

## Introduction

On August 3, 2004, members of the Fiscal Crisis and Management Assistance Team (FCMAT) met with representatives of the Fresno County Office of Education and the Fresno Unified School District to discuss the reasonableness of the district's 2004-05 June adopted budget. At the conclusion of the meeting, there was consensus among all participants that Fresno Unified should consider readopting a 2004-05 fiscal year budget plan that more clearly addressed the significant financial challenges facing the district.

On August 16, 2004, the county office officially notified the California Department of Education (CDE) that the district's June adopted budget was disapproved. The County Superintendent engaged the services of FCMAT to conduct a fiscal health analysis of the budget and complete a multiyear projection to identify the impact of the district's ongoing deficit spending and the fiscal problems if the district did not take action to reduce expenditures. A FCMAT study team reported to the Fresno Unified district offices on August 18 to begin collecting information, analyzing data, and interviewing district office staff.

The scope and objectives of the first phase of the study were to:

1. Conduct a fiscal health analysis of the Fresno Unified School District's 2004-05 budget and provide a written report of the findings and recommendations to the COE and district administration.
2. Prepare a multiyear financial projection of the Fresno Unified School District's general fund to identify the shortfall of funds needed to sustain fiscal solvency, based on the 2004-05 fiscal year budget and two subsequent years.

The district completed revisions to the original adopted budget and the board approved the final adopted budget on August 25, 2004. The final adopted budget did not meet the required reserve level and projected significant deficit balances in the 2005-06 and 2006-07 fiscal years.

Under the provisions of Education Code Section 42127 (d), the County Superintendent notified the district, FCMAT, and the California Department of Education on September 1 that the August 25 budget had been disapproved by the county office. The County Superintendent cited the rising costs of fully paid lifetime medical benefits for retirees and the most recent actuarial estimate of the unfunded liability at \$872,070,250. At the time of the September 1 letter from the Fresno COE, initial statewide interpretations of the Governmental Standards Accounting Board Statement No. 45 (GASB 45) were that districts may have to develop a plan to fully fund the liability over a 30-year period. Fresno Unified does have to record the liability but GASB 45 does not require the district to fund the liability over the extended period. Had this been required, it would have led to an annual funding transfer of almost \$30 million from the district's general fund unrestricted revenue sources to the self-insurance fund.

The County Superintendent exercised his authority under the provisions of AB 1200 and assigned FCMAT as fiscal advisor to the district to assist in the development of a budget plan that complies with the standards and criteria adopted by the State Board of Education pursuant to Education Code Section 33127. These standards require a district with student average daily attendance (ADA) levels between 30,000 and 400,000 to maintain a reserve level of 2% of the general fund total expenditure budget. For the 2004-05 fiscal year, districts in this category are able to reduce their reserves to a 1% level as a remaining one-time flexibility provision from the 2003-04 state budget trailer bill, AB 1754. The reserve level must be restored to the 2% level in subsequent years.

On September 24, 2004, the County Superintendent notified the district, FCMAT, and the CDE that the second revised budget (referred to in this report as budget revision #1) had been disapproved as it did not meet the provisions of Education Code 33127. The Superintendent cited issues of GASB 45 and non-finalized contract negotiations as two of the major factors affecting approval. The Superintendent noted the need for the district to provide the county office with an AB 1200 disclosure projecting the future costs of any negotiated contract settlements along with identification of a funding stream to support such costs, prior to contract ratification by the Governing Board. The Superintendent also cited the provisions of AB 2756, which require the district Superintendent and Chief Business Official to certify that the district can meet the costs incurred under proposed collective bargaining agreements.

## Study Team

The FCMAT study team was composed of the following members:

Joel Montero  
Deputy Executive Officer  
Fiscal Crisis and Management  
Assistance Team  
Petaluma, California

Barbara Dean  
Management Analyst  
Fiscal Crisis and Management  
Assistance Team  
Bakersfield, California

Anthony Bridges  
Management Analyst  
Fiscal Crisis and Management  
Assistance Team  
Atascadero, California

Eric D. Smith  
Management Analyst  
Fiscal Crisis and Management  
Assistance Team  
Templeton, California

Linda Grundhoffer  
FCMAT Fiscal Consultant  
Danville, California

Michele Dodge  
FCMAT Fiscal Consultant  
Plymouth, California

Laura Haywood  
Public Information Specialist  
Fiscal Crisis and Management  
Assistance Team  
Bakersfield, California

## **Study Guidelines**

FCMAT staff members and consultants visited the district from August through October, beginning in August 2004, to conduct interviews, collect data and review documentation. Findings and recommendations are presented in the following sections:

1. Executive Summary
2. 2004-05 Budget Review
3. Special Revenue Funds
4. Enterprise Funds
5. Internal Service Funds
6. Cash Flow
7. Secondary Class Sizes
8. Appendices



## Executive Summary

Fresno Unified School District is the fourth largest district in the state of California. The district serves students in the greater Fresno area in grades kindergarten through 12, plus preschool, charter school, community day school, continuation school, and adult school sites. The student population spans a broad range of ethnic and cultural backgrounds.

The district has confronted the need to make expenditure reductions in the past. A report by School Services of California dated March 16, 2001 noted that unrestricted revenues would drop as a result of lower student enrollment levels and would not be enough to support ongoing expenditure obligations. In addition, staffing levels that exceeded labor contract parameters and the level of general fund support needed for the Peer Assistance and Review (PAR) program were contributing to the decline in district reserves.

The administration and school board did take steps to reduce expenditures, resulting in cuts of \$25.1 million in 2001-02, \$9.7 million in 2002-03, and \$24 million in 2003-04. The final adopted budget for the 2004-05 year (not approved until August 19, 2004) includes \$18.65 million in cuts. Overall, the district reported cuts of \$77.45 million over a five-year period. Additional savings were realized by using flexibility options allowed in the 2002-03 and 2003-04 fiscal years.

The district experienced declining enrollment in the 2003-04 year and projected a decline of 600 enrolled students in the June adoption of the 2004-05 budget. The CBEDS count for October 2003, excluding Bethune Elementary charter school, was 80,421 students. The October 2004 CBEDS count, excluding Bethune, is 79,503 students, a decrease of 918 students. The Fresno County Office of Education is now the sponsoring agency of the charter school. State revenue limit funding allows a declining enrollment district to receive funds based on the higher of the current or prior year ADA, resulting in the fiscal impact of student losses being felt in the following school year.

Historically, the district has experienced multiple changes in the Superintendent and Chief Financial Officer (CFO) positions. There have been approximately 10 superintendents or interim superintendents and 10 CFOs or interim CFOs since 1990. Some of those who held these positions were in them for as few as six months. This has led to a lack of organizational stability in the leadership and oversight of the district's resources, and has been felt most distinctly in the extreme financial difficulties the district is now experiencing.

The Fiscal Crisis and Management Assistance Team (FCMAT) began its review of the district's finances by providing the Fiscal Services department with an extensive document request list that was fulfilled prior to the team's arrival at the district in mid August. In September, the district completed budget revision #1, which FCMAT has used as the base year data for its multiyear projection. The primary calculations of the multiyear projection show increasing deficit spending. In addition, a number of other factors and decreases in

funding levels will send the district further into a deficit unless it takes immediate steps to mitigate the effects. These other factors include the rising costs of health premiums for both active employees and retirees, declining enrollment, the rising cost of workers' compensation claims, and the large unfunded liability for health and workers' compensation self-insurance.

The resultant projected shortfall indicated in the multiyear projection for fiscal years 2005-06 and 2006-07 reflects a district in serious fiscal crisis and approaching insolvency. Under AB 1200 and AB 2756, the Fresno Unified School District and Fresno County Office of Education must collaborate to restore fiscal solvency to the district. This will include addressing the increasing level of deficit spending and restoring the projected non-existent ending fund balance and reserves in the amount of \$35,950,540 in 2005-06 and \$80,415,938 in 2006-07.

As significant as the projected shortfalls may be, the impact to the general fund of other factors will push the budget shortfalls to even more extraordinary deficit levels, depending on the recovery strategies developed by the district and approved by the County Office of Education. The most serious of these unbudgeted factors include:

- The need for the general fund to support the actuarially determined reserve amount for the medical self-insurance plan incurred but not reported (IBNR) claims for active employees in the amount of \$23 million.
- The need for the general fund to service the unfunded liability for workers' compensation claims in the amount of \$41 million.
- The need for the general fund to support the "pay as you go" health benefit costs for active employees and retirees if annual inflation factors are in excess of 15%.

If these factors were required to be addressed entirely in the 2005-06 fiscal year, the resulting budgetary shortfall would increase to over \$100,000,000.

FCMAT has included a copy of the School Services of California Comparative Revenue and Expenditure Analysis report dated November 15, 2004 as Appendix F to this report. This document presents a perspective on the district's financial trends as compared to nine large school districts and 16 unified school districts in Fresno and contiguous counties.

FCMAT analyzed numerous district funds to determine their fiscal status. In the category of special revenue funds, this included: Adult Education Fund #11, Child Development Fund #12, Deferred Maintenance Fund #14, Building Fund #21, Capital Facilities Fund #25, State School Lease Purchase Fund #30, County School Facilities Fund #35, Special Reserve Fund for Capital Outlay #40, and Tax Override Fund #53.

The Adult Education program excels fiscally and in the delivery of quality educational programs. It had a positive ending balance of \$7,315,591 at the close of the 2003-04 fiscal year. Direct and indirect cost calculations should be reviewed to ensure that the maximum possible revenues are being received.

The Child Development Fund will not be able to sustain a positive balance in the future without general fund support if services and staffing levels remain the same.

Because the district has significant deferred maintenance needs, it should continue to fully match the state's deferred contribution.

Appropriate interfund borrowing from the building fund may be necessary to meet the district's cash flow requirements. The district's maximum allowable debt limit is \$335.3 million, with current outstanding debt at \$264 million. However, the district still has \$151 million of its Measure K general obligation bond. The lease-purchase fund can be closed once the Office of Public School Construction (OPSC) has closed out all the district's related projects.

The district has aggressively participated in the state school facilities program. It should explore whether it is eligible for 100% funding through the state's financial hardship program. The district also should immediately refile state school facilities program applications previously rescinded by the OPSC to try to regain the amount originally funded for each project.

A penalty owed to the State Allocation Board for falsifying fund release authorizations should be identified as an expenditure in the Special Reserve Fund for Capital Outlay. The annual repayment amount is \$605,115 for a period of five years.

In the category of enterprise funds, the district has only Cafeteria Fund #61. The cafeteria fund balance has continued to grow over the five-year period reviewed by FCMAT.

The district's internal service funds consist of Self-Insurance Fund #67 (medical-post retirement benefits, property and liability, workers' compensation, and a defined benefit plan). Each of these funds is intended to be self-supporting. However, an actuarial report issued in September 2004 shows that the district has an unfunded prior liability of \$807,928,949 for its medical-post retirement benefits, and a total gross liability of more than \$1.1 billion. Eventually, the district's net assets could be entirely enveloped by this liability.

In addition, based on the district's October 2004 actuarial report, the district will need to devise a multiyear plan to service the unfunded liability for workers' compensation claims of approximately \$41 million as of June 30, 2004.

The accounting manager tracks cash flow regularly. If the district receives its June apportionment on time, FCMAT projects a positive balance at June 30, 2005. If the apportionment is deferred until July, as in the previous two fiscal years, there would be a negative \$10.9 million cash balance in the general fund for approximately five to 10 days until the deferred apportionment is received. The district should ensure that cash projections are updated on a frequent basis as available general fund cash balances decline.

Secondary schools in the district appear to have large numbers of low-enrollment classes. Some of these classes are very specialized or advanced, and might be more appropriately offered through a local community college. Based on the negotiated agreement with the teachers union, site teaching staff numbers are determined from student enrollment. An analysis to consider the fiscal impact of setting minimum class sizes should be discussed. During negotiations, the actual enrollment periods that will be used to determine staffing levels should be identified.

Curriculum and instruction administrators and fiscal services staff should work with secondary school principals to determine whether classes offered outside the traditional six-period day are financially viable.

## 2004-05 Budget Review

### Findings

Prior to the arrival of the team in mid August, FCMAT provided the district with an extensive document request list. The staff of the Fiscal Services department provided electronic files directly from the financial system, American Management Systems, as well as physical files. Throughout the review process, the data and information provided by district staff has been well organized, detailed, and does reconcile back to budgeted amounts in the revised current year budget.

In September, the district completed budget revision #1, which recognized changes to the general fund, children's center fund, adult education fund, and deferred maintenance fund budgets. Updates also included the corrected 2004-05 beginning fund balances once the the 2003-04 books had been closed. The general fund unrestricted beginning balance came in at \$13,482,791 which was \$2,202,666 higher than the June estimated beginning balance. FCMAT has used budget revision #1 as the base year data for the multiyear projection.

### Multiyear Projections

The district's fiscal services department has prepared multiyear projections as required by the annual budget adoption and interim reporting processes. FCMAT reviewed the 2003-04 fiscal year first and second interim multiyear projections. California school districts must certify either a positive, qualified, or negative certification at interim reporting periods. The criteria for each category as defined in Education Code section 42131 states:

A **negative** certification shall be assigned to any school district that, based upon current projections, will be unable to meet its financial obligations for the remainder of the fiscal year or the subsequent fiscal year. A **qualified** certification shall be assigned to any school district that, based upon current projections, may not meet its financial obligations for the current fiscal year or two subsequent fiscal years. A **positive** certification shall be assigned to any school district that, based upon current projections, will meet its financial obligations for the current fiscal year and subsequent two fiscal years.

The narrative sections of the November 26, 2003 and March 2, 2004 board items for approval and certification of the 2003-04 interim reports included information identifying material shortfalls in the two subsequent fiscal years (2004-05 and 2005-06) requiring that budget cuts be made. The first interim narrative asked the board to approve a positive certification for the current and two subsequent years, while at the same time stating that \$27.1 million in cuts for 2004-05 and \$17.8 million in cuts for 2005-06 would be necessary to achieve and maintain a positive certification status.

At the second interim reporting period, the board was once again asked to approve a positive certification even though the projected shortfall for 2004-05 fell within a range of

\$19.6 to \$30.1 million, depending on whether or not the state budget included a cost of living adjustment (COLA). The shortfall for 2005-06, requiring additional budget reductions, was estimated at \$15.5 million. At both reporting periods, the dollar value of the needed reductions was included in the projected expenditures as a credit adjustment.

It was not until the multiyear presentation in the 2004-05 revised adoption budget and the 2003-04 unaudited actuals financial reports that the district showed the significant budgetary shortfalls for the 2004-05 and 2005-06 fiscal years without a credit adjustment.

FCMAT takes the position that a district should certify a qualified interim report, at the very least, until such time as necessary budget reductions have been specifically determined and approved by the Governing Board. Until that time, FCMAT believes that multiyear projections should identify the true budgetary shortfall and inability of a school district to meet the minimum reserve requirements.

#### **FCMAT Multiyear Projections**

The team developed the multiyear projection of the district's general fund using the 2004-05 budget revision #1 allocations for the base year. FCMAT used School Services of California's Multiyear Projection (MYP) software to calculate the general fund balances for the 2005-06 and 2006-07 fiscal years. Projection assumptions are developed using past trends and known variables affecting revenues and expenditures. The School Services of California (SSC) dashboard is used for future statutory revenue COLA, as well as deficit, consumer price index (CPI), and interest factors. The following table summarizes the multiyear projection totals for the combined general fund (please see next page):

	2004-05	2005-06 projected	2006-07 projected
Total Revenues	611,000,594	613,696,501	624,628,610
Total Expenditures	619,754,459	643,091,926	668,640,743
Excess/(Deficiency) of Revenue over Expense before Other Financing Sources and Uses	-8,753,865	-29,395,425	-44,012,133
Transfers In	3,134,919	3,202,351	3,316,809
Transfers Out	-3,077,919	-3,142,351	-3,256,809
Net Increase/ (Decrease) to Fund Balance	-8,696,865	-29,335,425	-43,952,133
Unaudited Beginning Balance	18,070,966	9,374,101	-19,961,324
Ending Balance	9,374,101	-19,961,324	-63,913,457
Components not available for reserve	-3,064,330	-3,064,530	-3,064,530
Required Reserve	6,228,324	12,924,686	13,437,951
<b>Free/(Deficit) Balance</b>	<b>81,447</b>	<b>-35,950,540</b>	<b>-80,415,938</b>

Clearly, the primary calculations of the FCMAT multiyear projection show increasing deficit spending and that the district cannot continue to operate in the same manner as it recently has. Even more startling and significant, however, is the impact of a multitude of other factors that will send the district general fund deeper into a deficit level from which it will not recover without changing the way it does business.

### **Other Factors Affecting the General Fund**

In some cases, unrestricted general fund revenues are needed to offset costs recorded in other funds. The following list summarizes issues that may positively or negatively impact the general fund balances in the current and subsequent budget years. These issues are explained in greater detail, by fund, in the report sections for other fund types.

The federal revenue portion of the child development fund budget has decreased in the prior and current years. In order to sustain increasing salary and benefit costs, the child development budget for supplies, services, and capital outlay has been reduced. Without changes in the future delivery of services and staffing levels for this fund, the general fund will have to make interfund transfers to keep the child development fund balance positive. **(Negative estimated general fund impact: -\$50,000 to -\$100,000 annually.)**

The “pay as you go” health benefit cost for current active employees and retirees may require inflation increases higher than the projected 15% level unless cost containment strategies are considered. **(Negative estimated general fund impact: unknown annually.)**

Federal and state categorical programs may be required to contribute to the cost of post-retirement health benefits. **(Negative federal and state program impact, positive general fund unrestricted impact annually.)**

Based on the district's recent workers' compensation actuarial report, the district will need to devise a multiyear plan to service the unfunded liability for workers' compensation claims of \$41 million as of June 30, 2004. The estimated outstanding losses are based on the non-discounted amount of \$41 million. The present value of estimated outstanding losses is the amount of the unfunded liability discounted for anticipated income due to investment earnings. Since the district has no reserves to generate investment income, the non-discounted amount of \$41,809,618 is recognized. **(Negative estimated general fund impact: -\$41 million.)**

An actuarial study conducted in November of 2004 of the medical self-insurance plan reflects a reserve requirement of \$23,321,849. Since there are insufficient reserve levels, the district will need to make contributions of \$23,321,849 to establish the required reserve amount to service the incurred but not reported (IBNR) claims of active employees. **(Negative estimated general fund impact: -\$23 million.)**

Based on the district's current tax rate, and outstanding debt, the district's lease tax override schedule reflects insufficient revenues to meet its debt obligations after January 2006. As a result, the district anticipates making an annual contribution of \$2.4 million from the general fund starting in January 2006. (**Negative estimated general fund impact: -\$2.4 million**)

Fresno Unified School District offers lifetime retiree health benefits to employees who have worked at least 15 years in the district. The district should determine the actual funding level of the annual required contribution. The current "pay as you go" method is allowable, but will result in a cumulatively larger unfunded liability. Eventually, the district's net assets could be entirely enveloped by this liability. This is an important cash flow decision that will not immediately affect the actual expenditure level but may become insurmountable over time.

Enrollment levels in the past five years have fluctuated. The district experienced declining enrollment last year and is facing a larger decline in the current year than had been anticipated. At the same time, local charter school enrollments are increasing. The funding per average daily attendance (ADA) in the revenue limit calculation is based on prior year ADA for a declining enrollment district. However, the revenue calculation is decreased by allocations for prior year students who left Fresno Unified schools to go to a charter school in the current year.

The district's annual reserve requirement identified in the California Department of Education Standards and Criteria is 2%. Flexibility provisions in AB 1754, the 2003-04 state budget trailer bill, permit a one-time 50% reduction of the 2004-05 reserve requirement, which must be restored in subsequent years. In 1999-2000 the general fund maintained a reserve balance of 3.79%. The available reserve level has moved up and down in the past four years, with a current reserve balance of 1.013% in budget revision #1. One percent this year is equivalent to \$6.2 million, requiring the district to restore over \$6 million for next year's reserve before beginning to address ongoing deficit spending issues.

The general fund ended the 2003-04 fiscal year with a negative cash balance as a result of the state deferring payment of the June revenue limit apportionments to early July. The state deferral will be repeated in the 2004-05 fiscal year. The general fund cash flow will be further affected by the property tax shift component of this year's state budget.

Assembly Bill 825, signed into law by Governor Schwarzenegger on September 29, 2004, will go into effect in the 2005-06 fiscal year. The bill creates six block grants from more than two dozen current categorical programs to increase operational flexibility and efficiency. Limited transfers are allowed between the block grants and other categorical programs.

The dollars in each block grant can be used for any of the purposes allowed by the component programs as they existed on January 1, 2004. Augmentations are limited to 20% of the program's or block grant's funding level and transfers out are limited to 15%. Transfers out can be made to augment any categorical program, including special education. Although the district may be able to transfer out \$1.43 million to assist programs supported by the unrestricted general fund, it will no longer be able to utilize the mega-item transfer of \$1.5 million.

### **Projection Specifics**

The multiyear projection focuses primarily on unrestricted revenue and expenditure allocations and the amounts needed for support to restricted programs such as special education, transportation, community day school, Peer Assistance and Review (PAR), and routine restricted maintenance. Other restricted programs are carefully monitored and required to contain expenditures within available funding allocations. The comments noted below are for unrestricted budget allocations.

### **Revenues**

Revenue limit sources make up 60.5% of the district's total general fund budgeted revenues. The revenue calculation is based on student ADA levels, COLA and deficit adjustments, and qualifying add-on or deduct amounts. After analyzing the trends in student enrollment and ADA ratios, and changing enrollment levels over the past five years, FCMAT decreased the expected student numbers by 320 ADA in the projection years for regular district attendance categories. At the same time, based on trends, FCMAT increased expected student ADA for charter schools by 5%. Now that the district has completed the October CBEDS count, it is anticipated that additional revenue reductions for the 2005-06 and 2006-07 revenue limit calculations will be needed in the interim report multiyear projections. Corresponding expenditure reductions in the areas of salaries and benefits should also be incorporated in the projections to reflect reduced staffing levels in both certificated and classified categories.

State revenues have been adjusted by COLA factors and changes in enrollment levels. Restricted federal and state revenues were decreased in future years by the 2003-04 carryover balances of \$7.5 million that are included in the 2004-05 revenue accounts and are budgeted to be spent this year. State and federal restricted expenditures were adjusted for COLA and changes in student enrollment, in addition to being reduced for restricted ending balances that were included in the base year totals.

Local revenues in 2004-05 include donations and local agency agreements that are annually determined in budget development. FCMAT did not project all of the revenue or expenditure amounts tied to these sources into the subsequent years, as these are not necessarily ongoing in nature.

## Expenditures

Certificated salaries have been projected by including an annual 1.2% step and column adjustment. Based on FCMAT's projected declining enrollment levels, total amounts for teacher and administrative salaries have been proportionately decreased. The projection years reflect the ongoing cost of the current contract language to reduce class sizes by one in 2005-06.

**Adjustments were included in the subsequent years as a result of the decrease in the indirect cost rate that may be charged to special projects. While FCMAT made adjustments to the amounts for certificated and classified salaries and employee benefits, the special projects may elect to apply the savings to other areas of the program budgets instead of increasing staff.**

Classified salaries have been projected with a .73% step and column adjustment and a similar proportional salary decrease in the category of administrative and supervisory salaries due to FCMAT's projected declining enrollment. Actual decisions of where to decrease certificated and classified staffing levels as a result of declining enrollment will be a district decision during each future year.

FCMAT did not include any base salary increases above step and column costs. Any changes in compensation should be applied to multiyear projections only after negotiations have concluded.

Employee benefits represent 23.7% of the current year general fund budget and is the area of the budget that is hardest to project. Double digit inflation levels for both active and retiree health benefits and the recent dramatic increase in workers' compensation costs must be considered carefully in the projection years. FCMAT has included an annual health coverage increase of 15% and workers' compensation increases of 10% in the projection. Unemployment insurance rates doubled in the 2004-05 year and are projected forward at the current rate. Changes to statutory benefits such as STRS, PERS, Social Security and Medicare are proportional to changes in salary accounts.

Statewide averages for employee salary and benefits generally run between 83% and 87% of a district's total general fund budget. In the 2004-05 district budget, these categories account for 83.8%. In 2003-04, the percentage was 86.4%. The current budget has reduced salaries in 2004-05 by approximately 2%, while employee benefits have increased by 12.4%.

The district's 2004-05 budgeted unrestricted general fund expenditures, excluding the necessary contribution to restricted programs, equal \$367,627,641. Employee salaries and benefits take up \$345,420,224 of these discretionary dollars. Each year, the costs in these areas continue to increase with step and column adjustments and increases for health coverage,

thereby decreasing the discretionary dollars available for materials and supplies, services and contracts, capital outlay, and other outgo.

Books and supplies have been adjusted by the decline in student enrollment and the consumer price index (CPI) factor.

Services and other operating expenses have been adjusted by the decline in enrollment levels in appropriate categories such as utility usage and repairs, and the CPI. An additional \$1 million expense has been included in the 2005-06 and 2006-07 fiscal years to cover new operating costs for the two new school sites opening each year.

Capital outlay for buildings and equipment has been maintained at the current year level.

Other outgo is a category that includes a transfer of in-lieu taxes to charter schools. FCMAT has calculated the increase in the transfer amount based on the 5% projected charter growth.

The district's indirect cost rate has decreased. Indirect costs are those costs of general management, i.e., activities providing for the direction and control of the local educational agency's LEA's affairs that are agencywide. General management costs consist of expenditures for administrative activities necessary for the general operation of the LEA such as accounting, budgeting, payroll preparation, personnel management, purchasing, and information technology. Also included in indirect costs is a proportional share of plant maintenance and operations and facilities rents and leases attributable to the administrative activities on the basis of space occupied. In 2003-04, the district's approved indirect cost rate applied to special projects was 7.79%. In 2004-05, the approved rate is 5.95%, and for 2005-06 the rate is 3.24%. Application of the indirect cost rate results in an offset (credit) toward the costs noted above. The reduced rate means fewer dollars are credited back to the general fund.

Transfers in and out reflect the deferred maintenance transfer from the bond fund passing through the general fund for the routine restricted maintenance contribution. The future transfer amounts for deferred maintenance are based on one half of one percent of projected general fund expenditures. A current year transfer from the capital facilities fund has been continued in the projection years.

The contributions to restricted programs have been adjusted for anticipated increases in special education program costs, home to school and special education transportation costs, as well as the current contribution to the community day school and PAR programs. All other categorical programs are projected to balance without general fund unrestricted support.

The contribution to the routine restricted maintenance program reflects an ongoing requirement to set aside 3% of the total general fund budget to support the maintenance and upkeep of district facilities as a result of previously received state building funds. In 2004-05, the district is permitted to again use the 2003-04 flexibility provision to transfer 2% of only unrestricted expenditure totals. For subsequent years, FCMAT has calculated the 3% contribution on the total general fund expenditures as required. Expenditure changes approved by the board for subsequent years will directly affect the routine restricted maintenance and deferred maintenance calculations.

The contribution to restricted programs for each of the projection years includes the following amounts:

For 2005-06	Special Education	\$22,000,000
	Transportation	\$ 7,000,000
	Routine Restricted Maintenance	\$19,239,440
	Community Day & PAR	\$ 500,000
	Total Contributions	\$48,739,440
For 2006-07	Special Education	\$24,000,000
	Transportation	\$ 7,246,000
	Routine Restricted Maintenance	\$19,959,999
	Community Day & PAR	\$ 500,000
	Total Contributions	\$51,705,999

Appendix B of this report includes tables in a Standardized Account Code Structure (SACS) format with additional revenue and expenditure detail by unrestricted and restricted sources.

## Recommendations

1. The shortfall projected for the 2005-06 and 2006-07 fiscal years based on current revenue and expenditure allocations reflects a district in serious fiscal crisis and approaching insolvency. The provisions of AB 1200 and AB 2756 require that the district and the County Superintendent of Schools office collaborate to restore fiscal solvency to the district.
2. The district must address the increasing level of deficit spending and re-establish the projected non-existent fund balance and reserves in order to eliminate the forecasted deficit balances of -\$35,950,540 in 2005-06 and -\$80,415,938 in 2006-07.

3. The impact of the other fund factors noted in this report will push the projected deficit balances to even more unmanageable levels. The Fiscal Services department must commit every available resource to the task of specifically identifying the dollar values of these factors and bringing forward options and recommendations for a recovery plan. All partners involved in the education of Fresno Unified students should be advised of the problems that exist and the potential solutions that will be developed in the upcoming months.

## Special Revenue Funds

In addition to the general fund and the charter school fund and pursuant to the California School Accounting Manual (CSAM), the district operates other funds. Some of these funds are required and must meet established criteria; other funds are optional and may be used at the district's discretion. Funds are broken into major categories of Governmental Funds (1-60), Proprietary Funds (61-70), Fiduciary Funds (71-95), and Account Groups (96-99).

The business office has specific documents, system reports, payroll and benefit information, and worksheet calculations that are maintained in file folders for budget development. The budget file includes a narrative description of the program and highlights of changes in the new budget year.

Special revenue funds are a subset within governmental funds and are established to account for the proceeds from specific revenue sources (other than trusts or for major capital projects) that are restricted by law to the financing of particular activities. The district operates the following special revenue funds:

### Adult Education Fund #11:

The adult education fund is used to account separately for federal, state, and local revenues for adult education programs.

The principal revenue accounts in this fund are:

- Investment Act (WIA)
- Other adult education block entitlement
- Apprentice transfer from the general fund
- Workforce federal revenue (e.g., adult basic education)
- All other state revenue
- Interest
- Adult education fees
- All other local revenue

Monies received for programs other than adult education may not be expended for adult education. Expenditures in this fund may be made only for direct instructional costs relating directly to the adult education program, including but not limited to the salaries and benefits of adult education teachers and aides; textbooks; instructional supplies; travel and conference expenses for employees who work in the program; and repair, maintenance, acquisition, and replacement of instructional equipment used in the program. Money in

this fund may also be expended for direct support costs of the adult education program and for indirect costs as specified in Education Code Section 52616.

The Fresno Adult School is the largest adult school program in Central California, serving approximately 31,000 students. It offers continuing education classes that are free to those prospective students who do not possess a high school diploma. Adult education also offers an independent study program as part of the high school diploma program. Included within this program are Adult Basic Education (ABE), English as a Second Language (ESL) and General Education Development (GED).

Based on FCMAT's review of the adult education fund, the program continues to excel both fiscally and in the delivery of quality education programs. In the 2000-01 fiscal year the adult education fund had an ending balance of \$4,211,965, which increased to \$7,315,591 by the close of the 2003-04 fiscal year. The adult education program is currently leasing facilities and is aggressively pursuing the outright purchase of a vacant property to construct a permanent facility. As a result, the district's 2004-05 budget reflects an interfund transfer of \$3.5 million to achieve this goal.

### **Child Development Fund #12:**

The child development fund is used to account separately for federal, state, and local revenues to operate child development programs (Education Code Section 8328).

The principal revenues and other sources in this fund are:

- Economic Opportunity Act
- Child nutrition programs (federal)
- State preschool
- Child nutrition programs (state)
- Child development apportionments
- All other state revenue
- Interest
- Child development parent fees
- All other local revenue
- Interfund transfers in

The child development fund may be used only for operational expenditures of child development programs.

Child development programs that are not subsidized by state or federal funds and that are operated with the intent of recovering the costs of the program through parent fees or other charges to users should be accounted for in an enterprise fund.

Based on the five-year comparison of revenue and expenditure totals, the child development fund has had a material decrease in federal funding in the current and prior years. The fund is projected to end the 2004-05 fiscal year with a zero balance.

The ongoing cost of step and column adjustments and increases in health and workers' compensation benefits have been funded through reductions in the categories of supplies, service, and capital outlay. In the future, the child development fund will not be able to sustain a positive fund balance without general fund support.

## Recommendations

1. The district must continue to actively manage the delivery of services and staffing levels for child development programs in order to operate in a manner that does not encroach on the general fund.

## Deferred Maintenance Fund #14

The deferred maintenance fund is used to account separately for state apportionments and LEAs' contributions for deferred maintenance purposes (Education Code sections 17582–17587).

The principal revenue (and other source) accounts in this fund are:

- Deferred maintenance allowance
- Interest
- Interfund transfers in

Expenditures in this fund are for major repairs or replacements under the plan approved by the State Allocation Board (Education Code Section 17582).

The state Legislature established the deferred maintenance fund in 1980 to aid school districts in maintaining facilities and sites. The deferred maintenance program requires the district and state to match equally the cost of major deferred maintenance projects. The district's maximum deferred maintenance apportionment is based on approximately one-half of one percent of the district's general fund and adult education fund operating expen-

ditures. However, historically the state has under-funded the program and is anticipated to fund only 91% to 93% of the maximum entitlement for the 2004-05 fiscal year.

The district has significant deferred maintenance needs. There is a tendency among school districts with severe fiscal constraints to suspend or even eliminate the deferred maintenance match, as it is considered an easy expenditure reduction that does not generally affect personnel. FCMAT believes that in the district's case, reductions would be a mistake. The district's has fully matched the state apportionment for the 2004-05 fiscal year and should continue to do so in future years.

## Recommendations

1. Because the district has significant deferred maintenance needs, it should continue to fully match the state's deferred maintenance contribution.

## Building Fund #2 I:

The building fund exists primarily to account separately for proceeds from the sale of bonds (Education Code Section 15146). Other authorized revenues to the building fund are (1) proceeds from the sale or lease with option to purchase of real property (Education Code Section 17462), and (2) revenue from rentals and leases of real property specifically authorized by the Governing Board for deposit into the fund (Education Code Section 41003).

The principal revenue (and other source) accounts in this fund are:

- Rentals and leases
- Interest
- Proceeds from the sale of bonds
- Proceeds from the sale/lease-purchase of land and buildings
- Federal Emergency Management Act (FEMA)

Most commonly, expenditures in the building fund are made against the Object 6000 series of accounts. Another authorized expenditure in the building fund is repayment of state school building aid out of proceeds from the sale of bonds (Education Code Section 16058).

Fresno Unified School District was one of the first districts in the state to place a general obligation bond measure on the ballot pursuant to Proposition 39. Prior to Proposition 39, school districts had to obtain a supermajority (66.67%) to pass a general obligation bond. Proposition 39 reduced the voter approval threshold to 55%.

In March of 2001, the voters of the Fresno Unified School District approved Measure K, a \$199 million school construction and modernization bond.

In addition to reducing the voter approval threshold to 55%, Proposition 39 imposed stringent accountability measures over the expenditure of bond funds. Chief among these is the establishment of a Citizen's Oversight Committee and the requirement that the district hire an independent audit firm to annually conduct financial and performance audits.

Due to its precarious fiscal status, the district should be aware that it might be prohibited from issuing non-voter-approved debt pursuant to Education Code Section 17150. This includes such debt instruments as certificates of participation (COPS), revenue bonds, tax and revenue anticipation notes (TRANS) or any other debt instrument that does not require the approval of voters in the district.

Education Code Section 42603 allows a district to temporarily borrow from other funds, including the building funds. The continued monitoring and management of general fund cash is essential, as the need for cash will fluctuate depending on how quickly the district can eliminate deficit spending. As the economy changes and the district's negative certification is lifted, other alternatives for cash management may be viable. In the interim, the district may consider Education Code Section 42620, obtaining a short-term loan from the Fresno County Treasurer.

The district estimates its current debt at \$301.2 million including general obligation bonds and outstanding certificates of participation. The district's voter-approved debt is subject to federal arbitrage regulations.

Present law includes three exceptions applicable to education-related bonds. First, issuers of all types of tax-exempt bonds are not required to rebate arbitrage profits if all of the proceeds of the bonds are spent for the purpose of the borrowing within six months after issuance. In the case of governmental bonds (including bonds to finance public schools), the six-month expenditure exception is treated as satisfied if at least 95% of the proceeds is spent within six months and the remaining 5% is spent within 12 months after the bonds are issued.

Second, in the case of bonds issued to finance certain construction activities, including school construction and renovation, the six-month period is extended to 24 months for construction proceeds. Arbitrage profits earned on construction proceeds are not required to be rebated if all such proceeds (other than certain retainage amounts) are spent by the end of the 24-month period and prescribed intermediate spending percentages are satisfied.

Third, governmental bonds issued by "small" governments are not subject to the rebate requirement. Small governments are defined as general-purpose governmental units that

issue no more than \$5 million of tax-exempt governmental bonds in a calendar year. The \$5 million limit is increased to \$10 million if at least \$5 million of the bonds are used to finance construction of public schools.

In general, arbitrage profits may be earned only during specified periods (e.g., defined “temporary periods”) before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., “reasonably required reserve or replacement funds”). Subject to limited exceptions, profits that are earned during these periods or on such investments must be rebated to the federal government.

## Recommendations

1. In accordance with legal requirements pursuant to Proposition 39, the district should continue to perform annual independent financial and performance audits as required for the district’s Measure K General Obligation Bond.
2. The district should review Education Code Section 15106, which limits the amount of voter-approved debt a unified school district can issue to 2.5 % of the district’s assessed valuation. Based on the district’s figures, the district’s maximum allowable debt limit is \$335.3 million and its current outstanding debt is \$264 million. However, the district still has \$151 million in Measure K general obligation bond authority.
3. In lieu of interfund borrowings from the building funds per Education Code 42603, the district should obtain a short-term advance apportionment loan from the Fresno County Treasurer pursuant to Education Code Section 42620 to meet its general fund cash flow requirements.
4. Section 148 of the Internal Revenue Code requires school districts that issue tax-exempt debt to have performed arbitrage rebate calculations every three years from the date of bond issuance. The district should continue the practice of having arbitrage rebate calculations performed and include the findings of these calculations within the annual independent performance and financial audit for the board.

## Capital Facilities Fund #25:

The capital facilities fund is used primarily to account separately for monies received from fees levied on developers or other agencies as a condition for approving a development. The authority for the levies may be county/city ordinances (Government Code sections 65970–65981) or private agreements between the LEA and the developer. Interest earned in the capital facilities fund is restricted to that fund (Government Code Section 66006).

The principal revenue accounts in this fund are:

- Interest
- Mitigation/developer fees

Expenditures in the capital facilities fund are restricted to the purposes specified in Government Code sections 65970–65981 or as specified in agreements with the developer (Government Code Section 66006).

The state Legislature established the capital facilities fund in 1987 for the purposes of collecting developer fees. The district is currently levying the maximum fee of \$2.24 per square foot for residential construction and \$.36 per square foot for commercial and industrial construction.

Statute limits the use of developer fees to the construction and reconstruction of school facilities. Additionally, the law specifically prohibits the use of developer fees on 1) routine repair and maintenance; 2) asbestos work other than incidental to regular construction or reconstruction; 3) deferred maintenance as prescribed in Education Code Section 39618.

Government Code Section 66001(d) and (e) requires the district to closely monitor when developer fees are collected and when the fees are committed or expended. Any fee revenue not expended or committed within five years must be rejustified by the board or returned to the current owners of the structure on which the fee was paid.

### **State School Lease Purchase Fund #30:**

Education Code sections 17000–17080 use the state school building lease-purchase fund primarily to account separately for state apportionments as provided. The LEA may be required to transfer to this fund any available monies from other funds as its contribution to a particular project.

The principal revenue (and other source) accounts for this fund are:

- School facilities apportionments
- Interest
- Interfund transfers in

Typical expenditures in this fund include items charged to Object 6200, Buildings and Improvement of Buildings, and Object 6300, Books and Media for New School Libraries. The state school lease purchase fund was created to account for statewide school facilities bond proceeds authorized under the expired Leroy Greene lease purchase program. Prior to August 1998, the district participated in this program for the construction and modernization of school facilities.

For new construction, the district was required to match the state's apportionment on a 50/50 basis, and for modernization projects it was required to contribute 20% of the project costs.

The state has closed out many of the district's lease purchase projects. As a result, the district is transferring excess contributions presumably back to their funds of origin. Once it can confirm with the Office of Public School Construction that all Lease Purchase Program projects are closed, the district should close the state school lease purchase fund by board resolution.

### **Recommendations**

1. After the Office of Public School Construction has closed out projects through accounting, the district should identify whether excess contributions were made to lease purchase projects and transfer these amounts back to their fund of origin.
2. Once the Office of Public School Construction has closed out all of the district's lease purchase program projects, the district should close the state school lease purchase fund via board resolution.

### **County School Facilities Fund #35:**

The county school facilities fund is used primarily to account separately for state apportionments as provided in Education Code sections 17009.5 and 17070.10–17076.10.

The principal revenue (and other source) accounts in this fund are:

- School facilities apportionments
- Interest

Typical expenditures in this fund include items charged to Object 6200, Buildings and Improvement of Buildings, and Object 6300, Books and Media for New School Libraries. The county school facilities fund was established by the Legislature in 1998 to account for statewide school facilities bond proceeds to be administered by the State Allocation Board through the Office of Public School Construction. The two primary uses of these funds are for growth (new construction) and modernization. For growth, the district is required to match the state's apportionment on a 50/50 basis. For modernization projects, the district must contribute 40% of the project costs.

The district has aggressively participated in the state school facilities program and has received in excess of \$143 million from the Office of Public School Construction. However, in April of 2004, the State Allocation Board (SAB) found that the district falsified 24

different fund release authorizations over a period of two years. As a result, it was determined that the district did not have valid contracts in place within the 18-month time limit on apportionment. Therefore,

- The district is now prohibited from self-certifying project information for a period of five years;
- The state apportionment on 11 projects totaling \$13,975,759 was rescinded; however, the district may refile these applications to try to regain the amount originally funded for each project;
- The district will repay to the state the principal sum of \$3,025,574 over a five-year term commencing on July 1, 2005, with simple interest charged at the pooled money investment account rate; and
- The district and SAB agreed that no further legal action would be taken relating to the above issues.

The district bonded indebtedness is in excess of 60%. As a result, the district should explore whether it is eligible for 100% funding through the state's financial hardship program.

In order to be eligible for this program, the district must meet the following criteria (the district must meet "A" and one requirement of item "B"):

- A. The district must be levying developer fees at the maximum developer fee justified under law or have an alternative revenue source equal to or greater than the developer fee otherwise justified under law at the time of request of financial hardship.
- B.
  1. The current bonded indebtedness of the district, at the time of request for financial hardship status, is at least 60% of the district's total bonding capacity.
  2. The district had a successful registered voter bond election for at least the maximum amount allowed under Proposition 39 within the previous two years from the date of the request for financial hardship status.
  3. The district is also the County Superintendent of Schools office.
  4. The district's bonding capacity at the time of the request for financial hardship status is \$5 million or less.
  5. Other reasonable evidence as approved by the State Allocation Board (SAB), provided the district has had a registered Proposition 39 voter bond election for at least the maximum amount allowed under Proposition 39 within the previous two years from the date of request for financial hardship status.

## Recommendations

1. The district should explore whether it is eligible for 100% funding through the state's financial hardship program and should submit the appropriate applications accordingly.
2. The district should immediately refile the state school facility program applications previously rescinded by OPSC under the state's financial hardship program. It is anticipated that the funding level will increase by \$13,975,759 to \$27,951,518.
3. The administrator of Fiscal Services should initiate a complete reconciliation of projects in the county school facilities fund and determine whether the district has sufficient funds to match the state's apportionment on pre-financial hardship applications.

## Special Reserve Fund for Capital Outlay #40:

The special reserve fund for capital outlay projects exists primarily to provide for the accumulation of general fund monies for capital outlay purposes (Education Code Section 42840). This fund may also be used to account for any other revenues specifically for capital projects that are not restricted to Funds 21, 25, 30, 35, or 49. Other authorized revenues that may be transferred to the special reserve fund for capital outlay projects are (1) proceeds from the sale or lease with option to purchase of real property (Education Code Section 17462), (2) rentals and leases of real property specifically authorized for deposit to the fund by the Governing Board (Education Code Section 41003); and (3) excess amounts sufficient to pay all unpaid bond obligations (Education Code Section 15235).

The principal revenue and other source accounts in this fund are:

- Other authorized interfund transfers in
- Proceeds from sale/lease-purchase of land and buildings
- Rentals and leases
- Interest

Transfers authorized by the Governing Board from the general fund must be expended for capital outlay purposes. Proceeds from the sale or lease with option to purchase may be spent for capital outlay purposes, costs of maintenance of LEAs' property, and future maintenance and renovation of school sites (Education Code Section 17462). Expenditures for capital outlay are made against the Object 6000 series of accounts.

In April 2004, the State Allocation Board (SAB) determined that the district falsified 24 different fund release authorizations over a period of two years. As a result, the SAB

concluded that the district did not have valid contracts in place within the 18-month time limit on apportionment. Therefore, the district must repay the state the principal sum of \$3,025,574, over a five-year term commencing July 1, 2005.

**Recommendations**

1. The district should identify the annual repayment amount of \$605,115 in this fund to repay the State Allocation Board until the penalty is paid in full. The annual payment should be identified in both the annual budget and the long-term debt account group.

**Tax Override Fund #53:**

The tax override fund is used for the repayment of voted indebtedness (other than bond interest and redemption fund repayments) to be financed from ad valorem (property tax) levies. An example is a public school building loan repayment. Interest earned in the tax override fund is credited to the general fund of the LEA.

The principal revenue accounts in this fund are:

- State subventions for homeowners’ exemptions
- Other subventions/in-lieu taxes
- Secured roll taxes
- Unsecured roll taxes
- Prior years’ taxes
- Supplemental taxes

The principal expenditure accounts in this fund are:

<i>Purpose for which levy was authorized:</i>	<i>Expenditure account</i>
State school building loan repayments (Education Code Section 16090) .....	7432
Payment to original district for acquisition of property (Education Code Section 35576) .....	7436
Compensatory education housing repayments (Education Code Section 16214) .....	7439
Lease-purchase payments (Education Code Section 17409) .....	7439
Construction of exceptional children’s facilities repayments (Education Code Section 16196).....	7439
Other voter-approved debt service 7439 and Object 7438, Debt Service - Interest	

The Fresno Unified School District was one of a handful of school districts that passed a lease override tax pursuant to Education Code Section 17409 and prior to passage of Proposition 13. The lease override tax was used as an alternative method to issue bonds to acquire school sites, buildings and related facilities. Under this method, the district leases sites, buildings and facilities constructed by a lessor to district plans and specifications. The term of each lease is 40 years and the title to sites and buildings constructed with the tax vest with the district once the lease expires. The maximum tax rate is \$.20 per \$100 of assessed valuation. Due to changes in the way assessed valuation is calculated after the passage of Proposition 13, the maximum tax rate is \$.05 per \$100 of assessed valuation.

In November 1977, voters of the district passed Measure C. Measure C asked the electorate:

*Shall the Governing Board of the Fresno Unified School District purchase site (where the site are not presently owned by the district), prepare plans and specifications and lease buildings and facilities to be constructed for use by the district consisting of the hereinafter specified fully furnished, equipped and landscaped school facilities to be located on the hereinafter specified sites:*

- 1) a new elementary school on a site on West Sierra Avenue within three quarters mile west of North Marks Avenue, Fresno;
- 2) a new elementary school within one-half mile of the intersection of West Herndon Avenue and North Valentine, Fresno;
- 3) a new elementary school to replace the existing portable Starr Elementary School, 1780 West Sierra Avenue, Fresno;
- 4) classroom additions to Kraft Elementary School, 650 West Sierra Avenue, Fresno;
- 5) a new elementary school on a site on East Butler Avenue within one quarter mile east of South Peach Avenue, in the unincorporated area of the County of Fresno;
- 6) a gymnasium addition to Sierra Junior High School, 4330 East Garland Avenue, Fresno;
- 7) classroom, music, shop, science, gymnasium, physical education, cafeteria and administrative additions to, and the renovation of, existing Bullard High School, 5445 North Palm Avenue, in the unincorporated area of Fresno County;
- 8) the remodeling of the existing Hamilton Junior High School, 102 East Clinton Avenue, Fresno; and
- 9) an addition to the existing vehicle garage of the district, 4998 North Brawley Avenue, Fresno;

*and, for such purposes, shall the maximum tax rate of the district be increased by not to exceed 20 cents for each \$100 of assessed valuation, such increase to be in effect in the Fresno Unified School District for the fiscal years 1978-79 to 2010-2011, and the amount of such increase used solely and exclusively for such purposes, the district reserving the right to lease than all of the proposed buildings and facilities if circumstances so require?*

The district has prepared a lease tax override fund schedule that reflects the fund's beginning balance as of June 30, 2003, a debt service schedule and revenue projections based on the district's lease override tax rate at \$.05 per \$100 of assessed valuation. The district's lease tax override fund and debt service schedule is as follows:

#### Tax Override Fund and Debt Service Schedule

	Beginning Balance (1)	Leasing Tax (2)	1993A COPs	1997A COPs	1998A COPs	2001 COPs	2003 COPs (3)	Interest Earnings (4)	District Contrib	Ending Balance
<b>Jan-98</b>	10,970,312	2,802,887	-448,455	-387,990	-2,679,624			329,109	0	10,586,241
<b>Jul-98</b>	6,530,677	2,835,220	-69,205	-1,440,588	-1,065,846			195,920	0	6,986,180
<b>Jan-99</b>	14,526,057	2,835,220	-459,205	-446,088	-2,760,846			435,782	0	14,130,921
<b>Jul-99</b>	14,130,921	2,881,062	-59,455	-1,611,088	-1,031,946			423,928	0	14,733,424
<b>Jan-00</b>	12,732,760	2,881,062	-469,455	-422,788	-2,886,946			381,983	0	12,216,618
<b>Jul-00</b>	6,352,322	2,992,222	-49,000	-1,642,788	-994,846			190,570	0	6,848,481
<b>Jan-01</b>	6,285,114	2,992,222	-479,000	-398,388	-2,984,846	0		188,553	0	5,603,657
<b>Jul-01</b>	4,093,801	3,090,085	-37,712	-1,643,388	-955,046	-158,996		40,938	0	4,429,683
<b>Jan-02</b>	4,429,683	3,090,085	-487,712	-373,488	-3,130,046	-408,745		44,297	0	3,164,075
<b>Jul-02</b>	2,304,033	3,201,429	-25,900	-1,678,488	-911,546	-194,545	0	23,040	2,400,000	5,118,025
<b>Jan-03</b>	5,118,025	3,201,429	-500,900	-346,335	-3,156,546	-934,545	0	51,180	0	3,432,309
<b>Jul-03</b>	7,596,466	3,354,445	-25,165	-1,701,335	-718,746	-171,588	-61,977	75,965		8,348,066
<b>Jan-04</b>	8,348,066	3,354,445	-525,165	-317,880	-3,268,746	-941,588	-1,167,592	83,481	0	5,565,022
<b>Jul-04</b>	5,565,022	3,421,534	-11,415	-1,757,880	-667,746	-156,188	-112,142	55,650		6,336,836
<b>Jan-05</b>	6,336,836	3,421,534	-52,800	-286,920	-3,422,746	-951,188	-1,167,142	63,368	0	3,940,944
<b>Jul-05</b>	3,940,944	3,489,965	0	-1,781,920	-612,646	-140,288	-101,592	39,409		4,833,873
<b>Jan-06</b>	4,833,873	3,489,965	0	-254,030	-3,597,646	-950,288	-1,166,592	48,339	0	2,403,622
<b>Jul-06</b>	2,403,622	3,559,764	0	-1,804,030	-551,453	-139,088	-90,942	24,036	2,400,000	5,801,910
<b>Jan-07</b>	5,801,910	3,559,764	0	-219,155	-5,076,453	-994,088	-1,200,942	58,019	0	1,929,055
<b>Jul-07</b>	1,929,055	3,630,959	0	-1,869,155	-456,428	-121,988	-79,842	19,291	2,400,000	5,451,893
<b>Jan-08</b>	5,451,893	3,630,959	0	-181,205	-5,301,428	-1,016,988	-1,214,842	54,519	0	1,422,909
<b>Jul-08</b>	1,422,909	3,703,579	0	-1,901,205	-352,261	-104,088	-67,073	14,229	2,400,000	5,116,090
<b>Jan-09</b>	5,116,090	3,703,579	0	-140,785	-5,537,261	-1,049,088	-1,222,073	51,161	0	921,623
<b>Jul-09</b>	921,623	3,777,650	0	-1,955,785	-238,191	-85,188	-51,914	9,216	2,400,000	4,777,413
<b>Jan-10</b>	4,777,413	3,777,650	0	-97,225	-5,813,191	-1,085,188	-1,231,914	47,774	0	375,320
<b>Jul-10</b>	375,320	3,853,203	0	-2,002,225	-112,753	-64,188	-34,214	3,753	3,100,000	5,118,897
<b>Jan-11</b>	5,118,897	3,853,203	0	-49,600	-6,087,753	-1,629,188	-1,249,214	51,189	0	7,535
<b>Jul-11</b>	7,535	0	0	4,210	25,419	-30,540	-14,470	75	1,243,505	1,235,734
<b>Jan-12</b>	1,235,734	0	0	0	183,419	-1,035,040	-396,470	12,357	0	0
		57,582,200	-614,545	-16,316,125	-41,606,608	-10,665,780	-10,630,945	711,832	13,943,505	

Based on the district's current tax rate, and outstanding debt, the district's lease tax override schedule reflects insufficient revenues to meet its debt obligations after January 2006. As a result, the district anticipates making an annual contribution of \$2.4 million from the general fund starting in January 2006. The total contribution through 2011 is estimated to be \$13,943,505.

FCMAT has identified several areas of concern with the district's lease tax override schedule. First, the district's projections use a 2% per annum inflationary increase each of the next six years, while the district's assessed valuation has increased by more than 8% over the last two years. The district should recalculate its projections each year by rebenching the base year and using actual increases in district assessed valuation. Second, if the district rebenches its lease override tax projections on a yearly basis, it follows that the interest income on these funds will also have to be recalculated. *Lastly, FCMAT notes that the lease tax override is not counted against the district's total bond indebtedness and that interest income being retained in Fund 53 may be transferred as revenue to the unrestricted general fund in accordance with the California State School Accounting Manual (CSAM).*

#### Fresno Unified School District Leasing Tax Fund

	Beginning Balance (1)	Leasing Tax (2)	1993A COPs	1997A COPs	1998A COPs	2001 COPs	2003 COPs (3)	Interest Earnings (4)
Jan-98	10,970,312	2,802,887	-448,455	-387,990	-2,679,624			329,109
Jul-98	6,530,677	2,835,220	-69,205	-1,440,588	-1,065,846			195,920
Jan-99	14,526,057	2,835,220	-459,205	-446,088	-2,760,846			435,782
Jul-99	14,130,921	2,881,062	-59,455	-1,611,088	-1,031,946			423,928
Jan-00	12,732,760	2,881,062	-469,455	-422,788	-2,886,946			381,983
Jul-00	6,352,322	2,992,222	-49,000	-1,642,788	-994,846			190,570
Jan-01	6,285,114	2,992,222	-479,000	-398,388	-2,984,846	0		188,553
Jul-01	4,093,801	3,090,085	-37,712	-1,643,388	-955,046	-158,996		40,938
Jan-02	4,429,683	3,090,085	-487,712	-373,488	-3,130,046	-408,745		44,297
Jul-02	2,304,033	3,201,429	-25,900	-1,678,488	-911,546	-194,545	0	23,040
Jan-03	5,118,025	3,201,429	-500,900	-346,335	-3,156,546	-934,545	0	51,180
Jul-03	7,596,466	3,354,445	-25,165	-1,701,335	-718,746	-171,588	-61,977	75,965
Jan-04	8,348,066	3,354,445	-525,165	-317,880	-3,268,746	-941,588	-1,167,592	83,481
Jul-04	5,565,022	3,421,534	-11,415	-1,757,880	-667,746	-156,188	-112,142	55,650
Jan-05	6,336,836	3,421,534	-52,800	-286,920	-3,422,746	-951,188	-1,167,142	63,368
Jul-05	3,940,944	14,680,829	0	-1,781,920	-612,646	-140,288	-101,592	39,409
Jan-06	4,833,873	14,680,829	0	-254,030	-3,597,646	-950,288	-1,166,592	48,339
Jul-06	2,403,622	14,974,446	0	-1,804,030	-551,453	-139,088	-90,942	24,036
Jan-07	5,801,910	14,974,446	0	-219,155	-5,076,453	-994,088	-1,200,942	58,019
Jul-07	1,929,055	15,273,935	0	-1,869,155	-456,428	-121,988	-79,842	19,291
Jan-08	5,451,893	15,273,935	0	-181,205	-5,301,428	-1,016,988	-1,214,842	54,519
Jul-08	1,422,909	15,579,413	0	-1,901,205	-352,261	-104,088	-67,073	14,229
Jan-09	5,116,090	15,579,413	0	-140,785	-5,537,261	-1,049,088	-1,222,073	51,161
Jul-09	921,623	15,891,001	0	-1,955,785	-238,191	-85,188	-51,914	9,216
Jan-10	4,777,413	15,891,001	0	-97,225	-5,813,191	-1,085,188	-1,231,914	47,774
Jul-10	375,320	16,208,821	0	-2,002,225	-112,753	-64,188	-34,214	3,753
Jan-11	5,118,897	16,208,821	0	-49,600	-6,087,753	-1,629,188	-1,249,214	51,189
Jul-11	7,535	0	0	4,210	25,419	-30,540	-14,470	75
Jan-12	1,235,734	0	0	0	183,419	-1,035,040	-396,470	12,357
		198,768,848	-614,545	-16,316,125	-41,606,608	-10,665,780	-10,630,945	711,832

In July 1996, Senate Bill 1562 was chaptered and Education Code Section 17410 was memorialized in statute. The significance of this code section is that districts with existing lease override taxes are allowed to expand the list of projects on which lease tax override proceeds could be used with a simple majority of vote of the electorate. Education Code Section 17410 states:

*17410. (a) If, at an election held pursuant to Section 17409, or the predecessor to that section, a majority of the electors voting on the proposition voted “Yes,” the governing board may call an election pursuant to this section. Before entering into one or more leases or agreements pursuant to this section and this article, the governing board of the district shall call, hold, and conduct an election in the manner provided in Section 42202 of the Education Code, as it existed on December 31, 1979, except that the ballot used in the election shall contain substantially the words: “Shall the governing board of the \_\_\_ district purchase (a site, sites) prepare plans and specifications (the reference to the site or sites and plans and specifications shall not be included if, prior to calling the election, the governing board of the district has acquired a site or sites or proposes to lease a site or sites or has prepared plans and specifications) and lease (a site, sites) and (a building, buildings) to be constructed for use by the school district (designating the location of the site or sites on which the building or buildings will be constructed and generally describing the building or buildings) and for those purposes, shall the tax rate increase authorized on (the date of the original election), be used solely and exclusively for those purposes in addition to those approved by the majority of electors at the election held pursuant to Section 17409, or the predecessor to that section, on (the date of the original election)?”*

*If, at the election held pursuant to this section, a majority of the electors voting on the proposition vote “Yes,” the governing board may proceed pursuant to this article to use that previously authorized tax increase for the purpose or purposes authorized under that election.*

*(b) It is the intent of the Legislature, in enacting this section, to permit the levy of a tax to the extent authorized at an election held pursuant to Section 17409, or the predecessor to that section, as modified to permit the proceeds of that tax to be expended for the purposes authorized at the election held pursuant to subdivision (a).*

Where appropriate, the district should use the additional revenues generated by restructuring the debt service schedule to “retire” existing debt obligations that are currently secured by the unrestricted general fund.

## Recommendations

1. Revenue projections should be rebenchmarked annually to reflect actual growth in the district’s assessed valuation.

2. Interest income projections should be recalculated annually based on increased assessed valuation and the \$.05 tax rate.
3. The district should investigate whether the project list may be expanded by a simple majority vote to include projects previously financed with certificates of participation, and retire the debt accordingly. It is estimated that as of June 30, 2004, the district has \$73.6 million in debt from outstanding certificates of participation and/or capital leases.

## Enterprise Funds

Enterprise funds may be used to account for any activity for which a fee is charged to external users for goods or services. An enterprise fund must be used to report any activity whose principal revenue sources meet any of the following criteria.

1. The LEA has issued debt backed solely by fees and charges from that activity.
2. There is a legal requirement that the cost of providing services, including capital costs such as depreciation or debt service, must be recovered through fees or charges.
3. The LEA's policy is to establish activity fees or charges designed to recover the cost of providing services, including capital costs such as depreciation or debt service.

An enterprise fund is accounted for on a full-accrual basis. In an enterprise fund, capital assets and long-term debt (including all long-term debt obligations such as vacation pay and capital leases) are recorded in the fund, not in the account groups. All revenues and expenses (rather than expenditures) are recorded, regardless of when they are received or paid. Depreciation of capital assets is recorded.

## Cafeteria Fund #6 I

The cafeteria fund may be accounted for as an enterprise fund rather than as a special revenue fund, even though its primary source of financing comes from federal and state child nutrition program revenues rather than through the price paid for meals by the students. The CDE recommends that an LEA only use an enterprise fund to account for its cafeteria operations if the LEA's Governing Board intends that its cafeteria program be operated in a manner similar to that used by private business enterprises and that all costs of providing services, including depreciation of capital assets, be fully recovered.

The cafeteria fund balance has continued to grow over the five-year period reviewed by FCMAT. The district has considered building a new central kitchen in past years and is currently pursuing the option of leasing a new construction facility that can revert back to the district at the end of the lease period. The designated amount shown in the 2004-05 budget may be used to service the lease payments.



## Internal Service Funds

Internal service funds are created principally to render services on a cost-reimbursement basis to other funds or departments of the LEA. Internal service funds are generally intended to be self-supporting.

### Self-Insurance Fund #67:

The self-insurance fund is used to separate monies received for self-insurance activities from other operating funds of an LEA.

Separate funds may be established for each type of self-insurance activity, such as workers' compensation, health and welfare, and deductible property loss (Education Code Section 17566).

The principal revenue accounts in this fund are the following:

- Premiums/contributions
- Interagency revenues
- All other local revenue interest
- In-district

Expenses from the self-insurance fund shall be made for the payment of claims, administrative costs, services, deductible insurance amounts, cost of excess insurance, and other related costs.

Amounts contributed to a self-insurance fund are lawfully restricted for insurance purposes (Education Code Section 17566).

Self-insurance differs from commercial insurance in that the district charges programs internally for insurance rather than purchasing it from a private carrier. Self-insurance also implies that the district will carry enough in reserves to pay all of its claims and protect itself against unforeseen disasters.

The district is self-insured for medical, property and liability, workers' compensation and the district's defined benefit plan (alternative retirement). A separate fund has been established for each of these activities. Each of these funds is intended to be self-supporting.

## Medical/Post-Retirement Benefits

### Findings

GASB 43 and 45 are new governmental accounting standards that direct how state and local governments will account for and report other post-employment benefits (OPEB) that are separate from pension benefits. The most common OPEB is retiree health benefits. Fresno Unified School District (Fresno) offers lifetime retiree health benefits to employees who have worked at least 15 years in the district.

GASB 43, Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans, involves the financial reporting (in the district's annual audit report) of these benefits. GASB 45, Accounting and Financial Reporting by Employers for Post-Employment Benefits, involves the actual accounting for those same benefits. The two statements are closely interrelated and will be considered together in this report.

The two new standards are phased in over a three-year period, based on the governmental unit's size. Fresno will be in the first group implementing these new standards because its total annual revenues exceed \$100 million. The reporting standard is implemented before the accounting standard, so financial statement footnote disclosure will occur a year before the actual accounting changes are necessary. As with many new accounting standards, early implementation is encouraged. Fresno will have to implement as follows:

- GASB 43, July 1, 2006
- GASB 45, July 1, 2007

The intent of the new reporting and accounting requirements is to understand what past negotiated retiree benefit commitments mean to current and future budgets, and to accurately reflect the cost of those commitments in the years the costs are incurred (which are the years the employees actually work for the district).

Future benefits result in a liability. Most districts have funded this liability on a "pay as you go" basis. This means the cost is booked and the expenses are funded based on the amount actually paid out for retiree benefits in the current year. One of the requirements of these new standards is an actuarial determination of the liability and expense, which will be reflected in the district's financial statements. Based on the number of employees, Fresno Unified is required to have a biannual actuarial report to value its plan costs. These new standards will result in large increases in the district's retiree benefit expenses, since the current "pay as you go" method only recognizes amounts paid out in the current year, not the future liability of the benefits of many retired employees.

The new standards also require an amortization of the existing unfunded retiree benefit liability. This unfunded liability does not have to be booked in the first year of imple-

mentation. Amortization can occur over a period as long as 30 years. Statement 45 also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. The actuarial valuation involves using the following to make certain calculations related to the plan:

- a. Actuarial cost method - there are several acceptable actuarial cost methods, and the district will need to discuss these with its actuary to determine whether there are inherent advantages or disadvantages in the method used.
- b. Actuarial assumptions - includes demographic (such as employee life spans, marriage status, termination status, etc.) and economic information (such as current and future investment returns and cost trends).
- c. Plan assets - must be transferred to an **irrevocable trust** to be counted as part of the funding available to pay the plan liability. Plan assets are reported based on market values (either at a specific date, or an average over the reporting period).
- d. Employer census data - demographic data related to eligible plan members.

The actuarial report will result in the district's annual required contribution (ARC), which is the district's accrued expense (and related liability) in its current year financial statements. Although labeled as a contribution, the district may choose not to fund the ARC, which would result in an unfunded liability. The ARC is made up of two different components:

- The normal cost, which is the current actuarial cost of the retiree benefits earned by employees in the current year.
- Amortization of the unfunded prior liability, which is the amortization of the prior unfunded employee benefit liability for a period of up to 30 years.

After the prior unfunded liability has been totally recognized, the ARC will consist solely of the current year actuarially determined costs of the benefits. Contributions toward the annual cost are made two ways: through actual payments to the insuring agency and through contributions to an irrevocable trust, whose assets will be held for future premium payments.

One advantage of establishing an irrevocable trust is that the annual actual costs (normal costs) of the retiree benefits can be charged equitably to all programs, including categorical programs. Under the "pay as you go" funding method, the unfunded liability unfairly burdens the unrestricted general fund.

According to the Office of Management and Budget, Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, post-retirement health benefits may be equitably charged to federal categorical funds based either on “pay as you go” or on the actuarially determined GAAP compliant expense, as long as an irrevocable trust is in place. Specifically, the circular states:

To be allowable in the current year, the PRHB (post-retirement health benefit) costs must be paid either to:

- a) An insurer or other benefit provider as current year costs or premiums, or
- b) An insurer or trustee to maintain a trust fund or reserve for the sole purpose of providing post retirement benefits to retirees and other beneficiaries.

This circular goes on to state that an equitable portion of the prior unfunded liability may also be charged to federal funds:

- 4) When a governmental unit converts to an acceptable actuarial cost method and funds PRHB costs in accordance with this method, the initial unfunded liability attributable to prior years shall be allowable if amortized over a period of years in accordance with GAAP, or, if no such GAAP period exists, over a period negotiated with the cognizant agency.

Thus, the district could charge a pro-rata share of the cost of these benefits, including amortization of the prior unfunded liability, to categorical programs, as long as all amounts that exceed the “pay as you go” level are deposited to an irrevocable trust.

A review of the draft Actuarial Report issued September 24, 2004 shows that the district has a “pay as you go” cost of **\$23,849,410** for the period of September 1, 2004 to August 31, 2005. This cost is estimated by the actuaries to increase approximately 7.7% annually over the next ten years.

The actuaries estimate the unfunded prior liability to be approximately \$807,928,949, and provide a discounted amortization of \$35,785,663 each year for 30 years to fund this liability.

The actuaries also calculate the current year cost of benefits accrued at \$32,499,601. This is the annual contribution required to fund retiree benefits over an eligible employee’s working lifetime, and differs from the “pay as you go” amount because it accrues costs before the employee has retired.

Combining the amortization of the prior unfunded liability with the current year costs would result in a total cost of \$68,285,264, which is almost three times the current “pay as you go” cost (estimated at \$23,849,410).

The actuaries go on to calculate the total gross liability, which is the estimated present value of all future retiree health benefits for all current employees and retirees. Part of this liability will be realized in the future because employees are still working, so this balance exceeds that of the prior unfunded liability. The total gross liability is estimated to exceed **\$1.1 billion**.

This information shows that the current method (“pay as you go”) drastically understates the actual cost of each employee in the district. The cost lags considerably because expenses are not recognized until the employee actually retires. All other employee costs are expensed during their employment lifetime.

## Recommendations

1. The district has a “pay as you go” cost of **\$23,849,410** for the period of September 1, 2004 to August 31, 2005. The actuaries estimate the “pay as you go” cost will increase approximately 7.7% annually over the next ten years. As a result, the district will need to adjust the “pay as you go” amount for current and active employees in the current and two subsequent year budgets in accordance with AB 1200.
2. The district should determine whether categorical funds will be charged their equitable portion of the “pay as you go” cost as well as the amortization of the prior unfunded liability.
3. The district should review the current unfunded retiree benefit liability and determine the period over which liability will be amortized, up to 30 years. The amortized liability and expense will be reflected in the entity-wide audited financial statements, and may reduce net assets.
4. The district should determine the actual funding level of the annual required contribution. The current “pay as you go” method is allowable, but will result in a cumulatively larger unfunded liability. Eventually, the district’s net assets could be entirely enveloped by this liability. This is an important cash flow decision that will not immediately affect the actual expenditure level but may become insurmountable over time.
5. If it is decided that funding levels will be established to at least partially address the annual cost exceeding the annual premiums, an irrevocable trust may be established. If an irrevocable trust is not established, any amounts set aside to fund the liability would not reduce the reported liability.
6. In accordance with GASB 45, the district should segregate the cost of retiree benefits for retirees under age 65 versus those retirees over age 65.

7. The district should communicate the results of these new standards to interested parties, including board members, the public, financing institutions, employees, and unions.

## **Self-Funded Medical Plan (Active Employees)**

### **Findings**

The district requested and received an estimate for the period of July 1, 2004 to June 30, 2005 of self-funding rates for the district's medical plan for active employees. The analysis relates only to self-funded benefits and does not take into consideration other benefits, such as mental health benefits, that may be offered by the district.

In accordance with Education Code Section 17566, an actuarial estimate of self-funded health plan costs is required every three years. Based on current fluctuations in the health industry, predicting health trends is subject to considerable uncertainty. In order to forecast accurate increases for the district's self-funded medical plan, the district should consider requesting an actuarial estimate on an annual basis.

### **Recommendations**

1. An actuarial study conducted in November 2004 of the medical self-insurance plan recommends a reserve requirement of \$23,321,849 to service the incurred but not reported (IBNR) claims of active employees. Since there are insufficient reserve levels, the district will need to make contributions of \$23,321,849 to establish the required reserve amount. (Negative general fund impact: -\$23 million.)
2. Request an actuarial estimate for self-funded health plan costs on an annual basis.

## **Property & Liability**

### **Findings**

The district has been self-insured for property and liability since 1979. It has a self-insurance retention (SIR) level of \$250,000 per occurrence. The district purchases "excess" insurance from private carriers for claims that exceed these thresholds.

Cost increases in liability insurance are largely attributed to the fallout from the September 11 disaster. Prior to this event, the liability insurance market was considered soft and it was not difficult to obtain competitive premiums. However, due to the enormous losses the insurance industry sustained as a result of September 11, premiums have become more costly.

In August 2004, ARM Tech conducted an actuarial study of the district's self-insured property and liability programs. In the report, ARM Tech estimated that the district had outstanding losses of \$948,799.

## Recommendations

1. The district should not make interfund transfers from within the self-insurance fund prior to validating actuarial information regarding outstanding claims.
2. The district should annually request an actuarial report for property and liability in order to monitor whether the program is fully funded.

## Workers' Compensation

### Findings

The district has been self-insured for workers' compensation since 1979. It has a self-insurance retention (SER) level of \$1,000,000 per occurrence. The district purchases "excess" insurance from private carriers for claims that exceed these thresholds. The district currently levies an internal charge of \$3.34 per \$100 of payroll that is insufficient to fund the current and projected claims for workers' compensation.

Cost increases in the workers' compensation industry during the past few years have been driven largely by the increasing size or magnitude of claims. Many attribute this increase in severity to changes in law that have increased medical costs. The other significant factor affecting workers' compensation claims is frequency, or number of claims. Frequency is generally measured by dividing the number of claims in a fiscal year by the size of payroll.

In October of 2001, ARM Tech prepared an actuarial report for the district for workers' compensation. In the report, ARM Tech indicated that the district had an unfunded liability of \$21,035,698. The district currently has no reserves in this fund and is in the process of identifying their current liability through preparation of an actuarial study.

In October 2004, ARM Tech prepared an updated actuarial report for the district for workers' compensation. In the report, ARM Tech indicated that the district now has an unfunded liability of \$41,809,618.

The estimated outstanding losses are based on the non-discounted amount of \$41 million. The present value of estimated outstanding losses is the amount of the unfunded liability, discounted for anticipated income due to investment earnings. Since the district has no reserves to generate investment income, the non-discounted amount of \$41,809,618 is recognized.

According to the district's independent financial audit as of 6-30-2003, the district has recorded \$11,152,702 in the long-term debt account group. Based on the actuarial of October 22, 2004, the district should increase the amount recorded for the unfunded liability to \$41,809,618 in the long-term debt account group.

Moreover, the district should obtain a yearly actuarial to identify whether the rates being charged will be sufficient to fully fund the workers' compensation program.

## Recommendations

1. Due to the potential long-term exposure in the area of risk management, and the potential fiscal impact of the district's self-insured program for workers' compensation claims, the district should request an annual actuarial report.
2. The district should annually provide information to the Governing Board regarding the estimated accrued but unfunded cost of workers' compensation claims in accordance with Education Code 42141.
3. The district will need to devise a long-term plan to service the unfunded liability for workers' compensation claims. As an example, districts under state intervention typically develop a five-year financial recovery plan. Based on this model, the district would need to make an annual contribution of \$8,361,923 to service the unfunded liability over a five-year period. District staff should meet with the County Office of Education to determine the allowable standard to meet this requirement in accordance with AB 1200, Multiyear Financial Projections.
4. The district has recorded \$11,152,702 in the long-term debt account group for workers' compensation claims. Based on the workers' compensation actuarial report of October 2004, the district should increase the amount recorded for the unfunded liability to \$41,809,618 in the long-term debt account group.

## Defined Benefit Findings

Fresno Unified School District operates a self-funded defined benefit plan for part-time employees that do not qualify for STRS and PERS participation. This fund was board approved in 1991 and became effective on January 1, 1992. The defined benefit rate is \$2.35 per \$100 of payroll for both the district and district employees, an increase of 1.8% over the prior year based on the actuarial report completed in April 2003. FCMAT was unable to validate whether the premiums transferred to this fund were appropriate due to the lack of actuarial data.

## Recommendations

1. The district should obtain an actuarial report yearly to validate the premiums transferred to this fund. Once the actuarial has been completed, the district should determine whether the defined benefit fund balance is available to be transferred.

## Cash Flow Findings

The accounting manager tracks cash flow on a regular basis and has access to the county treasury's system to verify cash balances daily, if necessary. Cash flow is projected based on the approved budget allocations, and is reconciled at the end of the month based on actual financial transactions. The accounting manager provides the cash flow spreadsheet to the Fiscal Services Director for first interim and second interim reporting, and communicates cash concerns on an as-needed basis throughout the year. This process is appropriate and thorough.

A review of the rough draft cash flow spreadsheet prepared as of mid-August (and clearly communicated to FCMAT as a rough draft) showed that the accounting manager had not been provided with the latest budget updates, which projected greater expenditures and a greater budget deficit (resulting in a more severe cash flow shortfall). During periods of tight cash flow, it is even more important that such revisions be provided to the accounting manager so that the monthly cash projections can be revised and updated as necessary.

FCMAT prepared a 2004-05 general fund cash flow projection based on budget revision #1, as of September 15, 2004. The projection bases cash receipts and disbursements as generally occurring in the same pattern as the prior year, as the timing of primary revenue and expenditure sources has not changed. In the past two years, the state has deferred the June apportionment. If the district receives its June apportionment on time, FCMAT projections reflect a positive balance at June 30, 2005. If that apportionment is deferred until July, as occurred in June 2003 and June 2004, the district is projected to once again have a negative \$10.9 million cash balance in the general fund. This balance is consistent with the budgeted \$8.7 million deficit.

FCMAT projected that the district would complete intrafund receivables and payables by September 30, within 90 days of the prior fiscal year end. Based on these assumptions, it is likely that the district general fund will experience a negative cash flow by the end of November 2004.

Of course, many variables could change this projection, and the district can borrow temporarily from other funds to avert a negative cash situation. Staff verify that they are prepared to borrow temporarily from building funds if necessary. In January, the district should receive its property tax Education Revenue Augmentation Fund (ERAF) cash infusion, which will help carry it through several months.

**Recommendations**

1. The Accounting Manager should be provided with budget updates at key reporting periods to ensure cash flow projections are up to date.
2. Fiscal staff should be prepared to implement procedures to cover mid-year cash shortfalls.

## Secondary Class Sizes

### Findings

As the district struggles with the funding shortfalls that are prevalent in California, the area of class sizes and staffing can't be overlooked. The district's collective bargaining agreement provides for small classes, an admirable educational goal, but not always a fiscally viable reality.

EdSource recently released a study, *How California Ranks, a Look at the State's Investment in K-12 Education Over the Past Decade*, which points out that California's overall state funding for K-12 schools ranks 29<sup>th</sup> in the nation and is third from the bottom when comparing the ten most populous states, while teacher salaries are highest in the nation (which has a strong correlation to California's high cost of living). These comparisons are based on 2002-03 figures; however, the picture hasn't changed dramatically. With low funding and high salaries, California boasts some of the highest class sizes in the nation. Fresno Unified has done an admirable job of keeping class sizes smaller than average, but it cannot continue to afford this program.

District staff indicate that concerns have been voiced over secondary class sizes. FCMAT obtained a data download of the district's master class listing for middle and high schools during the 2003-04 school year as of November 17, 2003.

A review of this master class data bank showed that some classes are consistently over the contracted class sizes, while others are consistently under. FCMAT separately identified special day classes and other special education classes and excluded them from the analysis because their class sizes are more restricted by law.

Based on the negotiated agreement with the teachers union, site teaching staff numbers are determined from student enrollment. An analysis to consider the fiscal impact of setting minimum class sizes should be discussed. During negotiations, the actual enrollment periods used to determine staffing levels should be identified.

A detailed analysis of each school's classes is complex due to the numerous variables. FCMAT excluded obvious anomalies, such as single student classes that are generally student assistants or special study situations, or classes assigned to periods outside of the regular six-period day. The remaining data reveals that there are many classes that are extremely small, thus expensive. Many of these classes are specialized career or advanced college preparatory classes. Using one high school as an example, the team found the following statistics:

Fresno High School

2003-04 Attendance: 2,601

Total Classes (including SDC and extra periods): 757

Classes with Enrollment of 29 or less: 463

Classes with Enrollment of 25 or less: 383

Classes with Enrollment of 20 or less: 287

Special Day Classes: 55 (included in totals of 29, 25, and 20)

The number of classes with 25 and 20 or fewer students at first appears daunting. However, 55 of those classes are special day classes, legally capped due to the students' special needs. Forty-seven of those classes were outside of the traditional six assigned periods. Fresno High School had additional periods of 7 to 12, and all 47 of those classes had enrollment below 20 students. Most of the classes in periods 7 to 12 had low enrollment and were highly specialized classes such as advanced science, technology, and career classes. Some classes may be part of the 9<sup>th</sup> grade class size reduction program, which partially funds the cost of lowering certain 9<sup>th</sup> grade class sizes to 20:1. Other classes, such as ROTC, receive partial funding to help offset the class cost.

These notations are based on raw data provided by the district. The information includes students at CART as well as internal schools. Classes involved in the 9<sup>th</sup> grade Class Size Reduction program will be combined with spring classes, and most will then meet the required yearly averages. Evaluating class sizes should take into consideration current curriculum delivery models and graduation requirements as well as teacher/student ratios.

Further detailed review shows many classes and teachers appear underutilized. Some examples include:

- One teacher has four periods of CAD/CAM and Engineering classes, and two periods with a description of "Prod Devl". Each of these classes has either two or four students enrolled.
- One teacher has three periods of Art Glass II and three other Art classes. Each of the Art Glass II classes has enrollment of 24 to 27 students. This same teacher has a 9<sup>th</sup> period class with one student enrolled.
- One teacher has three periods of Zoology and Environment Research. Each class has enrollment ranging from two to five students.
- One teacher teaches Cisco 1-4 and Technology Applications for three periods. Each class has four students enrolled.
- One teacher has five periods of Biology A, and two of those periods have low enrollments of 12 and 20 students.
- One teacher has two classes of Engine Tech, with two students in each class.

- One teacher has four periods of English I, with enrollment of 9, 10, 13, and 22 students.
- One teacher teaches two Telecommunications classes, with three and five students enrolled in those two classes.
- One teacher has three Home Ec/Career/Technical classes, with enrollments of 22 to 25 students in each class.
- One teacher has five periods of English IA, with enrollments ranging from 21 to 30 students. While these classes might be eligible for 9<sup>th</sup> Grade CSR funding, they are overenrolled for the 20:1 ratios.
- One teacher has six periods of various computer classes, including three periods of Computer Skills and two periods of Multimedia. Enrollment in these classes ranged from 15 to 24 students.
- One teacher has five periods of advanced English (IIIA, IVA, and University Prep), with class sizes ranging from 12 to 28 students.
- One teacher has five periods of Principles of Technology, with class enrollment of 15 to 25 students.
- One teacher has five periods of Advanced Media classes, with enrollments ranging from two to seven students. Three of these classes were outside of the traditional six-period day.
- One teacher has five periods of Home Ec and Clothing Fashion classes, with enrollment in four of the classes of 19 to 24 students.
- One teacher has three English II classes, with enrollment of 10 to 13 students.
- One teacher has English 11 and English 12, with 2 and 7 students.
- One teacher has English III and English IV classes, with 13 to 17 students enrolled.
- An English IIIA and Journalism teacher has three classes with enrollments of 13 to 17 students.
- One teacher had three Intro to Algebra/Geometry classes with 14 to 21 students enrolled.
- One teacher has five periods of Intro to Business, with 17 to 25 students in each period.
- Several teachers have many periods of Algebra IA, with enrollments of 22 to 28. While these classes might be eligible for 9<sup>th</sup> Grade CSR funding, they are overenrolled for the 20:1 ratios.
- One teacher teaches various musical instrument classes with enrollments of 6 to 24 students, and a second music teacher has enrollments ranging from 9 to 28.
- A French teacher has five different periods with enrollments of 7 to 29 students.

- One teacher has five periods of Chemistry, Engineering, and Technology applications, with enrollments of 2 to 16 students.
- One teacher has two periods of Bioengineering, with 12 and 17 students enrolled.
- One teacher teaches two periods each of English 11, Technology Applications, and Environmental, with enrollments ranging from 5 to 15 students.
- One teacher has four periods of advanced Chemistry and Environmental classes, with enrollments of 1 to 15 students.
- One teacher has five periods of Biology and Environmental Sciences, with 15 to 17 students in each class.
- One teacher has four periods of Marketing IA and Marketing IIIA, with enrollments of 15 to 21 students in each class.
- Many classes were not yet assigned to teachers (indicated as “Staff” for the teacher name), and had lower enrollment (below 25 students and often below 15 students). These classes included Modern World History, Latin, Technology, Psychology, Drafting, Economics, English, and many other classes.

This is not a complete listing, but appears representative of the many instances of smaller class sizes at each of the secondary schools. These classes represent enrollment sizes even below those dictated by contract. In many instances, the classes are offered by multiple teachers or during multiple periods despite low class enrollment. Schools may consider reducing the number of sections offered, and enrolling more students in the remaining sections to maximize teacher time and classroom space.

In some instances the classes are very specialized or very advanced classes that are of interest only to small numbers of students. In some districts, these specialized offerings are being reduced, or partnerships are created with community colleges that offer the classes to a broader pool of interested students.

Because of the complexity of school scheduling, and the high volume of classes and schools, not all sites were reviewed in such detail. However, a cursory review of other secondary schools indicated similar patterns throughout those schools.

These findings indicate the same concerns as expressed by School Services of California in its March 2001 report.

## Recommendations

1. The curriculum and instruction administrators should work with principals to reduce the number of sections offered in low enrollment classes. More students can be enrolled in the remaining sections to maximize teacher time and classroom space.
2. District curriculum staff should consider a partnership with a community college for more advanced offerings that only attract a small number of students from each school.
3. Curriculum and instruction administrators and fiscal services staff should work with individual principals to determine whether extra classes outside of the traditional six-period day are attracting sufficient enrollment to be financially viable.



## **Appendices**

Appendix A - Financial Trends

Appendix B - Multiyear General Fund

Appendix C - Other Funds

Appendix D - Sample Lease Override Resolution

Appendix E - Budget Revision 1 - Projected Cash Flow

Appendix F - Comparative Revenue and Expenditure Analysis

Appendix G - Study Agreement