Los Angeles County Office of Education

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November 8, 2018

Ms. Monica Garcia, Board President
Los Angeles Unified School District
333 South Beaudry Avenue, 24th Floor
Los Angeles, CA 90017-5141

Dear Ms. Garcia:

BUDGET APPROVAL

Under Education Code (EC) Section 42127, the Los Angeles County Superintendent of Schools (County Superintendent) has completed the review of the Los Angeles Unified School District's (District) revised budget for fiscal year 2018-19. **That review has resulted in approving the District's budget** with the following comments and concerns.

In our letter dated September 10, 2018, the District's Board of Education was required to do the following no later than October 8, 2018:

- Address deficit spending in an updated Fiscal Stabilization Plan (FSP) with Board Resolution,
- Make any necessary Board-approved adjustments to the 2018-19 budget, adopt an updated, detailed FSP with Board Resolution, and allocate the potential expenditure reductions to the appropriate account codes in its multiyear projections,
- Any reductions that require negotiation with the District's bargaining units should be included only if those negotiations have been settled. Revenue enhancements that require approval by the District's voters, such as a parcel tax, cannot be considered until voter approval is obtained,
- Submit a Board-approved budget adjustment for the discretionary one-time Proposition 98 funds difference, along with any dependent expenditures,
- Monitor all Fiscally Independent Charter Schools (FICS), facilitate resolution of negative ending net positions or negative resource balances, and incorporate 2017-18 Unaudited Actuals ending net position in a status update on the FICS with a written summary of their oversight efforts,
- Board-approve and submit the 2018-19 Revised Budget to the County Superintendent.

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As required, the District submitted its General Fund revised budget and the updated FSP with Board Resolution that address deficit spending, make a Board-approved budget adjustment for the discretionary one-time Proposition 98 funds difference, along with any dependent expenditures, and allocate the potential expenditure reductions to the appropriate account codes in its multiyear projections. In addition, the FICS Status Report incorporates 2017-18 Unaudited Actuals ending net positions, provides 2017-18 oversight report reasons for net deficit and corrective actions plans, with a written summary.

FISCAL STABILIZATION PLAN

We noted in our review that the District's updated FSP-Option 1 includes four reductions:

- $42.9 million, or approximately 15 percent, for Central Office Reduction,
- $35.0 million for Administrator to Teacher Ratio (R2) penalties elimination pending waiver approval by the California Department of Education (CDE),
- $5.0 million for Change in Procurement Cycle, and
- $3.0 million for Attendance Incentive Program additional allocation discontinuance.

The alternate updated FSP-Option 2 excludes 2019-20 and 2020-21 years for R2 item above, but includes two added reductions:

- $6.0 million for Freeze on Travel, Cellphone and Equipment, and
- $29.0 million, or approximately another 10 percent, for Central Office Reduction as detailed by each division.

DEFICIT SPENDING

We have noted the District is projecting an operating deficit of $64.7 million, representing 1.33 percent of the unrestricted General Fund's projected expenditures and other outgo for fiscal year 2018-19. The District also projects operating deficits of $82.3 million and $129.7 million, representing 1.73 percent and 2.75 percent for fiscal years 2019-20 and 2020-21, respectively. According to our review, and as confirmed by the District, the projected deficits are primarily due to revenue loss associated with declining enrollment, the increasing costs related to pensions, Special Education encroachment and facilities maintenance required minimum contribution.

The District's General Fund ending balance and reserves are projected to decrease as a result of deficit spending, which is illustrated in the table below.

Unrestricted General Fund Projection
($ millions)

	2018-19	**2019-20**	**2020-21**
Beginning Unrestricted General Fund Balance	$1,863.3	$1,798.6	$1,716.3
Projected Deficit Spending	($64.7)	($82.3)	($129.7)
Ending Unrestricted General Fund Balance	$1,798.6	$1,716.3	$1,586.6
REU Amount	$775.0	$441.4	$76.5
REU Percent	10.26 percent	5.97 percent	1.04 percent

We emphasize the need for the Board to recognize the long-term impact of the District's structural deficit spending and are concerned that time-sensitive financial decisions are being postponed. Over the three-year span, the unrestricted General Fund's reserve is projected to decrease from $778.3 million to $76.5 million, **a decline of 90.17 percent.** The deficit spending in 2019-20 and 2020-21 depletes reserves to the State Criteria and Standards required level in 2020-21. Therefore, **we require that the District address deficit spending in an updated FSP with Board Resolution to be submitted with its 2018-19 First Interim, due to our office on or before December 17, 2018.** Our recommendation is to seek ways to balance the budget through expenditure reductions, revenue enhancements, or a combination of the two.

DECLINING ENROLLMENT AND REDUCED STATE FUNDING

The District's 2018-19 Adopted Budget reflects declining enrollment from traditional schools and locally funded/affiliated charter schools with projected funded average daily attendance (ADA) of 471,854 in 2018-19, 459,876 in 2019-20 and 445,720 in 2020-21. The estimated impact of the declining enrollment on the District's projected funded ADA reflects a two-year loss totaling 26,134 ADA, representing a 5.54 percent decrease from the District's 2018-19 ADA.

We remind the District EC Section 42238.5(a)(1) allows districts with declining attendance to continue to receive funding based on **the greater of** prior year or current year actual attendance. This provides a one-year delay for the loss of revenue due to declining enrollment/attendance.

Declining enrollment districts with charter schools must consider the effect of the movement of district ADA to district-authorized charter schools. ADA for students who attended a district non-charter the previous year, and who now attend a district-authorized charter, is deducted from prior year ADA for purposes of calculating declining enrollment ADA.

However, the District will lose State funding over time if the decline in enrollment continues. It must carefully monitor its enrollment trends and adjust its financial projections accordingly for the current and subsequent fiscal years if further material reductions in enrollment occur or are expected to occur, as well as develop long-range facilities plans to address corresponding declining enrollment.

LABOR CONTRACT NEGOTIATIONS

According to the information provided in the District's budget, except for the comprehensive Health Benefits Agreement, Service Employees International Union, Associated Administrators Los Angeles and California School Employees Association settlements, the United Teachers Los Angeles certificated union's and four classified unions' labor contract negotiations for 2017-18 and 2018-19 remain unsettled. However, potential increases have been calculated and incorporated into budgeted salary and benefit assignments of ending fund balance. Because labor costs make up a large portion of the District's budget, we are concerned any salary and benefit increase, if paid from reserves or other one-time resources, could adversely affect the fiscal condition of the District. We caution the District this approach of funding ongoing salary increases with one-time resources is not a best business practice.

This letter is a reminder, before the District's Board of Education takes any action on a proposed collective bargaining agreement, the District must meet the public disclosure requirements of Government Code Section 3547.5 and the California Code of Regulations Title V, Section 15449. The document used for this analysis was included in Informational Bulletin No. 4845, dated July 2, 2018, and is titled "2018-19 Forms for Assembly Bill (AB) 1200: Public Disclosure of Proposed Collective Bargaining Agreements." This document can be found at the following website:

https://www.lacoe.edu/BusinessServices/DocumentsForms.aspx

DEBT ISSUANCE

This letter also serves as a reminder of the statutory requirements placed on debt issuance by school districts with qualified or negative interim report certifications. These requirements are specifically addressed by EC Section 42133 (a).

FISCALLY INDEPENDENT CHARTER SCHOOLS OVERSIGHT

Authorizing districts are required, by EC Section 47604.32, to ensure each charter school under its authority complies with all reports required by law of charter schools, and to monitor the fiscal solvency of that charter school. Furthermore, EC Section 47604(c) specifies failure to comply with all oversight responsibility could result in a district losing its protection against liability for any nonprofit public benefit corporation charter school that the district has authorized.

Therefore, it is critical that charter schools' budgets and Interim Reports contain sufficient fiscal information to enable their authorizing districts to perform adequate review and analysis of the report as part of their fiscal oversight responsibilities. As part of this oversight responsibility, authorizers should request a rationale for all negative fund balances, for which the district would be held liable. Authorizing districts are urged to collect supporting data, in addition to the budget, from their charter schools similar to what districts submit to LACOE, including detailed assumptions and multiyear projections.

Effective 2018-19, the District's Charter School Division no longer consolidates and reports the direct-funded charter schools' budgeted revenues and expenditures under SACS Form 09 (Charter Schools Special Revenue Fund) and SACS Form 62 (Charter Schools Enterprise Fund). These FICS complete and report the SACS forms directly to the District for routing to LACOE.

The District routed its 220+ FICS SACS Form 62 for 2018-19 July 1 Budget with 12 FICS having a 2018-19 negative ending net position totaling $20.9 million. Subsequently, the District's 2017-18 Unaudited Actuals were submitted with 15 FICS having a 2017-18 negative ending net position totaling $26.9 million. **The District is required to continue to monitor all FICS, facilitate resolution of 2018-19 projected negative ending net positions, and submit First Interim Reports for each FICS, either in SACS form or an alternate form. Written status reports on the 15 FICS and any new FICS with negative ending net position, should be submitted subsequently.**

SUBMISSION OF STUDIES, REPORTS, EVALUATIONS, AND/OR AUDITS

EC Sections 42127 and 42127.6 require districts to submit to the County Superintendent any studies, reports, evaluations, or audits completed of the district that contain evidence that the district is showing fiscal distress. They also require the County Superintendent to incorporate that information into our analysis of budgets, interim reports, and the district's overall financial condition.

We remind the District to submit any such documents to this office that are commissioned by the District (e.g., reports completed by the Fiscal Crisis and Management Assistance Team), or by the State Superintendent of Public Instruction, and/or a State control agency, and an internal audit division any time they are received by the District.

DISTRICT FOLLOW-UP REQUIREMENTS

In summary, the District's Board of Education is required to do the following for its 2018-19 First Interim, due to our office on or before December 17, 2018.

- Address deficit spending in an updated FSP with Board Resolution,
- Make any necessary Board-approved adjustments to the 2018-19 budget, and adopt an updated, detailed FSP with Board Resolution,
- Continue to allocate any potential expenditure reductions to the appropriate account codes in its multiyear projections, instead of as a lump-sum amount,
- Any reductions that require negotiation with the District's bargaining units should be included only if those negotiations have been settled. Revenue enhancements that require approval by the District's voters, such as a parcel tax, cannot be considered until voter approval is obtained,
- Continue to monitor all FICS, facilitate resolution of 2018-19 projected negative ending net positions, and submit First Interim Reports for each FICS, either in SACS form or an alternate form. Written status reports on the 15 FICS and any new FICS with negative ending net position, should be submitted subsequently.
- Board-approve and submit the 2018-19 First Interim to the County Superintendent.

The above requirements, particularly the multiyear projections without unallocated expenditure reductions, FSP with Board Resolution, and FICS resolution of negative ending net positions, will be crucial factors in our review and certification concurrence with the District's 2018-19 First Interim, due to the County Superintendent no later than December 17, 2018.

CONCLUSION

While the District has fulfilled the conditions for approval of the 2018-19 revised budget, the District must implement and monitor the updated FSP to ensure that required reserves are maintained as projected. LAUSD continues to show signs of fiscal distress. Our concerns are in alignment with the Fiscal Crisis and Management Assistance Team's (FCMAT) Indicators of fiscal insolvency in the areas of:

1. Deficit spending and failure to maintain adequate reserves and fund balance (6), and
2. Insufficient consideration of long-term bargaining agreement effects (7).

While LACOE is approving the LAUSD budget, based on the information provided, we are looking for the Governing Board to take all necessary actions to balance the District's budget. The drastic reserve reduction continues to be alarming and of great concern to LACOE. Our previous letters have stated that should LAUSD's structural deficit spending trajectory continue, and the County Superintendent determines that a more intensive approach is necessary, the County Superintendent has the authority to assign a fiscal expert or a fiscal advisor with stay and rescind authority over board actions in order to stabilize the District's financial situation.

As noted, the 2018-19 revised budget incorporates assigned ending fund balance for across-the-board salary increases for incomplete negotiations that are expected to exceed the projected state funded cost-of-living adjustment. As we have noted in previous letters, the use of one-time funding sources to cover ongoing salary expenditures is a key indicator of risk for potential insolvency.

The Governing Board is ultimately responsible for ensuring that all local decisions support and promote the fiscal health of the organization. The County Superintendent will continue to work closely with the District Board of Education, Administration and staff to monitor the District's commitment to fiscal solvency. If you have questions regarding your District's budget approval, please call Keith Crafton at (562) 922-6131 or your Business Services Consultant, Teri Stockman at (562) 922-6135.

Sincerely,

Dr. Candi Clark

Dr. Candi Clark
Chief Financial Officer, Business Services
Los Angeles County Office of Education (LACOE)

CC/KDC/TSS

cc: Debra Duardo, M.S.W., Ed.D., Superintendent, LACOE
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