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March 22, 2017

Dr. Michelle Rodriguez
Superintendent
Pajaro Valley Unified School District
294 Green Valley Road
Watsonville, CA 95076

Dear Dr. Rodriguez:

Thank you for allowing School Services of California, Inc., (SSC) to assist the Pajaro Valley Unified School District (District) in a Budget Review for Negotiations, including a review of the multiyear projections (MYP), and a comparison of certificated salaries and benefits with comparable districts.

Executive Summary

The District requested SSC to conduct a Budget Review for Negotiations, including a review of the MYP, and also generate a comparison of certificated salaries and benefits with comparable districts. SSC reviewed various documents, including state-certified and locally-developed data to augment both analyses.

The objective of the Budget Review for Negotiations was to determine if the District is using reasonable assumptions in the preparation of the 2016-17 budget, as well as the MYP, which includes the 2017-18 and 2018-19 fiscal years as required by law. SSC also reviewed the budget to identify areas which restrict the District's available resources to commit to ongoing expenditures through the collective bargaining process or other means.

The results of the Budget Review for Negotiations determined that the District used reasonable assumptions, anchored in current conditions, to develop the revenues and expenditures in its budget. The MYP prepared as of the First Interim report, based on conditions at the time, projects deficit spending for the current and two subsequent years. The Governor, in a subsequent budget release, reduced revenue projections starting in 2017-18, which has an adverse impact on the projected financial condition of districts across the state. This will increase the District's deficit spending unless other actions are taken to balance the budget. The District's unrestricted ending fund balance for the most recently completed year, 2015-16, provides a safety net in the event that the state experiences another recession and projected revenues decline further.

The objective of the comparison of salaries and benefits was to determine how the District's certificated total compensation (annual salary plus annual health and welfare benefit contribution) ranked against comparative districts. The results of the certificated total compensation comparison reveal that the District's total compensation ranks favorably amongst the comparable districts. However, the salary on its own ranks unfavorably. This is a direct result of the higher health and welfare benefit contribution provided by the District. If the District places a priority on increasing salaries to attract and retain employees, it must strongly consider the option of reducing the health and welfare benefit contribution or other staffing costs in the absence of an available ongoing source to pay for the salary increase.

Scope and Methodology

The District requested SSC to perform a Budget Review for Negotiations, which involved analyzing each major revenue and expenditure category in the General Fund and ancillary funds (to the extent those funds have a fiscal impact on the General Fund). Also, SSC included state-certified data illustrating how the District's certificated salaries and benefits rank when compared with comparable districts. The state-certified data is presented after the analysis of the budget.

The review of revenues and expenditures included:

- An examination of projected enrollment and average daily attendance (ADA)
- A review of budget assumptions for the Local Control Funding Formula (LCFF)
- Verification of State Budget assumptions for one-time sources and categorical funds
- A review of budget assumptions for federal revenues and local sources
- A review of budget assumptions for the expenditures of salaries, benefits, supplies, operational items, capital outlay, and contributions to restricted programs
- A review of the District's budget and MYP for 2016-17, 2017-18, and 2018-19
- A review of the 2015-16 audit report
- Inquiries of District office staff

Budget Review for Negotiations

The Budget Review for Negotiations involved a detailed examination of the 2014-15 and 2015-16 Unaudited Actuals reports; the 2015-16 Adopted Budget, First Interim report, and Second Interim report; and the 2016-17 Adopted Budget and First Interim report. For the purpose of reviewing the LCFF projections and the MYP, our analysis was focused on the 2016-17 First Interim report presented to and approved by the Board on December 7, 2016. The review was performed by reviewing detailed data from District documents.

While the focus was primarily on fiscal documentation for the 2016-17 fiscal year, we analyzed the District's projections in previous fiscal years (2014-15 and 2015-16) and compared projections to the Unaudited Actuals in those years to identify any trends that exist. Our main focus was on the unrestricted side of the General Fund as an indicator of fiscal solvency and the availability of discretionary resources that can be used by the Board for any educational purpose. Conversely, restricted funds are restricted by a third party, and must be used for a specific purpose as identified by the third party. Examples of restricted funding include Title I, Special Education and Routine Restricted Maintenance.

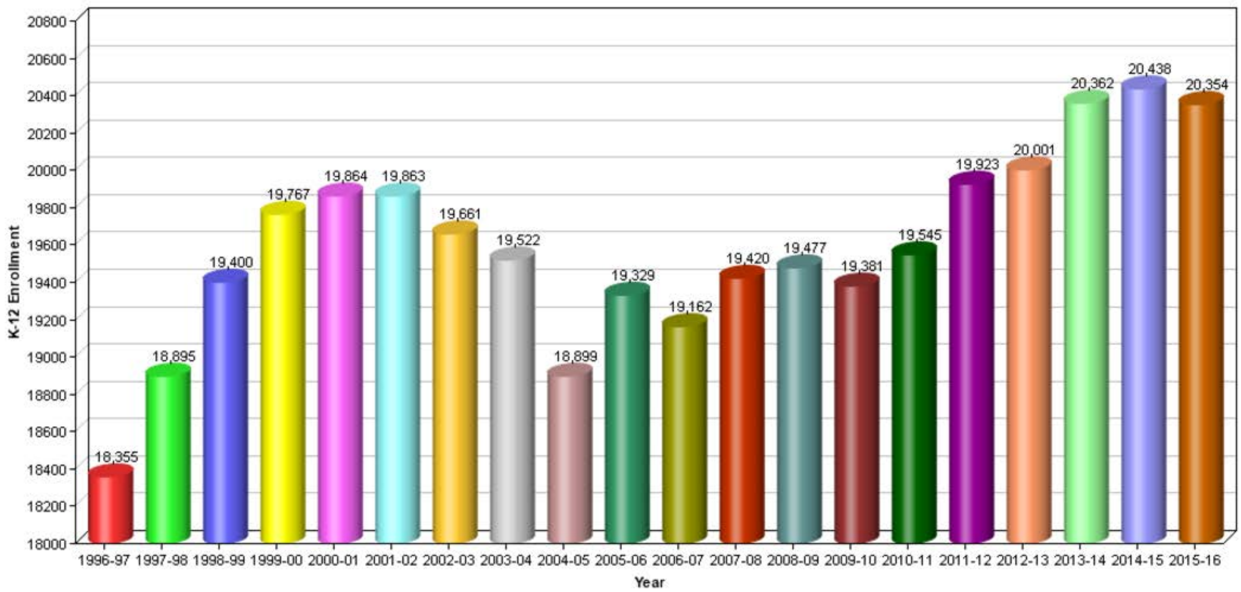
Budget Monitoring

A budget is not a static document. Changes to revenues and expenditures occur throughout the budget cycle due to state-influenced factors—both positive and negative—and local factors based on Board priorities, staffing needs, program changes, unforeseen circumstances, and more. In addition to the state-required Adopted Budget, the District prepares interim reports in December (the First Interim report) and in March (the Second Interim report). The First and Second Interim reports reflect changes in revenues and expenditures as the fiscal year progresses.

The District monitors and updates revenues and expenditures throughout the fiscal year, and every reporting period in 2014-15, 2015-16, and 2016-17 reflects changes to revenue and expenditure line items in the District's budget.

Enrollment and ADA

Enrollment projections form the basis for most school district revenues and expenditures—enrollment drives ADA, unduplicated counts, and staffing. The District has experienced a modest 6% increase in enrollment since the 2005-06 fiscal year. The District is fortunate to be experiencing a trend of slightly increasing enrollment because a district with declining enrollment is typically unable to reduce expenditures quick enough to keep pace with the drop in revenues based on enrollment and ADA. This is why districts have the choice of using current-year or prior-year ADA for the bulk of their state funding, which in essence provides an additional year for a district declining in enrollment (and ADA) to adjust expenditures downward. The enrollment history for the District, and sponsored charter schools, is displayed in the following chart.



Source: Dataquest on the California Department of Education (CDE) website

The tables below display the District's funded ADA for the previous four years and the projected funded ADA for the subsequent three years.

ADA	2012-13*	2013-14	2014-15*	2015-16
Revenue Limit/LCFF Funded ADA	17,242	17,540	17,434	17,454
Change From Prior Year	-9	298	-106	20

Source: CDE principal apportionment exhibits
* Due to declining ADA, the District used the prior-year ADA as the basis for funding.

The District's ADA as estimated for the 2016-17 First Interim report and MYP is as follows:

	2016-17	2017-18	2018-19
Estimated LCFF Funded ADA	17,454	17,454	17,454
Change From Prior Year	-	-	-

Source: 2016-17 First Interim report and LCFF Calculation provided by District

The figures above show the District has somewhat unpredictable ADA patterns with an increase of 298 in one year and a decrease of 106 in the next year. As of the First Interim report, the enrollment increased in 2016-17 by 15 students, based on data that was not yet certified in the California Longitudinal Pupil Achievement Data System (CALPADS). Conversations with staff identified that enrollment and ADA projections for 2016-17 and subsequent years will be updated once a final CALPADS number is determined. However, based on the modest increase in enrollment, a projection of flat ADA appears reasonable.

The District is the sponsor for five charter schools. This becomes important in the year when the District experiences a decline in ADA from the previous year. Although districts have the option of receiving funding based on the greater of prior-year or current-year ADA, a charter school is only funded on its current-year ADA. In accordance with Education Code Section 42238.05, a district who sponsors at least one charter school, and is electing to receive funding based on prior-year ADA must adjust the prior-year ADA for two causes:

1. Reduce prior-year ADA for students who attended a noncharter school of the district in the prior year, but attend a sponsored charter of the district in the current year

2. Increase prior-year ADA for students who attended a sponsored charter of the district in the prior year, but attend a noncharter school of the district in the current year.

The net of these two factors shall be used to adjust the prior-year ADA, but in no case may prior-year ADA be increased as a result of this calculation. The District has reported this activity in each fiscal year, but the swings are quite significant, especially from 2013-14 to 2014-15. Although this only comes into play during fiscal years in which the district ADA declines, the calculation for the 2014-15 fiscal year resulted in a decrease in funded ADA of 92.86 which is approximately $750,000 for the District. The District should continue to review the factors it uses for the calculation to ensure it is correctly reporting the ADA adjustment.

CHARTER ADA ADJUSTMENT			2013-14	2014-15	2015-16
ADA transfer: Student from District to Charter (cross fiscal year)					
	Grades TK-3	A-6	9.54	43.62	13.05
	Grades 4-6	A-7	37.37	95.20	87.34
	Grades 7-8	A-8	53.15	11.74	9.86
	Grades 9-12	A-9	55.36	76.22	60.88
			155.42	226.78	171.13
ADA transfer: Student from Charter to District (cross fiscal year)					
	Grades TK-3	A-11	13.05	13.98	10.45
	Grades 4-6	A-12	78.76	19.46	24.14
	Grades 7-8	A-13	15.51	41.91	61.90
	Grades 9-12	A-14	87.52	58.57	57.14
			194.84	133.92	153.63
Difference (if diff. < 0, no adj. to PY ADA)			(39.42)	92.86	17.50

Source: District provided First Interim LCFF Calculator

Declining or even flat enrollment places pressure on the District to reduce expenditures each year. Even with this one-year abeyance of the revenue reduction, it is still very challenging for districts in a declining or flat enrollment situation to ratchet down expenditures. This is because reducing staff and other costs directly related to the loss in students is not enough to keep up with the loss of revenues—other staff and programs have to be cut.

Revenues

The District's LCFF revenue estimate, prepared using the Fiscal Crisis and Management Assistance Team LCFF calculator, appears to take into account the changes that influence the LCFF calculation for the District, and we believe the calculation was reasonable based on the assumptions at the time.

In the 2016-17 First Interim report, projections for LCFF revenues were $171,294,988. This is an increase of $9.7 million over 2015-16 funding. The gap closure percentage used to perform this calculation was 54.18%, which was based upon Governor Jerry Brown's adopted State Budget that was final in July 2016. The Governor's January Budget proposal for 2017-18 provided an upward revision to the 2016-17 gap closure percentage resulting in a revised percentage of 55.28%, and an increase in ongoing revenues of approximately $200,000.

However, the Governor's January Budget proposal for 2017-18 lowered the projected gap funding for 2017-18 from 72.99% to 23.67%. Fortunately, the District did not use the original percentage projected by the Governor, but rather, an average of the Governor's percentage and the percentage required to maintain purchasing power. The result was that the District's projections assumed a gap closure percentage of 46.15%. The reduction down to 23.67% will result in a decrease in ongoing revenues of approximately $2.3 million, or $133 per ADA. This will be discussed further in the MYP section of this report.

While the increase in LCFF revenue from year to year appears to be substantial, some of the change in revenues do not actually increase resources available to the District. This is due to several revenue and expense issues that must be considered in budgeting for the current and future fiscal years.

- The LCFF gap funding percentages used in the assumptions are not guaranteed in legislation and are likely to decrease should California's economy falter. This level of risk is mitigated each year as Districts move closer to their target, but nonetheless, the risk still exists.

- Grades K-3 class-size reduction (CSR) funding is implicitly included in school district LCFF targets through a $737 per ADA grade K-3 adjustment. The current value of this grade span adjustment for the District, if it were fully funded today, is estimated to be approximately $4.3 million. However, in the current year, the District receives approximately $3.8 million. In order to retain these funds, all districts must be moving their transitional kindergarten to grade 3 average class size by school site to the 24:1 target at the same pace as receiving gap funding under the LCFF unless there is a local collective bargaining agreement that specifies otherwise, or a district is already at 24:1. Such is the case for the District, as the District has a collectively bargained alternative in Article VI of its agreement with the Pajaro Valley Federation of Teachers. The agreement calls for the District to be at 24:1, even though not all the funding has been received. If the funding is no longer provided by the state, the maximum class size will revert to 31. Many districts used the flexibility available under the former K-3 CSR program during the Great Recession to continue receiving the funding under that program (which was later subsumed into the LCFF), but increased class sizes to the statutory limits allowed without the program.

There are, however, new requirements under the LCFF that the District must plan to meet when budgeting expenditures. The District is required to show that it is providing increased or improved services for its unduplicated pupils above what is provided to all students. Unduplicated pupils are classified as English learners, foster youth, or eligible for the free and reduced-price meals program. The calculation is the average of a three-year percentage for the District and is estimated at 79.16% in 2016-17. The 2015-16 percentage, based on state-certified data, reflects 79.48%. The 2016-17 percentage appears reasonable based on review of state-certified data and discussions with District office staff.

State statutes and regulations now require that the proportion of increased funding a school district receives as a result of the percentage of eligible students enrolled is accounted for in the district's Local Control and Accountability Plan. Therefore, the District must recognize that a proportional share of any additional revenues received through the LCFF must be used to provide increased or improved services targeted to meet the needs of eligible students and should be taken into account during budget preparation and planning whenever the District is considering its future expenditure commitments. Although the District is receiving approximately $9.7 million in new LCFF funds for 2016-17 based on the First Interim LCFF calculator, approximately $6.9 million is the share of revenues that should be used to provide increased or improved services for the eligible students, for a total of $25 million. As the District moves towards its target, it should ensure that funds received for its unduplicated pupils are spent in accordance with the law.

The final State Budget for 2016-17 included $214 per ADA in one-time discretionary funds that are applied to outstanding prior year state-mandated cost claims. The funding was included in the First Interim report, and appropriately backed out in subsequent years. SSC believes that one-time discretionary funds should only be applied to one-time uses such as increasing reserves, purchasing instructional materials, textbooks, technology, etc.

The State Budget for 2016-17 also included $149 per unduplicated pupil in grades 9 through 12 in one-time funds for the College Readiness Block Grant. These funds are to be used for increasing the matriculation rate for districts' unduplicated pupils. The District has budgeted the revenues and expenditures in its First Interim budget, for a total of approximately $536,000 in additional restricted revenues. Although this is a restricted source of one-time funds, it may relieve some amount of expenditures that were planned for this purpose out of unrestricted funds, and the District has until June 30, 2019, to spend or encumber these funds.

In addition, the 2015-16 State Budget included a one-time appropriation that is restricted for educator effectiveness and professional development. The appropriation equates to approximately $1,466 per certificated full-time equivalent staff member from the 2014-15 fiscal year. The District recognized the revenues in 2015-16 and has budgeted the remainder of the funds to be expended in 2016-17. Although this is a restricted source of one-time funds, it may relieve some amount of expenditures that were planned for this purpose out of unrestricted funds, and the District has until June 30, 2018, to spend or encumber these funds.

Upon our review of the 2014-15 Unaudited Actuals compared with the Second Interim report, unrestricted General Fund revenues increased 0.7%, primarily resulting from an increase in local revenues.

Upon our review of the 2015-16 Unaudited Actuals compared with the Second Interim report, unrestricted General Fund revenues increased 1.4%. In both instances, a change of 2% or less reflects the strong budgeting practices that have been implemented by the District.

Expenditures

In the review of unrestricted salary and benefit expenses as compared to unrestricted total expenditures in 2016-17, the District projects to spend 87% of all expenditures on salaries and benefits. This leaves only 13% for all other expenditures. Expenditures for salaries and benefits will continue to grow due to unfunded special education costs, health and welfare benefit (HWB) contributions, and the increase in the employer contribution rate for the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS).

Although the District has experienced fluctuations in enrollment, it is projecting a flattening of enrollment for the foreseeable future. A comparison of 2015-16 Unaudited Actuals to 2016-17 First Interim shows an increase to salaries of $15.3 million. Both the certificated and classified units received a four percent compensation increase in 2016-17, as well as step and column increases. The remainder of the increase is attributable to a retroactive pay raise for 2015-16 that was paid in 2016-17, as well as additional personnel.

Unrestricted	2015-16 Unaudited Actuals	2016-17 First Interim	Difference
Certificated Salaries	$78,439,920	$88,977,656	($10,537,736)
Classified Salaries	$29,723,697	$34,457,350	($4,733,653)
Total	$108,163,617	$123,435,006	($15,271,389)

Source: 2016-17 First Interim report provided by District

Most districts begin each fiscal year with unfilled positions and employees come and go during the year. Despite best efforts, those positions remain unfilled while applicants are screened and interviewed. These unfilled positions result in vacancy savings, which create a savings to the district's bottom line. The amount of vacancy savings can vary greatly from year to year as the factors that generate vacancies can significantly change. Currently, the District budgets the full cost of salaries and benefits at Adopted Budget and adjusts its projections during the First Interim and Second Interim reporting periods. Given that the Adopted Budget includes the full cost of salaries and benefits, it's conceivable that the District will recognize vacancy savings between this point and the end of the fiscal year. The District should review the vacancy savings based on historical trends and vacancies and consider including a factor at Adopted Budget and amortizing the cost all the way through the Estimated Actuals reporting period.

Recent changes in accounting standards now require districts to recognize the state's contribution to CalSTRS on behalf of the district. The entry has no effect on the bottom line for the District's operations, but does affect its minimum reserve for economic uncertainty, and should be included in the budget. The District has properly included this entry in its budget projections.

The District provides a significant HWB package for eligible employees. It covers the full cost of a plan, with contributions in 2016-17 ranging from \$10,000 to \$29,000 annually. The District's current practice for budgeting health and welfare benefit contributions is to apply the average cost for all vacant/new positions of approximately \$20,000. Once an employee is hired, and selects a plan, the District adjusts its budget based on the actual cost of the plan. The District should consider reviewing its estimates for health and welfare benefit contributions for vacant positions to ensure a reasonable figure. Although the District's average contribution is approximately \$20,000, new hires may opt for a lower cost plan, or be covered under a spouse's plan.

In addition to paying for health benefits for current employees, the District offers other postemployment benefits (OPEB). OPEB represents a benefit to current employees that will be received once the employee meets the eligibility criterion and this creates an actuarially determined liability, which factors in the cost of health benefits for current retirees as well as the future cost for current employees. The District has set up an irrevocable trust in Fund 71, the Retiree Benefit Fund, and the cash in this fund is used by the actuary to offset the District's actuarially determined postemployment benefit liability, which, as of the latest actuarial study dated June 8, 2015, was approximately \$72 million. To satisfy this liability, the actuary report states that the District would need to set aside approximately \$11.2 million per year, also known as the annual OPEB cost, over the next 20 years. This amount includes payments for current retirees as well as future retirees. Currently, the "pay-as-you-go," which, for the 2015-16 year, was approximately \$4.1 million, is being paid from the General Fund. The District should consider developing a plan to fully fund the annual OPEB cost, rather than just the pay-as-you-go, to ensure there are sufficient funds to satisfy the liability.

Overall, unrestricted General Fund expenditures in 2014-15 decreased \$1.3 million (1.0%) from Second Interim to Unaudited Actuals. The decrease was primarily due to salary savings from unfilled positions.

Upon our review of the 2015-16 Unaudited Actuals compared with the Second Interim report, unrestricted General Fund expenditures decreased $10.5 million, or 7.8%. The decrease was primarily due to one-time state funds for Smarter Balance testing and staff development that were unspent. Additionally, the District recognized some savings in department budgets. These funds are re-appropriated in the 2016-17 budget.

Contributions

District contributions from the unrestricted General Fund to the restricted General Fund increased by $1.1 million from 2014-15 Unaudited Actuals to 2015-16 Unaudited Actuals, and an additional $6.4 million to 2016-17 First Interim (see the table below). This is primarily due to an increase in contributions to special education programs. The increase to special education is largely driven by an increase in the number of personnel, as well as the retroactive raise for 2015-16 that was applied in 2016-17.

	2014-15 Unaudited Actuals	2015-16 Unaudited Actuals	2016-17 First Interim
Contributions	$25,075,264	$26,179,610	$32,654,898

Source: District-provided data

The 2015-16 State Budget contained some changes to the Routine Restricted Maintenance Account (RRMA) contribution requirements. For 2015-16 and 2016-17, the minimum contribution is the lesser of 3% or the amount contributed for 2014-15. For 2017-18 through 2019-20, the minimum contribution is the greater of (1) the lesser of 3% or the amount contributed for 2014-15, or (2) 2%. As of the 2016-17 First Interim, the District is budgeting approximately 2.7% of total General Fund expenditures into the RRMA. The District has not utilized the flexibility in statute to adjust its RRMA contribution in the budget and MYP according to these new provisions, but it remains available as an option, and the District should take careful consideration of the resources needed to appropriately maintain the facilities that house its educational programs and students.

While most districts in California must make contributions to each of the programs discussed in this section, the costs can be actively managed. In recent years, the District’s contributions to these programs have continued to increase, especially in special education. The District should closely manage the expenditures of these programs on an ongoing basis and implement strategies to moderate the increasing trend in the unrestricted contributions required.

Other Funds

The Charter School Fund (Fund 09), used to record the activity related to the five charter schools sponsored by the District, had a surplus in the 2015-16 fiscal year and maintains a healthy fund balance to support operations. Despite the healthy fund balance, the District operates one charter school, Diamond Tech Institute, which incurs a deficit. The District is aware of this, but has made it a priority to operate the school and provide support from the General Fund. The District should continue to review the operations of the school to determine if it can be self-supporting, similar to the other four charter schools.

The Adult Education Fund (Fund 11) had a surplus in the 2015-16 fiscal year, due in large part from the block grant, and does not require a contribution from the General Fund. The District received approximately $1.6 million in additional funds in 2015-16 as part of the Adult Education Consortia Block Grant. Looking forward to 2016-17, the fund is self-sustaining, and no support is required from the General Fund.

The Cafeteria Fund (Fund 13) had a surplus in 2015-16, and no support from the General Fund was needed. Management has worked diligently to create a nutritional program that is economically viable. Although the fund is projecting a deficit in 2016-17, the fund balance (39%) is sufficient to cover the deficit for many years. The District was notified by the California Department of Education (CDE) that the fund balance, while positive, exceeded the federal threshold of three months' cash reserves. The District and CDE are in the midst of a plan to spend down the excess fund balance over a five year period. The fund is self-sustaining, and no support is required from the General Fund.

The Deferred Maintenance Fund (Fund 14) is not currently supported by any transfers and ended the 2015-16 fiscal year with a fund balance of $800,000. Although the District is planning to exhaust the fund balance in 2016-17, deferred maintenance needs are ongoing. The District should continue to monitor its need for maintenance and repairs and ensure sufficient funds are set aside for these purposes.

The Capital Facilities Fund (Fund 25) is primarily used by the District to collect developer fees and fund facility projects related to growth. The fund is not supported by any transfers from the General Fund.

It is important to continue to monitor the other funds of the District to ensure that they are self-supporting, including the payment of indirect costs and the cost of postemployment benefits, where applicable.

Multiyear Projections

We reviewed the District's MYP as of the 2016-17 First Interim report, as well as revised projections for LCFF funding in the out years, which are based upon an average of the Department of Finance (DOF) projections for gap funding from the 2016-17 Enacted State Budget as well as the SSC calculation which maintains the District's purchasing power. The gap funding percentages changed slightly with the release of the State's Adopted Budget, but the change for the District is minimal. However, the change to the 2017-18 revenues is more significant, and the District should reflect these changes when they present their Second Interim report to the Board in March. There is uncertainty surrounding the out-year estimates provided by the DOF because they are not set in statute. Prudent budgeting practice would dictate a conservative approach given the potential for significantly different funding outcomes. In addition to using a more conservative approach, we recommend that the District set aside one-year's growth of LCFF revenue in its ending balance.

Enrollment projections form the basis for most school district revenues and expenditures—enrollment drives ADA, unduplicated pupil counts, and staffing. According to the District's budget and MYP, the District's First Interim projects flat enrollment in the 2016-17 year and each of the subsequent years. The District should continue to review its estimates to ensure that the ADA estimates appear reasonable, and ongoing commitments are funded with current-year revenue. If the District begins relying on future dollars to fund current-year activities, it assumes a significant amount of risk if actual enrollment comes in lower than expected.

The MYP indicates that contributions are expected to increase in 2017-18 and 2018-19. As discussed earlier, the 2016-17 projection includes an increase in costs for additional personnel, and a retroactive raise from 2015-16. The District will continue to review these current-year costs and adjust its out-year projections accordingly. Given the recent projected increase in special education costs, the District should continue to closely monitor the contribution and ensure that it takes steps to stem the costs that increase on the natural.

Certificated and classified salaries are projected to increase in the out years by amounts that are less than the cost of step and column movement. The District has indicated that the lower costs are due to one-time payments occurring in the 2016-17 fiscal year that will not occur in the 2017-18 fiscal year.

Employee benefit costs continue to increase as a result of the increasing costs associated with the employee pension systems, as well as increasing HWB costs. The District has no cap on the employer HWB contributions, and pays up to $29,000 per employee. In an effort to contain costs, and generate additional resources for salaries, the District should consider implementing a hard cap districtwide, or a hard cap based on type of plan elected and number of dependents included in the coverage. The second part of the study discusses the District's HWB costs in more detail.

Costs associated with books and materials are decreasing in the out years to account for the expending of one-time funds in 2016-17. Costs are projected to increase for a variety of services as a result of inflation. The District has summarized the projected increases in its Assumptions for First Interim document.

The District utilized statewide factors for its assumptions, and a significant deficit is projected in all three years of the MYP. The deficit exists prior to any compensation increases, adjustments to ADA, adjustments based on the Governor's January Budget proposal, and other modifications to the budget, which will be based on decisions by the Board. While the District might be able to increase its ongoing revenues through increasing enrollment and ADA, the District has the most control over its expenditures. Therefore, any efforts to increase the available ongoing resources should include a review of overages in staffing ratios, chronically underspent department budgets, and other areas identified above.

Reserves

The District maintains an unrestricted fund balance to ensure that programs are not disrupted. The District's revenues and cash flow are heavily reliant upon the state making timely payments based on predetermined formulas and schedules. During the lean times, districts throughout the state relied on their fund balance to continue operating programs and minimize the impact on school sites.

The state requires a minimum unassigned reserve of 3%, which equates to 6 days of payroll. The national Government Finance Officers Association published a "Best Practice" report in September 2015, which stated that, regardless of a local educational agency's size, no less than two months of General Fund expenditures be set aside for reserves, which is 17%.

Fund 01 Balance	2015-16 Unaudited Actuals
Fund 01 Unassigned Fund Balance	$18,615,506
Fund 01 Total Expenditures + Transfers Out	$209,072,989
% of Fund Balance	**8.9%**

The District has done an admirable job of managing revenues and expenditures, as well as prioritizing unrestricted fund balance for one-time costs. This is highlighted by the District's intent and desire to use one-time funding for one-time purposes and not use future revenues for current-year expenditures, and an ending fund balance that reflects prudent planning.

Audit Findings for the Fiscal Year Ending June 30, 2016

School districts are required to have an external audit of their financial records on an annual basis. The most recent audit conducted was for the 2015-16 fiscal year. The District had no findings included in the report, which supports the notion that the District has adequate controls in place to provide fair and accurate reporting of its finances.

Conclusions

Given the many factors discussed in this report, the District appears to utilize industry standard practices in its budget based on the most recently known information when the budgets were prepared. No individual statewide factor appears to deviate significantly from what would be expected in a similarly sized district. The District should closely monitor its local factors, including

ADA, reserve levels and contributions to restricted programs to ensure that its estimates are based in sound factors. Close monitoring of all of these factors will help ensure that each budget revision and MYP is reflective of the current reality and demonstrates the multiyear impact of decisions that are made.

Comparability Analysis

Analysis

Before delving into the rankings, it's important to understand the relative demographics of each of the districts in the comparative group. Figure 1 lists each of the comparable districts, the 2014-15 ADA, and the unduplicated pupil percentage (UPP). The UPP represents the percentage of students who qualify as either socioeconomically disadvantaged, English language learner, or foster youth. 2014-15 is the most current statewide data available.

Figure 1: LCFF Funding – 2014-15 ADA

District	UPP	LCFF ADA Grades K-3	Grades 4-6	Grades 7-8	Grades 9-12	Total ADA
Salinas City Elementary	86.25%	5,100	3,657	0	0	8,758
North Monterey County Unified	83.09%	1,408	1,034	596	1,217	4,256
Pajaro Valley Unified	***79.71%***	***5,990***	***4,125***	***2,530***	***4,789***	***17,434***
Salinas Union High	71.11%	0	0	4,182	9,392	13,574
Monterey Peninsula Unified	70.10%	3,221	2,090	1,394	2,789	9,494
Hollister Elementary	69.33%	2,267	1,748	1,225	0	5,241
Gilroy Unified	59.28%	3,305	2,406	1,662	3,528	10,901
Morgan Hill Unified	43.70%	2,573	1,895	1,226	2,578	8,272
Santa Cruz City Schools	43.51%	1,501	1,160	746	3,204	6,612

Source: 2014-15 state-certified data

The UPP is more significant now than ever before as the state's funding system for K-12 education changed radically beginning in the 2013-14 fiscal year. The former system, known as the Revenue Limit, funded districts using one dollar amount per ADA, regardless of the composition of grade span or demographics served, and the state disbursed over 40 categorical programs that were restricted to be spent for specific purposes. Beginning in 2013-14, the Revenue Limit, and 40-plus categorical programs were rolled into the LCFF. The LCFF differentiates funding amounts based on grade span, as well demographics—specifically, those who qualify via the UPP. An additional

20% in funding is generated for all students who qualify as an unduplicated pupil, while a bonus 50% in funding is generated for each student above the 55% threshold.

The LCFF is phasing in over an eight-year period, with full implementation scheduled in 2020-21. Due to the fact that the District's UPP is nearly 80%, its LCFF funding at full implementation on a per-student basis will be more than all but two of the districts in the comparative group. The statewide average UPP is about 63%, so the District will receive significantly more supplemental and concentration grant funding than the average district across the state. Figure 2 shows the 2014-15 funding per ADA, as well as the funding per ADA at full implementation.

Figure 2: LCFF Funding – 2014-15 Funding (Amounts Per ADA)

District	Target	2014-15 Floor	Funding Gap	Growth	ERT*	Estimated 2014-15 Funding
Salinas Union High	$10,190	$7,777	$2,413	$728	0	$8,505
North Monterey County Unified	$10,552	$7,310	$3,242	$978	0	$8,287
Pajaro Valley Unified	***$10,222***	***$7,182***	***$3,040***	***$917***	***0***	***$8,099***
Santa Cruz City Schools	$8,867	$7,562	$1,305	$393	26	$7,981
Monterey Peninsula Unified	$9,664	$7,153	$2,511	$757	0	$7,910
Salinas City Elementary	$10,030	$6,562	$3,469	$1,046	0	$7,608
Gilroy Unified	$9,149	$6,516	$2,634	$794	0	$7,310
Hollister Elementary	$9,080	$6,316	$2,764	$834	0	$7,150
Morgan Hill Unified	$8,710	$6,463	$2,246	$677	0	$7,141

Source: 2014-15 state-certified data
*Economic Recovery Target (ERT)

The District has been able to maintain a very consistent ADA in spite of the fact that it is the sponsor for five charter schools.

Figure 3: ADA By Fiscal Year

District	% Change in ADA	TOTAL ADA 2010	2011	2012	2013	2014
Salinas City Elementary	11.11%	7,810	8,097	8,337	8,522	8,677
Salinas Union High	6.81%	12,635	12,775	12,979	13,120	13,496
Gilroy Unified	3.18%	10,526	10,549	10,776	10,870	10,861
Pajaro Valley Unified	***1.83%***	***17,034***	***17,198***	***17,187***	***17,486***	***17,346***
Santa Cruz City Schools	1.82%	6,437	6,532	6,580	6,601	6,554
North Monterey County Unified	1.66%	4,162	4,131	4,043	4,151	4,231

School Services of California INC.

Hollister Elementary	-1.86%	5,303	5,394	5,352	5,214	5,204
Morgan Hill Unified	-5.02%	8,546	8,373	8,321	8,181	8,117
Monterey Peninsula Unified	-7.76%	9,992	9,813	9,636	9,693	9,217

Source: 2014-15 state-certified data

These above data points help to shape the story about the District's resources that are available to spend. The state collects data annually when a district closes out its fiscal year. The data collected can be analyzed in many different formats, but there are several data points collected by the state that are pertinent to this study. The first data point relates to the personnel salary and benefit expenditures as a percentage of total General Fund expenditures. This shows numerically how much of the General Fund resources are used for people. Figure 4 shows that for the 2014-15 fiscal year, the District spent 83.35% of its General Fund on people which is the second highest percentage. However, if you look at the cost per ADA, that same number translates to more than $9,800 per ADA, which is nearly 9% higher than the next highest district.

Figure 4: Personnel Salary and Benefit Expense for 2014-15

District	% of Total Expenses, Transfer and Other Uses	Personnel Salary and Benefits Per ADA
Pajaro Valley Unified	***83.35%***	***$9,839***
Monterey Peninsula Unified	78.63%	$9,034
Santa Cruz City Schools	85.26%	$8,664
Salinas Union High	71.91%	$8,195
Hollister Elementary	82.38%	$8,027
Comparative Group Average	**77.31%**	**$7,915**
North Monterey County Unified	79.88%	$7,873
Gilroy Unified	81.38%	$7,479
Salinas City Elementary	73.02%	$7,061
Morgan Hill Unified	74.05%	$7,018

Source: 2014-15 state-certified data

The District provides a very competitive total compensation package (salary plus HWBs) when ranked against the comparative districts. However, the District has a substantially higher contribution for HWBs than the closest comparative district. The District's maximum contribution is almost 80% higher than the comparative group average. The most current health and welfare benefit contribution data is from the 2015-16 fiscal year.

Figure 5: Maximum and Average District Contributions for Health and Welfare Benefits for 2015-16		
District	**Maximum**	**Average**
Pajaro Valley Unified	***$28,293***	***$20,300***
Salinas City Elementary	$23,400	$16,005
Salinas Union High	$18,430	$13,659
Statewide Unified Average	**$18,527**	**$12,947**
North Monterey County Unified	$17,744	$12,224
Comparative Group Average	**$15,796**	**$11,689**
Gilroy Unified	$16,184	$10,768
Morgan Hill Unified	$11,714	$10,537
Santa Cruz City Schools	$14,128	$9,147
Monterey Peninsula Unified	$9,037	$8,793

Source: 2015-16 state-certified data

The next three data points show how the District's certificated nonmanagement total compensation ranks against the comparative districts. Total compensation includes both the salary, as well as the district contribution towards HWBs. An average is used to reflect the actual contributions, rather than the maximum available. As a result of the enormous HWB contribution, the District ranks first at BA +30, Step 1. The most current total compensation data is from the 2015-16 fiscal year.

Figure 6: Total Compensation: 2015-16 Step BA+30, Step 1 Plus Average Health and Welfare Benefit Contribution				
District	**Rank**	**Total Compensation**	**Salary BA+30, Step 1**	**Average HWB Contribution**
Pajaro Valley Unified	***1***	***$64,271***	***$43,971***	***$20,300***
Morgan Hill Unified	2	$60,902	$50,365	$10,537
Salinas City Elementary	3	$60,687	$44,682	$16,005
Gilroy Unified	4	$60,516	$49,748	$10,768
Salinas Union High	5	$60,115	$46,456	$13,659
North Monterey County Unified	6	$58,574	$46,350	$12,224
Santa Cruz City Schools	7	$58,544	$49,397	$9,147
Monterey Peninsula Unified	8	$52,546	$43,753	$8,793

Source: 2015-16 state-certified data

The District's rank falls in the middle of the salary schedule and ranks of 5 out of 8 districts.

Figure 6: Total Compensation: 2015-16 Step BA+60, Step 10 Plus Average Health and Welfare Benefit Contribution				
District	Rank	Total Compensation	Salary BA+60, Step 10	Average HWB Contribution
Salinas Union High	1	$86,558	$72,899	$13,659
Salinas City Elementary	2	$85,293	$69,288	$16,005
Morgan Hill Unified	3	$85,091	$74,554	$10,537
Gilroy Unified	4	$84,053	$73,285	$10,768
Pajaro Valley Unified	***5***	***$80,709***	***$60,409***	***$20,300***
North Monterey County Unified	6	$79,872	$67,648	$12,224
Santa Cruz City Schools	7	$78,661	$69,514	$9,147
Monterey Peninsula Unified	8	$71,998	$63,205	$8,793

Source: 2015-16 state-certified data

However, when comparing maximum total compensation the District rises and ranks 3 out of 8 in the comparative group.

Figure 7: Total Compensation: 2015-16 Maximum Salary Plus Average Health and Welfare Benefit Contribution				
District	Rank	Total Compensation	Maximum Scheduled Salary	Average HWB Contribution
Salinas Union High	1	$112,565	$98,906	$13,659
North Monterey County Unified	2	$105,446	$93,222	$12,224
Pajaro Valley Unified	***3***	***$104,897***	***$84,597***	***$20,300***
Morgan Hill Unified	4	$104,871	$94,334	$10,537
Salinas City Elementary	5	$103,916	$87,911	$16,005
Gilroy Unified	6	$103,869	$93,101	$10,768
Monterey Peninsula Unified	7	$102,408	$93,615	$8,793
Santa Cruz City Schools	8	$101,637	$92,490	$9,147

Source: 2015-16 state-certified data

The LCFF has benefited the District as the formula provides an equal base grant, by grade span, for all districts across the state, and additional funding for districts with high numbers of unduplicated pupils. The District has the third highest percentage of unduplicated pupils based on the comparative group, and is well above the state average of 63%.

In spite of the above average LCFF revenues, the District has been unable to keep pace with certificated nonmanagement salaries primarily as a result of the robust health and welfare benefit contribution. Even though the District ranks very favorably in total compensation, if salaries continue to be a priority for attracting and retaining new employees, the District must address the amount of funds that it contributes towards HWBs.

Sincerely,

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SHEILA G. VICKERS
Vice President