Sacramento City Unified School District
Fiscal Review

September 21, 2006

FISCAL CRISIS
& MANAGEMENT ASSISTANCE TEAM

Administrative Agent
Larry E. Reider
Kern County
Superintendent of Schools

Chief Executive Officer
Joel D. Montero

FCMAT

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September 21, 2006

M. Magdalena Carrillo Mejia, Superintendent
Sacramento City Unified School District
5735 47th Avenue
Sacramento, CA 95824

Dear Superintendent Mejia:

In March 2006, the Fiscal Crisis and Management Assistance Team (FCMAT) received a request from the Sacramento City Unified School District for a review that would perform the following:

1. Conduct an analysis of the district's 2006-07 budget assumptions and projections through June 30, 2006 for all funds and the multi-year projections of the general fund included in the district's second interim financial report. Provide information on potential areas for cost containment and the use of funds for the 2006-07 budgets.

2. Evaluate the district's procedures for budget development, monitoring, and budget revisions for all funds and provide recommendations for improvement, including examples of procedures and time lines that are consistent with professional standards within California's public education environment.

FCMAT visited the district May 8-10, 2006. This report is the result of that effort. We have appreciated the opportunity to serve you, and we extend our thanks to all the staff of the Sacramento City Unified School District.

Sincerely,

Joel D. Montero, Chief Executive Officer

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Foreword

FCMAT Background

The Fiscal Crisis and Management Assistance Team (FCMAT) was created by legislation in accordance with Assembly Bill 1200 in 1992 as a service to assist local educational agencies in complying with fiscal accountability standards.

AB 1200 was established from a need to ensure that local educational agencies throughout California were adequately prepared to meet and sustain their financial obligations. AB 1200 is also a statewide plan for county offices of education and school districts to work together on a local level to improve fiscal procedures and accountability standards. The legislation expanded the role of the county office in monitoring school districts under certain fiscal constraints to ensure these districts could meet their financial commitments on a multiyear basis. AB 2756 provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans. These include comprehensive assessments in five major operational areas and periodic reports that identify the district's progress on the improvement plans

Since 1992, FCMAT has been engaged to perform more than 600 reviews for local educational agencies, including school districts, county offices of education, charter schools and community colleges. Services range from fiscal crisis intervention to management review and assistance. FCMAT also provides professional development training. The Kern County Superintendent of Schools is the administrative agent for FCMAT. The agency is guided under the leadership of Joel D. Montero, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

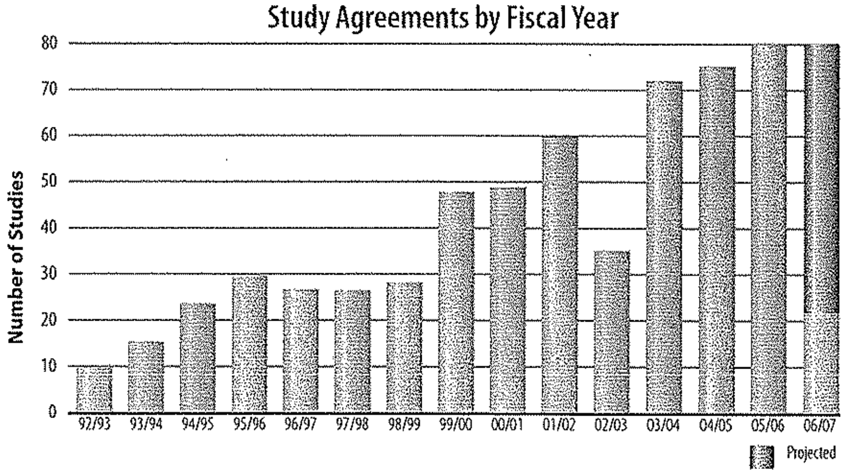
Total Number of Studies 604

Total Number of Districts in CA.......... 982

Management Assistance	555	(91.89%)
Fiscal Crisis/Emergency	42	(6.95%)
Emergency Loan	7	(1.16%)

Note: Some districts had multiple studies

(Rev. 9/21/06)



Introduction

Background

Located in the city of Sacramento, the Sacramento City Unified School District is among the state's 10 largest school districts and serves approximately 50,000 students in kindergarten through twelfth grade.

The district is composed of 54 elementary schools, six kindergarten through eighth grade schools, eight middle schools, six high schools, one continuation school, one independent study school, one alternative school, 12 charter schools, six of which are dependent, and five adult education centers.

In March 2006, the Fiscal Crisis and Management Assistance Team (FCMAT) received a request from the Sacramento City Unified School District for a study that would perform the following:

1. Conduct an analysis of the district's 2005-06 budget assumptions and projections through June 30, 2006 for all funds and the multiyear projections of the general fund included in the district's second interim financial report. Provide information on potential areas for cost containment and the use of funds for the 2006-07 budgets.

2. Evaluate the district's procedures for budget development, monitoring, and budget revisions for all funds and provide recommendations for improvement, including examples of procedures and time lines that are consistent with professional standards within California's public education environment.

Study Team

The study team was composed of the following members:

Michelle Plumbtree
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FCMAT Consultant
Kingsburg, CA

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FCMAT Public Information Specialist
Bakersfield, CA

Linda Grundhoffer
FCMAT Consultant
Danville, CA

Study Guidelines

FCMAT visited the district in May 2006 to conduct interviews, collect data and review documentation. This report is the result of those activities and is divided into the following sections:

I. Executive Summary
II. Position Control
III. 2005-06 Budget Assumptions
IV. Budgetary Review
V. Cost Containment
VI. Budget Development
VII. Categorical Funds
VIII. Staffing Formulas
IX. Reconciliation of Prior Year Accounts
X. Training
XI. Retiree/Post Retirement Benefits
XII. Long-Term Debt
XIII. Appendices

Executive Summary

At the request of the Superintendent and Governing Board, the Sacramento City Unified School District requested FCMAT to analyze district budgeting practices and conduct an analysis of the district's 2005-06 budget assumptions and projections through June 30, 2006.

Employee salaries and benefits make up the largest part of the district's budget, and projecting them accurately can be one of the most critical elements in any financial projection. At the time of FCMAT's visit, the district's salary and benefit compensation was 91.79% of the total general fund. Expenditure projections for certificated salaries, classified salaries, services/consultants and capital outlay categories all exceeded the current budgeted amount. Although expenditure transfers at year end may result in many of these underbudgeted categories self-correcting, this type of budget practice is neither correct nor safe and does not conform to industry standards. The district has been unable to maintain its required reserve at year-end closing since the 1998-99 fiscal year although the 2% has been maintained in the adopted budget and during interim reporting. For districts the size of Sacramento City Unified, the state recommends available reserves of at least 2% of total general fund expenditures, transfers out, and other uses.

There is a great need to mitigate the disparity between decreasing revenues and increasing expenditures, which is typical of school districts experiencing financial difficulties. Chief among these expenditure components are maintenance-of-effort costs, such as step-and-column movement, increases in statutory benefits, and health and welfare benefit increases that, over time, become institutionalized and part of the district's operating budget. Although the district has taken significant measures annually to establish a balanced adopted budget by reducing expenditures and\or enhancing revenues, it has been unable to curtail expenditures commensurate with the decline in revenues with ongoing adjustments. Unless adjustments are ongoing, they are only a temporary solution.

It is extremely difficult to accurately depict expenditures and identify areas of cost containment because the district uses average salaries for a significant portion of the salary and benefit budgets and makes large amounts of expenditure transfers at year end. To accurately reflect the district's budget throughout the fiscal year, it is necessary to make critical changes to the budget development process and to the way in which expenditures are charged during the fiscal year.

The district should identify budget areas where expenditures can be reduced or revenues increased to allow the district to implement a financial blueprint that can be sustained. The sooner budget adjustments and/or reductions are made in any given year, the more the ending fund balance will increase and deficit spending decrease. In addition, if revenues can be increased in any given year, and the increase is ongoing, the effect compounds year after year.

The district has implemented the Escape position control module to track specific employee names and full-time equivalent (FTEs) positions. However, the module does not track actual salary amounts for the largest portion of the salary and benefits categories, which is the certificated salaries/benefits paid from unrestricted funds. Fully utilizing the position control system for all salary accounts will eliminate manual entry to the budget. This change allows position control to regulate the budget all year long and ensures that salary and benefit lines are not vulnerable to overspending.

The district's estimated annual cost of salary and benefits is set up in the budget at the beginning of the year. Normally, that estimated cost, when driven by the position control system, includes the actual costs of employees. In the district's case, the estimates are not reliable because the budget process utilizes the estimated average costs for compensation and not actual costs. The district should ensure it has a reliable process to analyze actual salaries and benefits to date and compare them with remaining budgets monthly or at each interim reporting period.

The district should include in the annual budget a mission statement, statement of core values, or a strategic plan that has been approved by the Governing Board. The district also should draft and approve budget development policies so that district goals, objectives, concepts and guidelines can be linked to the district's expenditure plan. These policies must be adopted by the board so that the staff and public understand that the budget reflects the district's goals and objectives.

The district's categorical funds, made up of both federal and state programs, do not appear to be integrated with the budget development process since funding sources that require approval are set up in a reserve at budget adoption. This provides an inaccurate picture of the district's fiscal condition at budget adoption. The funds also do not appear to be monitored or used to the full extent possible due to the large carryover balances that exist in many categorical funds. The district should ensure that the instructional department continues to develop and monitor the district's categorical budget so that it remains in compliance with all state and federal requirements attached to those funds.

Findings and Recommendations

Position Control

Employee salaries and benefits make up the largest part of any school district's budget, and projecting them accurately can be one of the most critical elements of the financial projection. At the time of FCMAT's visit, the district's salary and benefit compensation was 91.79% of the total general fund. With 92% of the district's discretionary budget being expended for salary and benefit compensation, integration of the position control module should be a top priority. A reliable position control system establishes positions by site or department and prevents overstaffing by ensuring that staffing levels conform to district formulas and standards. To be effective, position control must be integrated with other financial modules such as budget development. The proper separation of duties also helps ensure a reliable and accountable position control system and is a key factor in maintaining strong internal controls.

The following chart demonstrates the increase in salary and benefit compensation statewide over the past six fiscal years:

Salary and Benefit Expenses (Unrestricted Average)	% of Total Expense	% of Total Expense Transfers and Other Uses
Unified Average 1999-00	88.39%	86.38%
Unified Average 2004-05	92.03%	91.06%
Increase in Percentage of Budget	3.64%	4.68%

Source: CDE Certified 2004-05 SACS Data & SSC Fiscal Report

The Sacramento City Unified School District has implemented the Escape position control module to track specific employee names and full-time equivalent (FTE) positions. However, the module does not list actual salary amounts for the teaching staff paid from unrestricted funds, which is the largest portion of the salary and benefits of the general fund budget. Employees charged to categorical funding, employees assigned to the central district office and classified employees are budgeted through the position control system with actual salaries and their payroll-driven costs.

Approximately 12 years ago, the district established a process to calculate an average salary for teaching staff paid from unrestricted funds and use that calculation for budgeting purposes. The previous process had been to budget person by person for actual salary amounts for all positions, site by site. This had been completed at the beginning of the budget development cycle and established the budget for all employees for the year.

The district hired a new Chief Business Official (CBO) during this time, and based on practices used in the CBO's previous school finance career, it was determined that the amount of staff time spent on budgeting actual salary amounts for all positions could be better spent performing other tasks. The process was changed to eliminate budgeting actual cost data and utilized estimates in lieu of actual data. Due to the increasing percentage of salaries and benefits that make up the total unrestricted expenditures of the unrestricted general fund, FCMAT believes the district should reconsider that determination.

The district saves a significant amount of time by using average salaries because of the considerable attrition that occurs and staff movement between positions. However, this practice also means that position control is not accurately driving the budget. In reality, the district does not know how closely the actual cost of salaries and benefits reconcile to the budget in any given year until the books are closed, and the total actual costs are realized and charged to their final account. Actual salaries and benefits are charged monthly for all positions, and the information is readily available by running financial reports from the Escape system. However, without additional calculations and reconciliations, information is not readily available to determine how actual costs and estimated costs for the rest of the year reconcile back to the budgeted amount. This is a weakness that must be addressed.

The position control module ensures that total FTEs are correct. Because the database does not include employee payments outside of normal salary, such as stipends, substitutes and extra hire, these additional salary payments and all budget revisions to any salary and benefit accounts must be manually entered into the budget. This means that the database is not all inclusive.

Entering all elements into position control, including actual costs for all employees and the additional compensation categories, would allow salary and benefit costs to be loaded directly during budget development, eliminating the need for manual entry, external applications and spreadsheets. This would save a considerable amount of time in budget development and result in a more efficient system that provides checks and balances on employee costs throughout the year. It would also be more efficient for all positions and salary accounts to be entered and updated in the position control so that the system can drive the budget all year, with periodic uploads of new data.

A fully functioning position control system will help the district maintain accurate budget projections, employee demographic data, and salary and benefit information.

Because the Personnel, Budget and Payroll departments work so closely in many areas, including position control, it is important that communication between the departments is open and shared. Many districts establish monthly meetings between the departments to resolve issues and develop new policies and procedures. Currently, weekly meetings are held that include Personnel, Payroll, Risk Management, the CBO and others to keep communication open so that issues, potential changes and resolutions are openly discussed. At this time, Budget and Personnel meet as needed. Standing monthly meetings would benefit both the Budget and Personnel departments, especially if the position control modifications recommended by FCMAT are implemented.

Internal controls help ensure efficient operations, reliable financial information, and legal compliance. They also protect the district from material weaknesses, serious errors and fraud. These controls should be in place regardless of the type of position control system used. Sacramento City Unified appears to have internal controls in place although FCMAT recommends that these controls be strengthened by using actual salaries instead of average salaries for position control and budgeting purposes.

The following table provides a sample distribution of responsibilities between the Business and Personnel departments to help provide the necessary internal control structure. Upon review of the district's current segregation of duties between the departments, it was determined that effective checks and balances exist between personnel decisions and budgeted appropriations. The only difference between the following table and the district's current distribution of responsibilities is that Personnel and not the Business Department reviews work calendars, which is an acceptable practice.

TASK	RESPONSIBILITY
Approve or authorize position	Governing Board
Input approved position into Position Control, with estimated salary/budget. Each position is given a unique number.	Business Department
Enter demographic data into the main demographic screen, including: Employee Name Employee Address Social Security Number Credential Classification Salary Schedule Placement Annual Review of Employee Assignments	Personnel Department
Update Employee Benefits Review and Update Employee Work Calendars Annually Review and Update Salary Schedules	Business Department
Account Codes Budget Development Budget Projections Multiyear Projections Salary Projections	Business Department

The district uses a personnel requisition form to initiate new positions, which is the recommended process for strong internal controls. This form identifies all pertinent information regarding funding, location and category to which the position will be charged and is prepared by the site, program or department requesting the position.

All transactions generated via the personnel requisition are first processed through the business office to ensure the position and adequate funding are available. If neither exists, further action is required. In addition, the business office is responsible for verifying the completeness and accuracy of the personnel requisition, since account coding is a budget function.

For a position control system to be an effective budgeting resource during budget development, all authorized positions for the current fiscal year should be rolled into the upcoming budget year in January or February, which is the district's practice. If budget reductions will be made in the new year, and previous year authorized positions will no longer exist, they should be eliminated from budget development via the appropriate procedure. New positions to be added in the new year should also follow this procedure. The rollover of position control data provides a starting point for budget development. From there, changes of any kind will need to be entered into both the budget development and position control modules once the proper procedures are followed.

Recommendations

The district should:

1. Establish standing monthly meetings between the Budget and Personnel departments to discuss issues and develop new policies and procedures for the position control process and increase efficiency and effectiveness.

2. Continue holding weekly meetings between Personnel, Payroll, Risk Management, the CBO and others for open communication and quick resolution of issues.

3, Consider hiring a consultant to train the staff on the position control module so it can be fully utilized. Training should include the employees who maintain/update the system, managers who supervise these employees, and a designated backup employee.

4. Review the distribution of position control responsibilities between the Business and Personnel departments when any changes in responsibility occur to ensure that internal controls continue to be in place for salary and benefits.

5. Fully utilize the online position control system by entering all salary accounts into the system, eliminating manual entry, allowing position control to regulate the budget all year long and ensuring that salary and benefit lines are not vulnerable to overexpenditure.

6. Stop the practice of budgeting by salary estimates so that additional calculations and reconciliations are not necessary to determine how actual costs to date and estimated costs for the rest of the year reconcile back to the budgeted amount.

7. Ensure that the position control system is fully integrated to help the district maintain accurate budget projections, employee demographic data, and salary and benefit information.

2005-06 Budget Assumptions

Budget assumptions play an important role in any budget because they provide the framework for carrying out the district's goals and objectives. Assumptions allow the board, and the district, to remind stakeholders that the budget directly correlates with the district's goals and objectives. The general expenditure plan in all funds should reflect the district's strategy for meeting the needs of students.

At the time of the 2005-06 second interim report, the district used the January 2006 School Services of California dartboard for COLA and Consumer Price Index (CPI) rates to calculate the general fund for the current and two subsequent years. This was an appropriate approach since more up to date information was unavailable at the time.

Although the district refers to the use of prior-year ADA for funding purposes on its revenue limit calculation, no specifics are included regarding the purpose of these figures for any of the projection years. Federal revenues were maintained at the 2005-06 level in the subsequent years, even though federal funding for some programs is being reduced as much as 3% and the district is experiencing declining enrollment. Although state revenues were correctly increased by the categorical COLA, many state programs will be affected by declining enrollment. State revenue in subsequent years included a budget for mandated costs, which is not a guaranteed income and should not be used as a budget item. Local revenues were maintained at the 2005-06 level. Unless local revenues, other than interest income, are reimbursements for known expenditures that are validated by either letters of intent or memorandums of understanding, they should not be budgeted in future years.

In expenditures, increases for step-and-column movement were included for subsequent years, but without amounts detailing what these cost the district. In addition, a 12% increase was noted for health and welfare, but the actual cost of the increased benefit was not included in the assumptions. No mention was made of any increase in the Workers Compensation rate, although this increase will probably be necessary to fund ongoing claims. Little detail was included about other expenditure accounts, creating the impression that dollars would be available, but there is no mention of how they would be determined or allocated.

Although the district indicates that its reserve for economic uncertainties of 2% will be maintained, the MYP does not reflect that statement. Expenditures are increasing, but the dollar amount for the reserve stays the same. Since the reserve is based on total expenditures and transfers out, it is not possible for the reserve to remain constant in the subsequent years.

Unrestricted and restricted programs should be further detailed in the budget document so that the board and other stakeholders can view the various types of funding the district receives and understand how the funds are used. The district does not focus on the restricted categorical funds that are self-supporting (which means that they do not encroach on the general fund). Detail instead is provided for the unrestricted and multifunded programs, which are transportation, routine repair and maintenance and special education, since they encroach on the general fund. Although other restricted programs do not encroach on the general fund, they must remain visible so that encroachment does not occur.

The district presented no assumptions regarding any of its other funds. There is no requirement in the Education Code or AB1200 to develop an MYP on other funds, but without doing so, it is difficult to assess whether other funds will encroach on the general fund. The district staff indicated that other funds are reviewed internally at the time of budget adoption, budget revisions and interim reporting periods to ensure they do not encroach on the general fund, but FCMAT was not presented with any assumptions related to this internal review.

The district's interim report assumptions are sparse and do not explain changes from the last reporting period by program or provide the appropriate detail for the subsequent years. A budget is like the blueprint for a structure, and the district's goals and expectations should be easily determined from the document.

Recommendations

The district should:

1. Use budget assumptions in a budget section that links allocated expenditures to the district's stated priorities and/or goals to help stakeholders understand the budget.

2. Prepare a more detailed template for presenting budget assumptions for the current year and each subsequent year of the MYP.

3. Provide more detail, with dollar amounts and/or percentage increases/decreases in the assumptions.

4. Pay more attention to all programs, including categorical funds that are self-supporting, when presenting information to the board at both budget adoption and interim reporting time. This also includes developing MYPs. The district currently focuses on the unrestricted funds and only on categorical programs with major encroachment. However, it is difficult to determine whether other programs are encroaching on the unrestricted funds without more detail.

5. Provide more attention to detail when projecting the MYP. An example of this need is the fact that the district used the same dollar amount for its 2% REU in all years, even though expenditures increased in each of the subsequent years.

6. Prepare an MYP for each of the other funds to ensure that they will not encroach on the general fund.

Budgetary Review

One of the unique characteristics of fund accounting, when compared to commercial accounting, is the use of budgetary accounts. These accounts project the amount to be received and expended in a specific period of time to carry out the educational agency's goals. Budgetary accounts allow for comparisons between projections and what has actually occurred during the fiscal year.

Governmental Accounting Standards Board (GASB) statement 34, which applies to both state and local governments, changed the way budget information is reported in the year-end audited financial statements. Agencies previously reported only the final budget and the results of financial transactions. Under GASB 34, the budgetary comparison must now include the original budget, the final budget, and the results of financial operations for the general and major special revenue funds.

Encumbrances are an important budgetary element that represents a commitment in the form of a purchase order to buy goods or services. They are a budgetary account used to prevent overspending of an appropriation. Escape, the financial system that Sacramento City Unified uses, has the option of encumbering all expenditure accounts that the district utilizes. This is an excellent way to monitor budgets and ensure that the portions of the budget that have been committed in any way are protected from being spent in any other manner. For nonsalary items, encumbrances are established when a purchase order is issued and disencumbered when payment is made for the item after its receipt.

The estimated annual cost of salaries and benefits is set up at the beginning of the year in the budget. In many districts, the estimated cost is more efficient when driven by a position control system that includes actual costs of employees. In the case of Sacramento City Unified, the estimates are not considered reliable because estimated average costs and not actual costs are included both in position control and the budget for the majority of positions. Some financial systems also encumber salaries and benefits in the budget, which means that the estimated salary and benefit costs for the remainder of the year are "set aside," or encumbered. When payrolls are generated, the actual payroll amounts paid are deducted from the encumbrance, with the remaining encumbrance representing the estimated amount the district will have to expend for the remainder of the year. Encumbering provides districts with a more accurate method of determining whether the budget for the remainder of the year will be sufficient. Escape has the encumbering option for salaries and benefits, but the district chose not to use it in the past. Therefore, the district must ensure it has a reliable process to analyze actual salary and benefit expenditures to date against the remaining budgets. Budgets must also be adjusted when salary amounts to be paid, or personnel, change.

Education Code section 42600 states that amounts budgeted in each major expenditure category shall be the maximum amount that can be expended under each such classification. During the fiscal year, budgets should be monitored to ensure that appropriations are not overspent and that revenues received or expenditures made are not different than expected. Necessary revisions to major expenditure classifications based on regular budget monitoring are subject to board approval. Normally, Sacramento City Unified submits budget revisions to the board for approval at the following times:

- 45 Days after the Governor signs the state budget
- Carryover and deferred revenue added to budget, October
- First interim, December
- Second interim, March
- May
- June

The district's scheduling of revisions is an acceptable and common practice statewide. Some school districts present revisions more frequently, such as monthly. This makes sense for adjustments that significantly affect the ending fund balance or other key aspects of the budget. Governing boards can set policy on how often revisions are presented in their specific district. A review of the January 2006 budget revision found that the district's budget revision packet submitted to the board for approval is very detailed, with three elements of information for each fund presented as follows:

1. Fund Description and Budget Update: This includes a narrative describing each fund's legal use, with additional information specific to the district relating to that fund. Information is also included on when the budget was last revised and any increases or decreases to the fund that have occurred since the last board-approved budget revision.

2. Budget Status: For each fund, the following is provided:

    - The 2005-06 adopted budget, adopted by the Governing Board June 2005

    - The revised operating budget, including all changes that have occurred since the budget was adopted

    - The actual financial information to date, including all revenues received, bills paid, or transfers made through the current reporting period

    - The encumbered transactions, which are purchase commitments based upon approved purchase requisitions, purchase orders or contracts

- The balance of the revised operating budget, which calculates the available balance after deducting the actual and encumbered transactions from the operating budget

- The percentage of budget, which provides the percentage of the operating budget used through the current reporting period

3. Budget Revisions: Includes a page for each fund identifying any changes to the budget that have occurred since the last budget revision. This information also includes details of budget increases or decreases. The operating budget, proposed budget revisions and revised operating budget are all outlined.

In governmental funds, the difference between assets and liabilities is reported as fund balance, which is then divided into reserved and unreserved portions. The reserved fund balance is the portion that is not available for expenditure or that is legally segregated for a specific future use. For example, stores, prepaid expenditures and revolving cash are not available for discretionary spending, so the portion of the ending fund balance that is attributed to those items must be reserved. The remaining amount of fund balance is unreserved, and is separated into designated and undesignated portions.

The state requires boards to designate a reserve for economic uncertainty, which in the district's case is 2%. Boards can also designate other specific balances for intended uses, such as equipment replacement or potential salary increases. Any remaining amounts after designations are considered undesignated, unappropriated fund balance.

FCMAT reviewed all the district's funds, resource by resource, to identify trends and questions about the current status of accounts. Various accounts were overdrawn or seemed to have a higher budget than necessary in both salary and nonsalary categories. Additional research showed that in many cases, expenditures are charged against one resource, but moved to a different resource during the year or at the end of the year. This practice raises concerns for the following reasons:

- Although the budget may reflect the reality of where expenditures will ultimately be charged, these expenditures cannot be determined until the end of the year, when all costs are finalized and expenditure transfers are complete.

- When so many costs are not charged appropriately and moved between unrestricted and restricted funds, a realistic fund balance between these two categories cannot be determined.

- Compliance with specific laws and regulations in restricted, categorical funds are difficult to monitor when costs are moved from where they are initially charged to specific categorical funds. FCMAT was told in interviews that the budget and program staffs closely monitor all expenditures throughout the year and at year end to ensure they comply with categorical program guidelines. However, unless expenditures are initially charged to their final destination, it is difficult to assess whether the guidelines are truly monitored when they are originally charged and later in the year when they are transferred to another source of funds.

- The copies of expenditure transfers provided to FCMAT had little backup substantiating whether the transfer is within program guidelines or the reasoning justified.

For the 2005-06 fiscal year, the following is a summary, provided by the district, of adjustments to be credited to the unrestricted resource, 0000, by transferring expenditures to other resources:

- Unrestricted Lottery (resource 1100), $6.3 million to be credited to object 1101, certificated salaries (but not moving the associated payroll benefits).

- Unrestricted Class Size Reduction (resource 1300), $13,490,617 to be credited to object 1101, certificated salaries (but not moving the associated payroll benefits).

- Restricted Title 2, (resource 4035), $900,000 to be credited to object 1101, certificated salaries (but not moving the associated payroll benefits).

- Restricted Staff Development funds (resource 7393), $2,134,000 to be credited to object 1101, certificated salaries (but not moving the associated payroll benefits). Review of resource 7393 reflects a budget of $2,579,100 in object 1101 with no expenditures charged against it, so if necessary, more than the $2,134,000 can be transferred if appropriate.

- Restricted Lottery (resource 6300), $1.1 million to be credited to object 4310, books and materials. FCMAT has projected that resource 0000 will be overspent by $543,764 in books and materials at June 30 prior to any transfer of any expenditures.

FCMAT had projected that resource 0000 would be overspent by $23,754,841 in certificated salaries at June 30 prior to any transfer of any expenditures listed previously. The net effect of the transfers is listed in the following table:

Resource Number	Amount
0000	(23,754,841)
1100	6,300,000
1300	13,490,617
4035	900,000
7393	2,134,000
Total 0000 Resource after Transfers	$930,224

All of the transferred expenditures should have been charged to the correct resource during the year to reflect the appropriate balances in both unrestricted and restricted portions of the budget at all times.

Included in the following portion of this report are additional budgets without associated expenditures. FCMAT assumes that the district will make additional expenditure transfers from the unrestricted 0000 resource to other resources, which will potentially further reduce this amount. If the transfers do occur, the negative June 30 balance will be fully covered.

The district also listed an adjustment of $1,033,746 for reading coaches in both certificated salary and payroll benefits objects between the 0000 unrestricted resource and resource 3030 (restricted Reading First funds) at year end. FCMAT's review found that the current 3030 budget did not include a sufficient unexpended budget balance to sustain this adjustment. Therefore, this has not been included as a possible transfer in the previous table to reduce the negative balances in unrestricted resources.

FCMAT was advised that other transfers occurred, such as within the restricted resource titled the Village Project, where $1,300,040 was transferred from object 4390 to salaries and benefits within the same resource number. Items should be budgeted in the fund accounts in which they are expected to be spent.

FCMAT's review found additional resources where expenditures are charged to one resource with the expectation that the expenditures will be charged to a different resource at the end of the year based on available balances. These transfers are to occur in the following areas:

- Federal special education, Resource 3310, has a classified salaries budget of $7,228,889 with no expenses charged against it and a related payroll benefits budget of $1,475,850. FCMAT has projected that resource 6500, state special education, will be overspent by $7,927,794 in classified salaries at June 30.

- Special Education Transportation, resource 7240, has a budget of $3,665,145 in classified salaries with no expenditures charged against that budget. The district moves appropriate expenditures from resource 7230 (home-to-school transportation) to resource 7240 at year end. FCMAT has projected that resource 7230 will be overspent by $4,119,212.57 in classified salaries at June 30.

- Peer Assistance and Review, resource 7271, has a budget of $194,610 in certificated salaries with no expenditures charged against it. Staff members indicated that appropriate unrestricted expenditures will be moved to this restricted budget at year end.

- Additional resources with material (more than $50,000) unexpended budgets in books and supplies (4*** object code range) are included the following table. FCMAT is uncertain whether expenditures will be moved from where they are currently charged to these budgets. However, if expenditures originally charged to the unrestricted budget are moved to some of these resources, the overall ending fund unrestricted balance would increase by the corresponding amount moved.

Restricted Resource Number	Object Category	Working budget with no associated expenditures
3015	Books and Supplies	$94,960
4201	Books and Supplies	$156,504
5967	Books and Supplies	$174,615
7271	Books and Supplies	$66,667
7325	Books and Supplies	$142,207
7394	Books and Supplies	$199,454
9405	Books and Supplies	$890,175
TOTAL		**$1,724,582**

All purchase orders should be properly encumbered against the budget until payment is made. Because some unrestricted budgets exceeded the budget allocation at the object level at the time of FCMAT's review, it appears that the financial system is allowing purchase orders and/or expenditures to be processed even if sufficient budgets do not exist. Even though there is sufficient budget overall, allowing overexpenditures in one area distorts balances by resource.

When purchase orders are created in the financial system, funds are encumbered until a payment is made or the order is cancelled. The purchasing system is integrated with the budget and accounting modules. If adequate funds are not available or if the budget code is not valid, the system can be set up to prevent the purchase order from being finalized or moved forward until a budget revision occurs. This is often referred to as being "hard coded" depending on the financial system being used. Basically, this means that the transaction does not occur unless the budget is sufficient to cover the full cost of the purchase order. Currently, a warning error might be generated when the budget is not adequate, but unless it is hard coded; transactions can continue to be processed.

A review of the district's budget also found that negative budget account lines exist in unrestricted resources. This is an inappropriate budgeting tool because it reduces the overall budget category in a nonspecific way, making it unclear why the reduction is occurring. FCMAT is uncertain why these negative budget lines occur. The following negative budgets were found, although this list is not all inclusive:

Resource Number and Title	Object Code Number and Title of Negative Budget	Negative Budget Amount
0870, Alternative Program	4390, Reserve	$(593,868.96)
0870, Alternative Program	5800, Other Contractual Expense	$(165,203)
0000, Unrestricted-No Reporting	4310, Instructional Materials	$(680,111.27)
0000, Unrestricted-No Reporting	4350, Warehouse Overhead	$(70,014.00)

FCMAT projected June 2006 actuals and compared those amounts with the district's May 2006 budget to determine whether the budget is sufficient for the remainder of the year. It is important to remember that the analysis **does not** take into account the end of the year transfers between unrestricted and restricted resources. These material transfers have been discussed previously in this section. The following information underscores why the district must begin budgeting expenditures in the categories to which they belong.

For *all unrestricted* general fund resources combined, the analysis of budget versus the estimated June actuals is as follows:

Sub OBJ	Revised Budget	Encumbered Amount	Expensed Amount	May Expense (June Est.)	Projected June Balance
1100	106,552,132.38	9.62	99,784,021.98	10,916,893.16	(4,148,792.38)
1200	3,194,100.69	-	2,718,810.63	312,911.12	162,378.94
1300	12,470,658.61	-	11,796,027.04	1,157,977.37	(483,345.80)
1900	1,756,260.23	-	1,907,428.09	(323,685.27)	172,517.41
Total 1000					**(4,297,241.83)**
2100	146,816.59	-	234,306.37	12,934.36	(100,424.14)
2200	9,248,161.05	-	9,262,279.75	838,634.60	(852,753.30)
2300	3,098,743.15	-	2,833,503.52	256,296.93	8,942.70
2400	13,010,294.85	-	12,038,215.04	1,152,800.29	(180,720.48)
2900	889,468.59	-	700,420.89	67,672.14	121,375.56
Total 2000					**(1,003,579.66)**
3100	10,781,934.22	-	9,396,494.88	976,851.89	408,587.45
3200	2,424,381.58	-	2,134,316.68	198,761.58	91,303.32
3300	3,809,344.57	-	3,306,197.21	326,644.05	176,503.31
3400	24,827,711.98	-	22,239,778.45	2,272,833.19	315,100.34
3500	984,242.61	-	628,201.89	64,031.10	292,009.62
3600	4,219,034.93	-	4,508,370.69	460,688.56	(750,024.32)
3700	7,838,304.43	-	7,418,001.01	751,499.66	(331,196.24)
3800	743,138.19	-	913,574.77	85,098.02	(255,534.60)
3900	367,198.27	-	100,784.55	10,226.47	256,187.25
Total 3000					**202,936.13**
4100	22,976.05	26,080.90	1,081,379.47	-	(1,084,484.32)
4200	62,167.49	18,281.65	35,963.06	-	7,922.78
4300	4,212,542.24	625,423.11	1,919,175.10	-	1,667,944.03
4400	277,122.68	628,233.96	231,035.71	-	(582,146.99)
Total 4000					**9,235.50**
5200	231,631.43	11,276.18	130,714.48	-	89,640.77
5300	85,868.04	-	79,482.58	-	6,385.46
5400	1,777,204.77	42,381.08	1,662,238.09	-	72,585.60
5500	7,540,915.00	113,725.58	6,375,118.20	-	1,052,071.22
5600	1,191,292.67	528,160.48	709,844.27	-	(46,712.08)
5800	3,766,051.26	1,759,324.41	8,031,825.82	-	(6,025,098.97)
5900	1,080,884.41	639,595.66	596,783.66	-	(155,494.91)
Total 5000					**(5,006,622.91)**
6100	73,060.37	5,967.00	125,103.60	-	(58,010.23)
6200	155,287.47	44,853.69	157,306.37	-	(46,872.59)
6400	(9,491.47)	67,458.99	66,783.30	-	(143,733.76)
6500	3,365.75	-	-	-	3,365.75
Total 6000					**(245,250.83)**

7100	-	6,150.00	24,600.00	-	(30,750.00)
7200	5,957,838.00	-	2,642,503.00	-	3,315,335.00
7400	125,000.00	45,818.84	2,056,135.39	-	(1,976,954.23)
Total 7000					**1,307,630.77**

The previous table does not include 57** and 73** objects.

As noted, expenditure projections for certificated salaries, classified salaries, services/consultants and capital outlay are all higher than the current budget. Expenditure transfers at year end will result in many of these underbudgeted categories self-correcting, but this type of budgeting is neither correct nor safe. Budgets must reflect what is expected to occur for the year. If expenditure transfers are known and anticipated, as most seem to be, the expenses should be charged against the correct category initially. Based on this analysis, the district's unrestricted resources are potentially underbudgeted by $9,032,892.83 based on FCMAT's projected June 30 actuals. Even though the district will be transferring a significant amount of expenditures at year end, delaying the transfer of expenditures to the appropriate resource until year end results in an unbalanced budget through most of the school year.

For *restricted* general fund resources, the analysis of the budget versus the estimated June actuals is as follows:

Object	Revised Budget	Encumbered Amount	Expensed Amount	May Expense (June Est.)	Projected June Balance
1100	32,788,606.25	-	24,010,074.10	2,659,900.86	6,118,631.29
1200	4,630,600.81	-	3,924,420.36	447,018.01	259,162.44
1300	3,794,244.60	-	3,161,398.86	316,238.55	316,607.19
1900	9,277,879.43	-	7,382,452.26	1,365,891.97	529,535.20
Total 1000					**7,223,936.12**
2100	7,937,157.85	-	7,620,240.84	823,963.07	(507,046.06)
2200	12,245,295.48	-	11,459,066.27	1,163,943.92	(377,714.71)
2300	2,729,190.44	-	2,414,722.56	248,985.77	65,482.11
2400	4,022,440.77	-	3,350,830.25	326,932.77	344,677.75
2900	1,442,465.55	-	1,327,842.63	136,200.45	(21,577.53)
Total 2000					**(496,178.44)**
3100	3,721,083.05	-	3,018,769.33	375,545.58	326,768.14
3200	3,324,432.11	-	2,187,067.02	223,240.68	914,124.41

3300	3,427,862.68	-	2,427,742.24	262,548.63	737,571.81
3400	15,572,260.67	-	12,301,835.10	1,452,959.92	1,817,465.65
3500	493,308.29	-	286,879.89	33,272.60	173,155.80
3600	2,537,361.87	-	2,059,754.82	239,548.95	238,058.10
3700	4,854,433.19	-	4,186,608.05	479,146.52	188,678.62
3800	681,514.83	-	762,142.59	79,168.67	(159,796.43)
3900	86,451.20	-	53,171.62	5,736.45	27,543.13
Total 3000					**4,263,569.23**
4100	4,910,584.56	361,160.98	2,109,833.94	-	2,439,589.64
4200	522,563.15	158,981.86	225,694.00	-	137,887.29
4300	23,533,304.99	1,908,888.86	4,373,713.20	-	17,250,702.93
4400	1,960,166.19	525,166.11	873,815.93	-	561,184.15
Total 4000					**20,389,364.01**
5300	104,197.06	-	39,259.06	-	64,938.00
5500	149,415.65	18,506.96	50,537.62	-	80,371.07
5600	1,246,189.58	287,632.94	759,088.31	-	199,468.33
5800	25,903,177.03	8,313,667.85	20,874,409.73	-	(3,284,900.55)
5900	378,115.67	40,555.80	276,729.11	-	60,830.76
Total 5000					**(2,879,292.39)**
6100	10,455.48	-	12,057.48	-	(1,602.00)
6200	115,290.15	23,748.44	10,686.36	-	80,855.35
6400	294,341.78	62,072.26	108,093.41	-	124,176.11
6500	-	-	-	-	-
Total 6000					**203,429.46**
7100	-	-	64,839.34	-	(64,839.34)
7400	80,771.72	-	80,771.72	-	-
Total 7000					(64,839.34)

The previous table does not include 57** and 73** objects.

Based on these estimates, approximately $28,639,988.65 in restricted funds will be unspent at year end. Expenditure transfers to these categories at year end will result in decreases in many of these categories, but the remaining amounts will still be significant. Budgets must reflect what is expected to occur for the year or adjusted during interim reporting periods

Revenues and expenditures for categorical programs should be reviewed and evaluated in the same manner as are the unrestricted general fund revenues and expenditures. Carryover and unearned income for categorical programs should be similarly monitored. Significant variances between restricted expenditure accounts are demonstrated by past budget reports, trends from interim reports to year end audited amounts, and the previous analysis of the estimated unspent categorical budgets on June 30. The budgets are set up as if all carryover and new funding will be spent in the current year. However, past trends show that this rarely occurs. Carryover instead has continued at the same rate at the end of each fiscal year. Whenever possible, restricted funding should be spent in the year it is earned. The district should develop a spending plan to use categorical funds so that they do not carry over unless there is a specific expenditure plan that requires several years of funding, such as saving for a future textbook adoption. Program guidelines must be followed to ensure that qualifying students receive the appropriate level of supplies and instructional support to achieve success.

According to the district's annual independent audits, the general fund ending fund balance has been inconsistent from year to year. The district has been in declining enrollment since the 2001-02 fiscal year. Because prior year ADA can be used when a district's enrollment is declining, the large decrease in fund balance between 2002-03 and 2003-04 was anticipated.

1998-99	$17,286,720
1999-2000	$15,712,335
2000-2001:	$26,740,110
2001-2002:	$23,208,133
2002-2003:	$27,839,396
2003-2004:	$19,970,997
2004-2005:	$22,147,676

The district has been unable to maintain its required reserve at year-end closing since the 1998-99 fiscal year, although the 2% has been maintained at both adopted budget and interim reporting as required. For districts the size of Sacramento City Unified, the state recommends available reserves of at least 2% of total general fund expenditures, transfers out, and other uses. For the years ending on June 30, 2004 and 2005, the state allowed districts to reduce their available reserves by one-half to 1%. However, for 2005-06, the required reserve again increased to 2%.

Total long-term debt increased at a significant rate from 1998-99 to 2002-03, with the balance decreasing in 2003-04 and then increasing again in 04-05.

	Budget 2005-06	Actual 2004-05	Actual 2003-04	Actual 2002-03	Actual 2001-02	Actual 2000-01	Actual 1999-2000	Actual 1998-99
General Fund, Available Reserves as percentages of Total Outgo	2.0	1.4	1.5	1.7	1.7	1.8	1.6	1.7
All Funds, Total Long Term Debt	347,886,784	364,233,225	322,847,729	331,397,938	222,991,308	179,898,672	122,737,981	73,968,430

Source: Annual independent audits

Recommendations

The district should:

1. Ensure it has a reliable process to analyze actual salary and benefits to date and compare them with remaining budget balances at least monthly.

2. Adjust salary and benefit budgets when changes occur in the amounts to be paid, or in personnel.

3. Consider using the encumbering option for salaries and benefits to analyze actual salary and benefit expenditures to date against the remaining budgets in a more efficient and reliable way.

4. Charge expenditures to the budget categories to which they belong as they occur rather than using the current practice of moving expenditures via transfers at year end. The current practice should be discontinued as soon as possible.

5. Establish a system to ensure that funds are spent in accordance with applicable laws and regulations when transferring expenditures from one resource to another. It is difficult to certify that the purchases are within the guidelines of the categorical, restricted fund to which they belong when the expenditures are moved from one funding source to another. The district has a variety of means to ensure compliance when expenditures are originally charged, however, another compliance review must occur when the transfer is made to the final destination. This is because the compliance requirements of the original expenditure probably are different from the requirements of the resource where the expenditure is transferred. For example, unrestricted expenditures do not have the compliance issues of categoricals, yet so many expenditures are moved from 0000 to categoricals.

6. Discontinue the practice of negative budgeting.

7. Prevent carryover by reviewing and spending funds in restricted categorical programs in the year they are received whenever possible.

8. Implement the purchase order system to automatically verify fund availability and account coding when the site or department prepares a purchase requisition. If funds are not available, the district should require a budget transfer before processing. For categorical funds, the system should be set up so that the program manager's electronic approval is required before the order is made.

9. Optimize categorical expenditures so that students receive the maximum benefit in accordance with program guidelines.

10. Develop monthly budget monitoring processes for all resources.

11. Ensure that budget information is updated regularly throughout the year.

Cost Containment

There is no list of guidelines that all school districts should follow when identifying areas for budget reduction, but districts should choose areas that will help them build a sustainable financial recovery. Developing a recovery plan will be useful when considering how to improve employee compensation levels while addressing increasing costs in other expenditure categories. These plans also help districts determine expenditure reductions. To remain fiscally viable, all areas of expense must be reviewed.

The sooner budget adjustments and/or reductions are made, the more resources that can be saved in the year by increasing the ending fund balance as deficit spending decreases. If revenues can be increased in any given year, and the increase is an ongoing one, the affect compounds year after year.

Districts should avoid rollover budgeting, in which the prior year adopted budget is moved to the new budget year. Districts that utilize rollover budgeting do not adjust for actual expenditures or adjust budgets accordingly. In many cases, it is more appropriate to start with a zero-based budget as is commonly done with summer school. This allows the district to review available funding, determine the most efficient way to expend these resources and decide whether expenditures meet the district's goals and objectives. In large districts, a modified budget development model can be used to help ensure that appropriate budget adjustments are made for the new year allocations.

Restricted dollars should be considered first. As the district identifies its goals and instructional priorities, categorical dollars should be included in the budget development process. The district should maximize the use of categorical funds by identifying the goals that can be met with these funds.

The district should ensure that categorical, restricted resources pay for themselves, including paying for general fund overhead expenses, such as direct support, indirect costs, PERS revenue limit reduction, post retirement benefits and all other costs. Categorical funds should be charged their fair share of "overhead" costs. Overhead charges should be discussed at the board level so that there is an understanding of the costs for a district to implement categorical programs.

At Sacramento City Unified, an indirect charge is not being applied against resource 8150, the routine repair and maintenance resource. An indirect charge should be assessed against this restricted resource just as it should be assessed against all allowable resources.

Categorical funds are meant to be expended in the same year the funds are generated. Many districts carry over large balances and fail to utilize them. Because the ending fund balances of categorical funds are restricted, the balances do not help meet the reserve levels mandated by criteria and standards. Both restricted carryover and deferred revenue should be discussed and a conscious plan developed to spend the balances.

Although district staff indicated to FCMAT that carryover balances and deferred revenues were monitored closely and that site spending plans were monitored by the budget office, it appears that the process is flawed due to the large carryovers. Based on these carryovers during the past several years, FCMAT has concluded that the process requires a thorough review by top-level management.

Sites or departments should not have carryover from year to year. If the sites or departments do not expend their allotment, those funds should be used in an area identified as needing increased financial resources. Funds are sometimes saved from year to year for a specific large purchase. These types of carryover funds should be approved by the Superintendent or superintendent's designee.

All funds should be reviewed to ensure appropriate charges are being made. Allowable indirect and direct charges should be applied so that the general fund is "reimbursed" for costs specific to the other funds' activities. These other funds should not encroach on the general fund, but when they do, a recovery plan should be developed to end the encroachment.

FCMAT reviewed the interfund transfers for 2004-05 and 2003-04 based on information contained in the annual independent audits, and found that the following transfers occurred:

2004-05

From	To	Amount	Reason
General Fund	Charter Schools Fund	$340,884	Contribution for dependent charters
Charter Schools Fund	General Fund	$1,995,987	Transfer charter school fees
Adult Education Fund	General Fund	$765,708	Indirect support
Child Development Fund	General Fund	$888,631	Indirect support
Building Fund	Deferred Maintenance Fund	$1,500,000	Deferred Maintenance Fund
Developer Fee Fund	Charter School Fund	$647,247	Contribution for dependent charters
County School Facilities fund	Building Fund	$30,223,145	Construction projects
Cafeteria Fund	General fund	$1,086,508	Indirect support
Self Insurance Fund	General Fund	$587,996	Indirect Support
	TOTAL	**$38,036,106**	

2003-04

From	To	Amount	Reason
Building Fund	General Fund	1,013,000	Reason not specified
Charter Schools Fund	General Fund	1,368,354	Transfer charter school fees
Adult Education Fund	General Fund	789,909	Indirect support

Child Development Fund	General Fund	923,871	Indirect support
Building Fund	Deferred Maintenance Fund	$1,500,000	Deferred Maintenance Fund
Cafeteria Fund	General fund	1,128,668	Indirect support
Self Insurance Fund	General Fund	503,597	Indirect Support
	TOTAL	$7,227,399	

Based on this analysis, it appears that the district's "other funds" are paying indirect support to the general fund for administrative oversight with the exception of the following:

- The district collects developer fees, as allowed by law. The Government Code allows for a 3% indirect to be charged against the fund for administrative expenses, but the district does not currently do so. Unless 3% of administrative charges are being directly charged against the fund, the district can assess a 3% indirect charge based on revenues collected in any one year and transfer that amount to the general fund to offset the administrative costs incurred in collecting and reporting on the use of the funds.

It is helpful for governing boards to define policy in the areas of staffing ratios and class sizes (often in collective bargaining agreements), allocation of supplies or operating expenditures, student transportation, a requirement for categorical programs to be self-supporting, reserve levels, priorities for annual budgets, budgetary goals, and other fiscal related issues. Such policies can clearly communicate values, perspective, and priorities, and help departments and programs operate within the district's fiscal constraints.

Most districts have staffing allocations for the certificated classroom staff, but they can also be utilized for other district positions such as site administrators, site support, student services employees, maintenance and operations workers, food services and other district office personnel. The district utilizes staffing formulas for all school site staff charged to the general fund unrestricted portion of the budget. Allocations can be based on different factors, such as student enrollment, the number of staff members on site, student mobility, free and reduced meal data, and school calendars.

All expense areas must be reviewed when developing a financial recovery plan or planning for increased ongoing expenditures in the future. A typical list of questions that help determine where savings might be realized could include the following:

- Are teacher/student ratios being maintained at contract levels, or is there room for class consolidation or combinations without going over the established ratios in order to align FTEs?

- Does the district monitor staffing levels throughout the year, especially at second semester to determine whether temporary or long-term substitutes can be released? It is much easier to add teachers during the year if staffing estimates were too conservative. The ability to decrease the number of teachers during the fiscal year is limited by Education Code requirements.

- Are unfilled positions kept in the budget after the first and second interim reporting periods if the positions will not be filled in the current budget year?

- Is the budget updated to reflect changes in salary levels when new hires take the place of longtime staff?

- Are the prior year current liabilities and accounts receivable closed out within 120 days of the fiscal year to minimize the impact of reconciling unpaid or uncollected items during year end closing?

- Are onetime revenue sources such as carryover, grants and donations being used to fund ongoing expenditures such as salary?

- When reserves are spent down, is this accomplished in a conscious manner for onetime purposes?

- Is overtime pay kept to a minimum level, for safety and emergency needs only?

- Is further consolidation of school sites necessary?

- Is the concept of "total compensation" being used in negotiations to recognize the percentage increases for step-and-column movement, increases to benefit caps, statutory benefit increases due to raises, and wage increases?

- Are health plan costs being reviewed for cost containment opportunities in the plan design, such as second opinion requirements and primary physician assignments?

- Has the district conducted a re-enrollment on health benefits to make sure that employees are not covered after separation from the district and that retiree benefits are not being offered after the contracted age (i.e., age 65)?

- Has the district discussed the method of coordinating Medicare benefits with the retiree health plan's benefits? This can result in a substantial reduction in retiree health costs.

- Has the district ensured that it has a process to collect overpayments to employees? Employees are overpaid for various reasons, and it is important for the district to collect these overpayments when they occur.

- Has the district considered establishing a special month-end payroll in which employees are required to pick up their monthly paychecks at the district office? Many districts that implement this change find that some employees should not be receiving monthly paychecks for a variety of reasons.

- Are substitute teacher costs being evaluated to establish clear guidelines for using a substitute?

  At Sacramento City Unified, all substitute teachers are being charged to one central account in the unrestricted resource, 0000, regardless of whether an employee is sick or an additional teacher is needed due to a special project. Instead, different accounts should be established to track the reason for using the substitute such as illness, field trips and special reasons. If employees are ill, the district should cover the cost for a substitute from a central account since this is not something under a site administrator's control. However, if a substitute is used to provide additional coverage or for a field trip, site discretionary budgets should cover costs because these factors are controllable. Site budgets should be used for all expenditures that are in that site administrator's control. This may lead to more conservative use of substitutes.

- How closely is the Workers' Compensation program monitored? Are claims being questioned, and is the employee's status being monitored? Are employees being required to perform limited, appropriate duties whenever possible? Are injured employees being required to watch training films or participate in other activities to build job skills? Has an early return-to-work policy been implemented?

- Are annual supply allocations being carried over to the next year, or are they being absorbed back into the general fund if unused?

- Are categorical funds being maximized for appropriate uses?

- Are indirect costs being applied to categorical programs at the maximum allowable level?

- Are facility use fees being assessed when local groups use school facilities?

- Has the district quantified the available dollars that can be prioritized for uses that may include salary increases?

- Are contracted services reviewed annually to ensure that the district is receiving what it is paying for and that a less-expensive vendor is not available? This could include legal services, which can be negotiated by requesting competitive quotes.

- Are copy machine costs being monitored? Costs for leases, materials and agreements on existing copiers at school sites and offices should be compared on a per-copy basis. Using an outside vendor is sometimes more cost effective because maintenance and replacement costs on older machines are very expensive.

- Have cleaning standards been established in the operations departments? Districts often can save costs by taking this approach, which involves setting standards with specific task time lines for each custodian.

- Has the use of cell phones been reviewed at a policy and expenditure level?

- Has the automated substitute calling system been integrated with payroll?

- Have nontransportation distances been increased for students, reducing the number of buses needed and/or the number of driver hours?

Governing boards should ensure that guidelines are developed for collective bargaining, and these guidelines should align with the district's instructional and fiscal goals over the next several years. The Superintendent should ensure that the district has a formal process that identifies the collective bargaining multiyear costs for the Governing Board, and that all expenditure changes are identified prior to any imposition of new collective bargaining obligations. The Governing Board should ensure that the projected district revenues and expenditures are validated over a period of several years and that the fiscal issues faced by the district are not worsened by bargaining settlements. The public should be informed of budget reductions and/or changes that will be required for a bargaining agreement before any contract is approved by the board. The public also should be notified of the provisions of the final proposed bargaining settlement and provided with an opportunity to comment.

One of the greatest obstacles for a district experiencing financial difficulties is determining operational and programmatic priorities. One method is to identify the costs related to providing required instructional classes, categorical compliance, student safety, an appropriate level of administrative oversight, fiscal management and reporting, and the functions related to payroll, purchasing, and payables. Once these costs are calculated, the district can determine how much money is available for optional uses. Optional uses might include elective classes, additional supplies, or capital improvements not funded with state monies.

Determining what to keep and what to eliminate in the budget often causes dissension in the community, which may result in further declining enrollment. However, this discussion can also bring the district's financial status to the public's attention and prompt a collaborative effort to find solutions. This could include the development of a priority list to determine the order in which the optional costs can be added back to the budget as funding becomes available.

Additional areas to be reviewed for potential cost containment include the following:

- The district is required to transfer one-half of 1% annually to the deferred maintenance fund in order to receive matching state funds for deferred maintenance needs. The district can transfer those dollars through the Routine Repair and Maintenance (RRM) Resource and count the amount as part of the 3% requirement of EC 17070.75 that must be committed annually to maintain school district facilities constructed or modernized using state funds.

- The district does not have a cap on employee health benefits. Because the cost of health and welfare benefits continues to increase by 8% or more annually, some educational agencies are having a difficult time in maintaining these benefit plans. The concept of implementing a cap on benefits should be explored during negotiations with the collective bargaining units as a way to reduce overall costs and potentially allow the district to afford more substantial raises.

Recommendations

The district should:

1. Identify additional budget areas where expenditures can be reduced or revenues increased to allow the district to implement a financial recovery that can be sustained.

2. Identify budget adjustments early so that the effect is greater over time. Delaying action could lead to more significant reductions at a later time.

3. Continue to discuss the district's financial status with the public, initiating a collaborative effort to find solutions to the fiscal problems.

4. Develop a programmatic and operational priority list to determine the order in which reduced programs and operations can be added back to the budget as funding becomes available.

5 Review the current process of monitoring carryover balances and deferred revenues to make it more efficient and to ensure that these balances are spent on the students that generated the dollars.

6. Assess indirect charges against all allowable resources to the maximum amount allowed, including the Routine Repair and Maintenance resource, just as they would be assessed against other restricted funds.

7. Assess a 3% administrative charge against the developer fee fund, as allowed by law.

8. Transfer the deferred maintenance match through the Routine Repair and Maintenance Resource in order to count the match toward the overall 3% requirement of EC 17070.75 when the match is funded through the general fund.

9. Negotiate a cap on health benefit plans with the collective bargaining units.

10. Use different accounts to fund substitute teachers based on the reason for using the substitute. The central district budget should be charged for substitutes needed because of employee illness. Site discretionary budgets should be charged for substitutes that are used for reasons that are in the site administrator's control.

11. Ensure that there is a process to collect overpayments to employees. Although it was reported that the district has such a process, some employees indicated that it is not consistently used.

12. Consider identifying a specific special month-end payroll in which employees are required to pick up their monthly paychecks at the district office.

13. Discuss the method of coordinating Medicare benefits with the retiree health-plan benefits to determine whether an overall reduction in retiree health costs can be achieved.

14. Discuss a health and welfare cap or increase to the copayment to help curb increasing premiums.

Budget Development

The district has experienced significant turnover in key staff and administrative positions during the past several years. This can affect the budget development process because information from past decisions is not readily available unless it has been documented in a formal manner. FCMAT was unable to find evidence that the district's current budget development process links expenditures to educational goals and priorities.

The district should establish a comprehensive budget development process that includes categorical funds and provides for input from all key stakeholders, including the board, curriculum and instruction, human resources, special education, and school site administrators.

The budget development process needs policy input from the board to help the district develop an expenditure plan that fulfills district goals and objectives. The Governing Board should focus on expenditure standards and formulas to meet the district's goals instead of focusing on specific line items. The board should direct the staff to design an expenditure plan that meets student and district needs.

Many types of budget development models exist. These models include the following:

- Decentralized budgeting: Major budgeting and related decisions are made at the school-site level.
- Centralized budgeting: Budget decisions are made in a "top-down" method, commonly used when the district has a severe financial condition or needs to exert greater fiscal control.
- Blended decentralized/centralized method: Uses budget committees to gain broad participation while maintaining control.
- Zero-based budgeting: The entire budget is recreated and analyzed each year.
- Rollover budgeting: Prior year budgets are moved forward and reviewed for additions or deletions.
- Enrollment-based budgets: Accurate demographic information becomes the basis for budget allocations.
- Program budgeting: Spending plans are based on the expected results of services to be performed by the organizational units.
- Program planning and budget systems: current and future budgets are considered.

Naturally, one budget approach seldom meets all of a district's needs or requirements. Many districts have created a process that combines elements from the previously noted budget types. The primary consideration in choosing a budget development process is to assess the district's budget needs and tailor the process to the unique characteristics of the district. All budget methods must be carefully communicated to interested parties so that the advantages of the chosen method are evident.

Attached to the appendix section of this report is a sample budget development schedule of assigned tasks and functions related to building the district's annual budget, including a budget development calendar to define the time lines and assign responsibility to district administrators and the staff. This sample may be used all or in part to establish a budget development system that will meet the district's needs.

The district's business office does not have formal, documented budget development processes and procedures. The budget office uses a technical process that includes revenue forecasts, expenditure verifications and projections and expenditure plans. The process should also clearly identify onetime sources and uses of funds, and these should be clearly reflected in the budget. Reasonable ADA and cost-of-living (COLA) estimates should continue to be used when planning and budgeting. This type of process should be applied to all funds.

The district produces an annual budget calendar. The 2006-07 Budget Calendar contains the various statutory and critical dates that are critical to effective budget development. However, first and second interim dates should be included as reminders of the statutory requirements of updating budgets. A board presentation has been scheduled for August/September to discuss budget revisions that are necessary after the state budget is adopted. This meets the statutory requirement to adjust the budget within 45 days after the state budget is signed. Adding the interim report dates would make the calendar more inclusive of the different statutory budget revision time lines.

Recommendations

The district should:

1. Include in the annual budget a mission statement, statement of core values, or a strategic plan that has been approved by the Governing Board.

2. Draft and approve budget development policies so that district goals, objectives, concepts and guidelines can be linked to the district's expenditure plan. These policies must be adopted by the board so that staff and the public understand that the budget reflects the district's goals and objectives.

3. Develop spending standards and formulas that clearly reflect the district's goals and objectives, and include them in the budget document.

4. Document the technical process used for budget development.

5. Clearly identify onetime sources and uses of funds

6. Continue holding board study sessions and community meetings during budget development to demonstrate that the district is working with the community and ensuring that the public is part of the process. This will also communicate to the public that the district wants to answer questions about the budget.

7. Link expenditures by program and/or department to the district's strategic priorities and core values, and include this information in the formal budget document. This should help clarify the expenditure plan for both the Governing Board and interested community members.

8. Continue to create a comprehensive budget development calendar detailing major budget preparation activities. This calendar should allow for input from the board, Superintendent and cabinet regarding district goals and objectives for the upcoming year and subsequent years.

9. Create a formal budget development procedures manual and develop desk manuals for each business office position that participates in budget development. These manuals should specify how various tasks are carried out to ensure the efficiency and accuracy of budget data, and maintain continuity in case of staff turnover.

10. Continue to produce the Budget Process Handbook, an accounting and budget procedures manual for sites and departments. This handbook should be revised periodically and forwarded to sites and departments annually so that they understand what is expected of them and why.

11. Review all revenues and designate onetime income for onetime expenses.

12. Add interim reporting requirements to the annual budget calendar.

Categorical Funds

The district's categorical funds, made up of both state and federal programs, do not appear to be integrated with the budget development process. Site funding sources that need site approval are set up in a reserve account at budget adoption, causing an inaccurate picture of the district's fiscal position. The funds do not appear to be monitored or used to the full extent possible because of the large carryover balances that exist in many categorical funds. The district should ensure that the instructional department develops and monitors the district's categorical budget.

The district's categorical funds are discussed and staffing is authorized during budget development in the "one stop staffing sessions" that are held with each school site and department head. The district staff indicated that categorical dollars are monitored as closely or closer than unrestricted funds. However, based on the large carryover balances that exist, it appears that many categorical programs are not integrated with the budget development process sufficiently to expend the carryover and are not monitored or used to the full extent possible.

The district should continue to ensure that the funds are specifically allotted to cover expenditures that are consistent with categorical funding guidelines and restrictions. The Superintendent, superintendent's cabinet and business office should establish procedures to ensure that categorical funds are used to meet district goals and objectives. Categorical program fund carryovers and unearned income should be monitored in the same manner as general fund unrestricted expenditures.

Although categorical funds are intended to be spent in the same year as the funds are generated, it is important to note that in some cases, carryover exists for planned future purchases. These types of exceptions should be approved by the board and Superintendent so that it is understood that saving restricted dollars is the exception rather than the rule.

Because categorical funds have a variety of compliance and accountability requirements, it is critical that additional oversight and approval be required prior to funds being spent. The partnership between business and instruction is essential to ensuring that categorical funds are spent correctly.

Although revenue estimates for consolidated application funds are entered into the adopted budget, the associated expenditure budgets for those specific funds are set aside in a reserve until the school site plans are approved and the district determines how funds will be expended. This means that the adopted budget does not contain many categorical expenditures, providing an inaccurate picture of the district's fiscal position. This practice allows the district to estimate a much lower Routine Restricted Maintenance calculation because the annual calculation is based solely on adopted budget amounts for expenditures and transfers out. The requirement is intended to ensure that the district adequately maintains facilities that have been built or modernized with state funding.

There is some concern about the length of time it takes for the business office to allocate categorical dollars to sites. If the allocations occur too late in the year, the sites have an inadequate amount of time to expend the funds on the students that generated them. At a minimum, the sites should initially receive an estimate of the restricted dollars they will receive at the time of budget adoption. This estimate can be updated when the actual numbers are known.

Recommendations

The district should:

1. Ensure that the instructional department develops and monitors the district's categorical budget, including carryover.

2. Budget expenditures and revenue for consolidated application funding prior to the school site plan being approved. Once school site plans are approved, budgets should be adjusted accordingly.

3. Estimate and budget for deferred revenues, carryover balances and their appropriate expenditures and include them in the adopted budget.

5. Ensure that additional review and approval occurs for all personnel and purchase requisitions that are charged to categorical programs for compliance and approval.

6. Develop plans to expend carryover funds, with the recognition that these funds are not recurring. In addition, plans should be made for categorical funds the district expects to receive. All expenditure plans must be consistent with categorical funding guidelines and restrictions.

7. Encourage schools to consider all funding sources when addressing key strategies. Whenever an item or program can be legitimately funded from either restricted or unrestricted funds, restricted funds should be used first because these funds are allocated for students in the year they are received.

8. Aggressively evaluate categorical carryover to ensure that departments and sites use available dollars effectively. The funds should be used to respond to district needs in the year they are allocated. From February to June, the Superintendent should receive a monthly report describing whether these funds can be redirected to reduce carryover and unused balances and how this could occur.
9. Include the review of categorical program supervision, delivery and expenditures when evaluating managers responsible for these funds.

Staffing Formulas

The district has a staffing formula and worksheet for assigning certificated classroom teachers to a site. This formula may not be clearly understood because the number of teachers that are assigned to a site is not solely dependent on the number of students. When districts have contractually agreed to provide paid preparation time for teachers during the school day, additional certificated staff must be hired to provide instruction for students during the period when other teachers are "preparing." If the students' instructional day is six hours, for example, but teachers provide instruction for only five of the six hours, an additional teacher must be hired for every five teachers assigned to a site. Sites are therefore often staffed at a ratio greater than 1.0 FTE, e.g., 1.2 FTE per X students.

The district does not have staffing ratios for classifications of employees other than school site personnel charged to unrestricted funding sources. Without general staffing ratios for other classifications of employees, some may perceive discrepancies in how schools are staffed and believe that schools must compete for staff members.

The district currently adjusts teacher staffing levels on approximately the third week of school, and other school site staffing is adjusted based on actual third-month enrollment. The best practice is for adjustments to be performed near the beginning of school. This is because when the budget is adopted prior to the beginning of the new school year, staffing is generated by an estimate of the number of students that will attend school. Many districts wait until CBEDS data is released to compare the actual number of students with staffing estimates to determine whether the school sites are understaffed or overstaffed. For consistency, the district may want to consider performing staffing adjustments for all school site personnel charged to unrestricted funding sources at the same time. If teacher staffing is adjusted at the third week of school, other school site staffing also should be adjusted then.

The district uses position control in the budgeting process. Administrators outside the Business and Personnel departments currently participate in the budget development process pertaining to staffing needs or changes prior to budget adoption. This process is called the "one stop staffing process" and should be continued. Once school begins and staffing is adjusted based on actual number of students, the same administrators should have the opportunity to validate the information affecting their site or department.

Recommendations

The district should:

1. Update the current staffing formula with additional narrative to enable the staff and public to understand that providing preparation periods requires additional teaching staff. Based on interviews, there may be little understanding of this formula and of the fact that the number of teachers assigned to a site does not depend solely on the number of students.

2. Continue to ensure that staffing is adjusted once the new school year begins and actual number of students is known. The district should also consider adjusting all staffing at the same time (e.g. CBEDS the third week of school) instead of different times as is the current practice.

3. Allow administrators outside the Business and Personnel departments to validate position control data relating to their site or department when staffing is adjusted based on actual students in addition to the validation that occurs during budget development. The more validation the district performs on the position control database, the more confident it can be that accurate data is being used to calculate operational costs at specific departments and sites. Although the sites and departments cannot adjust position control data, they can review and validate the information, which would make the budget office more confident that personnel are being correctly identified in the system.

Reconciliation of Prior Year Accounts

The general ledger financial report is one of the most important reports used by FCMAT to verify certain procedures. FCMAT's review of the district's general ledger report helped answer the following important questions:

- Were prior year accounts receivable, payable, due to, due from and deferred revenue accounts cleared in the current year?
- Was each resource in balance?
- Were beginning balances from the prior year posted correctly?

The district has not ensured that all prior year accounts payable and receivable are cleared by a certain date. Changes in prior year payables and receivables can affect the current year's budget if they are not received or expended as recorded in the previous year. Staff members indicated that some prior year accounts, such as due-to and due-from accounts, are cleared immediately when a new year begins, but that practice is not followed for all prior year accounts, which is illustrated by the outstanding amounts in the following table.

FCMAT's review in May 2006 found that the account "Prior Year Liability" was still outstanding in the following resources in the general fund:

Resource Number	Resource Name	Amount
0000	Unrestricted	$(11,553.69)
0103	API School Employee Performance Bonus	$5,697.61
0105	Governor's Performance Awards	$1,049.79
0812	Donations-Special Funds	$950.49
3010	IASA, Title 1, Basic Grants	$(4,213.50)
3030	NCLB Title 1, Part B, Reading First Program	$13,336.24
3170	IASA-Title I Comp School Reform	$606.22
3405	Special Education-Workability	$50.64
3710	IASA Drug Free School Entitlements	$231.04
4035	NCLB Title II, Part A	$51,033.97
4045	Title II Part D	$41.87
4110	IASA Title VI-Formula Entitlements	$440.47
4124	21st Century Learning Centers	$103,277
4203	Title III, Limited English Prof. Student	$2,671.95
4230	Title VII Bilingual Ed.-Discretionary	$(5.22)
5630	Homeless Children Education Grants	$915.30

5640	Medi-Cal Billing Option	$128.30
5844	Foreign Language Assist: LEA Grants	$5,049.01
5855	Safe and Drug Free Schools & Communities	$1,839.45
6010	Healthy Start, After School/Safe Neighborhood	$3,794.53
6240	Healthy Start-Planning and Operations	$346.56
6286	English Language Learners, Teacher Training	$248.30
6330	School Community Policing Partnership	$292.62
6350	ROC/P Apportionment	$251.38
6500	Special Education	$4,239.56
7010	Agricultural Vocational Education	$16.21
7021	Leaf Pilot Program Grant	$4,210.33
7045	Targeted Instructional Improvement Grant	$16,699.01
7090	Economic Impact Aid	$1,237.67
7091	Economic Impact Aid-LEP	$2,158.07
7156	Instructional Materials Realignment	$2,069. 50
7158	Instructional Materials, William Case	$(715.56)
7220	Partnership Academies Program	$(71.92)
7230	Transportation, Home to School	$11,002.13
7258	High Priority Schools Grant	$5,359.40
7260	School Improvement Program	$7,472.47
7320	Staff Development, Admin. Training	$(3,493.60)
8100	Routine Repair and Maintenance	$901.08

In addition, the accounts receivable account in the general fund unrestricted resource (0000) still had an outstanding balance of $143,774.90.

There were also various due-to and due-from accounts with balances, but the staff indicated that these balances were due to current year transactions. Certain objects are most often used during year-end closing when expenditures are correctly classified after the point that cash can be transferred to the appropriate resource or fund. According to the district staff, the accounting staff also uses these objects during the fiscal year when expenditures are coded to multiple sources, such as sales tax payable. Because of the district's use of these objects during the fiscal year, FCMAT was not able to identify whether any of the outstanding balances in these accounts were due to prior year transactions. Using the same account for both current and prior year transactions is not a common practice and makes it much more difficult to monitor activity and prior year balances.

Recommendation

The district should:

1. Ensure that the general ledger is reviewed monthly and that all prior-year activity is cleared before the second interim report is due.

2. Conduct a monthly review of the general ledger, including accounts payable and receivable, to ensure that the general ledger is in balance and to determine if accounts have been properly reconciled and/or cleared. The district should reverse entries and follow up as needed with outside agencies or vendors regarding payment or collection. In addition, the staff should make certain that current year revenues are not overstated by the inadvertent posting of a prior year accrual to current year income. All prior year accounts should be cleared by second interim at the latest, although clearing them prior to that is recommended.

3. Immediately review and correctly adjust all outstanding receivables and payables in all funds so that the effect on the 2005-06 year is realized as soon as possible.

4. Consider stopping the practice of using the general ledger accounts payable and receivable for current year transactions. If the practice of charging both current and prior year in the general ledger continues, the district should specify different object codes for each year so that it is clear to which year the transaction belongs.

Training

Staff members indicated that there is a need for additional training on the Escape system. The district was one of the software's beta testers and has used Escape for approximately 10 years. Over a period of time, some knowledge of the system has been lost or is not current, and some staff members lack familiarity with the system's various features. The system has the capacity to solve many cumbersome system issues, but this capacity is not being fully utilized.

During FCMAT's visit, specific financial reports were requested in formats usually provided during district assignments. In many cases, when the format was very specific, FCMAT was told that the report would take "up to five days to run." Although the five days may have been an exaggeration, it was repeated enough times that FCMAT assumed it was a fact. The staff indicated that there may be a more efficient way to run these reports, but no one was certain.

Training on the Escape system currently consists of two sessions offered monthly, totaling seven hours. During the training, users are introduced to the system's many modules. In addition, monthly training is offered on appropriation transfers (budget transfers) at two separate times to help ensure that all staff would have an opportunity to attend.

The district has developed a Budget Process Handbook, which is a detailed resource covering many topics related to the budget, such as the budget code structure, requisition types, position control, per diem, and grant guidelines. The handbook provided to FCMAT was revised as of July 1, 2002. The information in the handbook was helpful and detailed processes in many important business areas.

Recommendations

The district should:

1. Conduct an annual training session for school administrators and key staff members on the various features of the Escape system, in addition to the trainings that are already occurring on a regular basis.

2. Investigate whether the Escape system could be set up to offer answers for the cumbersome system issues faced by the district.

3. Work closely with the vendor and ensure that the staff is adequately trained on the system so that staff members have knowledge of all modules and options.

4. Consider whether the district should request proposals for another, more integrated financial system.

5. Continue to update the Budget Process Handbook, which was last revised as of July 1, 2002, and ensure that it is followed. Providing up-to-date information to sites and departments will ensure that data submitted to the district office is correct and accurate.

Retiree/Post Employment Benefits

Funding retiree health and welfare benefits has been a major issue for many employers in both the private and public sectors. Because few employers are able to fund these benefits in advance, many such as Sacramento City Unified, use the pay-as-you-go method.

New Governmental Accounting Standards Board (GASB) standards 43 and 45 direct how state and local governments account for and report other post-employment benefits (OPEB) that are separate from pension benefits. The most common OPEB is retiree health benefits.

GASB is a not-for-profit agency that develops and issues financial and accounting standards for state and local governmental agencies. These standards are consistent with standards established by the Generally Accepted Accounting Principles (GAAP), which cover nonstate and local government agencies.

Sacramento City Unified's certificated and classified union contracts offer retiree benefits to retirees. In addition, certificated employees have vested rights to lifetime benefits.

Districts that fail to fund the new GASB requirement could experience reduced bond ratings when rating agencies review their financial statements, as these statements will have to account for any unfunded liabilities. Reduced bond ratings will result in higher issuance costs and interest rates. Financial statements will weaken over time unless the liability is reduced. A district's ability to borrow and incur additional debt also could be affected. Failure to implement GASB 45 could result in an adverse opinion by a district auditor. Although the pay-as-you-go method is permissible, using it means that the growing liability will be unmatched by a reserve of equal value. While professional accounting standards do not require public agencies to set aside the funding, failure to do so will have fiscal and reporting consequences. Post-employment benefit costs continue to rise and incurring this type of debt should be avoided, if possible.

On February 2, 2006, the district submitted an informational item to the Governing Board, asking for acceptance of the newest actuarial report and related information on the retiree health care liability estimates. The data in the report was as of February 1, 2005, with the report dated June 21, 2005. GASB 43 and 45 are new, but Education Code section 42140 has for some time required school agencies that provide health and welfare benefits for retired employees up to age 65 to report to the board an estimate of the accrued, but unfunded costs of the benefits. This Education Code requirement is to obtain an actuarial every three years, at the minimum.

GASB 43, Financial Reporting for Post-employment Benefit Plans Other Than Pension

Plans, provides financial reporting procedures (in the district's annual audit report) for these benefits. GASB 45, Accounting and Financial Reporting by Employers for Post-employment Benefits, provides the accounting procedures. The two statements are closely related and are considered together in this report.

The two standards are phased in over three years, based on the governmental unit's size. This is similar to the implementation for GASB 34. The district will be part of the first group of districts implementing these new standards. The reporting standard is implemented before the accounting standard, so financial statement footnote disclosure will occur one year before the actual accounting changes are necessary. As with many new accounting standards, early implementation is encouraged.

The new reporting and accounting requirements were created to help districts realize how past negotiated retiree benefit commitments affect current and future budgets. The requirements also help districts accurately reflect the cost of those commitments in the years the costs are incurred (the years the employees work for the district). GASB 45 requires OPEB to be recognized as an expense and obligation, if applicable, on the LEA's financial statements reported on the full accrual basis of accounting. This is for districts with any benefit structure for retirees, whether for a lifetime or some shorter time frame.

Future benefits result in a liability. Because most educational agencies, like Sacramento City Unified, have funded this liability on a pay-as-you-go basis, these new GASB reporting and accounting requirements will substantially affect financial statements.

As of February 1, 2005, the pay-as-you-go cost of providing retiree health benefits was estimated to be $13,218,445, with the cost expected to increase over the next 10 years at an annual rate of 6.5%. 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 participating employees, the district 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 recognizes only amounts paid out in the current year, not the future liability of benefits for 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 implementation. The amortization can occur over a period of time 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:

- Actuarial cost method – Several acceptable actuarial cost methods are available. The district will need to discuss these with its actuary to determine whether there are inherent advantages or disadvantages in the method used.

- Actuarial assumptions – These include demographic information (such as employee life spans, marriage status and termination status) and economic data (such as current and future investment returns and cost trends).

- Plan assets – These 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).

- Employer census data – These consist of 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, resulting in an unfunded liability. The ARC has two components:

- The normal cost – The current actuarial cost of the retiree benefits earned by employees in the current year.

- Amortization of the unfunded prior liability – The amortization of the prior unfunded employee benefits liability for a period of up to 30 years.

The most recent actuarial report reflects that for current employees, the value of benefits accrued in the year beginning February 1, 2005 is $13,785,561, which would increase each year based on actual payroll. If the district had begun prefunding retiree health benefits when each current employee and retiree was hired, an estimated $431,791,399 might have been accumulated to date. This amount is often called the "past service liability."

After the prior unfunded liability has been totally recognized, the ARC will consist solely of the current year's actuarially determined costs of the benefits. Contributions toward the annual cost are made through premiums paid to the insuring agency and through contributions to an irrevocable trust (Fund 71), whose assets are 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. This method also drastically understates the actual cost of each district employee. The cost lags considerably because expenses are not recognized until the employee actually retires. All other employee costs are expensed during their employment lifetime.

As a result of these new accounting standards, the district will need to make several decisions and take actions as follows:

- Discuss the various actuarial methods with its actuary to determine which will best meet the district's needs.
- Determine whether categorical funds will be charged the amortization of the prior unfunded liability in addition to an equitable portion of the ongoing cost.
- Review the current unfunded OPEB liability and determine the period of amortization. The standards allow up to 30 years. The amortized liability and expense will be reflected in the entitywide audited financial statements and will reduce net assets.
- Determine the actual funding level of the ARC. The current method will result in a cumulatively larger unfunded liability. This is an important cash flow issue, but it will not affect the actual expenditure level.
- Establish an irrevocable trust if it is decided that funding levels will be established to at least partially address the annual cost exceeding the annual premiums. If an irrevocable trust is not established, any amounts set aside to fund the liability will not reduce the reported liability.
- Communicate the results of these new standards to interested parties, including board members, the public, financing institutions, employees, and unions.
- Determine whether the district can afford retiree benefits at the current level. Although any changes must be negotiated with employee unions, the discussion must occur at some point due to the significant effect on the district.

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 the pay-as-you-go method or on the actuarially determined GAAP compliant expense as long as an irrevocable trust is in place. Specifically, the circular states that to be allowable in the current year, the PRHB (post-retirement health benefit) costs must be paid to one of the following:

- An insurer or other benefit provider as current year costs or premiums, or
- 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 also may be charged to federal funds, as follows:

1. 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.

The district therefore 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. Although no such guidance exists for state categorical funds, the state often follows the same guidelines set forth for federal grants.

The circular does not provide specific details on how categorical programs can be charged for retiree liabilities, so the district may generate its own method. The most acceptable methodology found across the state is basing the pro-rata rate on all relevant salaries. Based on GASB 45, it seems permissible to charge a rate on current costs as well as a phase-in (amortization) of the prior liability (which will probably be amortized over 30 years by most districts). The amortized liability and expense will be reflected in the entity-wide audited financial statements and may reduce net assets.

The chosen methodology should be fair and equitable to both categorical and unrestricted funds and should be consistently and uniformly applied to all district operations. It will be charged just as other payroll costs are charged based on a rate on relevant payroll (i.e., lifetime benefits should be based only on teachers' salaries if only teachers have lifetime benefits). Whatever method the district chooses, it should be fully documented and the records retained indefinitely. In addition, the rate should be recalculated each time a new actuarial report is received. Documentation is crucial because these new requirements will receive much attention in the near future. Also, as more districts implement the new standards, it will be possible to see what different methodologies other districts are using.

Recommendations

The district should:

1. Discuss the various actuarial methods with its actuary to determine which will best meet the district's needs.

2. Adjust the pay-as-you-go amount for current active employees in the current and two subsequent year budgets so that the multiyear projection contains realistic expenditure estimates in accordance with AB 1200.

3 Determine whether categorical funds will be charged the amortization of the prior unfunded liability in addition to an equitable portion of the ongoing cost.

4 Determine a fair and equitable charge to both unrestricted and categorical funds for the amortization of the prior unfunded liability if the district decides to charge the liability to categorical funds. The district should ensure that whatever method is chosen, the costs to all programs is fully documented for future reference and discussion in an audit.

5. Review the current unfunded retiree benefit liability and determine the period of time to be used for its amortization, up to 30 years.

6. Determine the funding level of the annual required contribution.

7. Decide whether to establish an irrevocable trust. If it is decided that funding levels will be established at least partially to address the annual cost exceeding the annual premiums, but an irrevocable trust is not established, any amounts set aside to fund the liability will not reduce the reported liability.

8. Communicate the results of these new standards to interested parties, including board members, the public, financing institutions, employees and the collective bargaining units.

Long-Term Debt

The district's total long-term debt has continued to increase since 1998-99, with the exception of 2003-04, when it slightly decreased. Between 1998-99 and 2004-05 audited actuals, the total amount has increased by $290,264,795. Long-term debt consists of the following:

Special Tax Bonds, Series 1997C (taxpayer obligation): The balance as of June 30, 2005 was $4,875,000. Payments are made from the South Pocket facilities fund.

State School Building Aid loan: The balance as of June 30, 2005 was $2,438. Payments are made from the tax override fund.

General Obligation Bonds (taxpayer obligations): The balance as of June 30, 2005 was $258,095,000. Payments are made from the bond interest and redemption fund and were as follows:

- 1999 Series A, $50,000,000: construct, repair and expand local schools. February 10, 2000
- 2001 Series Refunding Bonds, $52,310,000: refund a portion of the district's 1999 Series A. October 12, 2001
- 1999 Series B, $45,000,000: construct, repair and expand local schools. March 27, 2001
- 1999 Series C, $45,000,000: construct, repair and expand local schools. May 7, 2002
- 1999 Series D, $55,000,000; construct, repair and expand local schools. August 1, 2004
- 2002 Series A, $80,000,000: construct, repair and expand local schools. March 1, 2003

Certificates of Participation (COPs): The balance as of June 30, 2005 was $94,795,000. Payments are made from the building fund and were as follows.

- February 5, 1998, $18,400,000. Used to defease the April 1997 COPs and to finance various district roofing and construction projects.
- May 1, 1999, $16,715,000. Used to maximize modernization and site improvements district-wide in conjunction with the state modernization program.
- April 18, 2001, $43,580,000. Used to advance refund of Series 1999C COPs and to provide additional capital for construction projects.
- July 11, 2002, $58,000,000. Used to advance refund of 1998 Series A COPs and 1999 series D COPs and to provide additional capital for construction projects.

Capitalized Lease Obligations: The balance as of June 30, 2005 was $289,196. Payments are made from the general fund.

Compensated Absences: The balance as of June 30, 2005 was $6,161,541. If needed, payments are made from the fund in which the absence was earned.

Business type activities (capitalized lease obligations): The balance as of June 30, 2005 was $15,050.

Recommendations

The district should:

1. Continue to monitor long-term debt so that payment sources are known and anticipated.

Appendices

A. *Sample Budget Development Schedule*

B. *Study Agreement*

Appendix A – Sample Budget Development Schedule

I. <u>INTRODUCTION</u>

The SAMPLE District 2006-07 Budget Guidelines closely parallel the 2005-06 Budget Guidelines within resources available. It is intended that the budget development process will allow an individual manager the appropriate flexibility to budget the resources which he or she deems necessary to achieve success for a given program. Therefore, only general allocations will be made to the Division/School level with very few restrictions directed toward specific expenditures. The flexibility of the budget development process is consistent with the participative management concept of the district.

Available resources are limited. It is anticipated that District enrollment will show a growth of XXX students in 2006-07. The State cost of living adjustment (COLA) for 2006-07 is estimated to be 5.92% at this time. Adjustments to allocations <u>may</u> be made once the State budget is actually signed and information becomes available. Consequently, the challenge to each manager is to achieve established objectives within the framework of existing budgetary constraints.

II. <u>RESPONSIBILITY FOR BUDGET DEVELOPMENT</u>

A. <u>Board of Trustees</u> - The ultimate responsibility for the budget lies with the Board of Trustees, whose primary budget development tasks include establishing budget criteria and reviewing, directing, and approving the Budget and the Revised Budget.

B. <u>Superintendent</u> - The Superintendent oversees and directs the budget development process and submits the Budget and the Revised Budget to the Board of Trustees for approval.

C. <u>Superintendent's Cabinet</u> - The Superintendent's Cabinet studies and reviews budget amounts and processes, and serves as the primary decision-making unit in the allocation of funds to District components.

D. <u>Superintendent's Council</u> - The Superintendent's Council reviews and makes recommendations concerning budget-related processes.

E. <u>Assistant Superintendent, Business Services</u> - The Deputy Superintendent, Business Services has the primary responsibility with respect to budget development processes, budget guidelines, and distribution of all budget documents.

F. <u>Division Heads/Principals</u> - The budget will be formulated on a participative management basis with Division Heads and School Principals responsible for the budgets of their respective divisions or schools.

G. Department Coordinators - Department Coordinators will be responsible for developing the objectives of their programs and submitting budget requests to Division Heads or Principals in accordance with approved objectives and budget guidelines.

H. Business Services Staff - The Business Services staff will assist Division Heads and Principals in the budget development process, provide required data to the Assistant Superintendent, Business Services, and communicate all budget-related matters to the appropriate instructional and support staff. The Business Services staff is responsible for entries to the computerized budget report for a given division/school.

I. Other District Personnel, Students and Citizens - Budget development will allow for input from representatives of the community, parents, students, bargaining units and members, and site administrators to provide the Board with recommendations for budget priorities. Consideration will be given to all budget recommendations provided by employees, students and citizens.

III. BUDGET DEVELOPMENT CRITERIA

A. General Fund budgeted expenditures will not exceed budgeted revenue and/or reserves, except by the amount of authorized funds carried over from the fiscal year 2005-06 budget, in accordance with Board policy and state law.

B. The budget format will be based on the California School Accounting Manual and utilize the Standardized Account Code Structure (SACS).

C. Basic allocations for staffing and budget will be established in the same manner at each comprehensive high school, regardless of availability of supplemental resources (e.g. Title I). This policy assures that the District complies with Title I comparability requirements.

D. The Cafeteria Fund operating budget will show a positive fund balance as stipulated by Education Code requirements and the Board of Trustees.

E. Projected costs of current operations will be budgeted within the General Fund for the District's Health & Welfare program, which includes health, dental, vision care, long term disability and life insurance programs, and for Workers' Compensation. Transfers will also be budgeted as needed for Property and Liability deductibles to the insurance funds, where disbursements will be made during the year. Actual transfers for H & W and Workers' Compensation will be based on the established contribution rates and the numbers of employees/salaries covered

F. A transfer to the Deferred Maintenance Fund will be budgeted at a level which will, at a minimum, entitle the District to the maximum amount of State matching funds and ensure our continuing eligibility for modernization and hardship funding. The funds will be expended for projects approved by the State under the District's five-year plan.

G. The Adult Education Fund, as mandated by the State, will show revenues and expenditures for the adult education program. By law this fund cannot be supported through General Fund monies, nor can Adult Education Fund monies be used to support the General Fund.

H. Funds generated from Developer Fees will be placed in the Capital Facilities Fund-Developer Fees and expenditures will be incurred in accordance with Board-approved construction/reconstruction projects.

I. Redevelopment project revenues will be placed in the Capital Facilities Fund-Redevelopment and used for payment of the District's Certificate of Participation (COP) obligation.

IV. BUDGET CONCEPTS

A. The teacher staffing allocation for comprehensive schools will be based on projected enrollment for the upcoming year.

B. The other specific personnel allocations for four-year comprehensive schools include the allocations as required by the Master Plan for Special Education.

C. The lump sum allocation for comprehensive schools will be determined in the following manner:

A lump sum allocation of Seventy-seven and 14/100 Dollars ($77.14) per enrollee for all non-personnel expenses at the comprehensive school level will be based on the third month's ending enrollment of the 2005-06 school year. This allocation may be increased once the State's COLA percentage is known. An adjustment will be made in December of 2006 for changes in month 3 enrollment.

D. A special needs allocation for the comprehensive schools will be determined by the Superintendent's Cabinet in accordance with requests or program objectives submitted by each comprehensive school and the ability of the district to provide such an allocation. The total available for this purpose for all sites will be determined at a later time. The special needs allocation may include additions to any or all of the allocations previously

listed. Requests for special needs allocations should be made in writing to the Superintendent's Cabinet. The major criterion used in considering a request will be the uniqueness to a particular school of the expenditure being proposed. Special needs allocations are for one year only.

E. All returning personnel will be budgeted at a dollar amount consistent with placement on the appropriate salary schedule. All foreseeable class and step increases in FY 2006-07 must be budgeted.

F. New or vacant teaching positions should be budgeted at the appropriate step of the Teachers' Salary Schedule, if known, or Step III/6 if not known. Budget adjustments will be made without reward or penalty if actual salaries are less than or greater than budgeted salaries.

G. Teacher Substitutes Regular will be budgeted at the school level based on 6.5 days per full-time teacher.

H. All new or vacant classified personnel positions should be budgeted at the level of Step 3 of the appropriate class.

I. No deviation from standardized classified personnel allocation may be made without prior written approval of the Superintendent.

J. Classified substitutes and overtime will be budgeted at 2.0% of eligible salaries in each category.

K. The budget shall have an "Appropriation for Contingencies" or Reserve of not less than two (2) percent of expenditures, the minimum level recommended by the State for a district our size.

SAMPLE
BUDGET GUIDELINES

V. BUDGET DEVELOPMENT CALENDAR

The following page is a Budget Development Calendar, which conforms to current law and requirements of the Board of Trustees.

BUDGET DEVELOPMENT CALENDAR 2006-07

DATE	FUNCTION	RESPONSIBILITY
December	Adoption of Budget Calendar	Board of Trustees and Superintendent
December	Approval of Budget Guidelines	Board of Trustees
December	Distribution of Budget Development Materials to Divisions and Sites	Business Services Division
December to January	Preparation of Preliminary Budgets by Divisions and Sites	Division and Site Administrators
January	Submission of Preliminary Budgets to Business Division	Division and Site Administrators
February to April	Preparation of Preliminary Draft of Budget	Business Division and Data Processing
As needed	Study Sessions on Preliminary Budget	Board of Trustees and Staff
June	Public Hearing on Budget	Board of Trustees
June	Adoption of Budget	Board of Trustees
On or before July 1	Filing of Budget at County Office	Assistant Supt. - Business Services
July	Review of Budget	Business Services Division
August	Public Hearing on Revised Budget	Board of Trustees
August	Adoption of Revised Budget	Board of Trustees
On or before September 8	Filing of Revised Budget at County Office	Assistant Supt. – Business Services

MANAGEMENT ASSISTANCE TEAM
STUDY AGREEMENT
April 21, 2006

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

1. BASIS OF AGREEMENT

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

2. SCOPE OF THE WORK

A. Scope and Objectives of the Study

The scope and objectives of this study are to:

1) Conduct an analysis of the District's 2006-07 budget assumptions and projections through June 30, 2006 for all funds and the multi year projections of the General Fund included in the District's Second Interim financial report. Provide information on potential areas for cost containment and the use of funds for the 2006-07 budgets.

2) Evaluate the District's procedures for budget development, monitoring, and budget revisions for all funds and provide recommendations for improvement, including examples of procedures and timelines that are consistent with professional standards within California's public education environment.

B. Services and Products to be Provided

1) Orientation Meeting - The Team will conduct an orientation session at the District to brief District management and supervisory personnel on the procedures of the Team and on the purpose and schedule of the study.

2) On-site Review - The Team will conduct an on-site review at the District office and at school sites if necessary.

3) Progress Reports - The Team will hold an exit meeting at the conclusion of the on-site review to inform the District of significant findings and recommendations to that point.

4) Exit Letter - The Team will issue an exit letter approximately 10 days after the exit meeting detailing significant findings and recommendations to date and memorializing the topics discussed in the exit meeting.

5) Draft Reports - Sufficient copies of a preliminary draft report will be delivered to the District administration for review and comment.

6) Final Report - Sufficient copies of the final study report will be delivered to the District following completion of the review.

3. PROJECT PERSONNEL

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

A. Michelle Plumbtree, FCMAT Management Analyst & Project Lead
B. Linda Grundhoffer, FCMAT Consultant
C. Margaret Rosales, FCMAT Consultant

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

4. PROJECT COSTS

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

A. $400.00 per day for each Team Member while on site, conducting fieldwork at other locations, presenting reports, or participating in meetings. $400 per day for off site work of FCMAT Consultant Team Members for document review, analysis, data gathering, and report writing and review.

B. All out-of-pocket expenses, including travel, meals, lodging, etc. Based on the elements listed in item 2 A, total estimated cost of the review is $16,000. Changes to the scope of work will result in a revised estimate of costs. The District will be invoiced at actual costs of the study team for items 4A and 4B.

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

5. RESPONSIBILITIES OF THE DISTRICT

A. The District will provide office and conference room space while on-site reviews are in progress.
B. The District will provide the following (if requested):

1) A map of the local area
2) Existing policies, regulations and prior reports addressing the study request
3) Current organizational charts

4) Current and four (4) prior years' audit reports
5) Any documents requested on a supplemental listing

C. The District Administration will review a preliminary draft copy of the study. Any comments regarding the accuracy of the data presented in the report or the practicability of the recommendations will be reviewed with the Team prior to completion of the final report.

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

6. PROJECT SCHEDULE

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

Orientation:	May 8, 2006 @ 8:30 a.m.
Staff Interviews:	May 8-10, 2006
Exit Interviews:	May 10, 2006 @ 3:30 p.m.
Exit Letter:	May 19, 2006
Preliminary Report Submitted:	June 30, 2006
Final Report Submitted:	To be determined
Board Presentation:	To be determined

(All proposed dates are tentative at this time and are subject to change by the District or FCMAT Team)

7. CONTACT PERSON

Please print name of contact person:__________________________
Tom Barentson, Deputy Superintendent/CFO

Telephone 916 643-9055 FAX ____________

Internet Address Tom-Barentson@sac-city.k12.ca.us & gaylemc@sac-city.k12.ca.us

____

Thomas S. Barentson, Deputy Superintendent/CFO Date
Sacramento City Unified School District

____

Joel D. Montero, Chief Executive Officer Date
Fiscal Crisis and Management Assistance Team

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