state's nine criteria pursuant to Education Code 35753.)

In accordance with Education Code Section 35735.1, the computation of the base revenue limit for the newly organized school districts will be based on the current information available for each affected school district for the second principal apportionment of the 2009-10 fiscal year and will be used for budgetary estimates of ADA, full-time equivalent employees (FTEs), salaries and benefits. None of the school districts are considered "Basic Aid" for purposes of this calculation.

B. Services and Products to be Provided

- 1) Orientation Meeting - The Team will conduct an orientation session at the School District to brief District management and supervisory personnel on the procedures of the Team and on the purpose and schedule of the study.
- 2) On-site Review - The Team will conduct an on-site review at the District office and at school sites if necessary.
- 3) Exit Report - The Team will hold an exit meeting at the conclusion of the on-site review to inform the District of significant findings and recommendations to that point.
- 4) Exit Letter - The Team will issue an exit letter approximately 10 days after the exit meeting detailing significant findings and recommendations to date and memorializing the topics discussed in the exit meeting.
- 5) Draft Reports - Sufficient copies of a preliminary draft report will be delivered to the District administration for review and comment.
- 6) Final Report - Sufficient copies of the final study report will be delivered to the District administration following completion of the review.
- 7) Follow-Up Support – Six months after the completion of the study, FCMAT will return to the District, if requested, to confirm the District’s progress in implementing the recommendations included in the report, at no cost. Status of the recommendations will be documented to the District in a FCMAT Management Letter.

3. PROJECT PERSONNEL

The study team will be supervised by Anthony L. Bridges, Deputy Executive Officer, Fiscal Crisis and Management Assistance Team, Kern County Superintendent of Schools Office. The study team may also include:

- | | |
|-------------------------|---|
| <i>A. Diane Branham</i> | <i>FCMAT Fiscal Intervention Specialist</i> |
| <i>B. Eric D. Smith</i> | <i>FCMAT Consultant</i> |
| <i>C.</i> | <i>FCMAT Fiscal Consultant</i> |

Other equally qualified consultants will be substituted in the event one of the above noted individuals is unable to participate in the study.

4. **PROJECT COSTS**

The cost for studies requested pursuant to E.C. 42127.8(d)(1) shall be:

- A. \$500.00 per day for each Team Member while on site, conducting fieldwork at other locations, preparing and presenting reports, or participating in meetings.
- B. All out-of-pocket expenses, including travel, meals, lodging, etc. The District will be billed for the daily rate and expenses of the independent consultant, only. The District will be invoiced at actual costs, with 50% of the estimated cost due following the completion of the on-site review and the remaining amount due upon acceptance of the final report by the District.

Based on the elements noted in section 2 A, the total cost of the study is estimated at \$14,500.

- C. Any change to the scope will affect the estimate of total cost.

Payments for FCMAT services are payable to Kern County Superintendent of Schools - Administrative Agent.

5. **RESPONSIBILITIES OF THE DISTRICT**

- A. The District will provide office and conference room space while on-site reviews are in progress.
- B. The District will provide the following (if requested):
 - 1) A map of the local area
 - 2) Existing policies, regulations and prior reports addressing the study request
 - 3) Current organizational charts
 - 4) Current and four (4) prior year's audit reports
 - 5) Any documents requested on a supplemental listing
- C. The District Administration will review a preliminary draft copy of the study. Any comments regarding the accuracy of the data presented in the report or the practicability of the recommendations will be reviewed with the Team prior to completion of the final report.

Pursuant to EC 45125.1(c), representatives of FCMAT will have limited contact with District pupils. The District shall take appropriate steps to comply with EC 45125.1(c).

6. **PROJECT SCHEDULE**

The following schedule outlines the planned completion dates for key study milestones:

<i>Orientation:</i>	<i>June 1, 2010</i>
<i>Staff Interviews:</i>	<i>to be determined</i>
<i>Exit Interviews:</i>	<i>to be determined</i>
<i>Preliminary Report Submitted:</i>	<i>to be determined</i>
<i>Final Report Submitted:</i>	<i>to be determined</i>
<i>Board Presentation:</i>	<i>to be determined</i>
<i>Follow-Up Support:</i>	<i>If requested</i>

7. **CONTACT PERSON**

Name of contact person: Jennifer Walters, Superintendent

Telephone: (760) 432-2110 FAX: (760) 735-2874

E-Mail jwalters@eusd4kids.org

Linda Woods May 13, 2010
Linda Woods Date
Clerk of the Board of Education

Anthony L. Bridges May 10, 2010
Anthony L. Bridges, Deputy Executive Officer Date
Fiscal Crisis and Management Assistance Team

In keeping with the provisions of AB1200, the County Superintendent will be notified of this agreement between the District and FCMAT and will receive a copy of the final report.