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Summary of Problems in Fiscal Management at the San Mateo Union High School District

Issue

To what extent is the San Mateo Union High School District being fiscally responsible in managing its budget and extensive construction programs? How do the District's financial uncertainties affect the community and the young people it serves?

Summary

A "basic aid district", such as the San Mateo Union High School District (SMUHSD or District), derives most of its revenue from property taxes. That District is in financial crisis due to financial imprudence, to wit:

- Borrowing \$74 million through certificates of participation (COPS) to pay for cost overruns in the 2000 Measure D voter approved construction bond projects
- Adopting deficit spending budgets in four of the last five years
- Failing to react to rapidly decreasing reserves while continuing optimistic revenue projections despite significant reductions in property tax allocations
- Failing to seek outside financial advice and guidance as deficits continued and reserves dwindled
- Completing employee agreements using inadequate data and unclear analysis of funding
- Communicating poorly with the staff and community regarding fiscal and construction matters

The current fiscal crisis has shaken community confidence in the Board of Trustees and specific staff members, and the community and parents are incensed over the situation. Many teachers and classified staff were dismissed or reassigned on very short notice to bring the reserve close to the State-mandated 3 percent. In a poll by the San Mateo Union High School District Teachers Association, 96 percent of those voting expressed "no confidence" in the Superintendent and an Associate Superintendent and called for their dismissal.

The San Mateo County Civil Grand Jury (Grand Jury) recommends that the SMUHSD:

- Continue to use the recently retained financial services firm to analyze revenues, expenses, construction management and general procedures, and do so until District reserves are at an acceptable level
- Appoint an independent and skilled Blue Ribbon Citizens Advisory Committee with a comprehensive scope of duties to oversee, monitor and report monthly to the Board of Trustees and the public on all aspects of budget-related activities
- Ensure that the Citizens Measure M Bond Oversight Committee has the required financial and construction management skills and is independent from staff and Board. The membership of this committee should be finalized by June 1, 2007. Monthly written and oral reports should be presented by the Oversight Committee to the Board of Trustees and the public
- Establish a policy and a plan requiring a reserve at least as great as the 4.5 percent reserve recommended by the San Mateo County Superintendent of Schools, with the ultimate goal of exceeding the California average for basic aid districts.
- Establish a policy requiring adequate and reliable fiscal data before negotiating employee agreements
- Establish stronger communications with the San Mateo County Assessor, County Controller and any other agencies that fiscally affect the SMUHSD finances
- Adopt a communication program that allows for public comment at the beginning and conclusion of Board of Trustee meetings
- Use the District's website to distribute at a minimum budgets, audits and citizen oversight committee reports

Problems in Fiscal Management at the San Mateo Union High School District

Issue

To what extent is the San Mateo Union High School District being fiscally responsible in managing its budget and extensive construction programs? How do the District's financial uncertainties affect the community and the young people it serves?

Background

The Revenue Stream

A "basic aid district", such as the San Mateo Union High School District (SMUHSD or District), derives most of its revenue from property taxes. Because District income is very reliant on this revenue stream, close communication among the SMUHSD, the County Assessor and the County Controller is critical.

Successful property tax appeals reduced actual revenues from the forecast allocation for all County agencies receiving property taxes. As with other agencies, the SMUHSD experiences reductions in its allocation each year. In the fiscal year ended June 30, 2006, reductions amounted to more than \$1.5 million. Reductions in recent years are as follows:

<u>Fiscal Year</u>	<u>District Property Tax Appropriation Reductions</u>
2006-07	\$ 222,541*
2005-06	1,643,848
2004-05	198,877
2003-04	403,438
2002-03	811,069
2001-02	94,924
2000-01	63,698

Although the variations are extreme, in the worst case they amount to less than 2 percent of total expenditures in a given year. The San Mateo County Office of Education's letter of January 12, 2007, reviewed the District's First Interim Report for fiscal year 2006-07 and noted, "The district's multi-year budget projection indicates a 94 percent decline in the General Fund's ending balance from 2000-01 to 2008-09." This bodes ill for the future fiscal health of the District.

* partial year

Budget/Reserves

The SMUHSD Board of Trustees approved and submitted its 2006-2007 budget (Appendix A) to the San Mateo County Superintendent of Schools for approval before submitting it to the California Department of Education. In early August 2006, the County Superintendent of Schools met with the SMUHSD Board of Trustees and the Superintendent and notified them that their budget would not receive a *positive* certification and would receive a *qualified* certification only if the \$217,838 (0.25 percent) year-end budget reserve was increased to \$2 million, still below the three percent reserve required by the State.

The scale from good to bad in the financial rating of a school district is first a *positive* certification, then a *qualified* or *conditional* certification, and finally a *negative* certification. A *negative* certification brings many strictures to a district. To receive the *qualified* certification instead of a *negative* certification, adjustments were to be made by SMUHSD by September 29, 2006, and were to include a recovery plan reflecting what expenses were to be cut. With a *qualified* certification, the County Superintendent of Schools must review and approve many District financial transactions.

The SMUHSD Board of Trustees included public input in their deliberations, made staff cuts and submitted their revised budget and recovery plan to the County Superintendent of Schools. In December 2006, the District approved their First Interim report. In a January 2007 letter, the County Office of Education acknowledged receipt of the First Interim Report. The District's report indicated that they might not be able to maintain the mandated reserves in that year and the two subsequent years. If the district does not maintain these reserves, the State Education Code requires the District's *qualified* certification to be changed to *negative*.

The District's 2006-07 First Interim Report projected fiscal year end reserves for 2006-07, 2007-08 and 2008-09 to be below the State-mandated three percent each year. The 2008-09 year end reserve was projected to be \$431,117, less than 0.5 percent of the budget.

On March 8, 2007, the SMUHSD Board of Trustees approved their Second Interim Report with a "self-qualified certification" which must receive concurrence from the County Superintendent of Schools. Expenditures continue to exceed revenues. The Board's official position, "The District may be able to meet its financial obligations for the current year and the two subsequent years," is the main justification given to the County Superintendent of Schools, who must analyze the report before accepting or rejecting it. This dubious optimism is based on projections that:

- There will be no staff raises.
- There will be a 4.5 percent property tax increase.
- There will be a sale of an additional certificate of participation (COP) that consolidates existing debt and provides an additional \$24 million to the District.

This ostensibly would allow the District to begin the 2007-2008 fiscal year with the State-required reserve.

The average reserve for basic aid school districts in California is 10 percent. Many districts in San Mateo County are significantly above this average. State law requires school districts to maintain a 3 percent reserve. The County Superintendent of Schools recommends basic aid districts maintain a 4.5 percent reserve due to the fluctuation of their income.

On October 31, 2006, Unrestricted Funds Available for Reserves in San Mateo County Basic Aid Districts were as follows:

<u>District</u>	<u>Unrestricted Funds Available for Reserves</u>	<u>Percent Available for Reserves</u>
Belmont-Redwood Shores	\$1,203,039	4.79%
Brisbane	373,112	6.38%
Hillsborough	2,703,258	13.94%
Las Lomas	2,542,964	17.16%
Menlo Park	5,213,783	21.05%
Portola Valley	1,415,259	13.86%
Woodside	276,244	4.0%
San Mateo Union High	2,115,391	2.31%
Sequoia Union High	2,735,259	5.99%

Note that SMUHSD had by far the lowest reserves percentage of any district listed.

Salaries

Most of a school district budget is allocated for salaries; salaries are 85.5 percent of SMUHSD expenses. Most school districts negotiate agreements with employee organizations only when the source of funds and the financial impact on all elements of the budget are known. In 2006, agreements were made before the significant drop in property tax allocations were known. The low reserve going into the year forced the intervention of the County Superintendent of Schools and required employee dismissals to bring reserves closer to the State-mandated levels.

Certificates of Participation (COP)

On March 8, 2007, the District Board of Trustees approved the consolidation of three COPs totaling \$50 million to take advantage of more favorable financing terms. A COP is a lending mechanism used by government agencies that does not require voter approval. Money was borrowed through the sale of COPs in fiscal years 2004, 2006 and 2007 to pay for additional cost overruns for construction projects financed by the \$137.5 million Measure D bond issue approved by the voters in November 2000. The March 8, 2007, COP was approved for \$74 million to consolidate the \$50 million in the three

original COPs plus an additional \$23 to \$30 million for further costs related to the Measure D projects.

The District's annual cost for the \$74 million COP repayment is estimated at \$2.7 million in 2008, rising to approximately \$5 million in 2044, and totaling \$164 million in principal and interest on the \$74 million borrowed (Appendix C). Repayment will come from the General Fund, developer fees and Redevelopment Agency (RDA) agreements. Developer Fees and RDA agreements can change radically from year to year and are notoriously unreliable. The portion of the COP repayment charged to the General Fund is estimated at \$475,000 in 2008, increasing by one percent each year over the 37-year repayment period to about \$680,000 in 2044.

Because of the District's *qualified* certification, the District must now secure the approval of the County Superintendent of Schools prior to incurring additional indebtedness. According to the District's auditor, two of the original three COPs violated the State Education Code because the District did not obtain the concurrence of the County Superintendent of Schools.

The voters approved Measure M, another construction bond measure, for \$298 million in November 2006. During the bond campaign there was limited, if any, discussion of the \$30 million raised from issuance of COPs 2 and 3, which were sold in January and June 2006, just a few months before the election.

Communication with County Agencies

The County Office of Education meets periodically with school district officials to help them assess property tax revenue fluctuations. These meetings include representatives from the County Assessor's Office and the County Controller's Office. The County Superintendent of Schools has increased the number and scope of meetings in recent months, and some districts, including the SMUHSD, have established their own connections with the County Assessor and County Controller. Cities within the County are also affected by varying tax revenues, and to address this problem, financial officers from those cities meet monthly with the Controller, Assessor and their staffs.

Investigation

Members of the Grand Jury met with current and retired staff and members of the Board of Trustees of the SMUHSD. Meetings were also conducted with staff of the County Assessor's Office, the County Controller's Office, other school districts, construction officials, the County Office of Education, citizens and other education auditing and financial professionals.

Findings

Four of the last five annual budgets adopted by the Board of Trustees have had deficits between \$1.7 million and \$2.4 million. Reductions in County property tax allocations lowered property tax income and reduced the SMUHSD economic uncertainty reserves to just \$217,838 in the budget adopted for 2006-07, a reserve of only 0.25 percent.

Terms of annual employee agreements have been entered into with no plan for maintaining the State-mandated reserves for economic uncertainty while at the same time meeting other District expenses, and living up to the commitments of the employee agreements.

Accounting standards (Statement of Financial Accounting Standards No.5 – Accounting for Contingencies) require that uncertainties regarding potential loss be disclosed in audited financial statements. The District’s auditor failed to disclose the potential for reduction in property tax allocations in the audit statements for the fiscal years ending June 30th of 2005 and 2006.

With the additional money to be borrowed on the new COP, the total cost of the Measure D bond projects is \$280 million, which includes bond money, COPs, developer fees and State grants. The original bond measure approved by the voters in 2000 was for \$137.5 million. Adding the COP dollars (not developer fees or grant dollars) brings the total borrowed funds to \$211.5 million, an increase of \$74 million or 53.8 percent over what voters approved.

SMUHSD communication with County officials regarding property tax revenues has not been effective. Many of those interviewed by the Grand Jury felt the interface between the school districts and the County Assessor and Controller was “laborious” and often ineffective. Efforts are now being made at both the County and District level to improve the situation.

Although financial acumen by both the Superintendent and the Board of Trustees has been sorely lacking, financial assistance and advice from outside advisors has not been sought by the Board of Trustees or staff and even appears to be undesired by some members. Firms such as California Schools Services, Inc. and Financial Crisis Management Assistance Team (FCMAT) provide such advice and are used by many school districts in the County and throughout California. Only in February 2007 did the County Superintendent of Schools and the SMUHSD Superintendent mutually agree to engage FCMAT to review the District’s finances and recovery plan. The County Office of Education will pay for the review, and the FCMAT findings should be complete in April 2007.

Conclusions

The financial reserves of the SMUHSD are dangerously low and will only improve if many of the dubious assumptions in the Second Interim Report approved by the Board on March 8, 2007, come to fruition. SMUHSD did not maintain adequate reserves for economic uncertainties to deal with unpredictable property tax revenues. The reserves do not approach either the State-wide average for basic aid school districts, or the County average. The District's precariously low reserves and the burden of COP payments have made it the only basic aid district in the County to experience a crisis of such an urgent nature.

Adequate cost control measures and analyses were not used for Measure D construction projects. Expenses to the District were \$74 million dollars (53.8 percent) over the amount authorized by the voters in November 2000. This shortfall was covered through the sale of COPs for a total of \$74 million. In 2006, two COPs for a total of \$30 million were sold without consultation with the County Superintendent of Schools as required by the California Education Code for school districts with a *qualified* certification. Financial reports to the Board of Trustees have been very limited.

When the voters approved the \$137.5 million Measure D bond in 2000, they were not informed that an additional sale of COPS would be required to finance the construction projects. Whether the sale of COPs was planned in advance or was necessitated by construction cost overruns is contested; varied opinions were expressed by those interviewed. Nonetheless, the borrowed funds (now estimated at \$74 million) were not incorporated into the Measure M bond issue approved by the voters in November 2006 and will constitute an additional annual expense to the District through 2044.

During construction, the Measure D Bond Citizens Oversight Committee met every two months, yet reported to the Board of Trustees just once a year. This committee's advisor was the previous Associate Superintendent for Business Services. Because they now believe that the financial accounting was inadequate, the committee has written a "Lessons Learned" paper (Appendix B) that describes how financial reporting on projects should be changed. The report also includes numerous significant points and suggestions that would be helpful to the Measure M Citizens Bond Oversight Committee, especially if the two committees meet and share their thoughts on "Lessons Learned."

The Measure M Bond Oversight Committee should frequently report to the Board of Trustees and the public both the good and the bad news. The Board of Trustees should ensure that construction projects stay on budget; and if necessary, scale back individual projects to meet that goal.

The District's fiscal crisis has shaken community confidence in the Board of Trustees and specific staff members, causing consternation among the parents and the community at large. Many parents are concerned about the quality of their children's education and of the reputation of their school district. Many teachers and classified staff were dismissed or reassigned on very short notice to meet demands by the San Mateo County

Superintendent of Schools that the reserve be brought close to the State-mandated three percent level by September 29, 2006, to achieve at least a *qualified* certification and avoid a *negative* certification. Ninety-six percent of the SMUHSD Teachers Association who voted expressed “no confidence” in the Superintendent and an Associate Superintendent and called for their dismissal.

Operation of a basic aid school district requires the Board of Trustees and staff to be conservative and to pay very close attention to the financial aspects of their district, including County tax collections and reductions in allocations. The District relies on property taxes and very limited State funding. Being a basic aid district has its rewards. For example, the funds available for each student are well above those in the revenue limit districts that make up the vast majority of California school districts. If a basic aid district is to gain the maximum benefit from these additional funds, the staff and Board of Trustees must be active and vigilant. They must ask informed questions and be open to public concerns. Communication with the community and the staff regarding finances has been poor.

SMUHSD has not used adequate systems and procedures for monitoring and controlling costs. Employee agreements were negotiated before good financial data were available. SMUHSD used overly optimistic expectations of property tax revenues for budgets, and continued deficit spending for the last few years. Audited financial statements have not listed contingencies for potential loss from reduction in property tax allocations (most arising from successful property tax appeals) as required by financial accounting standards.

SMUHSD has not used the services of outside advisors and analysts. It is not clear whether the analysis agreement with FCMAT commissioned by the County Office of Education and the SMUHSD Superintendent will cover all the necessary areas; it may be necessary to amend the agreement in May 2007 to continue external oversight until reserves are at a level acceptable to the State and the County Superintendent of Schools.

A Grand Jury report may be released later this year addressing financial aspects of District operations, including construction contract administration and the sale of COPS.

Recommendations

The Grand Jury recommends that the San Mateo Union High School District Board of Trustees direct the Superintendent to:

- 1.1 Continue the services of the Financial Crisis and Management Assistance Team (FCMAT) to review and advise the Board of Trustees and staff on the analysis of revenues, expenses and procedures. The District should continue with this oversight process until reserves are at a level acceptable to the County Superintendent of Schools and State Department of Education.

- 1.2 Ensure that the Citizens Measure M Bond Oversight Committee have the required financial and construction management skills and are independent from staff and Board of Trustees. The membership of this committee should be finalized by June 1, 2007. Monthly written and oral reports should be presented by the Oversight Committee to the Board of Trustees and the public. The Measure D and Measure M Bond Citizens Oversight Committees should meet to discuss the material presented in the Measure D “Lessons Learned” paper.
- 1.3 Establish a monthly meeting schedule with the County Controller, County Assessor and County Office of Education by June 1, 2007, so that the District staff can receive critical information on matters relating to property appraisals, property tax assessments and reductions in property tax allocations.
- 1.4 Upgrade the District’s website by June 1, 2007, to include, at minimum: financial statements, staff reports relating to agenda items, management letters from the auditor, budgets, interim reports and monthly reports from the oversight committees.
- 1.5 Televisе Board of Trustees meetings and structure agendas to allow for public input at both the beginning and end of the meeting; this should begin by June 1, 2007.

The Grand Jury recommends that by June 1, 2007, the San Mateo Union High School District Board of Trustees:

- 2.1 Adopt a policy requiring adequate, reliable financial data to be used in the preparation of a plan describing how all costs will be covered while maintaining the required reserve. Most importantly, this should contain a plan for reducing or postponing the scope of a project if it appears that the project will exceed the approved budget.
- 2.2 Establish a policy and a plan requiring a reserve at least as great as the 4.5 percent reserve recommended by the San Mateo County Superintendent of Schools, with the ultimate goal of exceeding the California average for basic aid districts.
- 2.3 Appoint an independent, qualified Blue Ribbon Citizens Advisory Committee to monitor all District activities relating to the budget. This Blue Ribbon Committee should report orally and in writing to the Board of Trustees and the community at regular monthly meetings beginning by June 1, 2007.

Appendix A
A San Mateo County Office of Education General Fund Summary for the SMUHSD, 1995-96 to 2006-07
Illustrating Total Reserves v. 3% Required Reserves

	2006-07 First Interim	2006-07 Adopted Budget	2005-06 Unaudited Actuals	2004-05 Unaudited Actuals	2003-04 Unaudited Actuals	2002-03 Unaudited Actuals	2001-02 Unaudited Actuals	2000-01 Unaudited Actuals	1999-00 Unaudited Actuals	1998-99 Unaudited Actuals	1997-98 Unaudited Actuals	1996-97 Unaudited Actuals	1995-96 Unaudited Actuals
A. REVENUES:													
Revenue Limit Sources	76,439,307	75,131,379	71,469,428	68,382,371	68,559,796	64,436,868	61,057,942	55,177,359	49,976,772	46,006,332	42,893,247	41,196,491	40,276,266
Federal Revenues	2,200,350	2,170,643	2,349,634	2,516,106	2,214,381	2,072,279	1,746,037	1,409,804	1,197,611	890,693	812,905	646,623	700,768
Other State Revenues	7,501,697	3,824,166	4,118,290	4,576,198	1,568,384	5,647,979	8,813,369	9,824,576	9,013,614	6,280,309	5,617,734	5,336,548	4,856,124
Other Local Revenues	4,587,328	4,167,211	7,193,073	4,734,592	4,757,284	4,233,626	3,811,606	3,792,342	3,299,142	3,089,183	3,087,062	3,587,766	3,508,677
TOTAL REVENUES	\$ 90,728,682	\$ 85,293,399	\$ 85,130,425	\$ 80,209,267	\$ 77,099,846	\$ 76,390,752	\$ 75,428,954	\$ 70,204,081	\$ 63,487,139	\$ 56,266,517	\$ 52,410,948	\$ 50,767,428	\$ 49,341,835
B. EXPENDITURES:													
Certificated Salaries	41,410,360	41,268,118	41,131,085	39,835,624	37,530,458	38,753,271	36,521,600	33,171,061	29,680,386	26,773,464	25,191,067	24,319,058	24,235,172
Classified Salaries	14,004,470	15,518,766	15,710,683	15,194,590	14,679,159	15,939,490	14,948,484	13,191,907	11,927,304	10,962,852	10,071,564	9,442,285	9,589,059
Employee Benefits	17,563,556	17,737,184	16,882,371	16,097,151	14,294,040	12,296,991	10,431,354	9,372,980	8,304,151	8,315,181	8,064,635	7,688,173	8,012,650
Books & Supplies	5,542,050	1,708,125	3,726,318	3,984,967	2,722,006	3,701,911	4,115,052	3,105,269	2,529,779	2,293,281	1,838,098	1,889,137	1,532,512
Svcs & Oth Oper Exp	9,471,624	8,446,438	8,185,606	6,798,749	6,793,877	7,146,242	7,359,785	6,624,630	5,186,316	5,009,153	4,463,445	4,346,488	4,658,901
Capital Outlay	25,425	0	0	7,338	0	284,876	845,234	2,210,875	1,864,970	1,489,978	1,030,054	895,949	364,454
Other Outgo (excluding Transfers of Indirect/Direct Support Cost)	2,891,832	2,801,832	2,295,167	809,971	1,063,965	890,276	1,302,427	666,032	354,425	207,133	144,474	220,464	92,978
Direct Support/Indirect Costs	(403,888)	(403,888)	(336,629)	(359,210)	(252,014)	(354,367)	(301,842)	(271,120)	(250,435)	(283,664)	(272,924)	(266,000)	(266,000)
TOTAL EXPENDITURES	\$ 90,505,429	\$ 87,076,575	\$ 87,594,601	\$ 82,369,181	\$ 76,831,492	\$ 78,658,690	\$ 75,222,094	\$ 68,071,634	\$ 59,596,896	\$ 54,767,378	\$ 50,530,413	\$ 48,535,554	\$ 48,219,726
C. REVENUES LESS EXPENDITURES	\$ 223,253	\$ (1,783,176)	\$ (2,464,176)	\$ (2,159,914)	\$ 268,353	\$ (2,267,938)	\$ 206,860	\$ 2,132,447	\$ 3,890,243	\$ 1,499,139	\$ 1,880,535	\$ 2,231,874	\$ 1,122,109
D. OTHER SOURCES AND USES													
Interfnd Transfers In	0	0	1,272,945	867,184	600,000	125,000	225,000	208,680	100,000	100,000	0	0	25,000
Interfnd Transfers Out	1,230,000	534,000	745,890	724,214	630,000	628,000	678,974	623,989	378,814	1,211,663	586,455	813,314	772,581
Other Sources	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Uses	0	0	0	0	0	0	0	310,449	0	0	0	0	0
Contrib to Restr Prog	0	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL OTHER SOURCES AND USES	\$ (1,230,000)	\$ (534,000)	\$ 527,055	\$ 142,970	\$ (30,000)	\$ (503,000)	\$ (453,974)	\$ (725,758)	\$ (278,814)	\$ (1,111,663)	\$ (586,455)	\$ (813,314)	\$ (747,581)
E. CHANGE IN FUND BALANCE	\$ (1,006,747)	\$ (2,317,176)	\$ (1,937,121)	\$ (2,016,944)	\$ 238,353	\$ (2,770,938)	\$ (247,114)	\$ 1,406,689	\$ 3,611,429	\$ 387,476	\$ 1,294,080	\$ 1,418,560	\$ 374,528
F1) BEGINNING FUND BALANCE													
a) As of July 1 - Unaudited (F1c)	3,122,138	3,122,138	4,952,470	6,969,413	6,731,060	9,501,998	9,890,606	8,483,917	4,872,488	4,386,031	3,118,386	1,547,738	1,425,931
b) Aud Adj/Restatements (F1d)	0	0	106,789	0	0	0	(141,494)	0	0	98,981	(26,435)	152,088	(252,721)
F2) ENDING FUND BALANCE, June 30	\$ 2,115,391	\$ 804,961	\$ 3,122,138	\$ 4,952,470	\$ 6,969,413	\$ 6,731,060	\$ 9,501,998	\$ 9,890,606	\$ 8,483,917	\$ 4,872,488	\$ 4,386,031	\$ 3,118,386	\$ 1,547,738
COMPONENTS OF ENDING FUND BALANCE													
	0	589,946	552,381	470,610	815,397	765,713	1,616,424	2,165,708	1,687,598	447,939			
	2,115,391	215,015	2,569,757	4,481,860	6,154,016	5,965,347	7,885,574	7,724,898	6,796,319	4,424,549			
Special Reserve Fund 17, Ending Fund Balance	\$ 2,823	\$ 1,823	\$ 1,823	\$ 137,523	\$ 104,423	\$ 72,226	\$ 40,717	\$ 81,486	\$ 245,652	\$ 296,590			
Total R	\$ 2,115,391	\$ 217,838	\$ 2,571,580	\$ 4,619,383	\$ 6,258,439	\$ 6,037,573	\$ 7,926,291	\$ 7,806,384	\$ 7,041,971	\$ 4,721,139			
3% Required Reserve (L	2,752,063	2,628,317	2,650,215	2,492,802	2,323,845	2,378,601	2,277,032	2,070,182	1,799,271	1,679,371	1,533,506	1,480,466	1,469,769

NOTE: Components of Ending Fund Balance for 2005-06 Adopted Budget reflects adjustments from the 2004-05 Unaudited Actuals and not the Estimated Ending Funding Balance submitted July 1st

NOTE: Beginning in Fiscal Year 2003-04, "Revenue Limit Sources" includes Excess ERAF Taxes for Special Education Funding

Appendix B Lessons Learned from Measure D

Citizen's Oversight Committee (COC) "Lessons Learned"

The members of the Measure D Citizen's Oversight Committee (2001-2006) would like to pass on the following "Lessons Learned" to the new Measure M COC.

1. Project Budget and Financial Reporting. There should be regular (probably monthly) Budget and Financial reporting to the District Administration, Board and COC. Any consultant's reports should be formatted to be consistent with the District's account categories and financial reports. These reports should be regular Board Agenda items.

2. Project Management. There needs to be one person or a team with overall responsibility for the construction program planning and implementation. This is too big a program for this to be an added duty for existing staff. While consultants may be used for construction management and other duties the overall responsibility for the program remains with the District. Site committees should be strengthened to insure that the design and construction management staffs listen to their clients. The project manager should also try to access State Bond funds.

3. Conservative Estimates. When developing project budgets, schedules and contingency reserves estimates should be realistic and conservative. Do not try to do more than can be effectively managed at one time. This will be a multiyear program.

4. Remember Maintenance and Operating Costs. When adding new facilities, be realistic about the need for adequate maintenance and increased operating costs. Don't build what we can't afford to operate and maintain.

5. It's Not Over until it's Over. Public construction today is very complex and subject to litigation. Try to minimize litigation but be prepared with adequate contingency reserves.

6. Keep the Public Informed. One of the key jobs of the COC is to keep the public informed of both good and bad news. This should be done through regular reports and meetings. The commitment of the oversight committee is critical to monitor projects beginning to end.

Appendix C

Prospective SMUHSD Formula for Repaying \$74 Million Certificate of Participation (COP) Using Redevelopment Agency (RDA) Fees, Developer Fees and the General Fund

Prospective Repayment Sources with General Fund Contribution

FY	Projected RDA Revenue (1)	Projected Developer Fee Revenue (2)	Estimated District GF Contribution (3)	Total Projected Debt Support	Levelized Debt Support(4)
6/30/08	1,790,000	475,000	475,000	2,740,000	2,740,000
6/30/09	1,881,000	475,000	479,750	2,835,750	2,835,750
6/30/10	4,909,000	475,000	484,548	5,868,548	3,265,000
6/30/11	1,606,000	475,000	489,393	2,570,393	3,265,000
6/30/12	1,706,000	475,000	494,287	2,675,287	3,265,000
6/30/13	1,809,000	475,000	499,230	2,783,230	3,265,000
6/30/14	1,914,000	475,000	504,222	2,893,222	3,265,000
6/30/15	2,024,000	475,000	509,264	3,008,264	3,265,000
6/30/16	2,138,000	475,000	514,357	3,127,357	3,265,000
6/30/17	2,253,000	475,000	519,501	3,247,501	3,318,801
6/30/18	2,372,000	475,000	524,696	3,371,696	3,371,696
6/30/19	2,495,000	475,000	529,942	3,499,942	3,499,942
6/30/20	2,620,000	475,000	535,242	3,630,242	3,630,242
6/30/21	3,222,000	475,000	540,594	4,237,594	4,237,594
6/30/22	3,418,000	475,000	546,000	4,439,000	4,439,000
6/30/23	3,620,000	475,000	551,460	4,646,460	4,646,460
6/30/24	3,829,000	475,000	556,975	4,860,975	4,860,975
6/30/25	4,043,000	475,000	562,545	5,080,545	5,080,545
6/30/26	4,416,000	475,000	568,170	5,459,170	5,459,170
6/30/27	4,647,000	475,000	573,852	5,695,852	5,695,852
6/30/28	5,128,000	475,000	579,590	6,182,590	6,182,590
6/30/29	5,372,000	475,000	585,386	6,432,386	6,432,386
6/30/30	4,300,000	475,000	591,240	5,366,240	5,366,240
6/30/31	4,491,000	475,000	597,152	5,563,152	5,563,152
6/30/32	4,702,000	475,000	603,124	5,780,124	5,780,124
6/30/33	4,917,000	475,000	609,155	6,001,155	6,001,155
6/30/34	3,401,000	475,000	615,247	4,491,247	4,491,247
6/30/35	3,532,000	475,000	621,399	4,628,399	4,628,399
6/30/36	3,668,000	475,000	627,613	4,770,613	4,770,613
6/30/37	3,808,000	475,000	633,889	4,916,889	4,916,889
6/30/38	3,269,000	475,000	640,228	4,384,228	4,384,228
6/30/39	3,387,000	475,000	646,631	4,508,631	4,508,631
6/30/40	3,509,000	475,000	653,097	4,637,097	4,637,097
6/30/41	3,634,000	475,000	659,628	4,768,628	4,768,628
6/30/42	3,762,000	475,000	666,224	4,903,224	4,903,224
6/30/43	3,893,000	475,000	672,886	5,040,886	5,040,886
6/30/44	3,922,000	475,000	679,615	5,076,615	5,076,615
Total	125,407,000	17,575,000	21,141,132	164,123,132	164,123,132

Assumptions:

- (1) Per RDA February 6, 2007 study by Fraser & Associates.
- (2) Median value over past 11 years of \$476,503.29.
- (3) Assumes a contribution of \$475,000 in FYE 2008, growing at 1% annually thereafter.
- (4) Adjusted revenue to levelize payments in order to comply with fair market rental restrictions on COP financings.

San Mateo Union High School District

Samuel Johnson, Jr., Superintendent

Ethel C. Konopka, Associate Supt. Human Resources-Admin. Serv.

Elizabeth McManus, Associate Supt. Business Services



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June 21, 2007

The Honorable John Grandsaert
Judge of the Superior Court
Hall of Justice
400 County Centers, 2nd Floor
Redwood City, CA 94063-1655

Re: Response from the San Mateo Union High School District to Grand Jury Report

Issued April 9, 2007 on the topic of *Problems in Fiscal Management at the San Mateo Union High School District*

Dear Judge Grandsaert:

On April 9, 2007, the Grand Jury of San Mateo County published its "Summary of Problems in Fiscal Management at the San Mateo Union High School District." The District would like to thank the Grand Jury for the investigation and analysis that they completed on our behalf. We take the Grand Jury's findings and implications very seriously. We fully intend to take all action necessary to restore confidence in our ability to manage our finances. In support of our commitment to addressing both the Grand Jury's and the Financial Crisis and Management Assistance Team's (FCMAT) reports and analyses, we have contracted with Dr. David Miller to serve as interim superintendent to replace Samuel Johnson, Jr. whose retirement is scheduled for June 29, 2007. Dr. Miller has extensive experience in school finance and currently serves on FCMAT's board of directors. We believe that Dr. Miller's insight into the issues will be invaluable in implementing corrective actions.

Please find our specific responses in the paragraphs below.

DISTRICT'S RESPONSE TO GRAND JURY'S FINDINGS

The Grand Jury's Findings appear on page 7 of their report.

Findings in First Paragraph: Four of the last five annual budgets adopted by the Board of Trustees have had deficits between \$1.7 million and \$2.4 million. Reductions in County property tax allocations lowered property tax income and reduced the SMUHSD economic uncertainty reserves to just \$217,838 in the budget adopted for 2006-07, a reserve of only 0.25 percent.

Response to: Findings in First Paragraph: We agree. As of the 2nd Interim Report date, the District has restored its reserve for economic uncertainty to \$2,003,526 or 2.2%. In addition, \$1M was set-aside in a property tax contra account in case we face further property tax refunds. The Budget Advisory Committee has recommended an additional \$1.3-1.5 M in revenue enhancement and or expenditure reductions. Implementing the BAC recommendations will enable the District to achieve the mandated 3% reserve for economic uncertainty in the 2007-08 adopted budget.

Findings in Second Paragraph: Terms of annual employee agreements have been entered into with no plan for maintaining the State-mandated reserves for economic uncertainty while at the same time meeting other District expenses, and living up to the commitments of the employee agreements.

Response to Findings in Second Paragraph: We agree and would like to offer the following insight: The District had ratified labor agreements based on revenue projections. Historically, these projections had been sufficiently accurate. The district erred in not adapting this practice to the unprecedented tax rebate levels required in the last three years, but has now made the required adjustments. The District will no longer ratify compensation adjustments until actual revenues are known after the close of the fiscal year.

Findings in Third Paragraph: Accounting standards (Statement of Financial Accounting Standards No.5 – Accounting for Contingencies) require that uncertainties regarding potential loss be disclosed in audited financial statements. The District’s auditor failed to disclose the potential for reduction in property tax allocations in the audit statements for the fiscal years ending June 30th of 2005 and 2006.

Response to Findings in Third Paragraph: We agree. The District’s auditor failed to disclose the potential for reduction in property tax allocations in the audit statements for the fiscal years ending June 30, 2005 and 2006. As of March 8, 2007, the District retained the services of a new auditor.

Findings in Fourth Paragraph: With the additional money to be borrowed on the new COP, the total cost of the Measure D bond projects is \$280 million, which includes bond money, COPs, developer fees, and State grants. The original bond measure approved by the voters in 2000 was for \$137.5 million. Adding the COP dollars (not developer fees or grant dollars) brings the total borrowed funds to \$211.5 million, an increase of \$74 million, or 53.8 percent over what voters approved.

Response to Findings in Fourth Paragraph: We agree and would like to offer the following insight: The Measure D bonds (\$137.5 million) were only part of a larger Capital Improvement Program undertaken to modernize the six comprehensive high schools in the District. The District leveraged the Measure D money with state funds, developer fees, interest earnings and COPs to reach a \$234 million budget. The additional funds do not come from property tax assessments on the District’s voters and the manner in which the Grand Jury has presented this finding could confuse citizens into believing that the District inappropriately increased the tax burden on them.

Unfortunately, the District experienced other cost overruns associated with several contractor bankruptcies, unforeseen conditions, such as the need to rebuild entirely San Mateo High School as well as other buildings in the District, and litigation that proved quite costly. The challenges that the District confronted in Measure D have been analyzed and safeguards are being put into place to ensure that sufficient contingencies exist in Measure M, with rigid policies and procedures adopted to minimize and track, change orders and litigation.

Findings in Fifth Paragraph: SMUHSD communication with County officials regarding property tax revenues has not been effective. Many of those interviewed by the Grand Jury felt the interface between the school districts and the County Assessor and Controller was “laborious” and often ineffective. Efforts are now being made at both the County and District level to improve the situation.

Response to Findings in Fifth Paragraph: We agree. The District is committed to working with the County to improve accuracy and communication.

Findings in Sixth Paragraph: Although financial acumen by both the Superintendent and the Board of Trustees has been sorely lacking, financial assistance and advice from outside advisors has not been sought by the Board of Trustees or staff and even appears to be undesired by some members. Firms such as California Schools Services, Inc. and Financial Crisis Management Assistance Team (FCMAT) provide such advice and are used by many school districts in the County and throughout California. Only in February 2007 did the County Superintendent of Schools and the SMUHSD Superintendent mutually agree to engage FCMAT to review the District's finances and recovery plan. The County Office of Education will pay for the review, and the FCMAT findings should be complete in April 2007.

Response to Findings in Sixth Paragraph: We agree that we should solicit advice from external resources to assure that best practices are established and followed. The District has membership in two organizations that provide financial assistance and/or advice -- School Services of California and Schools for Sound Finance. The District has taken significant steps in the 2006-07 year to strengthen the financial systems and will continue to monitor its performance closely. We have received the FCMAT report and are in the process of reviewing the findings.

DISTRICT'S RESPONSE TO GRAND JURY'S RECOMMENDATIONS

Grand Jury recommendation

1.1 Continue the services of the Financial Crisis and Management Assistance Team (FCMAT) to review and advise the Board of Trustees and staff on the analysis of revenues, expenses, and procedures. The District should continue with this oversight process until reserves are at a level acceptable to the County Superintendent of schools and State Department of Education.

District Response

1.1 We do intend to continue to seek support services from outside professional entities as appropriate. We are reviewing the FCMAT analysis. We need to explore all avenues of professional support and will select the organization that meets our needs and that can give us the most service for the best cost. Numerous changes have taken place since the 2006-07 Budget was adopted. A new Associate Superintendent of Business was hired. A complete analysis of the General Funds budgets was conducted and presented to the Board. New policies and procedures have been adopted and implemented. The District contracted with a highly qualified audit firm in March 2007 and the newly formed BAC has recommended that, rather than going outside for financial consultants, the District considers hiring an internal auditor or purchasing agent. All avenues of financial analytical support are being explored at this time.

Grand Jury recommendation

1.2 Ensure that the Citizens Measure M Bond Oversight Committee have the required financial and construction management skills and are independent from staff and board of Trustees. The membership of this committee should be finalized by June 1, 2007. The Oversight Committee should present monthly written and oral reports to the Board of Trustees and the public. The Measure D and Measure M Bond Citizens Oversight Committees should meet to discuss the material presented in the Measure D "Lessons Learned" paper.

District Response

1.2 This recommendation will be implemented as much as possible, given the membership constraints as found in Education Code Section 15282(a): one member active in a business organization representing the business community located within the district; one member active in a senior citizens' organization; one member active in a bona fide taxpayers' organization; one member who is the parent or guardian of a child enrolled in the district; one member who is the parent or guardian of a child enrolled in the district and who is active in a parent-teacher organization, such as the PTA or school site council; two other members, selected from the public at large.

Although Proposition 39 does not require that members of the Measure M Citizens Oversight Committee possess financial and construction management expertise, but rather expressly requires the constituency representation outlined above, we believe that the members, as much as possible, should have the financial and construction skills/understanding necessary to provide real oversight.

The District Board of Trustees appointed the Measure M Citizens Oversight Committee members on January 18 and February 8, 2007. The COC currently consists of nine members. These include, a licensed CPA and former Michigan school board member from a district with \$160 million in bonds and a financial analyst for the City of Santa Clara. We are seeking 3 additional qualified members. We will carefully review the backgrounds of the additional members to be selected and work to find the most qualified people. The Committee has already met and the "Lessons Learned" paper has been reviewed and discussed with members of the Measure D. The COC meets bi-monthly and is chartered to make reports to the Board. The COC agendas and minutes will be posted on the District's website.

Grand Jury recommendation

1.3 Establish a monthly meeting schedule with the County Controller, County Assessor, and County Office of Education by June 1, 2007, so that the District staff can receive critical information on matters relating to property appraisals, property tax assessments, and reductions in property tax allocations.

District Response

1.3 This recommendation will be implemented, although the timing of the meetings will be set to align with the dates that the San Mateo County Controller generates the property tax projection letters. We see October (Levy letter), December (15-P1), April (15-P2) and August (Annual property tax funding letter) as key meeting times. In addition, the District relies heavily on March county data for budget year property tax projections. The District concurs that we need to increase our communication with the County Assessor's Office and the County Controller's Office.

Grand Jury recommendation

1.4 Upgrade the District's website by June 1, 2007, to include, at minimum: financial statements, staff reports relating to agenda items, management letters from the auditor, budgets, interim reports and monthly reports from the oversight committees.

District Response

1.4 This recommendation will be implemented as soon as technologically feasible. Our District Webmaster has multiple responsibilities, which impacts the timing of our ability to make the changes requested. The District Webmaster is constructing links for updates on modernization. Fiscal information will be added by the District Webmaster and updated on a regular basis. We want our website to serve as a communication tool to the public and will work diligently to assure that the necessary upgrades and changes are made.

Grand Jury Recommendation

1.5 Televis Board of Trustees meetings and structure agendas to allow for public input at both the beginning and end of the meeting; this should begin by June 1, 2007.

District Response

1.5 We are not certain that this recommendation can be implemented, as the cost may be prohibitive. However, we will explore this avenue of communication as well as the possibility of broadcasting the meetings via radio and/or the Internet. The board will consider where the comment period should be placed on its agenda. We do want to encourage public input and participation.

Grand Jury Recommendations to be implemented by June 1, 2007

2.1 Adopt a policy requiring adequate, reliable financial data to be used in the preparation of a plan describing how all costs will be covered while maintaining the required reserve. Most importantly, this should contain a plan for reducing or postponing the scope of a project if it appears that the project will exceed the approved budget

District Response

2.1 This recommendation will be implemented by October 1, 2007, or as soon thereafter as the policy can be drafted and adopted.

Grand Jury recommendation

2.2 Establish a policy and a plan requiring a reserve at least as great as the 4.5 percent reserve recommended by the San Mateo County Superintendent of Schools, with the ultimate goal of exceeding the California average for basic aid districts.

District Response

2.2 This recommendation of establishing a policy to increase the reserve will be implemented by October 1, 2007, or as soon thereafter as the policy can be drafted and adopted. The District is required to maintain a 3% reserve for economic uncertainty and fully intends to comply. As a mechanism to provide an additional General Fund safety net, the District will continue to maintain a property tax contra account and intends to fund this account at 1.5M in the 2007-8 Budget. The Board has already established a goal of growing the reserve to 6% over the next five years.

Grand Jury Recommendation

2.3 Appoint an independent, qualified Blue Ribbon Citizens Advisory Committee to monitor all District activities relating to the budget. This Blue Ribbon Committee should report orally and in writing to the Board of Trustees and the community at regular monthly meetings beginning by June 1, 2007.

District Response

2.3 This recommendation for the establishment of a permanent budget advisory committee (BAC) is in the process of being finalized. The District has had in place since March 2007 a budget committee formed to recommend reductions to the 2007-08 budget necessary to establish the 3% reserve for economic uncertainty. The work of this committee has recently been completed and presented to the Board. The committee will be comprised of constituency representatives with financial analysis skills. This new budget advisory committee (BAC) will be engaged with the District in the development and assessment of the budget, asked to advise on how the budget document can be used more effectively as a communication tool with the public and to analyze particular issues where additional expertise will be valuable. This committee will report monthly (either oral or written) to the Board. We will request that a member of the committee be present at all Board meetings, ready to respond to questions of the Board.

In closing, the District, on behalf of its communities and students, would like to thank the Grand Jury for the work that they do to safeguard the welfare of the citizens of San Mateo County. The District recognizes the financial challenges it faces and continues to be hard at work to find solutions.

Sincerely,

Samuel Johnson, Jr,
Superintendent and Secretary
to the Board of Trustees