

February 22, 2007

Glenn Sewell, Superintendent
Vallecito Union School District
P.O. Box 329
Avery, California 95224-0329

Dear Superintendent Sewell,

In January 2007, the Vallecito Union School District contacted the Fiscal Crisis and Management Assistance Team (FCMAT) with a request for a review of the district's revenue calculations as they relate to basic aid funding. The district and FCMAT entered into an agreement for a study of basic aid funding. Specifically, the study agreement states that FCMAT will:

1. Review the district's revenue calculations as they relate to basic aid funding. In that review, look at the district's methodology on how the funds are projected and give recommendations as necessary. Prepare a management letter on findings and recommendations. Present information at a board workshop on topics related to basic aid funding, such as what basic aid funding is, how the funding is calculated, review of the district's processes in this area and best estimates for the future.

In late January, FCMAT reviewed the district's method for projecting basic aid funds and was asked to prepare a management letter with findings and recommendations, and then present information and answer questions at a board workshop on February 26 addressing the scope of the study. This management letter is a result of the January 31, 2007 visit to the district, subsequent document review and FCMAT's own calculations.

Vallecito Union is a declining enrollment district, with a 2005-06 average daily attendance (ADA) of 874.96 and an anticipated 2006-07 ADA of the same amount, as is permitted for declining enrollment districts. The district entered basic aid status for the first time during 2005-06. This occurred because the \$4,470,247 that the district received in local taxes in 2005-06, after a transfer of \$32,166 to the charter school, was \$3,409 over the revenue limit amount the district was eligible to receive.

Revenue Limits

The revenue limit calculation is an important factor in determining whether or not a district qualifies for basic aid. Basic aid status occurs when the amount of local taxes received by a school district is greater than the district's specific revenue limit entitlement in any given year.

Revenue limits, which are the mechanism to provide school districts with the majority of their funding, were established by SB 90 (Chapter 1406/1972), largely in response to the

initial 1971 State Supreme Court ruling in the Serrano vs. Priest equalization lawsuit. Since their inception in 1973-74, revenue limits have had two components:

- A basic education amount per unit of average daily attendance (ADA).
- A number of revenue limit adjustments that recognize specific needs, such as adjustments for unemployment insurance, necessary small schools and summer school funding.

The original base revenue limit was set in 1973-74 and included the following: (1) a district's total 1972-73 general purpose revenue (unrestricted state aid and local property taxes divided by the district's 1972-73 ADA), and (2) an adjustment for inflation.

Initial base revenue limits per ADA varied enormously because of large differences in assessed valuations, as well as differences in property tax rates. At that time, districts with the greatest funding had three or four times as much funding per pupil as districts with the least funding.

SB 90 sought to equalize these differences over time, primarily through a differential inflation increase that provided a larger dollar increase for low-revenue districts than for high-revenue districts. These formulas have increased the base revenue limits of low-revenue districts toward the statewide average and decreased the funding for high-revenue districts by providing them with a cost of living adjustment (COLA) significantly lower than actual inflation.

The Serrano case was heard at the Superior Court level in December 1972, just weeks after SB 90 was enacted. In his 1974 decision, the judge ruled that, while SB 90 was a step in the right direction, it did not equalize education funding adequately or quickly enough. As part of his decision, the judge established the guideline that the state's school finance system should reduce "wealth-related disparities" to "amounts considerably less than \$100 per pupil."

Prior to Proposition 13, school districts were allowed to levy what were known as permissive override taxes: additional property tax levies for select purposes such as child development, community services, or certain state school loan repayments. These override taxes were authorized by state law, and implementing them required only governing board permission. Under post-Proposition 13 formulas, districts that had levied these permissive override taxes in 1977-78 were allowed to permanently fold the dollar amount into their base revenue limit as an amount per ADA.

Base revenue limits were radically changed in the wake of Proposition 13. Two districts that previously had identical revenue limits per ADA in 1977-78 could have had very different base revenue limits starting in 1978-79. Also due to Proposition 13, the state discontinued most summer school programs and dramatically decreased adult education programs. School districts were allowed to calculate the revenue loss from these discontinued programs and add that as an amount per ADA to their base revenue limit.

From 1979-80 through 1982-83, the state continued to equalize the post-Proposition 13 revenue limits through inflation increases. Then, SB 813 (Chapter 498/1983), a critical school finance and school reform bill, was enacted, with the following features that are relevant to the history of revenue limits:

- Districts that had consistently declined from 1979-80 through 1982-83 received additional funds that were folded into the revenue limit as an amount per ADA, while growing districts received no comparable adjustment.
- Beginning in 1983-84, all districts of the same type – elementary, high school, or unified – received the same dollar inflation increase, rather than the increase being based on the revenue limit of the highest and lowest funded.

Longer day, longer year, and minimum teacher salary reform programs were implemented. All three of these programs operated on incentives. Participating districts received funding as a total dollar amount in one year, and that amount was folded into the district's base revenue limit per ADA in the subsequent years to provide an ongoing revenue stream. Not all districts participated in these programs, which also explains why the base revenue limit for some districts is higher than others.

Districts with below-average base revenue limits in 1983-84 had their revenue limits raised to the statewide average in 1984-85.

In 1985-86 and 1986-87 and again in 1989-90, the state appropriated a specific dollar amount for equalization that was less than the cost of raising all low-funded districts to the average. In these years, equalization aid was prorated, and all below-average districts received the same proportion of the distance to the average. A more recent series of equalization efforts began in 1995-96. In that year, the state again provided equalization aid to bring all below-average districts to the statewide average. And, in 1996-97, the state funded three "rounds" of equalization aid for low revenue limit districts. Under this process, the state brought all low-revenue limit districts up to the statewide average in the first round of equalization aid, recomputed the statewide average, provided a second round of equalization aid using this recomputed average, and repeated this process yet a third time.

By the time the three rounds of equalization aid were completed, over 90% of the pupils in the state were in school districts that were only minimally below the statewide average. The lowest funded elementary districts were only about \$40 per ADA below the average, and the lowest funded high school and unified districts were no more than \$20 per ADA below the average. While less than 10% of the ADA was in above-average districts, these districts ranged from just \$1 above the average to as much as several hundred dollars (or more) above the average.

Since 1998-99, average daily attendance has not included excused absences. To offset this funding loss, SB 727 (Chapter 855/1997) increased each school district's base revenue limit by the ratio of its 1996-97 ADA, including excused absences, to its 1996-97

ADA excluding excused absences. Thus, a district would not lose any money in future years if it maintained the same excused absence rate as it had in 1996-97. If a school district increased its attendance rate, it would generate more funding.

Equalization funding has continued, based on the annual governor's budget, in many years following SB 727.

Basic Aid Status

Even though Proposition 13 caused a significant reduction in property taxes, some school districts still receive very large amounts of local tax revenue from highly valued property situated within their boundaries. Some districts receive sufficient property tax revenue that, combined with basic aid, exceeds their computed revenue limit. These are called basic aid districts. They receive no state aid for their revenue limit; rather, all revenue limit dollars come from local taxes. The California Constitution guarantees that each school district will receive a minimum amount of state aid each year, called basic aid, which is the greater of \$120 per ADA or \$2,400 per district. However, state law changed in 2003-04 to count state categorical aid first toward meeting the minimum allocation of basic aid. As a result, only districts that receive less than \$120 per ADA or \$2,400 in state categorical aid will receive additional funding to reach the constitutionally required minimum level of funding.

Education Code (EC) Section 41975 states:

41975. (a) Apportionments and allowances to a school district from Section A of the State School Fund in a fiscal year may not be less than the product of one hundred twenty dollars (\$120) multiplied by the average daily attendance of the district in the preceding fiscal year, or two thousand four hundred dollars (\$2,400), whichever amount is the greater.

(b) State funds apportioned to each school district for categorical education programs, or other state funds apportioned to each school district from the State School Fund, shall be applied to meet the requirement of Section 6 of Article IX of the California Constitution to provide a minimum of one hundred twenty dollars (\$120) of state aid per pupil or two thousand four hundred dollars (\$2,400) per school district.

(c) Notwithstanding any other law, the Superintendent of Public Instruction may not increase the revenue limit apportionment of any school district to provide basic state aid pursuant to Section 6 of Article IX of the California Constitution or any other law, unless that school district has not received the greater amount of one hundred twenty dollars (\$120) per pupil or two thousand four hundred dollars (\$2,400) from all state funds, including funds for categorical education programs. If a school district receives less than the amount specified in this subdivision, the Superintendent of Public Instruction shall allocate the difference between the amount of state funds received and the constitutional minimum of the greater amount of one hundred twenty dollars (\$120) per pupil or two thousand four hundred dollars (\$2,400) per school district.

A district's total revenue limit is funded by a combination of state aid and local property tax revenues. For non-basic aid districts, state aid funding of the revenue limit would be the portion not provided by local revenues. The major item of local revenue is the district's share of the 2% maximum property tax rate on both the secured and unsecured property tax rolls. Since the state provides a tax exemption for homeowners, the state reimburses school districts for the corresponding loss in local tax collections, and this also counts as local revenue. Additional local revenue for revenue limit districts includes: supplemental secured roll taxes; timber yield taxes; other minor state subventions (e.g., aircraft taxes); prior year taxes (taxes that were delinquent in a prior year and were received in the current fiscal year, as well as any penalties and interest associated with those taxes); releases of prior year impounds; and Education Revenue Augmentation Fund (ERAF) taxes shifted from cities, counties and special districts.

Basic aid districts do not receive all of the same taxes as revenue limit districts do. The basic aid district receives only property taxes from the secured roll and unsecured roll. They do not receive any property taxes from the supplemental secured roll, nor do they receive any of the property taxes shifted from local governments (ERAF revenues).

ERAF taxes are basically used to "backfill" a district's revenue limit up to \$1 of its revenue limit. A district may not receive so many ERAF dollars that the sum of the local taxes plus the ERAF dollars exceeds its revenue limit. If any such excess occurs due to an estimation error or any other reason, the excess ERAF dollars must be reallocated to another school agency in the county. ERAF taxes are allocated to a district to the extent that ERAF taxes plus other property taxes equal the district's revenue limit minus at least \$1. Because of this, if there are sufficient ERAF taxes in the county to backfill, all non-basic aid districts will receive \$1 or more state aid in this calculation. The only exception is the basic aid districts, as they would receive no ERAF. For most districts, the amount of state aid is equal to the difference between the total revenue limit and the local taxes. Any shortfall in property taxes is made up through state aid. The more local taxes, the less state aid the district will receive. The non-basic aid districts do not benefit from this, as their total amount received is limited by the revenue limit calculation. Only the state benefits, as it does not have to provide as much aid to the revenue limit districts.

The number of basic aid districts changes annually, but overall they comprise fewer than 60 of the state's approximately 1,000 school districts, and less than 2% of the statewide ADA. Most are very small school districts. While the perception is that basic aid districts all have very high funding levels, this is not the case. Vallecito Union is one example. In the 2005-06 fiscal year, the first year of basic aid status, the district received less than \$3.78 per ADA extra from basic aid. Some districts with below-average funding are basic aid, with their low revenue limits fully paid for by property taxes.

When the California Department of Education (CDE) determines what each school district and county office of education will receive in state aid, the local revenue reported on the Report J-29B is used. That J-29B report is compiled by the county auditor and reviewed by the county superintendent of schools. There are three reports a year: P1 in November, P2 in April, and the annual in August. All are estimates until the final report

in August. The county auditor's estimates of local revenue are used by the county office and the CDE in the first and second principal apportionments: actual local revenue receipts are not reported until the annual recalculation of the apportionment. One reason that tax projections are made twice a year, at P1 and P2, is so the state can determine how much of a non-basic aid district's revenue limit will be paid from state dollars. Large differences between estimated and actual local taxes have a corresponding impact on state aid apportionments and/or the revenue limit calculation as a whole. Since revenue limit is funded through a combination of state aid and taxes, this allows the state to budget the correct amount of state aid.

Basic aid districts are not guaranteed a certain amount of local taxes, but know approximately the minimum they will receive. This minimum is what the district would receive as a revenue limit district.

Because basic aid districts do not receive additional funding for increases in ADA, state law provides two exceptions. Basic aid districts can receive funding from the state equal to 70% of the base revenue limit of the district where an interdistrict attendance pupil actually resides, unless that district also is a basic aid district. Basic aid districts may receive the 70% payment for interdistrict students if the student is:

- Enrolled under a school district of choice program (EC Section 48310(c), added by AB 97 in 2004).

EC Section 48310(c) states:

For any school district of choice that is a basic aid district, the Superintendent of Public Instruction shall calculate for that basic aid district an apportionment of state funds that provides 70 percent of the district revenue limit calculated pursuant to Section 42238 that would have been apportioned to the school district of residence for any average daily attendance credited pursuant to this section. For purposes of this subdivision, the term "basic aid district" means a school district that does not receive from the state, for any fiscal year in which the subdivision is applied, an apportionment of state funds pursuant to subdivision (h) of Section 42238.

- Enrolled under a court order that was not served before 1995-96 (the Tinsley case affecting several basic aid districts in San Mateo and Santa Clara counties per EC Section 54205). This code and option are not applicable in the case of Vallecito Union School District.

Similarly, a basic aid district that sponsors a charter school receives 70% of the base revenue limit of the district of residence if the district of residence is a revenue limit district rather than a basic aid district for any nonresident ADA attending that charter school (EC Section 47663). An exception is that the basic aid district does not receive any additional funding for pupils enrolled under any other form of interdistrict attendance

agreement, such as parental employment, or any funding for pupils who reside in another basic aid district.

EC Section 47663 states:

- (a) For a pupil of a charter school sponsored by a basic aid school district who resides in, and is otherwise eligible to attend, a school district other than a basic aid school district, the Superintendent of Public Instruction shall apportion to the sponsoring school district an amount equal to 70 percent of the revenue limit per unit of average daily attendance that would have been apportioned to the school district that the pupil resides in and would otherwise have been eligible to attend.
- (b) A district that loses basic aid status as a result of transferring property taxes to a charter school or schools pursuant to Section 47635 shall be eligible to receive a pro rata share of funding provided by subdivision (a), with the proration factor calculated as the ratio of the following:
 - (1) The amount of property taxes that the district receives in excess of its total revenue limit guarantee, prior to any transfers made pursuant to Section 47635.
 - (2) The total amount of property taxes transferred pursuant to Section 47635 to the charter school or schools that it sponsors.
- (c) The Superintendent of Public Instruction may not apportion funds for the attendance of a pupil in a charter school of a non-basic aid school district who resides in, and is otherwise eligible to attend school in, a basic aid school district unless the pupil is subject to the exception set forth in paragraph (5) of subdivision (b) of Section 47635.
- (d) For purposes of this section, “basic aid school district” means a school district that does not receive from the state, for any fiscal year in which the subdivision is applied, an apportionment of state funds pursuant to subdivision (h) of Section 42238.

There is no additional funding to basic aid districts for charter school pupils who reside in another basic aid district. Taxes for non-resident ADA attending the district’s charter school are not backfilled by state aid.

Approximately seven Vallecito Union students attend a county approved charter school, Mountain Oaks, but the aforementioned provision does not apply since the charter school is not district sponsored. All of the districts in the three counties with students attending Mountain Oaks transfer the portion of taxes applicable to their students attending the charter school throughout the year. The county office does the calculation and transfer, not the district. Basically, the taxes follow each student from their district of residence to Mountain Oaks. These are not funds that the district has earned or is entitled to.

Because basic aid status is so new to the district, and all tax amounts used in revenue calculations are estimates until the fiscal year is over, it is difficult for the district to estimate its 2006-07 tax receipts. This estimate is difficult for all basic aid districts, but even more so when there is no history on which to base it. The initial tax amounts provided from the county auditor are estimates that will not be finalized until the end of

the fiscal year. During 2005-06, the County Auditor's initial tax estimates showed an approximate 10% increase over 2004-05. At the end of the 2005-06 fiscal year, the local taxes received were only a 5% increase due to various issues, including an error made by the auditor's office. Using the initial 10% estimate in 2005-06 could have been disastrous if the entire 10% had been spent. Because 2005-06 was the first year of basic aid for the district, it is difficult to estimate the 2006-07 tax increase. The auditor has estimated a 14% increase for 2006-07; the district has estimated 7% based on historical data.

The following compares the initial tax estimates from the auditor's office to the amount the district received at year end.

Fiscal Year	Auditor's Tax Estimate for Fiscal Year	Auditor's Actual Tax Disbursement at end of Fiscal Year	Difference between the Estimate and the Actual Disbursement	Percent Change from the Estimate to the Actual
2001-02	\$3,707,534	\$3,931,513	+\$223,979	+6.04%
2002-03	\$4,087,973	\$4,274,287	+\$186,314	+4.56%
2003-04	\$4,554,561	\$4,404,856	\$(149,705)	(3.29)%
2004-05	\$4,567,782	\$4,289,753	\$(278,029)	(6.09)%
2005-06	\$4,821,751	\$4,502,413	\$(319,338)	(6.62)%
2006-07	\$5,140,242	Unknown	Unknown	Unknown

Breaking out the 2005-06 year even further, the tax estimates received from the auditor's office were as follows:

1st apportionment, November 2005: \$4,821,751
 2nd apportionment, April 2006: \$4,681,180

The actual amount received in August 2006 was \$4,502,413. Thus, even between the second apportionment in April and the final in August, the amount decreased by \$178,767. This exemplifies how difficult it is to estimate taxes in a current year. The P2 estimate would probably be used to estimate taxes for 2006-07, as it should include 90% of total collections for any given year. The 2006-07 budgeted revenue would then be overestimated based on the prior year P2 amount.

Estimates are just that: estimates. Tax rolls change constantly based on assessed values in the tax assessment area. No two districts are the same. The estimate that the county auditor's office provides is the actual tax roll value at the time of the estimate, but if any subsequent changes occur, such as a large parcel being rezoned and reassessed, the amount will change again. The 2005-06 change was attributable to an error that may or

may not recur. Regardless, since basic aid status is so new to the district, caution must be exercised.

The county auditor’s estimate for 2006-07 is \$5,140,242, a projected increase of \$637,829, or 14.167%, over 2005-06. Based on the above information and variances, FCMAT supports the district’s estimates. A 7% increase over 2005-06 appears reasonable.

The district has projected tax increases for the current and two subsequent years by reviewing past increases, looking at variances between estimated and actual tax disbursements, and by reviewing local economic factors, such as the Consumer Price Index (CPI) and local sales. The past actual disbursements and future estimates are as follows:

Fiscal Year	Auditor’s Tax Disbursement at End of Fiscal Year	Actual or Estimate	Change in Tax Amount	Less Estimated Charter Tax Amount	Net Change in Tax Received by District
2001-02	\$3,931,513	Actual	N/A	N/A	N/A
2002-03	\$4,274,287	Actual	\$342,774	N/A	N/A
2003-04	\$4,404,856	Actual	\$130,569	N/A	N/A
2004-05	\$4,289,753	Actual	\$(115,103)	N/A	N/A
2005-06	\$4,502,413	Actual	\$212,660	\$(32,166)	\$180,494
2006-07	\$4,817,582	Estimate	\$315,169	\$(35,000)	\$280,169
2007-08	\$5,058,461	Estimate	\$240,879	\$(35,000)	\$205,879
2008-09	\$5,311,384	Estimate	\$252,923	\$(35,000)	\$217,923

As seen in the above table, beginning in 2005-06 the district must subtract an amount from total taxes received for the countywide charter school. This is mandated by the state. The district is not responsible for determining the amount deducted; the county office performs the calculation on behalf of all districts in which the charter school’s students live. This deduction first appears in 2005-06, the first year of basic aid, as previously the amount of the tax transferred to the charter school was backfilled by the state as part of the revenue limit calculation. Once the district became basic aid, the state was not constitutionally required to transfer state aid for the charter deduction, so the district must deduct the amount from its local taxes. This is an additional cost to the district.

There is much resistance by the bargaining units, particularly the certificated unit, regarding the district’s tax estimate of a 7% increase over the 2005-06 taxes received, which has negatively affected negotiations. The district is being asked to give a higher percentage salary increase than it feels it can afford based on its tax estimates. The district has offered the employees a total compensation package of 9.44%, consisting of 6.5% on the salary schedule, raising the health benefit cap to \$8,000 and step and column, for a total cost of \$272,560. The bargaining unit has asked for a salary increase of 7.13% plus a settle-up clause for any dollars received over the 7% tax increase that the district has budgeted. One of its bases for the 7.13% is the COLA that revenue limit

districts have received. Basic aid districts do not receive this amount. Rather, they receive increased taxes based on factors unrelated to the state COLA. Although basic aid districts receive more local taxes than revenue limit districts, there is no guarantee of a specific percentage increase over the previous year.

The district feels strongly that its conservative estimate is critical to future fiscal solvency. The \$272,560 cost of the offered package is only \$7,609 less than the budgeted tax increase. Because it is in declining enrollment, the district strongly believes it should increase its reserve levels. Districts around the state increase reserves as a safety measure to offset declining enrollment. Estimates of future revenue are much easier for revenue limit districts, as they are guaranteed to receive a certain amount. Also, declining enrollment districts can use prior year ADA instead of the current lower ADA. Basically, non-basic aid districts can ignore local property taxes, as they know their revenue limit entitlement will be fully funded, with the difference coming from state aid. It is much more difficult for basic aid districts, as there is a minimum amount that can be received (the revenue limit amount) but no cap on the highest amount, which is an estimate until the fiscal year ends. Revenue limit funding is based on P2 attendance (April) or prior year, if declining. A good guideline is to determine what the district would receive in the worst case scenario, that is, if it became a revenue limit district again. This means it would be guaranteed an amount made up of both local taxes and state aid. When that occurs, a COLA increase is guaranteed, unless there is a deficit. A basic aid district does not receive that guarantee; it may receive an amount above the revenue limit amount, or it could even receive less than the COLA.

Employee bargaining units will request the highest possible salary increase, but the district must ensure it can afford the worst case scenario. If the district had been in basic aid status for a longer time, there would be a history to assist with determining estimates. However, since in 2005-06 the district received about 50% less than anticipated, and given the past estimates compared to actual disbursements for years prior to 2005-06, the district is in a difficult position and feels it must remain conservative “just in case.”

If the district were revenue limit funded, the approximate guaranteed dollars would have been:

	Projected 2005-06	Projected 2006-07
Prior year base revenue limit	\$4,799.28	\$5,001.28
Cost of Living Adjustment	\$202.00	\$296.08
Equalization aid	0	\$13.83
Revenue limit before deficit	\$5,001.28	\$5,311.19
Deficit	\$(42.81)	0
Current year funded revenue limit	\$4,958.47	\$5,311.19
Revenue limit ADA	901.16	874.96
Calculated revenue limit	\$4,468,374.83	\$4,647,078.80
Total gross taxes before charter deduction	\$4,502.413	\$4,817,582

Subtract charter tax	\$(32,166)	\$(35,000)
Total net local taxes	\$4,470,247	\$4,782,582
Taxes received more/(less) than revenue limit funding	\$1,872.17	\$135,503.20

The amount by which the district is currently basic aid is not substantially more than guaranteed by revenue limit funding. Of course, for the 2006-07 year, the \$135,503.20 is based on the district's estimate, but that estimate appears reasonable. The district could consider negotiating language stating that if the local taxes are underestimated, negotiations will be reopened. Another possibility is to consider negotiating based on the estimated revenue limit amount, and then negotiate for the basic aid amount once it is finalized. That would cause much less dissention and arguments at the table and could save time.

Another factor for basic aid districts is their cash flow. Revenue limit districts receive a monthly apportionment payment for the state aid portion, and the tax portion is paid mainly in December and April. Basic aid districts receive taxes in November, December, April and June. Because there is no state aid portion, there is no monthly allotment.

Appropriate Reserves

The criteria and standards associated with school district budgets mandate what percentage of total budget must be set aside into minimum reserve requirements. This standard states that "available reserves for any of the budget year or two subsequent fiscal years are not less than the following percentages or amounts as applied to total expenditures, transfers out and other financing uses."

Percentage Level	District ADA
5% or \$50,000 (greater of)	0 to 300
4% or \$50,000 (greater of)	301 to 1,000
3%	1,001 to 30,000
2%	30,001 to 400,000
1%	400,001 and over

Based on the district's ADA, there is a requirement for 4% or \$50,000, whichever is greater. In Vallecito Union's case, the 4% of total expenditures, transfers out and other financing uses is the mandated reserve.

It is always prudent to set aside additional reserve amounts over and above what is required. Reserves are required for emergencies, unplanned events, declining enrollment, lower state funding, and many more reasons. Determining the actual additional amount is difficult, as the percentage is often determined by past district practice, community perception and needs, and the overall risk level of the district. In addition to those district-specific issues, other areas to consider include:

- the size of the district (a smaller district needs a higher reserve percentage)

- the sources of revenues
- revenue trends (districts in deficit spending need larger reserves until adequate budget adjustments are made)
- future needs such as opening schools or purchasing school buses, and
- long-term obligations such as retiree debt.

It is usually advisable for basic aid districts to maintain higher reserves because of the issues associated with their status, including the dependence on property tax revenues, which leaves them more vulnerable to budget fluctuations than revenue limit districts. A revenue limit district is most likely to use reserves for an anticipated enrollment decline. For basic aid districts, the most likely reasons for needing reserves are an unexpected increase in enrollment or overprojected property taxes. Since basic aid districts do not receive additional funds from the state when enrollment increases, gaining students does not offer a financial advantage.

One common method for determining how much to increase reserves is to calculate the difference between the revenues received as a basic aid school district and what would be received under revenue limit funding with the same ADA. The amount to be added to the reserves should be based on that difference: the extra money that would be needed if enrollment increased significantly. Three of the four districts in Calaveras County are basic aid districts, and the Calaveras County Office of Education has cautioned all three to build reserves higher than the required state minimum.

In addition, the county office has included comments in various letters to the district regarding the district's basic aid status and reserves, including:

- 2005-06 first interim letter dated January 9, 2006: "As a basic aid district, Vallecito's primary source of funding will be subject to local property tax growth which is far less predictable than statutory COLA calculations. Given this, our office strongly supports the district's local requirement to maintain a reserve level above that required by the state minimum. This will help buffer the district from unanticipated ADA growth and relieve some of monthly cash flow need of the district."
- 2006-07 adopted budget letter dated August 4, 2006: "Given the district's basic aid status, it is recommended that the district maintain reserves at a higher level than the required minimum in order to maintain fiscal stability in the event of unanticipated ADA growth or slowing of tax revenue growth. Your current reserve level reflects the district's commitment to do this and is commendable for such."

FCMAT conducted an unofficial survey of basic aid districts around the state, and although these districts had different mechanisms to determine their ending fund balance, each had a reserve much higher than the state criteria and standards mandate, with an average of 10%.

The district board currently requires a 5% reserve level, which is in place for 2006-07. At the January 17, 2007 board meeting the board held a discussion regarding an increase to the district's reserve. It was unanimously voted to attain a reserve of 6% by the end of 2006-07 and increase it every year by 1% until a 10% reserve is achieved. There was agreement to review this area annually.

For the 2006-07 first interim report, which includes actuals through October 31, 2006, the budget included the recent negotiated salary settlement for classified, confidential and administrative staff. With those settlements and other adjustments, the fund balance decreased by \$261,235 due to a contribution for a special education bus, shared startup costs for special education programs at other districts, and computer expenditures. These expenditures resulted in an unrestricted ending fund balance of \$244,754, of which \$208,727 is designated for economic uncertainties and \$36,027 for possible mandated cost claim audits. The ending fund balance, including fund 17, enables the district to meet the 5% board approved reserve.

Salary Settlements, AB 1200 and Bargaining Agreements

Assembly Bill (AB) 1200 requires local educational agencies to publicly disclose the provisions of all collective bargaining agreements before entering into a written agreement (Government Code Section 3547.5).

This provision applies to both single-year and multiyear agreements where the contract has been reopened to determine compensation adjustments in a subsequent year. It is intended to ensure that the public is aware of the known costs and resources to fund a proposed collective bargaining agreement before it becomes binding on the district. These documents must be made available to the public at least 10 working days before the date on which the governing board will take action on the proposed agreement.

As part of the Legislature's new and tougher standards for school district accountability, Government Code Section 3547.5 was amended by AB 2756 (Chapter 52/Statutes 2004), effective June 21, 2004. The new language requires that a school district's superintendent and chief business official (CBO) certify in writing that the costs incurred by the district under the proposed collective bargaining agreement can be met by the district during the term of the agreement. The certification must "itemize any budget revision necessary to meet the costs of the agreement in each year of its term." AB 2756 also specifies that if the district does not adopt all of the budget revisions needed in the current year to meet the costs of the agreement in each year of its term, the county superintendent of schools is required to issue a qualified or negative certification for the district on its next interim report. The signatures of the superintendent and CBO must be on the disclosure sent to the county office for review. A final certification containing the board president's signature must be sent after the agreement is adopted at a public board meeting.

Because of these provisions, there is a statutory requirement for districts to complete a Public Disclosure of Collective Bargaining Agreement whenever negotiations are completed so that the full effect on the district's budget can be analyzed before final action is taken by the governing board.

Government Code Section 3540.2(a) states that a school district with a qualified or negative certification must allow the county office of education at least 10 working days to review and comment on any proposed agreements made between an exclusive employee representative and the public school employer prior to governing board approval. Since the district has had a positive certification on interim submittals, it is not required to follow this procedure. However, in case of a certification change, the district should be aware of this government code.

The actual revenues will only be ascertained when the year is over. Thus, only actual amounts should be used in negotiations, which for a basic aid district would be the lowest amount possible (the revenue limit amount). Additional dollars (the basic aid amount) can be used once received. Many basic aid districts negotiate with last year's dollars. Vallecito received \$4,289,753 in 2004-05 and \$4,502,414 in 2005-06. The actual growth was \$212,661, which would be available to fund any increases in 2006-07, including utility, step and column, insurance and salary increases. Growth between 2005-06 and 2006-07 would be used to fund 2007-08 increases, and so on. The districts that use this method always know the amount they have to work with in the current year and have better information for planning and responding to changes in tax growth, enrollment, etc.

In prior years, the district has settled with its bargaining units as follows:

1999-2000:	1.5%
2000-01:	3.17%
2001-02:	2.25%
2002-03:	1%
2003-04:	0%
2004-05:	2.15%
2005-06:	4.53%

The district should develop parameters and guidelines to ensure that the collective bargaining agreement does not impede efficient district operations. At least annually, management should analyze collective bargaining agreements to identify those characteristics that impede operations and should present those issues for consideration to the governing board. The board, in developing its guidelines for collective bargaining, should consider the impact on district operations of current bargaining language and propose amendments as appropriate to ensure effective and efficient district delivery of services. These parameters should be provided in closed session.

The district has discussed the idea of a salary formula for some time, but no formula is currently in place. Although salary formulas are used statewide, certain concerns should be noted. For instance, any formula has to consider that new unrestricted money coming in must pay for other ongoing costs, such as step and column movement, utilities and insurance (including property and liability). When the FCMAT study team asked to see the list of budget cuts brought to the board for the last several years, it was stated that none had been made. Since the district is declining in enrollment and no budget cuts have

been approved for the past few years, protections must be in place so that all new unrestricted money does not go directly to salary increases. Otherwise, ongoing increasing costs will need to be covered in other ways, such as cutting programs.

Because the school district has had declining enrollment and only recently entered basic aid status, FCMAT anticipated that budget cuts must have occurred in previous years. Actually, programs have remained strong and salary increases have occurred with no budget cuts. This means that the board has a goal of strong programs, which the public and parents also support. Nevertheless, all programs and salary increases are funded by state aid and local taxes. If no cuts are made and costs continue to increase, other areas of the budget may need to make up the difference. The public, board and staff must understand that to fund generous salary increases and to keep the high level of programs, other funding will need to be cut or shifted.

Most districts cannot afford to give the entire COLA to salaries because of ongoing commitments. When negotiations begin again, the formula should be discussed and reviewed. The union has stated it wants the “effective COLA” of 7.11% for 2006-07. However, the district has not received that effective COLA, since it is basic aid and local taxes are not expected to increase by that percentage. In addition, the funding has to cover other ongoing increasing costs, or budget cuts will be necessary. Because cuts did not occur for 2006-07, it is clear that a retroactive increase cannot be higher than the increase in local taxes after considering all other settlements and other increasing costs.

Many factors are involved in negotiating a salary formula. If a district is deficit spending in the current year, expenditures need to decrease (or revenues increase) in the subsequent year, or the district will again be deficit spending. Some of the new money will be needed to stop the deficit spending, new ongoing revenues will need to be determined, or the district will need to make budget cuts.

If the annual cost of step and column exceeds the savings from retirements and attrition, the budget must include an automatic expenditure increase. If ongoing costs increase, such as utilities, property and liability insurance or workers’ compensation, those expenses must come out of the new money unless other budget adjustments occur to cover the higher costs. The district has a cap on health and welfare benefits, so there is no cost increase in that area unless the cap is changed during negotiations, which is being considered in 2006-07 for the teachers’ unit.

If a district’s enrollment is declining, the costs per student typically grow rapidly. Declining enrollment districts hire few new teachers, and may even lay off the least senior teachers. Certain overhead costs are fixed, such as the need for one principal at each site, one superintendent, one chief business official, etc., and so the cost per student rises rapidly when enrollment declines.

If district enrollment is increasing, prompting the district to hire new teachers, the marginal costs for the new students will typically be lower than average. An exception is

when a district opens a new site and needs another principal and school office staff, and incurs utility costs.

If a district and bargaining unit agree on a salary formula, salary increases can be based on available dollars and not percentages. The amount of money available for new expenditures can be determined by computing the number of new dollars available and subtracting the dollars that are already committed (such as step and column, utility, and insurance increases).

Contingency language should be included to protect both parties so that, should certain limited conditions occur, the parties may reopen negotiations. For example, if the salary adjustment determined by the contingency language is less than Y or greater than X, either party may demand a return to the bargaining table.

There should also be reopeners whenever there are major changes in state law, such as occurred with the rebenching of base revenue limits to exclude excused absences. A contract that compared the 1998-99 funded base revenue limit per ADA with that of 1997-98 would have resulted in an extra 4%-5% increase because the 1998-99 amount contained an offset for the exclusion of excused absences. Another example is a change in the revenue limit base from the roll-in of categorical funds. If categorical funding becomes part of the revenue limit, no added revenues come to the school district, but a salary formula could require the increase to go to salaries. In that case, a lack of contingency language would increase salaries and would need to be offset by reducing expenditures elsewhere.

Contingency language should recognize the necessity to ensure that the funds being used for salary adjustments are unrestricted, ongoing funds actually received by the district. This protects the district should midyear budget cuts occur again.

A review of negotiations data showed that the district and the bargaining units do not understand "total compensation" in the same way. There needs to be a definition of what "new" money should cover each year. Currently, the percentage offered to the units can be divided into benefits and/or salary. That percentage should also pay for the statutory benefit costs, as well as step and column changes stemming from the salary increase. In other words, the salary formula should fund total compensation, including step and column, increases to benefit caps, statutory benefit increases due to raises, and wage increases. All parties should also keep in mind that the additional funding is not just intended for employee compensation.

For many reasons, no one formula and/or language works for all districts. The definition of terms and understanding of contract characteristics are essential for both sides of the table. Both sides must believe that the contingent provision is fair on a multiyear basis, or it won't work. If budget cuts/revisions are necessary to pay for the salary increase, all stakeholders should understand the consequence. There must be education on what the current practice really costs the district and what is being given up to increase salaries with new unrestricted dollars.

The term “effective COLA” frequently appears in district documents related to negotiations with the certificated union. One document states “the parties agree to continue negotiating during the 2006-07 school year on an agreed upon alternative definition for effective COLA for a basic aid district which will permit the parties to settle salary negotiations for the 2007-08 and 2008-09 school years.” The term “COLA” should not be utilized for basic aid districts. There is an “effective COLA” for non-basic aid (revenue limit) districts that combines the state COLA, ADA increase or decrease, equalization and deficit factor, and other items. Basic aid districts only receive tax increases, which is not the same as effective COLA, and does not include the same items.

The concept of designating 48% of the budget for certificated salaries is also frequently referenced. This allows the remainder of the new dollars received to go to other parts of the budget for increasing costs. However, until the true tax amount is determined in August, this settlement should not occur.

Calculations for salary schedule, stipends, step and column and unit adjustments must include statutory benefits at all times (calculated at 12.1686%), not just at the end of negotiations.

Retirements do not pay for step and column increases. This is especially true in declining enrollment districts. In addition, new teacher salaries and benefits are increasing. In past years, when retirement occurred, the replacement teacher was usually a new teacher whose cost was much less. This is no longer the trend.

Governing boards should ensure that guidelines are developed for collective bargaining that align with the district’s instructional and fiscal goals over multiple years. The superintendent should ensure that the district has a formal process in which collective bargaining multiyear costs are identified for the governing board, and that those expenditure changes are identified and implemented as necessary before the imposition of new collective bargaining obligations. The governing board should ensure that the costs and projected district revenues and expenditures are validated over several years so that the fiscal issues faced by the district are not worsened by bargaining settlements. The public should be informed about budget reductions and/or changes that will be required for a bargaining agreement before any contract is accepted by the board. Also, the public should be notified of the provisions of the final proposed bargaining settlement and provided with an opportunity to comment.

Summary

The study team supports the district’s tax estimates for 2006-07. A 7% increase over 2005-06 rather than 14.167% appears reasonable.

FCMAT concurs that there is no “effective” COLA for basic aid districts. The increase from one year to the next is independent of the COLA given to revenue limit districts.

The district and the unions should consider developing language for negotiations stating that if the local taxes are underestimated, and the unions settle on the district's estimate, the district will then reopen negotiations. Alternatively, the district could consider renegotiating based on the estimated revenue limit amount, and then negotiate the basic aid amount once it is finalized.

The district should increase its ending fund balance reserve to allow for emergencies, unplanned events, declining enrollment, lower state funding, and other factors, including the district's basic aid status. The board's action to require a 5% reserve level in 2006-07, with an increase to 6% by the end of 2006-07 and a 1% increase every year until a 10% reserve is achieved is reasonable and is supported by FCMAT.

The district must ensure protections for any salary formulas agreed on with the bargaining units: that new unrestricted money cannot go directly to salary increases, or ongoing increasing operational costs will need to be covered from other sources, such as program cuts.

A salary formula should be based on available dollars, not percentages. Contingency language might be included to protect both parties so that, should certain limited conditions occur, the parties may reopen negotiations.

There needs to be a mutual understanding of "total compensation," which includes any increases in step and column, benefit caps, statutory benefits, and wages. All parties must realize that new money to the district is not just intended for employee compensation.

Calculations for salary schedule, stipends, step and column and unit adjustments must always include statutory benefits (calculated at 12.1686%). Currently, these statutory benefits are often not included in expenditure estimates until negotiations conclude.

The employee organizations need to understand that retirements do not pay for step and column increases on a constant basis. This is especially true in declining enrollment districts. Another reason that retirement does not pay for step and column is that teacher costs have increased.

FCMAT has enjoyed working with district staff and looks forward to conducting an open forum with the community on February 26, 2007 on basic aid issues.

Sincerely,

Michelle Plumbtree
Fiscal Intervention Specialist