The Marin Common Message

Executive Summary

2014-15 First Interim

October 31, 2014

MCOE

MARIN COUNTY OFFICE OF EDUCATION

Table of Contents

Introduction

This edition of the Common Message is intended to provide information and guidance to assist local educational agencies (LEAs) in developing their 2014-15 first interim reports. It contains updates related to the proposed changes to the Local Control Funding Formula (LCFF) expenditure regulations and the Local Control Accountability Plan (LCAP) Template, Medi-Cal Administrative Activities and medical billing, federal funding and sequestration, and various technical clarifications.

Significant Changes since Budget Adoption

Summary of Material Changes

There are a few material changes LEAs should consider when revising their budgets for the First Interim report and multiyear projections.

- The State Board of Education is set to act on the permanent regulations and LCAP template at its November meeting. The proposed changes can be found in the LCAP Overview section of this document.

- Proposition 2 is on the ballot for the November 4 election. If passed, this proposition would strengthen the State's reserves and at the same time it would impose a cap on the reserves school districts could set aside for economic uncertainties under certain circumstances (see the Reserves section for details on the SB 858 reserve cap).

- On September 10, 2014 Governor Brown signed Assembly Bill 1522. Effective July 1, 2015, AB 1522 provides up to 24 hours or three days of paid sick leave for previously ineligible employees who work 30 or more days in a calendar year. For LEAs, employees previously not eligible for sick leave might include substitutes.

- On September 12, 2014, the California Department of Health Care Services (DHCS) announced that the Federal Centers for Medicare and Medicaid (CMS) agreed to end the current DHCS Reasonableness Test Criteria (RTC) comprehensive review process. More details on this change can be found in the Medi-Cal Administrative Activities (MAA) section.

- The federal sequestration cut was announced for FY 2015 (school year 2015-16) at 0.0554%, which is smaller than previous years. More details can be found in the Federal Funding / Sequestration section.

- Senate Bill 858 made changes to the Independent Study Program statutes. Some of the changes took effect in 2014-15 and the remaining changes will take effect in 2015-16. Reference the Independent Study section for more details on the changes.

Planning Factors for First Interim and MYPs

Key planning factors for LEAs to incorporate into the first interim report and MYP are listed below and based on the latest information available as of this writing (10/28/2014).

	Fiscal Year		
Planning Factor	**2014-15**	**2015-16**	**2016-17**
COLA (DOF)	0.85%	2.19%	2.14%
LCFF Gap Funding Percentage (DOF)	29.56%	20.68%	25.48%
STRS Employer Rates	8.88%	10.73%	12.58%
PERS Employer Rates (PERS Board / Actuary)	11.771%	12.6%	15.0%
Lottery - unrestricted per ADA*	$128	$128	$128
Lottery - Prop 20 per ADA*	$34	$34	$34
Mandated Cost (prior year) per ADA	$67	$0	$0
Mandate Block Grant for Districts – K-8 per ADA	$28	$28	$28
Mandate Block Grant for Districts – 9-12 per ADA	$56	$56	$56
Mandate Block Grant for Charters – K-8 per ADA	$14	$14	$14
Mandate Block Grant for Charters – 9-12 per ADA	$42	$42	$42
State Preschool Daily Reimbursement Rate	$22.28	$22.28	$22.28
General Child Care Daily Reimbursement Rate	$36.10	$36.10	$36.10

* Government Code 8880.5(a)(2) extended lottery funding based on the 2007-08 ROP ADA and Adult Education ADA through 2014-15. Under current law these two ADA counts will no longer be part of the lottery calculation for 2015-16 and beyond.

Additional guidance on budget and MYP planning can be found in the Guidance for Adopted Budgets and MYPs sections.

Key Guidance for First Interim

Situational Guidance and Multiyear Projections

The technical details of how to calculate LCFF entitlements are becoming routine with the benefit of a full year of implementation, the California Department of Education's (CDE) 2013-14 P2 certification, and continued refinements to the Fiscal Crisis and Management Assistance Team (FCMAT) LCFF Calculator. Nonetheless, the fiscal operating environment for districts remain somewhat uncertain, and each district must address its own unique set of risk factors in determining budget priorities and creating multiyear projections.

Factors contributing to an unpredictable operating environment exist on both the revenue and expenditure sides of the budget. These factors may cause future revenue uncertainty:

- The precise level of LCFF gap funding provided in any given year is subject to economic conditions as well as political decisions by the Governor and the Legislature.

- The dependence of LCFF entitlements on shifting unduplicated eligible pupil counts as well as ADA, which adds a level of complexity to revenue forecasting that was not present under the revenue limit system.

- While most of the 2013 sequestration cuts to Federal revenues appear to have been restored for the current fiscal year, sequestration provisions remain in effect through 2023.

- The future of state funding for facilities is in limbo due to the absence of bond funding for the School Facilities Program.

Future expenditure uncertainty may arise from the following:

- Possibly needing to shift supplemental and concentration grant funding so that it is “principally directed towards” providing increased or improved services to specific pupil subgroups as specified in the proposed LCFF expenditure regulations.

- Changing expenditure requirements as a result of LCAP development.

- Continued changes in legislative mandates including increased costs associated with retirement plans (STRS, PERS, and OPEB), potential penalties or other costs associated with the Affordable Care Act, and new leave costs associated with the Healthy Families Act.

- Pressure on labor costs that are complicated by the fact that districts in the same labor market may receive significantly different year over year funding increases.

- Costs associated with maintaining functions and programs that were previously funded through categorical programs such as deferred maintenance or adult education.

- Requirements to restore routine restricted maintenance to the 3% minimum level in 2015-16.

The uncertain operating environment reflected above is coupled with demands for ever greater transparency, local accountability under the LCAP, and with increased expectations from all sides due to the perception of the availability of more funding.

While further LCFF revenue growth is projected in 2015-16 and 2016-17, the new funding will not be sufficient to meet all the competing demands for increased expenditures. Funding for most districts will remain below 2007-08 levels. Districts will need to prioritize new expenditures based on the LCAP while still maintaining fiscal flexibility and solvency.

The keys to protecting fiscal flexibility and solvency in an uncertain environment include:

1. Maintaining adequate reserves to allow for unanticipated circumstances.

2. Maintaining fiscal flexibility by **limiting commitments** to future increased expenditures **based on projections** of future revenue growth, and/or establishing contingencies that allow expenditure plans to be changed if needed.

Reserves and fiscal flexibility are necessary to protect the integrity of the educational program in an unpredictable operating environment. Achieving this level of flexibility will require districts to build trust among constituents through clear, ongoing, and transparent communications regarding the general uncertainty and the unique situational challenges facing the district.

Multiyear Projections

Recommendations for creating multiyear projections that will align with the LCAP include:

- Gathering and documenting the best information available about all the known factors that will impact future revenues and expenditures (see the Planning Factors section of this document for recommended assumptions).

- Making reasonable, supportable, and conservative assumptions about how these factors will impact future revenues and expenditures, which includes modeling varying assumptions and scenarios.

- Using the best tools available to model the impact of these assumptions on future ending fund balances and cash flows.

- Making sure expenditure plans are aligned with the educational mission of the district as delineated in the LCAP.

- Maintaining fiscal flexibility for possible unanticipated changes by:

    - Maintaining adequate reserves.

    - Building in room for contingencies in expenditure plans, including collective bargaining agreements if possible.

    - ***Not*** using one-time resources for ongoing commitments.

- ***Not*** locking in ongoing spending commitments that the district can only afford in the future if projections play out exactly as predicted (or better).

- Clearly documenting, communicating and explaining assumptions to stakeholders including preparation to respond in a reasoned, transparent, and logically justified manner if assumptions are challenged.

Reserves

County offices continue to reinforce the need for reserves over the minimum reserve requirements. The experience of the past six years has clearly demonstrated these minimum levels are not sufficient to protect educational programs from severe disruption in an economic downturn. The typical 3% reserve minimum represents less than two weeks of payroll for many districts. Many LEAs have established reserve policies calling for higher than minimum reserves, recognizing their duty to maintain fiscal solvency. The adequacy of a reserve level should be assessed based on the LEA's own specific circumstances, and numerous models are available for consideration. Examples include:

- The Government Finance Officers Association recommends reserves equal to two months of average general fund operating expenditures, or about 17%.

- Rating agencies like Fitch or Moody's typically assess the adequacy of a district's reserves by comparing them to statewide averages, which have hovered around 15% for California unified school districts in recent years.

- The Fiscal Crisis and Management Assistance Team emphasizes the need to assess not only fund balance but also actual cash on hand.

There are many benefits to having higher than minimum reserves including:

- Financial flexibility to absorb unanticipated expenditures without significant disruption to educational programs.

- Protection against exposure to significant one-time outlays such as disasters, lawsuits, or material audit findings.

- Protection against the volatility of state revenues.

- Protection against the volatility of property tax revenues for basic aid districts.

- Cash management / avoiding the cost of borrowing cash.

- Protection against declining enrollment.

- Protection against the expiration of parcel taxes.
- Protection to cover increases in fixed and statutory costs.
- Financial flexibility to shift resources as priorities set through the LCAP process change.
- Planning for major projects such as information technology upgrades or deferred maintenance.

This is not an exhaustive list. Of all the reasons for carrying higher than minimum reserves, protecting against state revenue volatility is one of the most compelling. This is especially true during LCFF implementation because gap percentage funding is correlated with Prop. 98 growth. By providing a buffer from volatile state revenues, maintaining higher than minimum reserves creates stability to maintain instructional services and programs.

SB 858 Public Hearing Requirements for Reserves in Excess of Minimum Reserves

Beginning 2015-16 adopted budgets, SB 858 amended Education Code Section 42127 to require that a district's public hearing for budget adoption include the following for review and discussion:

- The minimum recommended reserve for economic uncertainties for each fiscal year identified in the budget.
- The combined assigned and unassigned ending fund balances that are in excess of the minimum recommended reserve for economic uncertainties for each fiscal year identified in the budget, pursuant to Education Code Section 33128(a). The fund balances included are Fund 01, General Fund, and Fund 17, Special Reserve Fund for Other Than Capital Outlay Projects.
- A statement of reasons that substantiates the need for an assigned and unassigned ending fund balance in excess of the minimum recommended reserve for economic uncertainties for each fiscal year.

The governing board of a school district shall include this information each time it files an adopted or revised budget with the county superintendent of schools. The county superintendent of schools shall determine whether a school district's adopted or revised budget complied with these requirements.

Proposition 2 Passage Triggers Cap on District Reserves

If voters approve Proposition 2 on November 4, 2014, it would create a Public School System Stabilization Account (PSSSA / Prop. 98 Rainy Day Reserve). However, even if the measure passes, contributions to the PSSSA reserve are unlikely to happen for several years, and are likely to be infrequent. For a contribution to the PSSSA reserve to occur, all of the following must be true:

1. All Prop. 98 maintenance factor amounts outstanding as of 2013-14 ($6.6 billion) must have been paid to schools.
2. Capital gains taxes must be greater than 8% of state general fund revenue (capital gains taxes have exceeded 8% seven times in the past 16 years).
3. Prop. 98 must be calculated using Test 1 (since the passage of Prop. 98 in 1988, Test 1 has been used in 1988-89, 2011-12, and 2012-13).
4. Prop. 98 must not be suspended (Prop. 98 has been suspended twice: 2004-05 and 2010-11).

If all of the conditions above are met, and a transfer is made to the Public School System Stabilization Account, then SB 858's reserve cap provisions come into effect. In the fiscal year immediately after a transfer to the PSSSA is made, a school district's adopted or revised budget is prohibited from containing a combined assigned or unassigned ending fund balance in excess of either two times the minimum recommended reserve for economic uncertainties, as established by the State Board of Education pursuant to Section 33128(a).

County Superintendents May Exempt Districts from Reserve Cap

The county superintendent of schools may waive the prohibition, pursuant to specified conditions, for up to two consecutive fiscal years within a three-year period if the school district provides documentation indicating that extraordinary fiscal circumstances substantiate the need for the additional reserve balances. Documentation indicating extraordinary fiscal circumstances may include, but is not limited to, multiyear infrastructure or technology projects. As a condition of receiving an exception, a school district shall do all of the following:

1. Provide a statement that substantiates the need for an assigned and unassigned ending fund balance in excess of the minimum recommended reserve for economic uncertainties.
2. Identify the funding amounts in the budget adopted by the school district that are associated with the extraordinary fiscal circumstances.
3. Provide documentation that no other fiscal resources are available to fund the extraordinary fiscal circumstances.

A flow chart illustrating the SB 858 reserve requirements is attached in Appendix A.

The cap on reserves will become operative on December 15, 2014, only if Prop. 2 is approved by the voters at the November 4, 2014 statewide general election. If Prop. 2 is not approved, the cap on reserves will not become operative and will be repealed on January 1, 2015.

Negotiations

Because of the uncertain fiscal operating environment (see Situational Guidance above), districts need to exercise caution and maintain flexibility through contract contingency language that protects the district from cost increases and/or revenue shortfalls beyond their control. Building relationships with employee groups based on earned trust, mutual respect, and a shared commitment to the education of students is critical.

The varying distribution of gap funding under the LCFF implementation period may complicate bargaining because districts may have widely divergent levels of funding. Changes to PERS and STRS contributions for new members, increased contribution rates for both systems, and evolving definitions of creditable compensation add further complexity, as does the ongoing implementation of the Affordable Care Act.

Maintaining competitive compensation structures going forward may require creative solutions, whether it is redefining comparable employers, using technology to drive operational efficiencies, re-examining staffing models, altering the balance between salaries and benefits, etc.

Districts will need to exercise caution in proposed language for negotiated bonus payments to avoid penalty and interest charges on retroactive payments. Examples of contract language, Earned Service Period and possible interest charges are attached as Appendix B.

Summary

LEAs adapted to unprecedented changes in 2013-14 under LCFF and LCAP. With the passage of a year, the adoption of the first LCAPs, and the 2013-14 P2 certification of the LCFF by CDE, the 2014-15 fiscal year represents a transition to a "new normal" with an emphasis on:

- Planning and budgeting in a transparent and inclusive manner.
- Maintaining expenditure flexibility to allow for changing priorities under the LCAP, changing expenditure requirements due to legislative mandates, and possible revenue volatility during LCFF implementation.

While funding is slowly being restored to pre-recession levels, LEAs cannot simply return to pre-recession practices and programs. LEAs must focus on improving and increasing services to students, especially in specific student subgroups, and will be held accountable through the LCAP.

This is an exciting time for public education in California, as districts have the opportunity to enhance services for the students for the first time in many years!

Appendices:

Appendix A – Examples of contract language for negotiations
Appendix B – Reserve cap flow chart