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February 3, 2012

To: Assistant Superintendents, Business Services
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Assistant Superintendents, Instructional Services
Directors, Business Services
Directors, Special Education Services
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From: Wendy Benkert, Ed.D., Assistant Superintendent
Business Services

Subject: **2011-12 Second Interim Budget Advisory**

Since May 2008, County Office Chief Business Officials have been working with various statewide educational organizations to craft common messages and to advise school districts on assumptions for budget and interim reports. The attached advisory provides guidance for the development of school districts' Second Interim Reports and multi-year projections and is based upon the Governor's Proposed 2012-13 State Budget and subsequent legislation.

If you have any questions or concerns regarding this information, please contact me at (714) 966-4229.

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Enclosures

Orange County Budget Advisory

2011-12 Second Interim Report & Related Multi-Year Projections

February 3, 2012

BACKGROUND

Since May 2008, County Office Chief Business Officials have been working together to craft common messages to advise school districts on assumptions for budget and interim reports. This edition provides guidance for the 2011-12 Second Interim Report and related Multi-Year Projections (MYPs). The advice contained in this version incorporates the Governor's Proposed 2012-13 State Budget and other changes since the "2011-12 First Interim Budget Advisory" which was issued on October 21, 2011.

On January 5, 2012, Governor Brown introduced his Proposed 2012-13 State Budget. The introduction of the Governor's Proposed 2012-13 State Budget begins the legislative process and many changes will take place prior to the enactment of a 2012-13 State Budget. This proposed budget has significantly reduced the State's general fund deficit, but still left a gap projected at \$9.2 billion for 2011-12 and 2012-13. The Governor proposes to close this gap by a combination of increased revenues, primarily taxes, and further reductions in non-Proposition 98 expenditures.

The cornerstone of this budget assumes passage of a new tax initiative proposed by the Governor, named the, "Temporary Taxes to Fund Education. Guaranteed Local Public Safety Funding." According to the Department of Finance (DOF), the initiative would generate an additional \$6.9 billion annually from 2013 to 2016. This initiative, if passed by the voters in the November 2012 election, would temporarily increase the state sales tax by ½ cent and would increase the income tax rate by up to 2% on the state's wealthiest taxpayers.

In addition to the tax increase, the Governor proposes to generate an additional \$1.4 billion in other revenue sources such as fees, loans and payment deferrals. Also included in the budget are more than \$2 billion in cuts to Health and Human Services, including CalWORKS, Medi-Cal/Medicare, and In-Home Support Services, as well as reductions to child care and certain mandates.

The Governor's Proposed 2012-13 State Budget increases K-14 Proposition 98 spending by about \$4.9 billion. Currently the 2011-12 Proposition 98 spending is about \$47.6 billion, but would increase to \$52.5 billion in 2012-13. **However, the budget proposal will only maintain programmatic funding at the current levels plus eliminate transportation funding.** The Proposition 98 increase will be used as follows:

- \$2.229 billion (\$2.1 billion K-12) to fund 2011-12 deferrals.
- \$2.4 billion (\$2.2 billion K-12) to pay down the cross fiscal year deferral credit card already on the books.
- \$98.6 million increase in Special Education funding for mental health services to disabled students that backfills one-time Proposition 63 funding used in 2011-12.
- \$110.1 million increase to support a new K-14 block grant for mandates.

The proposed budget also incorporates major reforms to K-12 education including increased categorical flexibility, a new weighted student funding formula, elimination of home-to-school and special education transportation funding, and elimination of the Transitional Kindergarten requirement. Further details of these proposed reforms are included in the following pages of this message.

"TRIGGER LANGUAGE"

2011-12 "TRIGGER REDUCTIONS"

AB 114, Chapter 43, Statutes of 2011, enacted "trigger language" for 2011-12 that automatically implemented reductions to K-12 education, if 2011-12 state revenue forecasts of \$88.5 billion were not met. The forecasts were approximately \$2.2 billion below estimates and therefore the "trigger" for 2011-12 was implemented as follows:

- All Tier I "trigger reductions" including a \$23 million across-the-board cut to child care and a \$30 million reduction to community colleges, accompanied by a \$10 increase to student enrollment fees (this is on top of the \$10 increase included in the first Budget bill).
- Part of the Tier II "trigger reductions" which included a \$79.6 million or 0.25% (or an average \$13/ADA) reduction to revenue limits; a \$248 million cut to home-to-school and special education transportation; and a \$72 million reduction to community colleges. The average \$13/ADA reduction is a one-time reduction and only affects fiscal year 2011-12. Please also note that the transportation trigger reduction may take the form of a 0.65% (or approximately \$41/ADA for the average unified school district) revenue limit reduction if Senate Bill 81 (SB 81) is signed by the Governor. Please refer to the "Revenue Limit and COLA" section on page 5 below for more details.

2012-13 "TRIGGER REDUCTIONS"

The Governor's Proposed 2012-13 State Budget provides for "trigger reductions" of \$5.4 billion to education and public safety should the Governor's tax initiative not pass in the November 2012 election. These reductions would become effective on January 1, 2013. Proposition 98 funding would then be projected at approximately \$47.7 billion. This would result in an approximate \$4.8 billion reduction to K-14 education. Based on Department of Finance (DOF) estimates, the impact on K-12 school districts would represent approximately \$370/ADA reduction to the revenue limit in addition to 100% elimination of each school district's home-to-school and special education transportation apportionment. Additionally, the \$2.4 billion K-14 cross fiscal year deferral reduction would be reversed. The Governor also proposes to shift \$2.6 billion in K-14 general obligation bond debt service payments to be counted towards the Proposition 98 minimum guarantee.

THE GOVERNOR'S 2012-13 BUDGET PROPOSAL

The Governor's Proposed 2012-13 State Budget provides both challenges and potential opportunities for school districts. Ms. Sue Burr, the Governor's Chief Education Policy Advisor and Executive Director of the State Board of Education, has emphasized that education continues to be the number one fiscal and programmatic priority of the Governor. The Governor has acknowledged that education has taken a majority of the budget reductions in past years. He offers to "protect education" through the proposed tax initiative which is intended to provide education with the same level of revenue limit funding as received in 2011-12 based on the total state revenue limit appropriation level. It is important to understand his proposal does not guarantee total flat funding of revenues for individual school districts. The total impact of the Governor's Proposed 2012-13 State Budget to individual school district budgets will vary because of other proposed funding changes that may or may not affect each school district, such as, the elimination of all transportation funding and the proposed weighted pupil formula for the majority of categorical funding. Additionally, the Governor states his commitment to restoring local control to school districts through his proposed weighted pupil funding formula and his elimination of categorical funding restrictions as proposed in his 2012-13 budget.

There are other important factors to also consider that may impact the development of financial projections. Some of those factors are listed below and categorized as "Economic and Other".

ECONOMIC FACTORS

- California has reduced its budget deficit from \$26.6 billion in 2011-12 to \$9.2 billion in 2012-13 per the Governor's Proposed 2012-13 State Budget.
- The stock market is showing signs of recovery although it is still somewhat volatile.
- Retail sales posted strong growth for the holiday season.
- There has been growth in the commercial sector of the construction industry although the housing market has not rebounded, particularly in California.
- The unemployment rate for the US dropped to 8.6% in November 2011. Although the unemployment rate for California has dropped, it still remains higher than the national rate at 11.3%.
- The European debt crisis is expected to slow economic growth in Europe and will likely impact the US economic growth.
- The Legislative Analyst's Office (LAO) estimates the Governor's proposed tax initiative will raise \$2.1 billion less than the Department of Finance (DOF). If the Legislative Analyst's Office (LAO) estimates become reality, this would require further expenditure reductions and could impact education funding.

OTHER FACTORS

- 2012 is a "presidential" election year.
- There are many controversial initiatives that could be on the November ballot. The number of ballot initiatives could impact a voter's support of any tax initiative.
- The California Legislature may not support the proposed expenditure reductions to the health and human services areas as currently proposed by the Governor in his budget.
- There are court challenges that could hinder the full implementation of budget reductions such as the Medi-Cal provider rate reduction which was stayed by the courts.

We recognize the uniqueness of each school district's financial situation and its ability to develop and implement realistic contingency plans in the event that the Governor's proposed tax initiative fails the November 2012 ballot. As we review the Second Interim report, some of the factors we will consider include:

- The percent of the school district's reserve for economic uncertainties.
- The cash flow projections and the school district's ability to meet its expenditure obligations for at least an 18 month period.
- The ability to immediately implement expenditure reductions if necessary.
- A review of the school district's previous expenditure reductions and any potential reductions that may still be available to the school district such as class size increases.
- The status of the school district's negotiations.
- Other reserves that are available for immediate use. For example, one-time savings from the current year associated with actual mid-year reductions being less than what school districts set-aside in their contingency plan.
- Revenue limits may need to be adjusted for the potential tax initiative loss.

Based on the Governor's commitments to education, and the uncertainty relative to the passage of the Governor's tax initiative, we recommend the following guidance:

- It is expected that school districts will maintain "best fiscal practices."

- **If school districts build their budgets using flat revenue limit funding, financial projections should have contingency plans for the possible failure of the Governor's tax initiative.**
- School district contingency plans must be realistic and ready for timely implementation if necessary.
- School districts must carefully review their MYPs for one-time revenues and note the ending date of the revenues to avoid over projecting those revenues.
- Cash flow becomes a critical consideration. School districts may find it more difficult to issue TRANs and the cost of any borrowing may increase. Cash flow should be looked at over an 18 month cycle rather than a 12 month cycle.

THE FOLLOWING SECTIONS PROVIDE MORE DETAILED ADVICE
RELATIVE TO CHANGES SINCE THE 2011-12 FIRST INTERIM BUDGET
ADVISORY DATED OCTOBER 21, 2011:

Revenue Limit and COLAs

The Governor's Proposed 2012-13 State Budget does not provide a statutory cost of living adjustment (COLA) for any program in 2012-13. The projected statutory COLA of 3.17% is not funded; therefore, the deficit factor will be increased to reflect this loss of funding. The proposed budget provides full funding for enrollment growth which is projected to be approximately 0.35%.

The 2011-12 Enacted State Budget and the Governor's Proposed 2012-13 State Budget specifies the statutory COLA and deficit factor for the revenue limits for 2011-12 and 2012-13 as defined in the following table:

	2011-12 Enacted State Budget	2012-13 Governor's Proposed Budget
Statutory Cost of Living Adjustment (COLA)	2.24%	3.17%
K-12 Deficit	19.754% (.80246)	21.666% (.78334)
County Office Deficit	20.041% (.79959)	22.497% (.77503)

Although unfunded, the 2.24% statutory COLA for 2011-12 and the 3.17% estimated COLA for 2012-13 translate into the following statewide average base revenue limit amount per ADA:

School District Type	2011-12 Statutory COLA 2.24% - Actual	2012-13 Estimated Statutory COLA 3.17%
Elementary	\$137	\$198
High School	\$164	\$238
Unified	\$143	\$207

The following are factors to be considered as a school district calculates its 2012-13 revenue limit;

- The 3.17% statutory COLA is not funded for 2012-13.
- The 0.25% or average of \$13/ADA revenue limit “trigger reduction” shall be implemented beginning in February 2012 for fiscal year 2011-12 only.
- The Department of Finance deficit amount appears to be insufficient to zero out the 3.17% COLA for school district base revenue limits. The calculation appears to generate an additional \$37 per ADA increase for the average unified school district. This increase is not in alignment with the Governor’s Proposed 2012-13 State Budget Message of “flat funding.” School districts should adhere to the “flat funding” message and use the same base revenue limit in 2012-13 as was used in 2011-12 before the implementation of the 0.25% or \$13/ADA “trigger reductions.”
- As discussed earlier, the Governor’s Proposed 2012-13 State Budget is based on the passage of his tax initiative. If this initiative fails on the November 2012 Election, the proposed budget has an automatic “trigger reduction” of \$2.4 billion for K-14 education. Per the Department of Finance calculations, this would result in a loss of approximately \$370/ADA. **It is strongly recommended that districts have a contingency plan in place that could be implemented in the event that the tax initiative is unsuccessful.**
- Complicating the revenue limit issue is Senate Bill 81 as amended on January 30, 2012. This bill would eliminate the “trigger reduction” for home-to-school and special education transportation and restore the \$248 million transportation appropriation. In its place, SB 81 proposes to increase the school district revenue limit deficit factor from 19.754% to 20.404% and the county office revenue limit deficit factor from 20.041% to 20.691%. In addition, SB 81 also increases the reduction to categorical programs for Basic Aid school districts in 2011-12 from 8.92% to 9.57% to ensure a “fair share” reduction commensurate with the revenue limit reduction for non-Basic Aid school districts in 2011-12. If signed by the Governor and enacted, SB 81 would take effect immediately as it is a trailer bill. This bill was sent to the Governor on February 2, 2012 and is awaiting his signature. **School districts must be aware of this potential change in funding and have a plan for the loss to their revenue limit if it were to be enacted. Although SB 81, if enacted, would restore the transportation appropriation for 2011-12, the Governor’s Proposed 2012-13 State Budget proposes to eliminate the entire transportation appropriation.**

The School Services of California Financial Projection Dartboard provides additional information relative to statutory COLAs and revenue limit deficits. **It is recommended that school districts utilize this information in preparing their Multi-Year Projections (MYPs). Given the uncertainty of the State’s economic recovery, school districts may want to have a contingency plan for any reduction to the out year COLAs when incorporating future statutory COLAs.**

Basic Aid School Districts

For 2011-12 and 2012-13, the State Budget provides for a reduction to state categorical funds provided to a basic aid school district in an amount equal to 8.92% of its revenue limit, commonly known as the “fair share” reduction. A school district receives a “fair share” reduction based on the district’s basic aid status at the Second Principal Apportionment in the prior year. This means that for a school district to be subject to the 8.92% cut in 2011-12, it must be a basic aid district in 2010-11. If a school district becomes basic aid in 2011-12, it will be “subject” to the “fair share” reduction in 2012-13. However, in no event would that reduction be more than the amount of local revenues that exceed the district’s revenue limit.

Basic aid school districts should be prepared to take their share of any “trigger language” reductions in the event the Governor’s tax initiative fails. Similar to the advice above, basic aid districts may need to develop contingency plans using the loss of \$370/ADA, or to the extent that categorical revenues are available for the State to reduce, including AB602 Special Education revenues. Complicating the “fair share” reduction for 2011-12 is the amendment of Senate Bill 81 on January 31, 2012, which if enacted increases the current year “fair share” reduction. See the previous section for details on SB 81.

Property Taxes

We recommend that school districts align their 2011-12 Second Interim projected year totals for property taxes with the 2011-12 P-1 property tax estimates that were provided in November 2011 by the Orange County Auditor-Controller's office. The 2011-12 P-2 property tax estimates won't be available until April 2012.

Interest Yield Projections

The projected average gross interest yield for 2011-12 and 2012-13 is 0.40%. This projection is provided by the Orange County Treasurer-Tax Collector and is based on the current yield environment taking into account any possible action from the Federal Open Market Committee. This information is updated throughout the year by the Orange County Treasurer.

Special Education

The Governor's Proposed 2012-13 State Budget for special education provides \$12.3 million for ADA growth. No COLA is provided for special education.

- Special Education Local Plan Areas (SELPAs) with growth will receive an estimated \$465.44 per ADA. This is the same as last year.
- Also, a \$17.4 million increase in federal funding will be allocated to SELPAs, estimated at \$2.94 per ADA.
- Under the Governor's mandate proposal, he would eliminate the Behavioral Intervention Plan (BIP) and would make its continuation optional for each school district.

AB 3632 mental health services to students with disabilities continue to be the responsibility of school districts for 2012-13. A total of \$417 million is provided to support mental health services including the \$98.6 million augmentation to backfill the loss of the Mental Health Act funding (Proposition 63).

School districts should review special education allocations with their SELPA for 2012-13 budget projections. As a result of AB 114, Proposition 98 Mental Health and Federal IDEA Mental Health revenues will shift in 2012-13 from a per pupil allocation to an ADA allocation. This has caused some SELPAs to lose upwards of 50% or more in mental health revenues in 2012-13.

Transportation

2011-12 FISCAL YEAR

AB 121, Chapter 41, Statutes of 2011 reduced home-to-school and special education transportation by \$248 million as a result of the mid-year "trigger reductions." These reductions were implemented for the applicable school districts in January 2012. School districts may be able to make changes to regular education home-to-school transportation as a result of these reductions. However all school districts must continue to provide special education transportation as required by a student's IEP.

Education Code Section 41851(c) was not amended by the "trigger reductions." This Education Code Section requires that a school district must expend 100% of the 2011-12 transportation entitlement (amount before the cut was applied) on transportation during 2011-12 in order to receive the same amount of funding for future years. The CDE is aware of this provision and is reviewing the possibility of a waiver for the reductions due to the "trigger language" implementation. This Education Code Section would become inoperative if the Governor's Proposal to eliminate all transportation for 2012-13 and beyond is enacted.

Complicating the decisions around the home-to-school transportation issue is the amendment of Senate Bill 81 on January 30, 2012. See page 5 for details on SB 81.

2012-13 FISCAL YEAR

The Governor's Proposed 2012-13 State Budget eliminates all regular education and special education home-to-school transportation including small school bus replacement funding for fiscal year 2012-13 and beyond. If this provision is enacted in the final budget document, school districts may be able to eliminate regular education home-to-school transportation, but would need to continue to provide special education transportation as required by the student's IEP.

It is recommended that school districts plan for the elimination of transportation funding for 2012-13 and beyond. There may be a need to increase the contribution to special education for transportation as a result of the reduction in funding. It is also advised that school districts exercise caution in dismantling their home-to-school transportation system pending further action by the Legislature relative to the Governor's budget proposal and to any implications as a result of SB 81.

Child Care Programs

The Governor's Proposed 2012-13 State Budget for child care funding has been reduced by \$516.8 million and is budgeted for a total of \$1.5 billion. These reductions reflect the alignment of eligibility for low income working families' child care services with federal welfare-to-work participation requirements. Specific reductions are as follows;

- Approximately 46,300 child care slots will be eliminated as families are required to meet federal welfare-to-work requirements.
- Standard reimbursement rates for direct contracted Title 5 centers (including half day State Preschool Programs) would be reduced by 10%.
- Approximately 15,700 child care slots would be eliminated by reducing the income eligibility ceiling for families from 70% of the state medium income to 200% of the federal poverty level.
- Reduces the reimbursement rate ceiling for voucher base programs from the 85th percentile of the private pay market, based on 2005 market survey data, to the 50th percentile based on the 2009 survey data.
- Eliminates the statutory COLA for non-CALWORKs child care programs.

For 2013-14 and beyond, the Governor's proposal reflects an administrative restructuring of child care programs. This would include shifting functions from alternative payment programs and Title 5 centers to the county government for administration of a voucher type program.

Lottery

Please note that Lottery funding will be calculated in the same manner as prior years, with the exception that through 2014-15, the following programs will be funded based on 2007-08 ADA rather than the prior year ADA:

- Adult Education
- Regional Occupational Center and Programs (ROC/P)

On April 8, 2010, the Legislature passed AB142 (Chapter 13 / 2010) which requires that not less than 37% of the total annual revenues from the sale of lottery tickets to be distributed to education.

The current projection for 2011-12 is \$117.25 per ADA (unrestricted) and \$23.25 per ADA (Prop. 20 restricted). The Lottery Commission will report the projections for 2012-13 in June 2012. **Until that time, it is recommended the 2012-13 lottery projection remain the same as 2011-12; \$117.25 per ADA (unrestricted) and \$23.25 per ADA (Prop. 20 restricted).**

Mandated Costs

Another reform proposed in the Governor's Proposed 2012-13 State Budget would provide a total of \$200 million to fund a mandated cost block grant incentive program for K-14 education. The proposal would eliminate approximately half of all existing mandates including graduation requirements and behavioral intervention plans. School districts could choose to continue to operate these programs, but would not receive any mandated cost reimbursement.

The remaining mandates that are not eliminated would become optional. Included in this list are immunizations, criminal background checks, and several mandates related to health and safety. The Governor's proposal would create block grant funding to encourage school districts to continue meeting requirements of these specified mandates and the funding would be contingent on complying with the mandate requirements.

At this time it is recommended that school districts continue to adhere to all mandate requirements and budget revenue on a cash basis. Legislation would be required to eliminate any mandates and would be introduced within the following months.

Forest Reserve Funds

The reauthorization of the Secure Rural Schools (SRS) & Communities Act is still not completed, even though a Senate bill has been introduced, and there is draft legislation in the House of Representatives. While we were hopeful that we would be included in the December 2011 Payroll Tax discussion, it was only partially acted upon. We have been told that Payroll Taxes, and Tax Extenders will be taken up again in February 2012, and we remain hopeful that our reauthorization is part of that comprehensive legislative package. For current budget planning purposes, counties should project an 88% loss to SRS funding.

Transitional Kindergarten

SB 1381, Chapter 705, Statutes of 2010 changed the birth date for enrollment in kindergarten by moving the date for eligible age requirement from December 2nd to September 1st. Under current law these changes are scheduled to be phased in over three years as follows:

- Eligibility by November 1 for 2012-13
- Eligibility by October 1 for 2013-14
- Eligibility by September 1 for 2014-15

This bill mandated a Transitional Kindergarten Program for students displaced as a result of the changes in eligibility birthdates. School districts are currently scheduled to collect ADA for these transitional kindergarten students. The Governor's Proposed 2012-13 State Budget proposes the elimination of the requirement that school districts provide transitional kindergarten instruction beginning with the 2012-13 school year. Transitional kindergarten would be optional for 2012-13 and would be a local decision for each school district. The proposed budget does not eliminate the eligibility age requirements which will begin in 2012-13 and move to November 1st from December 2nd.

Education Code 48000(b) is not proposed for elimination by the Governor. Therefore, school districts may admit students under the Governor's proposal early per the requirements of the education code, but the school district won't receive any ADA funding until that student reaches the age of five.

School districts may be entitled to receive ADA funding to serve "under-age children" based on currently existing statutes.

It is recommended that school districts review enrollment projections and decrease the revenue limit funding for ADA that would have been claimed for transitional kindergarten students in 2012-13. Additionally, staffing levels should be reviewed.

Expansion of Categorical Flexibility

The Governor is proposing that virtually all categorical programs, including K-3 CSR and Economic Impact Aid (EIA), be moved into "Tier III" categorical flexibility in 2012-13. The exceptions are Special Education, QEIA, Child Nutrition, Proposition 49 After-School, and preschool (Federal Programs are outside the purview of the state legislative action).

Should this flexibility not be enacted, please note that most of the temporary flexibility provisions were extended to June 30, 2015 with the exception of the K-3 Class Size Reduction (CSR) reduced penalty provisions. The flexibility provisions for the CSR reduced penalties expire on June 30, 2014 instead of June 30, 2015. This would impact the school districts MYPs as they prepare their 2012-13 budgets.

Weighted Pupil Funding Formula

The Governor has indicated that California's school finance system has become "too complex, administratively costly and inequitable". The Governor proposes major school finance reform to remedy these issues and to provide greater flexibility in the use of funding. This Weighted Pupil Funding Formula model would reflect the following elements;

- This funding formula would replace revenue limits and most state categorical programs. Attachment A provides a list of those categorical programs that would be included and those that would be excluded per the Department of Finance.
- The model would eliminate most categorical program requirements allowing total flexibility in use of the funds. However accountability requirements would be implemented at a future date.
- The model would be phased in over a five year period allocating 20% of the revenue limit funding and categorical program funding based on this new Weighted Pupil Funding Formula each year.
- The formula would be based on counts of English Learners (EL) and pupils eligible for free and reduced price lunches.

There is currently not enough detail in the Governor's Proposed 2012-13 State Budget to determine the financial impact on any given school district. Further details for this reform package will be forthcoming in the next couple of months. There currently is not a "hold harmless" provision indicating that there would be winners and losers under this proposal. This proposal is likely to be modeled after the proposal outlined in the paper; "Getting Beyond the Facts: Reforming California School Finance" by Alan Bersin, Michael W. Kirst, and Goodwin Liu.

At this time, it is recommended that school districts continue to maintain the current level of funding for revenue limits and categorical programs. Moreover, school districts should assume no further changes in categorical flexibility programs.

CASH MANAGEMENT

Intra-Year Principal Apportionment Deferrals

SB 82 was chaptered on March 24, 2011 and allows for intra-year deferrals in the 2011-12 fiscal year. Although the Governor's January Budget proposal is silent on intra-year deferrals for 2012-13 and beyond, at this time, we recommend that school districts anticipate the continued implementation of SB 82 deferrals in 2012-13 and subsequent fiscal years. The intra-year deferrals from SB 82 are as follows:

Timeframe	Deferral Amount
July 2011 to September 2011	\$700 million
July 2011 to January 2012	\$700 million (\$541 million was actually deferred)
August 2011 to January 2012	\$1.4 billion (\$1.2 billion was actually deferred)
October 2011 to January 2012	\$2.4 billion (\$2.2 billion from Principal Apportionment and the difference is a 100% deferral of the October consolidated categoricals payment plus a 7% deferral of the October Instructional Materials Realignment Program (IMFRP) payment)
March 2012 to April 2012	\$1.4 billion (\$837 million from Principal Apportionment and the difference will come from a 100% deferral of the March consolidated categoricals payment plus a 100% deferral of the March Economic Impact Aid (EIA) payment)

Cross Fiscal Year Principal Apportionment Deferrals

The Governor's 2012-13 January Budget proposes an increase of \$2.1 billion in Proposition 98 funding for the purpose of reducing ongoing K-12 school district revenue limit deferrals. The pay down of 2012-13 deferrals will only occur if the tax initiative is successful. If the tax initiative is unsuccessful, there is no change to the existing cross fiscal year cash deferral schedule. **Therefore, when preparing cash flow projections, we recommend that school districts use the current deferral schedule and not change projections until the outcome of the November 2012 election is known.** Please refer to the two tables shown below for a list of principal apportionment cross fiscal year cash deferrals for 2011-12 and 2012-13. See Attachment B for a graphic illustration of all principal apportionment deferrals both intra-year and inter-year.

2011-12	
Deferral Amount	Timeframe
\$2.0 billion	February 2012 to July 2012
\$1.3 billion	March 2012 to August 2012
\$763.8 million	April 2012 to August 2012
\$419 million	April 2012 to July 2012
\$678.6 million	April 2012 to August 2012
\$800 million	May 2012 to July 2012
\$1.0 billion	May 2012 to August 2012
\$2.5 billion	June 2012 to July 2012
\$9.4 billion	Deferred across fiscal years

2012-13		
If Tax Initiative Fails (status quo)	If Tax Initiative Passes	Timeframe
\$2.0 billion	<i>\$1.0 billion</i>	February 2013 to July 2013
\$1.3 billion	\$1.3 billion	March 2013 to August 2013
\$763.8 million	\$763.8 million	April 2013 to August 2013
\$419 million	\$419 million	April 2013 to July 2013

\$678.6 million	<i>\$147 million</i>	April 2013 to August 2013
\$800 million	\$800 million	May 2013 to July 2013
\$1.0 billion	<i>\$379 million</i>	May 2013 to August 2013
\$2.5 billion	\$2.5 billion	June 2013 to July 2013
\$9.4 billion	\$7.3 billion	Deferred across fiscal years

Also note that changes in property valuations can significantly affect cash flow. Additionally, the change in status from a Revenue Limit school district to a Basic Aid school district will impact the receipt of cash from monthly to primarily December and April.

Other Cross Fiscal Year Payment Deferrals

In addition to the cross fiscal year principal apportionment cash deferrals, there are three cross fiscal year cash deferrals applicable to K-3 Class Size Reduction, School Safety Violence Prevention, and Targeted Instructional Improvement Grant. The deferral amounts are listed below:

- \$570 million for K-3 Class Size Reduction (CSR)
- \$38.7 million for School Safety Violence Prevention
- \$100.1 million for the Targeted Instructional Improvement Grant

Apportionment Schedules

In addition to apportionment cash deferrals, the State of California modified the principal apportionment payment schedules in 2009-10 to enhance the State's cash position in future years. In light of the reduced and deferred apportionments and change in timing of distribution of funds from the State, a great deal of emphasis must be placed on cash flow analysis and monitoring.

Please note that the principal apportionment deferrals will impact each school district differently depending upon: (1) the amount of State Aid revenue limit funding that each district receives and (2) the principal apportionment schedule that is dictated by Education Code Section 14041. There are three separate principal apportionment schedules outlined in Education Code Section 14041(a). Most LEAs in California receive apportionments that are in accordance with Education Code Section 14041(a)(1)(2)(3)(4). However, there are three school districts in Orange County that receive apportionments in accordance with Education Code Section 14041(a)(7). The Education Code Section 14041(a)(7) principal apportionment schedule applies to school districts that reported less than 5,000 units of average daily attendance in the 1979-80 fiscal year and that received 39 percent or more, but less than 75 percent, of their total revenue limits from local property taxes in that fiscal year. Please see Attachments C-1 and C-2 for the two separate principal apportionment schedules that monthly percentages for 2011-12 and 2012-13.

These cash management challenges make it even more imperative that we consider reserve levels greater than the minimums required within the State's Criteria and Standards. Reserves are especially critical in order to meet cash flow needs that guarantee the ability to adequately meet payrolls and other obligations.

RESERVE FOR ECONOMIC UNCERTAINTIES

The revised 2009-10 Enacted Budget lowered the minimum reserve requirement levels for economic uncertainties to 1/3 the percentage level adopted by the State Board of Education as of May 1, 2009. SB 70 extended this provision for both 2010-11 and 2011-12. However, school districts are required to make progress in the 2012-13 fiscal year to return to compliance with the specified standards and criteria

adopted by the State Board of Education. By fiscal year 2013-14, school districts must meet compliance and restore the reserves to the percentage adopted by the State Board of Education as of May 1, 2009. We believe that the percentages established in the Criteria and Standards for reserves prior to the current Enacted Budget are the BARE MINIMUM. If a school district reduces the minimum reserve levels, it would take budget reductions of twice the amount of the lowered reserve levels to fully restore the reserve by June 30, 2014. With the continued deferral of apportionments, it is more critical than ever to maintain higher levels of reserves for cash flow purposes. A school district needs a state loan when they run out of cash and do not have any other borrowing options even if the school district has a positive fund balance.

County offices of education (COEs) and basic aid school districts are advised to maintain reserves much greater than the State required minimum because they do not have the prior year ADA protection provided to school districts under Education Code 42238.5, whereby revenue limit funding is based on ADA for either the current or prior fiscal year, whichever is greater.

NEGOTIATIONS

When considering a multi-year contract, school districts need to be very flexible and have appropriate contingency language, such as basing compensation increases on “funded COLA” or “effective COLA.” There may be different COLAs and deficits for revenue limits versus categorical programs and this should be considered during negotiations.

It is important to remember that the Governor's Proposed 2012-13 State Budget provides flat revenue limit funding, but is predicated on the passage of the November 2012 tax initiative. If it fails, “trigger language” would be implemented effective January 1, 2013 and would result in a reduction of approximately \$370/ADA per Department of Finance (DOF) calculations. School districts need to consider this as they negotiate changes to collective bargaining agreements.

SUMMARY

We recognize that these are extraordinary economic times and it is difficult to gauge the future. School district budgets should be managed with an eye to the significant downside risk created by the State's ongoing structural deficit and any mid-year reductions that would result under the Governor's budget proposals related to the failure of his proposed tax measure. In these times of great economic and budgetary uncertainty, school districts need reserves that are much greater than the minimum.

It is recommended that school districts continue to be cautious and focus on a multi-year strategy when recommending decisions and obtaining agreements. Attention should be focused on the multi-year projections for 2012-13 and beyond. School districts should develop financial projections and contingency plans accordingly. Consistent with past practices, we have included a sample Fiscal Solvency Statement (Attachment D) for district use as a communication tool with stakeholders.

We understand how difficult it is for school districts to deal with the increased pressures, significantly reduced funding, apportionment deferrals, and the uncertainty associated with a volatile economy. It is important that school districts be proactive to maintain their fiscal solvency through developing contingency plans that allow the most flexibility possible.

K-12 Categorical Programs Included in the Weighted Pupil Formula Proposed by the 2012-13 Governor's Budget Proposal

Item	Program
103	Apprentice Programs
104	Summer School Programs
105	ROC/Ps
108	Grade 7-12 Counseling
119	Foster Youth Programs
122	Specialized Secondary Program Grants
124	Gifted and Talented
128	Economic Impact Aid (EIA)
137	Professional Development Institutes for Math and English
144	Principal Training
156	Adult Education
158	Adults in Correctional Facilities
166	Partnership Academies
167	Agricultural Vocational Education
181	Educational Technology
188	Deferred Maintenance
189	Instructional Materials Block Grant
193	Staff Development
195	National Board Certification
198	California School Age Families Education Program
204	California High School Exit Exam
208	Civic Education
209	Teacher Dismissal Apportionments
211	Charter Schools Block Grant
211	Charter EIA
227	Community-Based English Tutoring
228	School Safety Block Grant
232	High School Class-Size Reduction (CSR)
Statutory	K-3 CSR
240	Advanced Placement Grant Programs
242	Student Leadership/California Association of Student Councils
243	Pupil Retention Block Grant
244	Teacher Credentialing Block Grant
245	Professional Development Block Grant
246	Targeted Instructional Improvement Block Grant
247	School and Library Improvement Block Grant
248	School Safety Competitive Grant
260	Physical Education Block Grant
265	Arts and Music Block Grant
267	Certificated Staff Mentoring
268	Oral Health Assessments
6360-101	Alternative Credentialing

K-12 Categorical Programs Not Included in the Weighted Pupil Formula

Item	Program
107	County Office Oversight (FCMAT)
113	Student Assessments
150	American Indian Early Education Programs
151	Indian Education Centers
161	Special Education
182	K-12 Internet Access
190	Community Day School
196	Child Development (Pre-K only in 2011-12)
203	Child Nutrition
220	Charter School Facility Grants
266	County Offices of Education: <i>Williams</i>
649	After-School

Source: Department of Finance

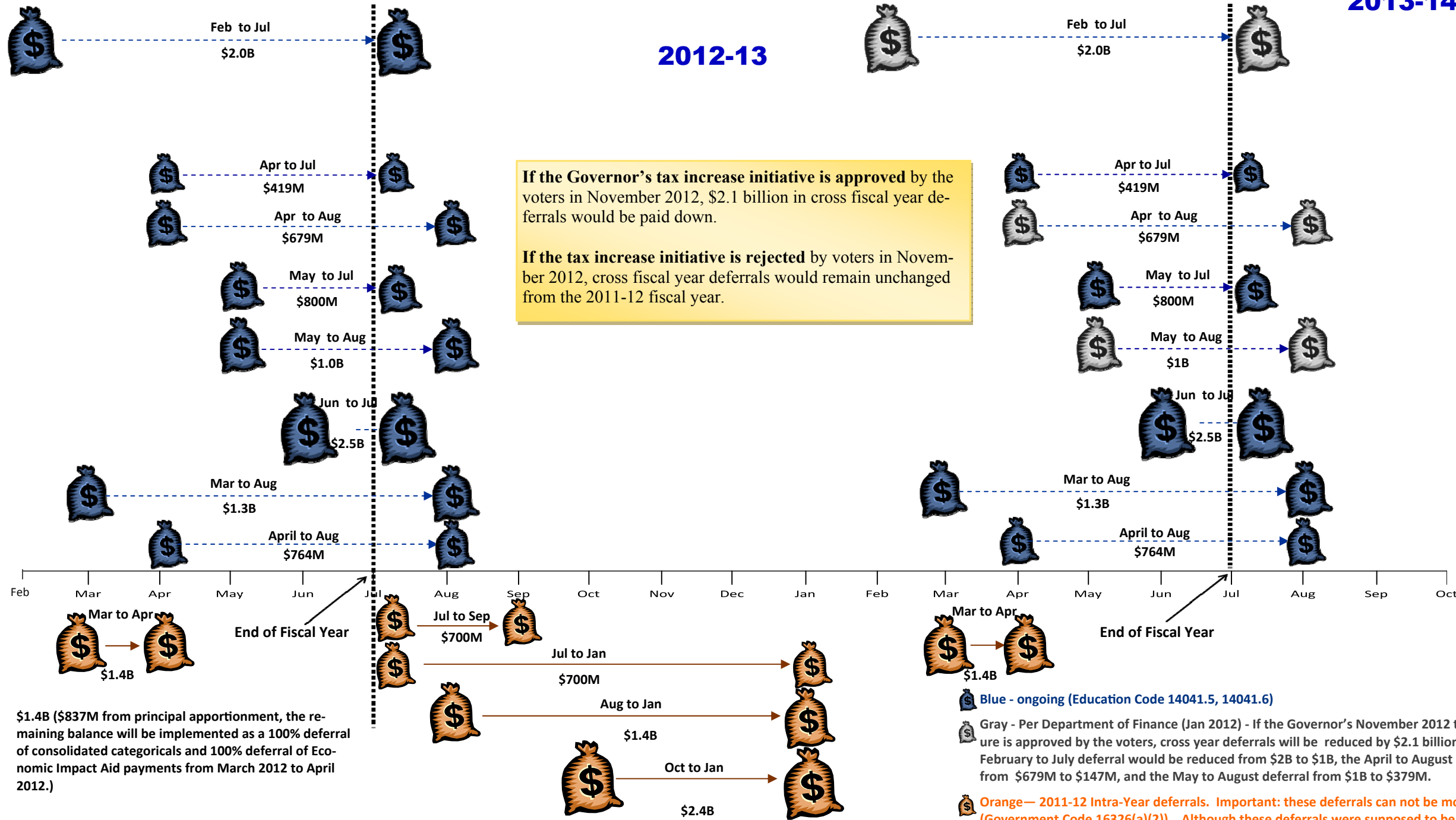
Delayed Principal Apportionment Funding

2012-13 Governor's Budget Proposal

2011-12

2013-14

2012-13



\$1.4B (\$837M from principal apportionment, the remaining balance will be implemented as a 100% deferral of consolidated categoricals and 100% deferral of Economic Impact Aid payments from March 2012 to April 2012.)

Principal Apportionment Schedule - Education Code Section 14041(a)(1)(2)(3)(4)

ATTACHMENT C-1

	2011-12												2012-13												2013-14			
	Advance							P-1					P-2	Advance							P-1					P-2	Advance	
	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug		
Education Code Section 14041(a)(1)(2)(3)(4)	5.00%	5.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	5.00%	5.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	5.00%	5.00%		
Percentage Paid in Current Month	0.00%	0.00%	9.00%	0.00%	9.00%	9.00%	9.00%	0.50%	0.00%	1.09%	1.50%	0.00%	0.00%	0.00%	9.00%	0.00%	9.00%	9.00%	9.00%	0.50%	0.00%	1.09%	1.50%	0.00%	0.00%	0.00%		
Deferred from July Advance			2.70%				2.30%								2.70%				2.30%									
Deferred from August Advance							5.00%												5.00%									
Deferred from October Advance							9.00%												9.00%									
Deferred from February P-1	0.10%	5.73%	2.32%										8.50%												8.50%			
Deferred from March P-1										3.51%				5.49%								3.51%				5.49%		
Deferred from April P-1		2.77%	1.71%										1.79%	6.12%										1.79%	6.12%			
Deferred from May P-1		3.61%	3.07%										3.31%	4.19%										3.31%	4.19%			
Deferred from June P-2	9.00%												9.00%											9.00%				
Total Received from Current Year	0.00%	0.00%	11.70%	0.00%	9.00%	9.00%	25.30%	0.50%	0.00%	4.60%	1.50%	0.00%	0.00%	0.00%	11.70%	0.00%	9.00%	9.00%	25.30%	0.50%	0.00%	4.60%	1.50%	0.00%	0.00%	0.00%		
Total Received from Prior Year	9.10%	12.10%	7.10%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	22.60%	15.80%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	22.60%	15.80%		
Grand Total Received	9.10%	12.10%	18.80%	0.00%	9.00%	9.00%	25.30%	0.50%	0.00%	4.60%	1.50%	0.00%	22.60%	15.80%	11.70%	0.00%	9.00%	9.00%	25.30%	0.50%	0.00%	4.60%	1.50%	0.00%	22.60%	15.80%		

Cumulative E.C. Section 14041 5/5/9				
2010-11 Cumulative Principal Apportionments	80.79%	92.90%	100.00%	
Difference				

Cumulative E.C. Section 14041	5.00%	10.00%	19.00%	28.00%	37.00%	46.00%	55.00%	64.00%	73.00%	82.00%	91.00%	100.00%		
2011-12 Cumulative Principal Apportionments	0.00%	0.00%	11.70%	11.70%	20.70%	29.70%	55.00%	55.50%	55.50%	60.10%	61.60%	61.60%	84.20%	100.00%
Difference	-5.00%	-10.00%	-7.30%	-16.30%	-16.30%	-16.30%	0.00%	-8.50%	-17.50%	-21.90%	-29.40%	-38.40%		

Cumulative E.C. Section 14041						5.00%	10.00%	19.00%	28.00%	37.00%	46.00%	55.00%	64.00%	73.00%	82.00%	91.00%	100.00%
2012-13 Cumulative Principal Apportionments						0.00%	0.00%	11.70%	11.70%	20.70%	29.70%	55.00%	55.50%	55.50%	60.10%	61.60%	61.60% 84.20%
Difference						-5.00%	-10.00%	-7.30%	-16.30%	-16.30%	-16.30%	0.00%	-8.50%	-17.50%	-21.90%	-29.40%	-38.40%

Assumptions:

- (1) For both 2011-12 and 2012-13, we assume that your 2011-12 Advance Apportionment is fixed for the entire 2011-12 fiscal year.
- (2) This apportionment schedule does not reflect any changes from 2011-12 because it is assumed that the tax initiative does not pass in November 2012.
- (3) It is assumed that the intra-year deferrals from 2011-12 will continue in future years.

Legend:

Orange: one-time 2011-12 Intra-Year Deferrals (SB82, Government Code Section 16326(a)(2))

Blue: ongoing Inter-Year Deferrals (Education Code Sections 14041.5, 14041.6)

Yellow Highlight: Percentage of Principal Apportionment payments deferred across fiscal years.

Principal Apportionment Schedule - Education Code Section 14041(a)(7)
(Only applicable to Brea Olinda Unified, Buena Park Elementary, and Laguna Beach Unified)

	2011-12												2012-13												2013-14	
	Advance						P-1				P-2	Advance						P-1					P-2	Advance		
	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Education Code Section 14041(a)(7)	15.00%	15.00%	15.00%	15.00%	0.00%	0.00%	6.00%	6.80%	6.80%	6.80%	6.80%	6.80%	15.00%	15.00%	15.00%	15.00%	0.00%	0.00%	6.00%	6.80%	6.80%	6.80%	6.80%	6.80%	15.00%	15.00%
Percentage Paid in Current Month	0.00%	0.00%	15.00%	0.00%	0.00%	0.00%	6.00%	0.41%	0.00%	0.82%	1.09%	0.00%	0.00%	0.00%	15.00%	0.00%	0.00%	0.00%	6.00%	0.41%	0.00%	0.82%	1.09%	0.00%	0.00%	0.00%
Deferred from July Advance			8.10%				6.90%								8.10%				6.90%							
Deferred from August Advance							15.00%												15.00%							
Deferred from September Advance																										
Deferred from October Advance							15.00%												15.00%							
Deferred from February P-1	0.08%	4.33%	1.75%										6.39%												6.39%	
Deferred from March P-1										2.65%				4.15%								2.65%				4.15%
Deferred from April P-1			2.09%	1.29%									1.36%	4.62%											1.36%	4.62%
Deferred from May P-1			3.08%	2.46%									2.52%	3.20%											2.52%	3.20%
Deferred from June P-2	6.80%												6.80%												6.80%	
Total Received from Current Year	0.00%	0.00%	23.10%	0.00%	0.00%	0.00%	42.90%	0.41%	0.00%	3.47%	1.09%	0.00%	0.00%	0.00%	23.10%	0.00%	0.00%	0.00%	42.90%	0.41%	0.00%	3.47%	1.09%	0.00%	0.00%	0.00%
Total Received from Prior Year	6.88%	9.50%	5.51%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	2.65%	0.00%	0.00%	17.07%	11.97%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	17.07%	11.97%
Grand Total Received	6.88%	9.50%	28.61%	0.00%	0.00%	0.00%	42.90%	0.41%	0.00%	6.12%	1.09%	0.00%	17.07%	11.97%	23.10%	0.00%	0.00%	0.00%	42.90%	0.41%	0.00%	3.47%	1.09%	0.00%	17.07%	11.97%

Cumulative E.C. Section 14041				
2010-11 Cumulative Principal Apportionments	84.99%	94.49%	100.00%	
Difference				

Cumulative E.C. Section 14041	15.00%	30.00%	45.00%	60.00%	60.00%	60.00%	66.00%	72.80%	79.60%	86.40%	93.20%	100.00%		
2011-12 Cumulative Principal Apportionments	0.00%	0.00%	23.10%	23.10%	23.10%	23.10%	66.00%	66.41%	66.41%	69.88%	70.96%	70.96%	88.03%	100.00%
Difference	-15.00%	-30.00%	-21.90%	-36.90%	-36.90%	-36.90%	0.00%	-6.39%	-13.19%	-16.52%	-22.24%	-29.04%		

Cumulative E.C. Section 14041															
2012-13 Cumulative Principal Apportionments	0.00%	0.00%	23.10%	23.10%	23.10%	23.10%	66.00%	66.41%	66.41%	69.88%	70.96%	70.96%	88.03%	100.00%	
Difference	-15.00%	-30.00%	-21.90%	-36.90%	-36.90%	-36.90%	0.00%	-6.39%	-13.19%	-16.52%	-22.24%	-29.04%			

- Assumptions:
- (1) For both 2011-12 and 2012-13, we assume that your 2011-12 Advance Apportionment is fixed for the entire 2011-12 fiscal year.
 - (2) This apportionment schedule does not reflect any changes from 2011-12 because it is assumed that the tax initiative does not pass in November 2012.
 - (3) It is assumed that the intra-year deferrals from 2011-12 will continue in future years.

Legend:
Orange: one-time 2011-12 Intra-Year Deferrals (SB82, Government Code Section 16326(a)(2))
Blue: ongoing Inter-Year Deferrals (Education Code Sections 14041.5, 14041.6)
Yellow Highlight: Percentage of Principal Apportionment payments deferred across fiscal years.

Attachment D – Fiscal Solvency Statement

In submitting the 2011-12 Second Interim Report, the Board understands its fiduciary responsibility to maintain fiscal solvency for the current and subsequent two fiscal years.

Due to California's sluggish economic recovery, the uncertain outcome of the Governor's tax initiative, and proposed implementation of trigger reductions for 2012-13, it is recognized that, if necessary, the school district plans to implement between \$(____) and \$(____) in ongoing budget reductions in 2012-13 and an additional \$(____) reductions in 2013-14 to maintain fiscal solvency.

With the 2011-12 Second Interim Report submission, the Board is providing a budget reductions plan along with an implementation timeline for fiscal year 2012-13.

Note: *There are multiple methods for budgeting for the proposed \$370/ADA trigger cut in the event the November tax initiative is unsuccessful: \$370/ADA cut on the revenue side, contingent reductions on the expenditure side, assigning fund balance to cover the reduction, or some combination of the above. If the District did not budget for the \$370/ADA reduction on the revenue side, we are strongly recommending that the following statement be added:*

Furthermore, in the event that the November 2012 tax initiative is unsuccessful, the District's funding will be reduced by an additional \$370/ADA or \$(____) million. The Board acknowledges that the District has a contingency plan in place to address this reduction in funding.