FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
CSIS California School Information Services

January 9, 2018

Melissa Hunt, Superintendent
San Marcos Unified School District
255 Pico Avenue, Suite 250
San Marcos, CA 92069

Dear Superintendent Hunt:

The purpose of this letter is to confirm the findings of the Fiscal Crisis and Management Assistance Team (FCMAT) regarding the assessment of the district's 2017-18 adopted general fund budget and multiyear financial projection and the results of the district's fiscal health rating based on the 20 factors in FCMAT's Fiscal Health Risk Analysis. As defined in the study agreement, dated September 5, 2017, the scope and objectives of the study are as follows:

1. Review the district's 2017-18 general fund budget and multiyear financial projection (MYFP) for the current and two subsequent fiscal years to validate the district's financial status. Make recommendations for expenditure reductions and/or revenue enhancements to help the district eliminate its structural budget deficit and maintain financial solvency.
2. Prepare an analysis using the 20 factors in FCMAT's Fiscal Health Risk Analysis, and identify the district's risk rating.

FCMAT conducted fieldwork at the district office on October 24-26, 2017 with additional off-site work during the weeks that followed. The team reviewed several documents and financial reports, including the district's annual independent audits, unaudited actuals, and documentation supporting budget estimates and calculations, student attendance reports and other historical financial information pertinent to the study. FCMAT's analysis of the district's MYFP was based on the validation of this information and on reports from the district's financial system at the time of FCMAT's fieldwork. Additional input from district and county office staff was also considered before finalizing the enclosed information.

Like most districts, San Marcos Unified School District finds itself with fewer resources available to address the ongoing commitments and demands on district resources including negotiated formula-driven salary increases, increases in employer contribution rates for the Public Employees' Retirement System (PERS) and State Teachers' Retirement System (STRS), and rising costs associated with meeting the needs of students who qualify for special education services. The district's fiscal position is further compromised by the increasing costs of Other Post Employment Benefits (OPEB) and contractual commitments in collective bargaining agreements that provide for automatic salary and benefit increases beyond step and column adjustments. As a result, the district is forced to make difficult choices that will require fiscal diligence on the part of the governing board, staff, and community to maintain financial solvency.

It has become increasingly apparent to the district administration, governing board and county office of education that the district's fiscal position has been compromised and that significant budget reduction measures are necessary to remain solvent. To substantiate these concerns, the district took proactive steps to conduct this third-party review as confirmation of its financial condition and the need to develop a long-term corrective plan. This study is one of many steps focused on actively managing the situation to avoid insolvency.

FCMAT reviewed the district's records, interviewed staff members, examined a variety of financial documents and conducted an extensive review of the district's calculations, estimates and assumptions applied to its 2017-18 adopted budget and MYFP to confirm the financial condition of the district's general fund for the fiscal years 2017-18 through 2019-20. To assess the reasonableness of the district's budget and MYFP, assumptions were compared against historical trends, documented commitments and industry standard variables. An extensive review of recorded historical revenue and expenditures was performed to identify significant changes by object code for all unrestricted general fund projections. Forecasted revenue and expenditures were consistent with historical activity adjusted for appropriate increases and/or identified projected changes.

Budget Assessment

FCMAT's analysis of the district's budget as adopted for the 2017-18 fiscal year, and as submitted to the San Diego County Office of Education, indicates that the district's fiscal condition is fairly presented. Revenue and expenditure budgets appear reasonable and reflective of actual anticipated revenue and expenditures that could be reasonably known at the time of preparation. Many factors are unknown at the time the budget is developed, as such estimates and assumptions that must be used for many components of the adopted budget. It is industry standard to adjust salary and benefit projections during the first interim budget revision period once student enrollment and staffing levels are known. Beginning balances are increased or decreased to reflect the actual results of activity for the prior fiscal year.

Salary and benefit projections were reviewed in detail by object code classification and position; all significant variances were evaluated for reasonability. The district applies a 2% increase to salaries for projected step/column costs in each of the two subsequent years of the MYFP. Based on analytical review of historical revenue and expenditure revisions between budget adoption and the first interim reporting period, FCMAT would anticipate increases to both revenue and expenditure budgets. Revenue budgets for the restricted general fund should increase based on carryover from the 2016-17 fiscal year; expenditure budgets should follow carryover in these programs. Carryover amounts beyond those projected in estimated actuals are not uncommon but do not impact the district's fiscal solvency in the unrestricted general fund. Revenue budgets in the unrestricted general fund will increase as revenue sources for mandated costs, lottery and other unpredictable sources become known. Likewise, adjustments to expenditure budgets for salaries and benefits are expected once staffing is known and health benefit elections of employees are solidified; these amounts will impact the district's unrestricted general fund.

Multiyear Financial Projection Analysis

Multiyear financial projections are required by Assembly Bill (AB) 1200 and AB 2756 and are a part of the adoption budget and interim reporting process. In June 2004, AB 2756 (Daucher) was passed and signed into law on an urgency basis. This legislation made substantive changes to the financial accountability and oversight processes used to monitor the fiscal position of school districts and county offices of education. Among other things, AB 2756 strengthened the roles of the Superintendent of Public Instruction (SPI), county offices of education and FCMAT and their ability to provide management assistance and intervene during fiscal crises. If a district is unable to maintain its reserve for economic uncertainty, the MYFP is the primary tool used to assist the county and the district in developing a plan to regain fiscal solvency and restore the required reserve.

When prepared with great detail and care based on known or reasonably estimated resources and commitments, the MYFP provides readers with the best perspective of the district's fiscal position and the ongoing effect of financial decisions made by the governing board. Districts often prepare and evaluate multiyear projections for the general fund as a whole; however, it is best practice to prepare and examine projections for the unrestricted general fund and each restricted resource in the general fund separately to accurately monitor the district's ongoing fiscal position and evaluate the impact of potential decisions. Fiscal solvency is based primarily on the district's ability to meet its obligations and maintain reserves at recommended levels with unrestricted resources. Restricted resource expenditure budgets often include salary and benefit expenditures and should be evaluated separately to avoid inadvertent dependence on the unrestricted general fund resources.

Any forecast of financial data has inherent limitations because calculations are based on certain assumptions and criteria, including enrollment trends, cost-of-living increases, forecasts of costs for utilities, fuel and other consumables, and local, state and national economic conditions. Therefore, projections should be viewed as trends based on current criteria and assumptions rather than as a prediction of exact numbers. MYFPs can serve as the basis for more informed decisions and the ability to forecast the fiscal effects of decisions, but should be updated at least at each interim financial reporting period and in preparation for negotiations.

The table below shows the unrestricted general fund projection as adopted June 27, 2017.

UNRESTRICTED SUMMARY	Base Year 2017-18	Year 1 2018-19	Year 2 2019-20
Revenues	$ 176,473,896.00	$ 183,421,139.00	$ 189,874,576.00
Expenditures	$ (154,023,187.95)	$ (163,200,379.49)	$ (172,489,124.49)
Excess (Deficiency) of Revenues Over Expenditures	**$ 22,450,708.05**	**$ 20,220,759.51**	**$ 17,385,451.51**
Other Financing Sources/Uses			
Interfund Transfers In	$ -	$ -	$ -
Interfund Transfers Out	(10,000.00)	(10,000.00)	(10,000.00)
Contributions	(34,465,306.95)	(37,384,310.26)	(40,487,953.26)
Other Financing Sources/Uses	$ (34,475,306.95)	$ (37,394,310.26)	$ (40,497,953.26)
Net Increase (Decrease) in Fund Balance	**$ (12,024,598.90)**	**$ (17,173,550.75)**	**$ (23,112,501.75)**
Fund Balance			
Beginning Fund Balance	$ 27,577,890.85	$ 15,553,291.95	$ (1,620,258.80)
Adjustments to Beginning Fund Balance			
Ending Fund Balance	**$ 15,553,291.95**	**$ (1,620,258.80)**	**$ (24,732,760.55)**
Reserve Balance %	**7.1%**	**-0.70%**	**-10.20%**
Reserve For Economic Uncertainties (3%)	**$ 6,568,097.20**	**$ 6,898,672.41**	**$ 7,275,367.05**
Unrestricted General Fund Balance after REU	**$ 8,985,194.75**	**$ (8,518,931.21)**	**$ (32,008,127.60)**

Source: SACS fund form 01 2017-18 adopted budget

FCMAT adjusted the projection above to incorporate changes in ending fund balance presented in the district's 2016-17 unaudited actuals.

ADJUSTED UNRESTRICTED SUMMARY	Base Year 2017-18	Year 1 2018-19	Year 2 2019-20
Revenues	$ 176,473,896.00	$ 183,421,139.00	$ 189,874,576.00
Expenditures	$ (154,023,187.95)	$ (163,200,379.49)	$ (172,489,124.49)
Excess (Deficiency) of Revenues Over Expenditures	**$ 22,450,708.05**	**$ 20,220,759.51**	**$ 17,385,451.51**
Other Financing Sources/Uses			
Interfund Transfers In	$ -	$ -	$ -
Interfund Transfers Out	(10,000.00)	(10,000.00)	(10,000.00)
Contributions	(34,465,306.95)	(37,384,310.26)	(40,487,953.26)
Other Financing Sources/Uses	$ (34,475,306.95)	$ (37,394,310.26)	$ (40,497,953.26)
Net Increase (Decrease) in Fund Balance	**$ (12,024,598.90)**	**$ (17,173,550.75)**	**$ (23,112,501.75)**
Fund Balance			
Beginning Fund Balance	$ 27,577,890.85	$ 17,632,544.10	$ 458,993.35
Beginning Fund Balance Adjustments	$ 2,079,252.15	$ -	$ -
Ending Fund Balance	**$ 17,632,544.10**	**$ 458,993.35**	**$ (22,653,508.40)**
Reserve Balance %	**8.1%**	**0.20%**	**-9.34%**
Reserve For Economic Uncertainties (3%)	**$ 6,568,097.20**	**$ 6,898,672.41**	**$ 7,275,367.05**
Unrestricted General Fund Balance after REU	**$ 11,064,446.90**	**$ (6,439,679.06)**	**$ (29,928,875.45)**

The assumptions utilized in the district's unrestricted general fund MYFP are reasonable. The MYFP indicates that the district will not meet its reserve requirement in the two subsequent fiscal years, 2018-19 and 2019-20, without a detailed plan to eliminate its deficit spending. Deficit spending occurs when expenditures and other financing uses exceed revenues and other sources. A structural deficit occurs when a deficit is present in each year of the projection indicating that the pattern will continue in the absence of expenditure reductions. A structural deficit exists in the district's unrestricted general fund adopted budget that continues in each fiscal year of the MYFP.

The following table represents the district's historical and projected financial position as adjusted for 2016-17 ending fund balances presented in the district's unaudited actuals.

Historical Fund Balance	Unrestricted	Increase/ (Decrease) Unrestricted	Restricted	Combined	Combined Increase/ (Decrease)
2010-11	$19,532,921	($1,541,885)	$1,487,666	$21,020,587	($1,142,590)
2011-12	$14,272,543	($5,260,378)	$1,903,035	$16,175,577	($4,845,009)
2012-13	$10,412,750	($3,859,793)	$2,402,391	$12,815,140	($3,360,437)
2013-14	$11,461,390	$1,048,640	$4,608,883	$16,070,273	$3,255,132
2014-15	$17,271,345	$5,809,955	$4,161,488	$21,432,833	$5,362,560
2015-16	$32,697,416	$15,426,071	$6,229,481	$38,926,897	$17,494,064
2016-17	$29,657,143	($3,040,273)	$5,426,128	$35,083,271	($3,843,626)
2017-18 Projected *	$17,632,544	($12,024,599)	$3,974,656.05	$21,607,200	($13,476,071)
2018-19 Projected	$458,993	($17,173,551)	$3,764,304.77	$4,223,298	($17,383,902)
2019-20 Projected	($22,653,509)	($23,112,502)	$3,553,953.49	$(19,099,555)	($23,322,853)

Source: Ed Data
*Adjusted to reflect 2016-17 ending fund balances reported in unaudited actuals

The projection of a structural deficit is consistent with the district's historical trends. With limited exception, the district has a long history of deficit spending. The years without a deficit were the first three transition years under the Local Control Funding Formula (LCFF) in which districts received funding increases related to the state's gap closure. The deficit spending cycle in the unrestricted general fund was further obscured during this period due to the receipt of mandate funding that was considered one-time in nature. While revenue received by districts in the transition years resulted in increased revenue for many districts, much of this funding was essentially the gradual elimination of the deficit applied to entitlements under the former revenue limit allocation formula during the Great Recession. The applied deficit factor was 22.272% in 2012-13, the year prior to implementing the transition formula for the LCFF. Most districts had already provided salary increases based on the increased level of funding in years preceding application of the deficit. Once the gap in the LCFF transition formula narrowed and the influx of state funding slowed, the deficit resurfaced and grew. These circumstances are exacerbated by automatic annual salary and benefit increases.

The district's deficit spending trend indicates a need to increase revenue and/or decrease expenditures to maintain a positive unappropriated fund balance. A negative ending fund balance is projected in the district's unrestricted general fund at the close of the 2018-19 fiscal year. FCMAT concurs with the district's assessment that without the implementation of significant expenditure reductions or revenue enhancements the district will have a negative combined general fund balance at the close of the 2019-20 fiscal year requiring fiscal intervention.

In each year of the MYFP the reserve for economic uncertainties (REU) is based on unrestricted general fund balances and any balances set aside by the governing board in a special reserve for other than capital outlay fund (fund 17); the district does not utilize fund 17. The district's MYFP for the unrestricted general fund indicates that although the district meets the 3% recommended REU in the budget year, it will not meet the recommended REU in the two subsequent fiscal years.

Factors that likely contributed to the current situation and/or present fiscal risk include commitment of one-time resources to ongoing expenditures, not examining the affordability of new or increasing expenditures prior to approval, and not identifying an uncommitted and ongoing revenue source or budget reductions sufficient to support the cost of new expenditures.

Revenue - LCFF

The state is in its fifth year of transitioning to full implementation of the LCFF. Prior to its implementation, districts were receiving only 77.728% of entitled state apportionment funding; at that time a 22.272% deficit factor was applied to revenue limit funding due to the state budget crisis. While many districts received increases in revenue attributable to gap funding with the implementation of LCFF, much of this additional funding would have resulted from the elimination of the deficit factor under the revenue limit model. The district had already committed much of this funding to salary and benefit increases granted over the years preceding the state budget crisis. In addition, one-time revenue received for mandated cost reimbursements in 2014-15 and 2015-16 was used to fund ongoing salaries and benefits for new district positions such as teacher, counselor and principal on special assignment.

Salary and Benefit Commitments

Because salaries and benefits usually make up at least 80% or more of total general fund expenditures, any increases in these amounts can significantly affect the district's ongoing fiscal solvency. The district has salary formula language in its collective bargaining agreements dating back to 1988-89. For many years, the salary formulas served the parties in facilitating the annual bargaining process. Over time, factors external to the district that were not originally contemplated by the parties when the salary formula was drafted may have impacted its fairness. It is not possible to construct contract salary formula language in public school districts that will be forever foolproof.

The district's salary formula language was designed during the time of revenue limits and categorical programs when, for the most part, state-funded school districts received approximately the same unrestricted per-student revenue increases. During that time, the state would announce the funding of a cost-of-living adjustment (COLA) that affected nearly all unified school districts approximately equally. In addition, when the original salary formula was developed, there was no indication of the significant rate increases that have occurred in employer contributions to the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS).

Examination of the salary formula in place at the time of this review revealed that it has not been updated or modified to reflect the current economic or state funding model conditions that face California school districts and specifically the San Marcos Unified School District. FCMAT examined both the 2016-17 and 2017-18 salary formula settlements against the actual school district economic and state funding model factors provided by the state. For certificated nonmanagement staff, the salary increases far exceeded what would be considered fair share settlements. In fact, the dollar cost of the salary settlement for 2017-18 for just the certificated nonmanagement unit exceeded all of the LCFF unrestricted nongrowth new revenue from the state. In addition, it consumed almost all of the revenue from the growth that resulted from increased average daily attendance (ADA). A portion of growth in revenues from new ADA should be set aside for the increased costs attributable to serving more students, e.g., new employee positions, supplies and services.

The 2017-18 salary formula reads as follows:

> The salary schedule for the 2017-18 school year shall be determined by increasing the 2016-17 district salary schedule by the 2017-18 LCFF-funded COLA plus the percentage difference (plus or minus) between the 2016-17 district per diem salary and the 2016-17 fourth-ranked (4^{th}) position per diem salary or \$3.00 less than the third-ranked (3^{rd}) position, whichever is greater, among the eleven (11) San Diego County unified school districts as of June 30, 2017. For comparison purpose, all salaries will be converted to per diem amounts (benchmark annual salary divided by the number of contract days).

The result for 2017-18 was an across-the-board salary increase of 4.59% calculated as follows:

Carlsbad Unified School District is ranked 3^{rd} position	\$459.54
Less \$3.00	(\$3.00)
Total Per Diem	\$456.54
San Marcos Unified School District is ranked 4^{th} position	\$443.13
Difference	\$13.41
Difference as a Percentage	3.03%
2017-18 COLA	1.56%
Total	4.59%

The 4.59% salary increase for the certificated nonmanagement unit alone cost approximately \$4.9 million. The new nongrowth unrestricted LCFF revenue the district received from the state in 2017-18 was approximately \$3.8 million. When growth in ADA funding is added, the total LCFF new revenue received is \$5.2 million, which, as stated earlier, was virtually fully consumed by salary increases for certificated nonmanagement staff. The result is that the salary increases for the other employee groups, the increased contribution percentages for CalPERS and CalSTRS, the increased costs for special education,

step and column movement costs, and the staffing required for the 166 new students resulted in deficit spending and had to come from the fund balance.

The district should consider the following in evaluating the feasibility of retaining the current certificated nonmanagement salary formula:

- Using the district's new unrestricted ongoing revenue as a component if a formula is used. The current formula relies on salary settlements in other districts that receive far more LCFF revenue. For example, San Diego Unified School District is in the comparison group and receives about $1,300 more per student.
- The increasing costs of CalPERS and CalSTRS due to changes in the employer contribution rates.
- The increasing costs of step and column.
- The portion of funding growth due to increased ADA that is necessary to serve those additional students.
- The corresponding loss in revenue should the district eventually decline in enrollment.
- Removing the LCFF COLA from any calculation until the LCFF is fully funded. Until full funding is achieved, the COLA is only used for increasing the district's target funding level, but does not directly equate to new revenues for the district.
- Considering that some of the 11 San Diego County unified school districts may require additional duties or services from their certificated nonmanagement employees to justify the salary increases provided to remain in compliance with state regulations for the supplemental portion of LCFF revenues generated by the number of targeted students.

As part of this review FCMAT completed a commonly used calculation to determine what a fair share salary settlement would be using district-provided nongrowth LCFF data. The calculation is as follows:

Item	2016-17	2017-18
Total Increase in LCFF Funding	$8,534,326	$3,834,993
(Less: Supplemental Funding)	($1,017,705)	($146,850)
Base Grant Funding Increase	$7,516,621	$3,688,143
Less:		
CalSTRS Rate Increase Cost	($1,975,434)	($1,997,578)
CalPERS Rate Increase	($610,647)	($482,823)
Total Pension Rate Increase	($2,586,081)	($2,480,401)
Total New Base Grant Dollars Net of Pension Increased Costs	$4,930,539	$1,207,742
Certificated Nonmanagement Share (Statewide Percentage 60%)	$2,958,324	$724,645
Less: Step and Column	($1,346,439)	($1,504,474)
Dollars Available for Salary	$1,611,885	($779,828)
Cost of 1%	$1,002,982	$1,060,516
Fair Share Salary % Increase	1.61%	-0.74%
District Salary Formula Increase Provided	3.26%	4.59%
Cost of District Salary Formula Increase	$3,269,722.57	$4,867,769.83

Using a commonly used fair share calculation reveals that all of the new nongrowth LCFF dollars received by the district in 2017-18, $3,834,993, were consumed by pension rate increases and step-and-column movement. The cost of the certificated nonmanagement salary increase alone for 2017-18 was $4,867,769, which exceeds the district's nongrowth 2017-18 increased LCFF revenues. LCFF new revenues including growth ADA totaled $5,236,327. The certificated nonmanagement salary increase alone for 2017-18 consumed approximately 93% of all new LCFF revenues.

Management and classified employee groups have similar formulas that yield different results from the certificated nonmanagement salary formula. However, the same concerns exist with those salary formulas.

FCMAT recommends that the district evaluate the current salary formulas for each employee group to determine if modification or elimination is warranted considering the district's current and projected financial status and external economic conditions for California school districts.

District-Provided Health and Welfare Benefits

The district's contractual language provides for an automatic increase to benefit caps through January 2018 without identification of new ongoing funding or decrease in ongoing expenditures to support such increases.

The district has an established cap for health benefits that automatically increases each year by the percentage increase in the highest Kaiser plan. This automatic increase ceases in January 2018. Employees are eligible for prorated health and welfare and $50,000 group term life insurance coverage if employed at 50% or more of a full time equivalent for certificated staff and assignments of four hours or more per day/20 hours or more per week for classified staff.

The district offers a selection of health plans and has an insurance committee to evaluate and recommend the most cost-conscious options. Effective January 1, 2017, the district transitioned to tiered rate health benefit caps for each eligible employee of $7,881, $14,158 and $19,359 for single, two-party and family coverage, respectively. The annual benefit cap will increase for all plans in January 2018. The Kaiser plan will have the highest percentage increase, but no cap will exceed the annual Kaiser premiums. Dental coverage is provided for all eligible employees through Delta Dental PPO and Premier Plans.

Special Education

The district's special education program has continued to require a contribution from the unrestricted general fund at double-digit rates. In addition to increases in compensation, the district's instructional staffing has increased to provide coverage during preparation and consulting periods.

Secondary special education teachers provide instruction to students for four out of six instructional periods each day. The two remaining periods are used for preparation and consultation. However, secondary general education teachers provide instruction to students for five out of six instructional periods and have one preparation period. The instructional and preparation periods contribute to the need for increased staffing levels districtwide but more significantly in the special education program, which significantly affects the special education budget.

Expenditure Reduction Plans

Since the district's MYFP indicates deficit spending and shortfalls in each year presented, immediate action should be taken to reduce the deficit and correct the problem. The district has been developing a list of expenditure reduction options for the governing board to consider, some of which incorporates reductions that may be implemented in the current fiscal year. The earlier this action is taken, the greater the impact on the district's multiyear financial outlook. Each dollar of ongoing expenditures eliminated in the current year yields $3 of cost savings by the end of the third year of the MYFP. Once the governing board has taken official action to reduce or eliminate a specific expenditure, the chief business official (CBO) can incorporate those reductions into the current year budget and/or MYFP.

Proposed reductions that include the elimination or reduction of positions and/or particular kinds of service that do not require collective bargaining may be incorporated into the budget and MYFP after the governing board takes official action on those specific reductions, authorizing the administration to carry them out. Proposed reductions that affect salary and/or benefits of active employees subject to collective bargaining should not be incorporated into the district's budget and/or MYFP until final agreement has been reached between the district and the bargaining units and ratified by the governing board.

Fiscal Health Risk Analysis

The preceding pages addressed FCMAT's evaluation of the district's 2017-18 adopted budget and its related assumptions. At the time of FCMAT's fieldwork, the district was preparing for the 2017-18 first interim budget revision cycle, the details of which were not considered in FCMAT's analysis. Additionally, the district was in the process of developing a plan to address the shortfalls identified in the 2017-18 adopted budget and accompanying MYFP.

Key Fiscal Indicators for K-12 Districts

FCMAT has developed the Fiscal Health Risk Analysis to evaluate key fiscal indicators that may help measure a school district's risk of insolvency in the current and two subsequent fiscal years. Like an MYFP, the Fiscal Health Risk Analysis should be viewed as a snapshot in time.

Any evaluation of financial data or other organizational issues has inherent limitations because budgets and projections are developed based on certain economic assumptions and criteria, including changes in enrollment; cost-of-living adjustments; forecasts for utilities, supplies and equipment; changing economic conditions at the state, federal and local levels; and changes in organization or key leadership positions.

A district must continually update its budget as new information becomes available both within the district and from other external agencies. This is particularly true as the LCFF nears full implementation. Economic factors such as a slowdown in revenue growth and increases in employee pension costs often place an unexpected burden on the district's unrestricted general fund. Local factors including declining enrollment, emerging charter schools and increasing instructional program costs like special education, which are already inadequately funded, are difficult to control and place greater burden on already limited unrestricted general fund resources.

The presence of any single criterion in the Fiscal Health Risk Analysis does not necessarily indicate a district in fiscal crisis. However, districts that answer "No" to seven or more of the 20 key indicators may have cause for concern and could require some level of fiscal intervention. The more indicators identified, the greater the risk of fiscal challenges that could lead to insolvency. Identifying weaknesses and risk early is the key to mitigating these challenges and maintaining fiscal health.

Each of the 20 key indicators below contains several questions. FCMAT's responses are based on interviews of district staff, review of documentation and independent validation where possible. Detailed responses are summarized for each key indicator in its entirety unless otherwise addressed in the preceding pages.

Is the district's fiscal health acceptable in the following areas? Yes / No / NA

1. Deficit Spending... NO

- Is the district avoiding deficit spending in the current year? .... NO
- Is the district avoiding deficit spending in the two subsequent fiscal years? .... NO
- Has the district decreased or eliminated deficit spending over the past two fiscal years? .... NO
- Is deficit spending covered by fund balance, ongoing revenues, or expenditure reductions? ..... Fund Balance
- Has the board approved a plan to eliminate deficit spending? .... NO

  As addressed earlier in this report, the district has routinely experienced deficit spending in its unrestricted general fund and only pulled out of a structural deficit cycle during the initial years of LCFF implementation as the transition funding essentially eliminated the deficit factor formerly applied under the revenue limit allocation. The district has been working on an expenditure reduction plan and indicates that it has identified options that eliminate deficit spending by the third year of the MYFP; however, many reductions affect staffing and some are subject to collective bargaining.

2. Fund Balance... YES

- Is the district's fund balance at or consistently above the recommended reserve for economic uncertainty? .... YES
- Is the fund balance stable or increasing due to ongoing revenues and/or expenditure reductions?..... .... NO
- Does the fund balance include any designated reserves for unfunded liabilities or one-time costs above the recommended reserve level?... YES

  While the district's unrestricted ending fund balance meets or exceeds the recommended minimum reserve for economic uncertainty in the budget year, the MYFP indicates that the district will be unable to meet the recommended reserve beginning in the first subsequent fiscal year. Absent expenditure reductions or revenue enhancements, the district can expect a negative ending fund balance by the end of 2019-20.

3. Reserve for Economic Uncertainty .... NO

- Is the district able to maintain its reserve for economic uncertainty in the current and two subsequent years based on current revenue and expenditure trends? .... NO
- Does the district have additional reserves in Fund 17, Special Reserve for Other Than Capital Projects?... NO
- If not, does the district's multiyear financial projection include a plan to restore the reserve for economic uncertainty? .... NO

As mentioned earlier, the district is developing a detailed fiscal recovery plan and has identified options to mitigate the structural deficit; however, many will affect staffing and some may require collective bargaining.

4. Enrollment and Attendance.. YES

- Has the district's enrollment been increasing or stable for multiple years? ....YES
- Is the district's enrollment projection updated at least semiannually?...YES
- Are staffing adjustments for certificated and classified employee groups consistent with the enrollment trends? ....YES
- Does the district analyze enrollment and average daily attendance (ADA) data? ....YES
- Does the district track historical data to establish future trends between P-1 and P-2 for projection purposes? ....YES
- Has the district implemented any attendance programs to increase ADA?.................................YES
- Do school sites maintain an accurate record of daily enrollment and attendance that is reconciled monthly?..YES
- Have approved charter schools had little or no impact on the district's student enrollment?.......YES
- Does the district have a board policy that attempts to reduce the effect that transfers out of the district have on the district's enrollment?..YES
- Did the district certify its CALPADS Fall 1 submission by the required deadline?......................YES

The district has been fortunate in that it is among very few that have experienced enrollment growth. The following table presents the district's historical and projected enrollment and average daily attendance (ADA).

Enrollment and Average Daily Attendance (ADA)					
YEAR	**Enrollment**	**Enrollment Increase/ (Decrease)**	**P-2 ADA**	**ADA Increase/ (Decrease)**	**% ADA to Enrollment**
2010-11	18321.00		17734.00		96.80%
2011-12	19117.00	796.00	18235.00	501.00	95.39%
2012-13	19617.00	500.00	18732.00	497.00	95.49%
2013-14 #	19979.00	362.00	19345.53	613.53	96.83%
2014-15 #	20340.00	361.00	19697.63	352.10	96.84%
2015-16 #	20701.00	361.00	20009.72	312.09	96.66%
2016-17 #	20862.00	161.00	20102.67	92.95	96.36%
2017-18 Projected *	21142.00	280.00	20291.00	188.33	95.97%
2018-19 Projected *	21249.00	107.00	20391.00	100.00	95.96%
2019-20 Projected*	21454.00	205.00	20591.00	200.00	95.98%

 # CDE apportionment exhibits and LCFF Calculator
** Enrollment/ADA from LCFF calculation*

Enrollment projections are reviewed and updated each budget revision/reporting cycle. The district continues to project increases to enrollment and incorporates the increases in anticipated ADA into its LCFF calculation. Increases in enrollment and ADA are considered and included conservatively in the LCFF calculation and MYFP. Salary and benefit increases for positions related to growth are also incorporated into the financial projections; however, the number of positions attributed in the out years appears to be low when compared to enrollment, ADA and associated revenue increases.

5. Debt .... YES

- Does the district have a recent actuarial study and a plan to set funds aside for unfunded liabilities? YES
- Does the district maintain low levels of non-voter-approved debt (such as COPs, bridge financing, BANS, RANS and others)? .... YES
- Is the district conforming to GASB 68 requirements by recognizing and reporting its proportionate share of net liability for pension programs? .... YES

The district does not have any COPs, bridge financing, BANS or RANS or other non-voter approved debt.

6. Cash Monitoring .... YES

- Can the district manage its cash in all funds without interfund borrowing?............................... YES
- If interfund borrowing is occurring, does the district repay the funds within the statutory period in accordance with Education Code Section 42603? .... N/A
- Does the district forecast its cash receipts and disbursements and verify them at least monthly to ensure that cash flow needs are known with plenty of notice?... YES
- Does the district have a plan to address short-term cash flow needs? .... YES
- Are cash balances reconciled to bank statements monthly? .... N/A

Monthly financial reports are prepared by business services and presented to the governing board and include updated components of general fund balance.

Absent expenditures reductions, the district will likely depend on interfund borrowing at some point beginning in 2018-19. The district has sufficient cash available in other funds to mitigate any potential delays in funding. However, the district may be unable to repay the borrowings in accordance with Education Code Section 42603 unless revenue increases and/or expenditures decrease.

7. Bargaining Agreements .... NO

- Has the district settled the total cost of the bargaining agreements at or under COLA during the current and past three years? .... NO

- Did the district conduct a pre-settlement analysis, including multiyear projections, identifying ongoing revenue sources or expenditure reductions to support the agreement, as well as the long-term effects on the district? .... NO
- Did the district correctly identify the related costs above the COLA, (i.e., statutory benefits, step and column)? .... YES
- Did the district address budget reductions necessary to sustain the total compensation increase, including a board-adopted plan? .... NO
- Did the superintendent and CBO certify the agreement prior to ratification? .... YES
- Is the governing board's action consistent with the superintendent's/CBO's certification? .... YES
- Did the district meet the public disclosure requirements, including disclosure of the costs associated with a tentative collective bargaining agreement, before it became binding on the district? . NO

  As addressed above, the district has a compensation formula embedded in collective bargaining agreements used to calculate compensation increases each year. Because this compensation formula is incorporated into contract language, it results in a lack of contemplation of the effect on the district's budget and whether sufficient ongoing resources are available to support the cost of the increases.

  Traditionally, all proposed increases to compensation are evaluated and publicly disclosed using a Disclosure of Collective Bargaining Agreement (DCBA) prior to approval by the governing board. The DCBA provides a detailed analysis of the proposed increases to compensation including benefits, and the impact on the district's budget and overall fiscal position. The resources or other budget modifications necessary to support the costs of the increases are also identified. The DCBA is submitted to the county office of education for evaluation prior to action of the governing board to approve the increases. The intent is to ensure the district has sufficient resources to support the ongoing costs of the proposed increases in the long term.

8. General Fund........ YES

- Is the percentage of the district's general fund unrestricted budget allocated to salaries and benefits at or under the statewide average? .... NO
- Does the district ensure that only ongoing restricted dollars pay for permanent staff? .... YES
- Does the budget include reductions in expenditures proportionate to one-time revenue sources, such as parcel taxes, that will terminate in the current or two subsequent fiscal years? .... YES
- Does the district ensure that the parcel tax does not pay for ongoing expenditures? .... N/A
- Does the district ensure that litigation and/or settlements are minimized? .... YES

Salaries & Benefits as a Percentage of Revenue Combined General Fund						
	2014-15	2015-16*	2016-17	2017-18	2018-19	2019-20
Revenue	$173,989,080.94	$206,684,903.88	$209,132,006.38	$205,460,502.16	$212,571,845.00	$219,189,382.00
Salaries & Benefits**	$140,605,324.44	$160,850,598.48	$178,474,312.63	$188,338,753.14	$198,482,975.03	$209,619,463.03
As a % of Revenue	80.81%	77.82%	85.34%	91.67%	93.37%	95.63%
Expenditures	$167,319,217.84	$189,131,101.01	$212,765,632.22	$218,926,573.44	$229,945,747.03	$242,502,235.03
As a % of Expenditures	84.03%	85.05%	83.88%	86.03%	86.32%	86.44%

* Districts received a significant increase in other state revenue in 2015-16
** Salary and benefit projections are inclusive of all benefits, including retiree

As indicated in the table above, the percentage of revenue committed to salaries and benefits has increased steadily year over year, with a current combined percentage of 91.67%. When evaluated as a percentage of total expenditures, 86.03% of the combined expenditure budget is committed to salaries and benefits; 91.74% of the district's unrestricted expenditure budget is committed to salaries and benefits excluding those for restricted programs supported by the unrestricted general fund, and including special education and the routine repair and maintenance resources. The statewide average of salaries as a percentage of total expenditures, as last provided by Schools Services of California, is 83.86%.

For the 2017-18 budget year salaries were increased for estimated step and column increases and COLA. In the two subsequent years of the MYFP only estimated step and column increases and increased staffing relative to projected growth and special education were added. No increases were included for estimated costs of fourth place language. The district applies a factor of 2% for estimated step/column increases in the two subsequent years of the MYFP.

FCMAT found that 2016-17 revenue and related expenditures commonly treated as one-time items in each budget year, such as Medi-Cal administrative activities, mandated cost funding and associated student body fundraising, were significantly reduced or omitted in the 2017-18 adopted budget. These budget items are commonly added during interim budget revision cycles as activity becomes known.

The CBO reported that he is involved in nearly all settlements with the exception of those related to special education. The CBO further reported that outstanding litigation would all be covered under the joint powers agreement (JPA). FCMAT's review of historical expenditures identified a considerable increase in legal expenses in the 2016-17 fiscal year, rising to more than four times the expenditures for the preceding fiscal year, 45% of which was directly linked to litigation and settlements. Projected expenditures in the current budget year were reduced by half.

9. Encroachment .... YES

- Is the district aware of the contributions to restricted programs in the current year? (Identify cost, programs and funds) ....YES
- Does the district have a reasonable plan to address increased encroachment trends? ....YES
- Does the district manage encroachment in all funds including the cafeteria fund? ....YES

Restricted resources dependent on the general fund for contributions include special education and the ongoing and major maintenance resources. Contributions to these programs are estimated at $34,465,307, $37,384,310 and $40,487,953 in the 2017-18, 2018-19 and 2019-20 fiscal years respectively. Annual contributions to the ongoing major maintenance resource are equivalent to the required 3% transfer and account for approximately $6.4 million, $6.9 million and $7.2 million, respectively. The remainder is solely related to special education.

Increases to STRS and PERS continue to impact contributions, and compensation formula language in collective bargaining agreements limits the district's ability to control increasing compensation costs. Projections for contributions to restricted resources for the 2018-19 and 2019-20 fiscal years are very conservative compared to previous years, suggesting that in the absence of significant changes to student populations, programs or funding for special education, the impact on the district's unrestricted general fund could be expected to be greater than projected. Operational efficiencies may be attainable, including those associated with staffing costs, but require in-depth analysis of program services.

No other restricted resources currently indicate a dependency on the unrestricted general fund.

Other Funds

FCMAT reviewed the financial status of all district funds outside the general fund to identify any dependency on, and/or potential vulnerability to, the unrestricted general fund.

Adult Education Fund (11)

The district's adult education fund is self-sustaining, requiring no contribution from the unrestricted general fund.

Cafeteria Fund (13)

The cafeteria fund is self-sustaining, requiring no contribution from the unrestricted general fund. While the 2017-18 adopted budget projects a deficit with budgeted expenditures exceeding revenue by $537,793.27, district staff report that excess expenditures are necessary to ensure reserve balances do not exceed allowable limits.

Foundation Special Reserve Fund (19)

The district's foundation special reserve fund is for fiscal management of grant proceeds that are disseminated to students for scholarships to Cal State schools. The beginning balance of the fund for 2017-18 was $56,635.20. The district reports that this program is winding down and will cease once grant funds are exhausted. A district employee manages this program and the district provides the office space; however, there is no financial impact on the district's general fund because the salary and benefits are reportedly backfilled by the San Marcos Promise foundation.

Building Fund (21)

The district's building fund is used to account for proceeds from Proposition K general obligation bond that are committed to the spending plan associated with the ballot language. The beginning balance of the fund for 2017-18 was $56,649,013.00.

Capital Facilities Fund (25)

Proceeds from developer fees and residual redevelopment agency collections are committed to long-term debt obligations of the district for facilities projects. The beginning balance of the fund for 2017-18 was $20,335,781.76.

Special Reserve for Capital Outlay Fund (40)

Proceeds set aside in the district's capital project fund for capital outlay projects are not currently tied to a specific project; however, district personnel report that the funds may ultimately be used for the costs associated with field turf replacement for two of the district's high schools and for school bus replacement. The beginning balance of the fund for 2017-18 was $1,282,619.09.

Capital Project Fund for Blended Component Units (49)

The capital project fund for blended component units maintains proceeds collected from community facilities districts and that are committed to debt service for current and future facilities projects. The beginning balance of the fund for 2017-18 was $8,207,522.22.

Bond Interest and Redemption Fund (51)

The district's bond interest and redemption fund is established in connection with the issuance of long-term debt. Tax collection proceeds and debt payment are managed by external agencies. The beginning balance of the fund for 2017-18 was $12,718,280.00.

Foundation Permanent Fund (57)

Proceeds held from donors in the foundation permanent fund are to remain unspent by the district, with the annual earnings available based on donor specifications. The beginning balance of the fund for 2017-18 was $37,195.48.

Enterprise Fund (63)

In 2016-17 the district transferred accounting for the Kids on Campus daycare program to the enterprise fund as fees charged to parents that are the sole funding source supporting expenditures of this program. The fiscal activity of this program was formerly accounted for in the district's unrestricted general fund. The beginning balance of the fund for 2017-18 was $217,264.27.

Self-Insurance Fund (67)

The district maintains a self-insurance fund to account for activity relative to its risk management program. Costs for the risk management coordinator are covered by the fund proceeds. An annual interfund transfer of $10,000 is made into this fund from the unrestricted general fund each fiscal year. The beginning balance of the fund for 2017-18 was $211,578.55.

10. Management Information Systems .... YES

- Is the district's financial data accurate and timely? .... YES
- Are the mandated county and state reports filed in a timely manner? .... YES
- Are key fiscal reports – including those on personnel, payroll and budget –accessible, timely, and understandable? .... YES

- Is the district on the same financial system as the county? ....YES
- If the district is on a separate financial system, is there an automated interface with the financial system maintained by the county? .... N/A
- Is the district able to accurately identify students who are eligible for free and reduced-price meals, English learners, and foster youth, in accord with Local Control Funding Formula (LCFF) and Local Control Accountability Plan (LCAP) requirements? ....YES
- Is the district able to collect, assess, and report student data in the California Longitudinal Pupil Achievement Data System (CALPADS)?..YES

The district manages its financial information using the countywide PeopleSoft financial system. Transition to this system took place beginning 2015-16. The system has presented challenges as some components, including budget, position control and payroll are either not integrated or require county office manipulation to ensure consolidation in the financial records. Financial data from integrated systems is reflected immediately in the general ledger when a transaction is processed and approved, providing access to timely financial data for routine monitoring. Financial data for payroll requires a secondary entry processed by the county office in a summarized format in conjunction with the payroll process. Because data is in summary form, encumbrance projections in this area are slightly skewed, requiring additional monitoring by the district. Standardized financial reports and/or detailed financial data are reportedly limited or cumbersome to access.

The Education Services Division manages the student information system. School sites enter enrollment and attendance data, and CALPADS reporting is overseen through the Education Services Division. District leadership is not aware of any challenges collecting, assessing and reporting student data.

11. Position Control and Human Resources.. YES

- Does the district maintain and use an effective and reliable position control system that tracks personnel allocations and expenditures? ....YES
- Is position control integrated with payroll and the financial system? ....NO
- Does the district control unauthorized hiring?..YES
- Is the district able to control overstaffing?...YES
- Are the appropriate levels of internal controls (i.e., checks and balances) in place between the business and personnel departments to prevent fraudulent activity?...YES
- Is position control reconciled against the budget during the fiscal year? ....YES
- Does the district offer or ensure that staff attend professional development regarding financial management and budget?..YES

District leadership lack understanding of the functionality of the PeopleSoft financial system and integration with other systems. Human Resources (HR) staff believe the position control and payroll systems are integrated in the PeopleSoft financial system. The county office reports there is no integration capability between the position control system and the financial system. Human Resources and Business Services maintain separate position control databases. The Human Resources database is primarily used to maintain personnel data including board-approved positions, staffing assignments and employee specific data. The Business Services position control tool is used for budget development, revision and tracking. Staff from both departments work together to reconcile the data between the databases.

While the district exercises some compensating control activities to partially mitigate weaknesses presented by the lack of system integration, moving to a single position control system utilized by both Human Resources and Business Services should be explored to improve data management accuracy and efficiency and to strengthen overall internal control.

Digital Schools (a PeopleSoft product) is used to process payroll but is not directly integrated with the PeopleSoft financial system. Financial records for payroll are uploaded in summary form into the financial system, while payroll details remain and can only be accessed in the Digital Schools payroll module.

District staff reported there have been challenges in the past relative to district hiring processes. The district has worked to centralize all aspects of interviewing and hiring new employees solely through the Human Resources Department.

The district is aware that some overstaffing likely exists in special education, primarily in instructional aide positions. District leadership has experienced challenges in coordinating special education staffing. The staffing has been managed independently of Business Services, and a collaborative effort that ensures expenditure control has not been implemented. Expenditures for salaries and benefits committed to special education have increased more than 15% over the last two years and are expected to continue to rise.

12. Budget Development and Adoption .... YES

- Is a budget calendar used that contains statutory due dates and the major budget development milestones?..YES
- Are clear processes and policies in place to analyze resources and allocations to ensure they align with strategic planning objectives and that the budget reflects the LEA's priorities and LCAP? ..YES
- Is the LCFF correctly calculated and understood? ....YES
- Are projections for ADA, enrollment, revenue and unduplicated pupil count accurate and reasonable?..YES
- Is the district decreasing deficit spending and maintaining adequate reserves and fund balance when compared with the prior year? .... NO
- Has the district ensured that the LCAP is incorporated in the budget?......................................YES
- Is the budget developed using a zero-based method rather than being a rollover budget? .... NO
- Does the district use position control data for budget development? ....YES
- Does the budget development process include input from staff, administrators, board and community, as well as the budget advisory committee (if there is one)?..YES

- Are the LCAP and the budget adopted within statutory timelines established by Education Code Section 42103, and are the documents filed with the county superintendent of schools no later than five days after adoption, or by July 1, whichever occurs first? ....YES

13. Multiyear Projections .... YES

- Has the district developed multiyear projections that have reasonable assumptions?..................YES
- Are projected fund balance reserves disclosed and based on the most reasonable and accurate information available?...YES
- At a minimum, are the multiyear projections compiled at budget adoption and at the time of interim reports?...YES
- For the purpose of calculating multiyear projections, is the district using the latest LCFF gap closure percentages that show the amount of funding necessary to maintain purchasing power for the LCFF statewide? ....YES
- Is the LCFF target for each year recalculated based on the grade span ADA, and then compared to the adjusted prior year funding, so that the funding gap would then be reduced by the funding gap percentage for the given year?...YES

14. Budget Monitoring and Updates .... YES

- Are budget assumptions updated throughout the year as updated information becomes available?... ....YES
- Are actual revenue and expenses in line with the most current budget? ....YES
- Are budget revisions completed in a timely manner? ....YES
- Does the district openly discuss the impact of budget revisions at the board level? ....YES
- Does the district abide by Education Code 42127(h) by informing the board of education and the public, within 45 days of enactment of the state budget, of any changes in the state budget that would affect the adopted budget?...YES
- Are budget revisions made or confirmed by the board at the same time the collective bargaining agreement is ratified? ....YES
- Has the district's long-term debt decreased from the prior fiscal year? ....NO
- Are contributions to restricted programs controlled and monitored?..NO
- Has the district identified the repayment sources for long-term debt or non-voter-approved debt (e.g., certificates of participation, capital leases)? ....YES
- Does the district's financial system have a hard-coded warning regarding insufficient funds for requisitions and purchase orders? ....YES
- Does the district encumber salaries and benefits? ....YES

- Are the balance sheet accounts in the general ledger reconciled regularly?..................................YES
- Does the district complete and file its interim budget reports within the statutory deadlines established by Education Code Section 42130 and following, in a format or on forms prescribed by the Superintendent of Public Instruction (SPI), and ensure that they are based on standards and criteria for fiscal stability?..YES

  With the exception of special education, all restricted programs are self-supporting and do not require contributions from the unrestricted general fund. Contributions to direct LCFF revenue to special education services are expected; however, rising salary and benefit costs and maintenance of effort requirements eliminate the district's ability to control program costs, which greatly exceed LCFF and special education funding. The district prepares and presents to the governing board a resolution every month reflective of the current budget revisions.

  Because the district has a long-standing compensation formula built into its collective bargaining agreements, the fiscal impact is automatically included in the budget; therefore, the district does not prepare the DCBA.

15. Retiree Health Benefits .... YES

- Has the district completed an actuarial valuation to determine the unfunded liability under GASB 45 requirements? ....YES
- Does the district have a plan for addressing the retiree benefits liabilities? ....NO
- Has the district conducted a re-enrollment process to identify eligible retirees? ....YES

  The district has a multi-tiered retiree benefit structure due to changes in benefit eligibility requirements and coverage over time. The district completed its most recent actuarial study on January 6, 2017. According to the study, the district provides health insurance benefits for approximately 426 retirees.

  The district does not have an OPEB set aside and mitigates its OPEB obligation using a pay-as-you-go approach. The annual enrollment process is managed through the Human Resources Department, with aging out of covered dependents.

16. Leadership/Stability .... YES

- Does the district have a superintendent and/or chief business official who has been with the district more than two years? ....YES
- Does the governing board adopt and revise understandable and timely policies and support the administration to ensure implementation? ....YES
- Does the superintendent adopt and revise understandable and timely administrative regulations and ensure that adopted board policies and approved administrative regulations are communicated to staff and followed? ....YES
- Does the governing board refrain from micromanaging district administration and staff? ....YES

The current superintendent has served in the district since 2001, was seated in the position of superintendent in January 2017 and was preceded by a leader who served in the position for approximately 11 years.

The district subscribes to GAMUT and routinely disseminates board policy updates among department leadership for review and modification where necessary. Recommendations are presented to the governing board for review, consideration and input. Board policies affecting staff duties are disseminated to staff and some policies, such as mandated reporting and acceptable use of technology, are annually circulated to staff via email.

17. Charter Schools .... YES

- Has the district identified a specific employee to be responsible for ensuring that adequate oversight occurs for all approved charter schools? .... YES
- Has the charter school submitted the mandated financial reports on time? .... YES
- Has the charter school commissioned an independent audit? .... YES
- Does the audit reflect findings that will not impact the fiscal certification of the authorizing agency? .... YES
- Is the district monitoring and reporting the current status to the board to ensure that an informed decision can be made regarding the reauthorization of the charter? .... NO

The district has an established process for reviewing charter school petitions and oversight requirements for those authorized. The Business Services Department conducts fiscal oversight, reviewing budget and financial reports. No reports are made to the governing board regarding the district's oversight of authorized charter schools, but changes to this process are under consideration.

18. Internal Controls and Annual Independent Audit Report .... YES

- Does the district implement appropriate measures to discourage and detect fraud? .... YES
- Did the district receive an independent audit report without material findings? .... YES
- Can the audit findings be addressed without affecting the district's fiscal health? .... YES
- Has the independent audit report been completed and presented within the statutory timeline? YES
- Are audit findings and recommendations reviewed with the board? .... YES
- Did the audit report meet both GAAP and GASB standards? .... YES

The CBO feels confident about the district's internal control structure, stating that segregation of duties and control activities are in place to ensure proper checks and balances. Annual audits are presented to the governing board and audit findings, if any, are routinely resolved.

19. Facilities .... YES

- Has the district passed a general obligation bond? .... YES
- Has the district met the audit and reporting requirements of Proposition 39? .... YES
- Is the district participating in the state's School Facilities Program? .... YES
- Does the district have sufficient personnel to properly track and account for facility-related projects? .... YES
- Has the district met the reporting requirements of the Williams Act? .... YES
- Is the district properly accounting for the 3% Routine Repair and Maintenance Account requirement at the time of budget adoption? * .... YES
- Does the district prioritize facility issues when adopting a budget? .... YES
- If needed, does the district have surplus property that may be sold or used for lease revenues? ... NO
- If needed, are there other potential statutory options? .... NO

  - Joint Use: Can the district enter into a joint use agreement with some entities without declaring the property surplus and without bidding?

  - Joint Occupancy: The Education Code provides for a joint venture that can authorize private development of district property that will result in some educational use.

- Does the district have a long-range facilities master plan that was completed or updated in the last two years? .... In Progress

The facilities department is staffed with three coordinators, an executive director and three clerical support staff. The department routinely collaborates with the Fiscal Services Department. Annual projects lists are prepared for each site and compared to a districtwide list of routine repair and maintenance projects, and a priority list is established. The district is implementing a facilities needs matrix.

The district is updating its facilities master plan, which is needed for the next general obligation bond measure and Proposition K wrap-up. Facilities requirements have been developed based on education standards. The district's architect will review all projects for building code updates. Updates to demographic and enrollment data are under way. The district anticipates completion near the end of January 2018.

*Although the requirement for a district to set aside monies for deferred maintenance has been eliminated as part of LCFF, the requirement to set aside funds for routine repair and maintenance has not. Education Code Section 17070.75 requires a school district to deposit 3% of its total general fund expenditures into its routine restricted maintenance account for the sole purpose of maintaining school facilities in good repair.

20. General Ledger .... YES

- Does the district record all financial activity for all programs accurately and in a timely manner, ensuring that work is properly supervised and reviewed? .... YES

- Has the district closed the general ledger (books) within the time prescribed by the county office of education?..YES
- Does the district follow a year-end closing schedule?...YES
- Have beginning balances in the new fiscal year been recorded correctly for each fund from the prior fiscal year?...YES
- Does the district adjust prior year accruals if the amounts actually received (A/R) or paid (A/P) are greater or less than the amounts accrued?...YES
- Does the district reconcile all suspense accounts, including payroll, at the close of the fiscal year? ... .YES

  The Business Services Department ensures funding changes and expenditure budgets are routinely reviewed and updated. A reconciliation between actuals and budget is performed to verify against actual assessments for salaries and benefits, and appropriate adjustments are made. Evaluation of salary and benefit data is routinely done to ensure budgets are adequate, although some challenges exist due to limitations of the financial system software.

Conclusion

Throughout this report, FCMAT has identified areas of risk compromising the district's fiscal health. Inadequate communication, attention and or corrective action has led to signs of fiscal distress, the most evident of which is ongoing deficit spending. A lack of attention paid to the compounding fiscal effect and/or affordability of long-standing agreements that provide automatic increases in compensation, despite a structural deficit, has greatly contributed to the district's current fiscal condition. More than 90% of the total revenue sources in the general fund are committed to salaries and benefits; this commitment grows to 93.4% and 95.6% in the two subsequent years of the MYFP. The two subsequent years also only incorporate increases for step and column adjustments and the COLA portion of the agreement; no consideration for adjustments required under the fourth-place language is included. Any additional increases in compensation will only further compromise the district's ongoing fiscal solvency.

The district's fiscal position is further endangered by increases in obligations to STRS, PERS and OPEB; these increases are outside the district's control as are increased compensation costs for step and column adjustments. It is essential to the district's ongoing fiscal solvency to compare all new and/or increased revenue sources against all uncontrollable increases in expenditure commitments prior to committing to new or increasing controllable expenditures, including those associated with programs, services, and salary and benefits. The long-standing language in the collective bargaining agreements prevents the district from ensuring it can afford the increases over the long term.

Increasing costs for programs and services for students with special needs is also a significant contributing factor to the district's rapidly declining fiscal position, in part because of automatic increases to salaries and benefits. A lack of collaboration and oversight among HR, Business Services and Education Services may have allowed for increased staffing that may or may not be the most efficient, effective delivery of services. A detailed examination of special education programs and services is highly recommended.

The district should take immediate action to avoid further erosion of its reserves and possible fiscal emergency requiring further intervention.

State Intervention

If a district is unable to meet its financial obligations for the current or two subsequent fiscal years resulting in a qualified or negative budget certification, the county superintendent of schools is required to notify the district's governing board and the SPI. The county office of education must follow Education Code Section 42127.6 in assisting a school district in this situation. The San Diego County Office of Education has already initiated this authority under 42127.6(a)(1)(E) by requesting the district to submit a proposal for addressing the fiscal conditions that resulted in the determination that the district may not be able to meet its fiscal obligations.

Absent corrective action, the district will require state intervention. If a California school district's governing board determines that it has insufficient funds to meet its current obligations, it may request an emergency apportionment loan from the state. These loans are provided only through a legislative appropriation that involves various lengthy and complicated steps and preparation by both the district and the county office. If a state loan becomes necessary, the governing board loses local control and the district superintendent position is eliminated and a state administrator is assigned. The district is responsible for repaying the state loan with interest, the cost of the state administrator and FCMAT's services; these costs are all factored into the loan. The most effective way for the district to avoid such intervention is to develop and implement a fiscal recovery plan that identifies revenue enhancements and/or expenditure reductions sufficient to mitigate the identified shortfall over the long term. Because more than 91.7% of the unrestricted general fund expenditure budget is composed of salaries and benefits, any solution is likely to include some form of staffing and/or compensation adjustments.

FCMAT would like to thank the San Marcos Unified School District staff and the San Diego County Office of Education for their cooperation and assistance in this review. If you have questions or require additional information about any of these issues, please do not hesitate to contact me at (661) 304-7072.

Sincerely,

Marisa A. Ploog, CPA, CFE, CGMA, CICA
Intervention Specialist