February 24, 2011

Denise Calvert, Deputy Superintendent
Sonoma County Office of Education
5340 Skylane Boulevard
Santa Rosa, California 95403

Jennie Snyder, Ed.D., Superintendent
Piner-Olivet Union School District
3450 Coffey Lane
Santa Rosa, California 95403

Dear Ms. Calvert and Ms. Snyder,

The purpose of this letter is to finalize the assignment of the Fiscal Crisis and Management Assistance Team (FCMAT) at the Piner-Olivet Union School District, which ended January 31, 2011. Since assignment to the district began in April 2009, FCMAT staff have served as both fiscal expert and fiscal advisor, depending on the status of the district's interim certification. The most recent study agreement for 2010-11 defines the scope of the assignment as follows:

1. The COE requests the team to provide fiscal expert services to the district including monitoring the district's cash flow and providing recommendations and support in the development of a financial recovery plan, 2010-11 adopted budget and multiyear financial projections.

Background

The district's financial condition appeared to be stable until the state's budget declined during the 2008-09 fiscal year. Stable enrollment had protected the district from large budget cuts, and the reserve for economic uncertainty amount of 3% was met in the current and subsequent years. The state's actions to offset its own fiscal issues have severely impacted educational agencies throughout the state, including Piner-Olivet.

The district's 2008-09 second interim financial report was downgraded from a qualified certification to a negative certification by the Sonoma County Office of Education because of the district's projected cash flow shortage at June 30, 2009 and because when combining the district's fund balance with Northwest Prep charter school's negative fund balance, the required 3% reserve was not in place in the current or two subsequent years.

The county office outlined specific requirements for the district to meet by the submission of the 2008-09 third interim financial report, with which the district complied. These requirements included the board making adequate budget reductions to maintain the 3% reserve and positive cash flow for the current and two subsequent years in all district funds. Adequate budget reductions were made, and with the county office temporary cash flow loan of $400,000, the district was able to maintain a positive cash balance at June 30, 2009. Another requirement was for the district to work with FCMAT as fiscal expert to assist the district in becoming financially solvent.

Between February and May 2009, the state reduced revenue to districts by approximately $530 per ADA. Approximately $350 of the $530 was an ongoing reduction in future years. This occurred late in 2008-09, so the district's budget adjustments to offset the decrease in revenue had to be made in the next fiscal year. This 2008-09 reduction in addition to other revenue reductions equaled approximately $880 per ADA in 2009-10. Exacerbating this budget crisis, the district had an unanticipated enrollment decrease in 2009-10 of approximately 60 students.

To balance the 2009-10 budget and maintain the required 3% reserve for economic uncertainties, the governing board made approximately $1.3 million in budget reductions. If the governing board had not taken this action, cuts of more than $2.4 million from the 2010-11 budget would have been necessary to balance the 2010-11 and 2011-12 budgets. The board made budget reductions of approximately $524,000 as part of the 2010-11 adopted budget, which was enough to balance the budget and to maintain a 3% reserve in the general fund for 2010-11, 2011-12 and 2012-13 using the information from the governor's January budget proposal for 2010-11. Along with budget reductions, the board took full advantage of the flexibility options provided in the state budget.

Current Status and Outlook

Although the financial condition of the district's general fund for 2010-11 has improved since the state budget was adopted, the outlook for 2011-12 and 2012-13 has worsened because of an unexpected enrollment decline of 100 students. The state adopted budget, signed 100 days after the deadline of June 30, did not include the projected revenue decrease of 3.85% that had been included in the May Revise budget, which resulted in a substantial increase in unrestricted revenue to the district of $325,174. However, the enrollment decline means that the district will need to make adjustments for future years to offset the loss of revenue. If that does not occur, the district will not be able to maintain a 3% reserve in future years.

Because the state continues to defer revenue to districts and make reductions to district budgets late in the fiscal year, the governing board has set up a second reserve for cash flow purposes. By allocating a portion of the one-time federal stimulus funds and the ongoing deferred maintenance revenue into this reserve in 2008-09, the district can use these funds if needed. This reserve has grown to $161,291 in 2010-11.

Although the recent passage of a Proposition 39 general obligation bond measure will have a positive effect on the district's financial condition in the future if the cost savings occur as projected, the savings cannot be included in any financial projections because the amount cannot be accurately quantified. However, the district's cash balance will increase once the bonds are sold, allowing the district to do temporary borrowings when cash flow shortages occur in the general fund. This will eliminate the need to temporarily borrow from the county office, which has occurred many times over the past several years.

It has been extremely difficult for the board to make these financial decisions, but if they had not been made, the district's budgets would not have been approved in 2009-10 and 2010-11. Without a balanced budget and 3% reserve, the district would have been considered a lack of going concern. The board is to be commended for making such difficult decisions. It is important for the district to continue its dedication to financial solvency so the county office is not again forced to provide outside assistance and oversight over the district's finances.

Even though the board has reduced the district's and both charter schools' budgets by amounts that show positive fund balances for 2010-11, 2011-12 and 2012-13, the state's budget is still out of balance by billions of dollars. On January 10, 2011, the governor unveiled the proposed budget for the 2011-12 fiscal year. As is always the case, the budget is based on a range of financial assumptions that are designed to project a particular fiscal position in June 2012. Unique to this budget is the issue of California's temporary tax increases and the potential of their extension for five additional years. County offices of education and school districts are placed in a position of having to decide, based on the information in the governor's budget, how to create their preliminary budgets for 2011-12.

FCMAT reminds the district of the importance of preparing conservative budgets and alternative scenarios so that the worst-case scenario is considered. FCMAT always recommends preparing budgets based on the most current information, SSC dartboard and current law. The 2011-12 budget assumes that flat funding will occur, which constitutes a reduction of about $19 per ADA, and that the current temporary tax increases sunset in December 2012, creating a reduction of about $330 per ADA, resulting in a total loss of approximately $349 per ADA. An even more conservative approach would be to consider whether the statutory COLAs for 2012-13 and 2013-14, 1.8% and 2.3% respectively, might actually be funded. FCMAT suggests that LEAs develop multiple scenarios in their multiyear projections that indicate the result of one or both of these subsequent year COLAs being 0%. And, of course, the district should follow the county office's instructions as to appropriate budget assumptions.

The district will need to continue to focus on certain key strategies to further strengthen the budget and controls related to budget, in addition to those mentioned above. Adequate budget planning and adjustments must be completed as the state continues to provide information related to its own budget, as that information affects the district's budget. Of course, the district must also continue to monitor declining enrollment and the loss of one-time funds (i.e., federal stimulus and job funds), to ensure that future decisions are made with these factors in mind.

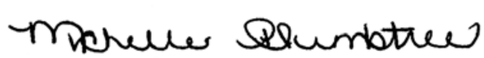
- March 15 layoff notices: Because the district will not know by March 15, 2011, whether the proposed tax extension will be placed on the ballot, or whether or not flexibility will be extended, the district must conservatively plan that those additions or extensions will not occur and should plan accordingly. The district should issue March 15 layoff notices to certificated staff based on the worst-case scenario. The district must use the March 15 layoff notice date correctly because a second layoff period may not be available under current statute. While FCMAT recognizes that it is extremely difficult on staff to receive such notices, if the district does not issue them, certificated staff levels will be too high (and thus costs too high) to remain fiscally solvent if the state budget deteriorates.
- Retiree packages: The retirement packages that have been offered to retirees each year are specified in the bargaining unit contracts. For each retiree the district has contributed an amount equal to the dollar amount of the employee-only cost at the time of retirement toward the health

premium until the retiree attains the age of 65. After age 65, there is no longer any district contribution. The district currently has 23 retirees on this plan at an annual cost of $71,943. To date, the district has budgeted and expended a similar amount each year. In addition, a "golden handshake" program has been offered to members of STRS (State Teachers' Retirement System) and PERS (Public Employees' Retirement System). The district currently has 14 retirees on this plan at a cost of $106,141. Although these retiree packages are called "incentives," the district has offered them each and every year because the contract had been interpreted that the district had to offer them. In the current year, 2010-11, the contract has been interpreted differently; that the district does not have to offer the incentives. FCMAT agrees with this interpretation. FCMAT continues to advise the district that what the district has offered in the past are not incentives since they have been offered each and every year (per contract interpretation). The goal of a true retirement incentive is to obtain more retirements over and above what would naturally occur through attrition, at an overall cost savings to the district. Because it is not possible to determine what natural attrition is when incentives are offered annually, FCMAT continues to recommend that this provision in the contract be reviewed and potentially eliminated so that confusion will not exist in the future and true attrition can be determined. Incentives should be offered only if there is a true cost savings to the district, which would mean more retirements occurring than normal.

- FCMAT has several concerns about the district's internal controls in several areas, including purchase orders, changes to payroll and position control and the use of specific consultants for various tasks. Strong internal controls are particularly important to provide the basis for a solid financial structure that allows a district to produce and be accountable to all its stakeholders. In the past two months, several changes have been implemented in the district, alleviating some of these concerns. FCMAT encourages the district to continue strengthening internal controls in all areas to ensure that assets and employees are adequately protected. Most of all, it is essential for prior written approval to be obtained for any purchases, contracts, and personnel changes. That approval should be determined based on board policy and, at a minimum, should come from the superintendent.

FCMAT appreciates the opportunity to serve the district and county and extends our thanks to all the staff and the governing board of the Piner-Olivet Union School District for their cooperation and assistance during this assignment.

Sincerely,



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