April 14, 2011

Jon R. Gundry, Interim Superintendent
Melvin Iizuka, Director, Division of Business Advisory Services
Los Angeles County Office of Education
9300 Imperial Highway
Downey, CA 90242

Dear Superintendent Gundry and Director Iizuka:

The purpose of this letter is to confirm the principal findings and recommendations identified by the Fiscal Crisis and Management Assistance Team (FCMAT) after meeting with district staff at the Inglewood Unified School District on March 22, 2011.

In March 2011, FCMAT and the county office entered into an agreement to determine the fiscal solvency of the Inglewood Unified School District and provide recommendations. Specifically, the study agreement states that FCMAT will complete the following scope of work:

1. The Los Angeles County Office of Education is requesting that FCMAT conduct a review the cash balances of each fund to determine the fiscal solvency of the Inglewood Unified School District. The FCMAT Team will review and validate the existing cash flow projections completed by the Fiscal Advisor as a preliminary step to determine if the district will require intervention by the State of California should it be determined that the district's cash balances are not sufficient to meet their current and ongoing fiscal obligations.

FCMAT conducted staff interviews at the district on March 21, 2011. During the visit, the team collected and reviewed documentation to determine whether the district has adequate cash flow to sustain its financial solvency.

Background

On December 10, 2010, the Los Angeles County Office of Education invoked Education Code Section 42127.6 and assigned a fiscal advisor to the district with the authority to stay and rescind potential actions by the Inglewood Board of Trustees that may impact the district's financial solvency. The most recent projections by the fiscal advisor and financial consultant team indicate that the district will have a negative cash balance in the general fund of approximately $12.9 million by June 30, 2011.

The district attempted to secure additional funds through the issuance of a Tax Revenue Anticipation Note (TRAN) to address the cash shortfall, but could not establish the credit requirements to complete the transaction. TRANs are short-term, interest-bearing notes issued by a government entity in anticipation of tax revenues that will be received at a later date. Under Government Code Section 53854, a local educational agency (LEA) may issue a TRAN payable up to 15 months after the date of issuance. The note is payable only from revenue received or accrued during the fiscal year in which it was issued. Unless the district can demonstrate fiscal solvency, it will have little or no ability to issue a future TRAN.

Findings

FCMAT concurs with the initial findings of the fiscal advisor and financial consultant team currently working with the district. The district and its governing board continue to reduce the budget and have made significant progress to date. However, this may be the most challenging budget in the state's history, and the governor's proposal uses a multitude of funding solutions and major spending reductions to address this crisis. Because of the number of one-time and permanent apportionment deferrals (cash) currently included in the state budget, the district's cash flow indicates that the general fund will have a negative balance of $2.7 million in May 2011, increasing to $11.8 million in June, absent other cash management strategies or intervention from the state.

The district's current fund balances as of April 6, 2011 are as follows:

Fund	Description	Cash Balance
01	General	7,416,108
11	Adult	451,192
12	Cafeteria	614,626
13	Child Development	66,759
14	Deferred Maintenance	112,218
21	Bond Fund	8,070,761
25	Capital Facilities	552,390
35	County Facilities	16,944,620
67	Self Insurance	(657,048)
73	Foundation Trust	288,455
76	Payroll Trust	1,834,635
Total		$35,694,716

The district payroll obligation across all funds for February 2011 was $8,767,880. The district will need to borrow from other funds to meet the payroll obligations in May and June. The monthly payroll obligation has been factored into the projected shortfall of $11.8 million as of June 30, 2011.

The chart below shows the projected cash flow prepared by the fiscal advisor:

Inglewood USD
Cash Flow Analysis
Prepared by VTD
For the Months of March 2011 through October 2011

	Actual Mar-11	Projected Apr-11	Projected May-11	Projected Jun-11	Projected Jul-11	Projected Aug-11	Projected Sep-11	Projected Oct-11
Beginning Cas	7,779,117.12	8,533,209.60	3,909,967.85	(2,670,419.86)	(11,772,762.82)	(12,968,082.29)	(7,876,347.12)	(1,468,427.34)
8020-8079	(164,112.75)	5,312,167.15	1,085,279.82	(777,887.56)	-	-	-	-
8010-8019	4,072,234.53	618,486.63	817,238.55	-	4,470,879.37	6,176,169.39	3,592,031.76	-
8080-8099	(151,299.82)	(381,232.50)	(381,232.50)	(381,232.50)	(107,640.50)	-	-	-
8100-8299	3,350,792.61	10,996.00	611,109.00	2,736,999.00	1,808,631.62	148,225.20	3,657,998.18	-
8300-8599	2,820,250.00	2,599,340.96	930,737.56	91,568.00	2,224,487.27	140,693.18	612,429.51	855,472.92
8600-8799	9,821.51	68,768.98	42,861.22	742,639.10	319,938.56	-	-	(26,559.54)
8910-8929	-	-	-	-	-	-	-	-
8930-8979	-	-	-	-	-	-	-	-
Subtotals	9,937,686.08	8,228,527.22	3,105,993.65	2,412,086.04	8,716,296.32	6,465,087.78	7,862,459.45	828,913.38
1000-1999	4,660,247.58	4,695,718.89	4,695,718.89	4,695,718.89	1,384,750.00	-	-	-
2000-2999	1,458,376.76	1,367,334.54	1,367,334.54	1,367,334.54	2,224,351.00	-	-	-
3000-3999	2,063,790.87	2,030,532.53	2,030,532.53	2,030,532.53	2,930,039.00	-	-	-
4000-5999	1,707,085.99	1,555,940.51	1,555,940.51	1,555,940.51	1,555,940.51	1,373,352.60	1,373,352.60	711,521.30
6000-6599	207,062.25	-	-	-	-	-	-	-
7000-7499	44,279.72	1,901,674.00	36,854.89	2,131,811.00	1,816,535.29	-	81,187.07	-
7600-7629	-	-	-	-	-	-	-	-
7630-7699	-	-	-	-	-	-	-	-
Subtotals	10,140,843.17	11,551,200.47	9,686,381.35	11,781,337.47	9,911,615.80	1,373,352.60	1,454,539.67	711,521.30
9200	(45,827.42)	(608,400.23)	-	-	-	-	-	-
9500	(911,422.15)	1,908,968.74	-	(266,908.47)	-	-	-	-
End Cash	8,533,209.60	3,909,967.85	(2,670,419.86)	(11,772,762.82)	(12,968,082.29)	(7,876,347.12)	(1,468,427.34)	(1,351,035.26)

Interfund Borrowing: Education Code Section 42603 provides that moneys held in any fund or account may be temporarily transferred to another fund or account for payment of obligations with certain limitations.

- Amounts transferred shall be repaid either in the same fiscal year, or in the following fiscal year if the transfer takes place within the final 120 calendar days of a fiscal year.
- Borrowing shall occur only when the fund receiving the money will earn sufficient income during the current fiscal year to repay the amount transferred.
- No more than 75 percent of the maximum of moneys held in any fund during a current fiscal year may be transferred.

Education Code 42603 also provides that the transfer shall be accounted for as temporary borrowing between funds or accounts and shall not be available for appropriation or be considered income to the borrowing fund or account. Temporary borrowings are not accounted for as interfund transfers, and do not affect the fund balance for either the borrowing or lending fund.

Because the district has a negative certificate, the LACOE may have specific requirements for interfund borrowing that include:

- The repayment plan
- Listing of all future obligations
- Cash flow schedules that support the repayment within the statutory time lines.

It should be noted that borrowing from capital facility funds will not negate existing contracts. Extreme care should be taken when borrowing from these funds to ensure there is sufficient cash available to pay construction obligations in accordance with the contract terms to avoid any potential legal action.

County Office of Education (COE): Education Code Sections 42621 and 42622 authorize county offices of education to lend funds to school districts. The funds must be repaid either within the fiscal year or within the next fiscal year, depending on the type of loan that is granted. Certain other restrictions apply, as indicated in the applicable statutes. Note that such loans are discretionary and are subject to availability of funds at the county office level. Funds are unavailable from the Los Angeles COE at this time.

County Treasurer: Education Code Section 42620 requires the county board of supervisors to lend money to school districts when certain conditions exist. However, Section 6 of Article XVI of the state Constitution requires these loans to be made before the last Monday in April. Loan and repayment terms vary by county. The district has not met the statutory time line to secure a loan from the County Treasurer's office.

Waiver of June Apportionment Deferral: The state established a deferral waiver process in 2010-11 to exempt school districts from the June to July deferral. The district has requested a waiver through the county office of the June to July deferral. Applications were due by April 1, 2011. The probability that the state will adopt additional deferrals or budget reductions will continue to put more districts at risk of insolvency in the coming fiscal year. One way to help ease the burden on struggling districts is to allow them to be exempt from certain deferrals if they are at risk of insolvency. As of this date, the district's request for exemption of the March deferral was approved, but the outcome of the June deferral is still pending. The approval of the exemption of the June deferral is anticipated to decrease the potential cash shortfall in June by approximately $4.5 million. The deferral exemption is only a temporary relief for cash flow purposes but does not affect the underlying structural deficit that the district is experiencing.

Los Angeles World Airports (LAWA) Funding: In February 2005, the city of Lennox and the Los Angeles World Airports (LAWA) negotiated a settlement to pay for noise attenuation projects. The Inglewood Unified School District also was a party to the settlement. The settlement agreement for Inglewood entitles the district to $118.5 million. According to district officials, the first payment of $59 million is anticipated to be received by the district in August 2011. However, FCMAT has no written documentation to support the receipt of these funds in the near future. According to district documents, schematic drawings and bid specifications have been designed in accordance with the criteria to mitigate and retrofit the district's schools. Approximately $3 million was advanced temporarily from the bond fund to develop the design drawings.

LAWA funds must be expended in accordance with the intent of the settlement agreement. Temporarily borrowing these funds does not represent an "expense" or an "appropriation." Instead, temporary borrowing is a general ledger entry only that establishes the liability to the general fund for repayment. The accounting treatment is like any other source of funds borrowed.

State Intervention Education Code Section 41325: When a district no longer has the cash to meet its financial obligations from all funds, it must apply for a state loan, equivalent to state receivership. In analyzing the need for a state loan, the district's cash flow projection must indicate that any type of internal or external borrowing can be repaid from the district's future revenues and within the statutory time lines.

State Loan: A loan (referred to in the Education Code as an emergency appropriation) from the state requires that one of the district's local representatives to the state Legislature sponsor a bill through the legislative process. This is typically an urgency bill, meaning it requires at least a two-thirds vote of each house of the Legislature so it can become effective upon the Governor's signature. The legislative process takes many months, so a state loan should be initiated early enough to ensure that the cash is available to meet the district's financial obligations. The timing of any proposed legislation is critical and needs to work within the time frame of the legislative calendar. Typically, the bill has to be introduced in January to work its way through the legislative committees and the floors of both houses by the summer or early fall of any fiscal year.

A state loan results in the state taking control of the school district. The degree of state control is determined by the size of the loan relative to the district's budget. Pursuant to Education Code 41326(a), if the loan is less than twice the size of the district's required reserve level, a state trustee is assigned and assumes authority over the financial aspects of the school district's activities.

If the size of the loan exceeds twice the size of the district's required reserve level, the following will occur:

- The school board loses its authority and becomes advisory only [EC 41326(c)(1)]
- The superintendent is no longer employed by the district [EC 41326(c)(2)]
- A state administrator is assigned and assumes the powers of the board and superintendent [EC 41326(b)]

State loans typically require principal and interest payments over 20 years. In both situations above, state control remains over the school district until the loan is fully repaid. The state trustee or state administrator reports directly to the state Superintendent of Public Instruction, not the local school board or community.

The state loan is sized to accommodate the anticipated cash that the district will need during the life of the loan to meet its financial obligations. In addition, all costs of ensuring the district's fiscal recovery are the responsibility of the district (EC 41328) and are added to the amount of the state loan. The cost of fiscal recovery when a state administrator is assigned includes the following:

- The cost of the salary and benefit compensation package for the state administrator (EC 41326[(b)][(8)]
- The cost of additional staffing as determined by the state administrator to be necessary for ensuring fiscal recovery (EC 41326[(b)][(9)]
- The cost of management reviews and developing a recovery plan, including the cost of the initial comprehensive review and follow-up reviews every six months encompassing these five areas of the district (EC 41327.1):

    - Community relations and governance
    - Pupil achievement
    - Financial management
    - Personnel management
    - Facilities management
- Any other expenditure deemed necessary by the state administrator to help ensure fiscal recovery

A state loan will be much larger than what the district would otherwise require if temporary borrowing was transacted internally or externally from local sources. Therefore, a district that receives a state loan will need to make additional budget reductions to accommodate the higher cost of fiscal recovery or propose a longer repayment schedule for the state loan. The most recent state loan to a school district had a stated interest rate of 5.44% applied to the entire amount of the loan. The annual debt service of $1.2 million is equivalent to approximately 10% of the district's unrestricted general fund, further compounding the amount of budget adjustments necessary to balance future budgets.

The comprehensive review and six-month follow-up studies measure the district's progress in meeting the standards established. In the areas where the district has progressed enough in meeting the standards, the board receives its powers back and a superintendent is hired to administer those areas. It normally takes several years before the board regains any of its powers. State control remains, either in the form of a state administrator or state trustee, with stay or rescind power over certain board actions until the state loan is repaid.

The state administrator's mission is to restore fiscal solvency as soon as possible so that the loan can be paid back to the state. This will be done by reducing expenditures to a level that is lower than revenues so that reserves can be rebuilt over time while the state loan is being repaid. This means that all possible avenues for balancing the budget are pursued. The state administrator cannot set aside any of the district's existing contractual obligations, including vendor contracts and bargaining unit contracts, without renegotiating the terms and conditions. If modifying provisions of these contracts is critical to gaining fiscal solvency, the state administrator has the power to invoke the time lines available in the contracts or by law, including the ability to use the impasse/fact-finding process to unilaterally impose changes in collective bargaining agreements.

Summary

While FCMAT believes that the district has sufficient cash across all funds as of June 30, 2011 to meet its financial obligations, there are many uncertainties with the state budget crisis. Therefore, it is critical for the district to parallel the cash management strategies recommended in this letter with cash flow projections.

Ultimately, LACOE must evaluate the district's ability to repay any temporary loans. If the county office determines at any point that repayment will not occur, the county office would require the district to be engaged in the state loan process.

In normal circumstances FCMAT would not recommend the use of capital facility funds to meet the district's financial obligations without a repayment plan. Under these circumstances the district will be forced to utilize all funding sources absent the district securing the LAWA funds temporarily, allowing time for the district to implement budget reductions.

To regain financial control and reduce the reliance on temporary borrowing solutions, the district must implement the necessary budget adjustments to balance revenues and cash inflows with monthly obligations at any given time within the fiscal year. Although the governing board and administration have made great strides cutting millions of dollars out of the district's general fund, the structural deficit has not been fully corrected.

Conclusion

Over time, a district in financial trouble will regain fiscal solvency. If the district and the board, while it has the power and authority, do not take the necessary actions locally to restore fiscal solvency, the same actions and more will be imposed by the state. In the long term, taking the necessary actions locally and avoiding a state loan will result in greater local control, less outside intervention, and better long-term outcomes for students, employees, and the community.

Recommendations

1. The district should exercise the provisions of Education Code Section 42603 and temporarily utilize any and all funds necessary to meet its financial obligations.
2. The district should contact LACOE and CDE to determine the final approval for the exemption of the June apportionment deferral.
3. The district should contact LACOE and apply for all waivers that may be available in the 2011-12 fiscal year.
4. The district should continue to pursue the timing and funding of the LAWA settlement. Any funds received should be utilized temporarily under the provisions of Education Code Section 42603 and under the terms and conditions of the settlement agreement.
5. Due to the current and ongoing uncertainty of the district's available cash to meet its financial obligations, FCMAT recommends that the district immediately meet with local legislators to begin the process to secure a state loan.

Please contact us with any questions or comments you may have regarding the contents of this letter. Once you have done so, the final letter will be issued.

FCMAT would like to thank the staff of the Los Angeles County Office of Education and the Inglewood Unified School District for their cooperation and assistance during this on-site review.

Sincerely,

Anthony L. Bridges, CFE
Deputy Executive Officer

Debi Deal, CFE
Fiscal Intervention Specialist

Cc: Joel Montero, FCMAT Chief Executive Officer