

David W. Gordon
Superintendent

June 5, 2019

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Jessie Ryan, Board President
Sacramento City Unified School District
5735 47th Avenue
Sacramento, CA 95824

SUBJECT: 2018-2019 AB 139 Annual Report (Third Period Interim Report)

Dear President Ryan:

This letter to the Sacramento City Unified School District (SCUSD) Governing Board is a summary of the analyses completed by the Sacramento County Office of Education (SCOE) regarding the fiscal status of the district for the 2018-2019 fiscal year. The summary reflects the main concerns noted in SCOE's assessment of the district's Adopted Budget, First, Second and Third Period Interim Reports. This report fulfills SCOE's requirement, pursuant to Education Code section 1240[e], to present an annual report to the governing board and the Superintendent of Public Instruction on the fiscal solvency of any district with a **qualified or negative** interim report.

The Sacramento County Superintendent of Schools disapproved the district's Adopted Budget for 2018-2019 as submitted. Based on our review of the multi-year projections and assumptions provided by the district, it appeared that the district would meet its 2018-2019 minimum reserve requirement, but would fall short in the two subsequent fiscal years by approximately \$22.1 million in 2019-2020, and \$40 million in 2020-2021. The 2019-2020 shortfall left the district with a negative fund balance. Therefore, the district's Adopted Budget was disapproved. Our office requested that the district submit, by October 8, 2018, a viable board-approved budget plan that reversed the deficit spending trend. The plan was to include support of ongoing expenditures from ongoing revenue sources, along with a timeline showing when and how each line item adjustment would be implemented. In addition, our office assigned a fiscal advisor to assist the district during this process.

The district submitted a Re-Adopted Budget to our office on October 5, 2018. Based on our review, it appeared that the district's unrestricted General Fund balance would decrease by approximately \$34 million in



2018-2019, \$43 million in 2019-2020, and \$49 million in 2020-2021. It appeared that the district would meet its 2018-2019 minimum reserve requirement, but would fall short in the two subsequent fiscal years, leaving a negative unrestricted ending fund balance of approximately \$17.5 million in 2019-2020, and \$66.5 million in 2020-2021. Therefore, our office disapproved the Re-Adopted Budget.

In response to disapproval of the Re-Adopted Budget, and pursuant to Education Code sections 42127.1 through 42127.3, the County Superintendent must call for the formation of a Budget Review Committee unless the governing board of the district and the County Superintendent agree to waive this requirement. A request to waive the requirement of a Budget Review Committee was made and sent to the California Department of Education (CDE) for approval. The fiscal advisor assigned by our office remained in place to assist the district in submitting a balanced budget to our office by December 31, 2018. Our office requested that the district submit a viable board-approved budget and multi-year expenditure plan that reversed the deficit spending trend with the 2018-2019 First Period Interim Report by December 14, 2018.

The district submitted its 2018-2019 First Period Interim Report with a negative certification. Based on the projections and assumptions provided by the district, it appeared that the district would meet its 2% unrestricted reserve requirement for the current fiscal year, but would fall short in the two subsequent fiscal years, leaving a negative unrestricted ending fund balance of approximately \$3.8 million in 2019-2020 and \$54.3 million in 2020-2021. In addition, the multi-year projections that were submitted projected that the unrestricted General Fund balance would decrease by approximately \$22.1 million in 2018-2019, \$42 million in 2019-2020, and \$50.5 million in 2020-2021. The cash flow projections submitted for 2018-2019 and 2019-2020 indicated that the district would run out of cash in November 2019. We therefore concurred with the district's negative certification.

The district identified cuts of \$12.9 million with the First Period Interim Report and continued to identify what appeared to be viable additional budget cuts amounting to \$2.3 million. Board approval was required for the \$2.3 million in budget cuts. The district sunshined bargaining proposals for 2019-2020, and began scheduling bargaining sessions with its five bargaining units with the intent to negotiate additional budget savings. We also urged the district to accelerate the process of identifying viable budget cuts that did not require negotiations.

The district submitted its Second Period Interim Report with a negative certification. Based on the projections and assumptions provided by the district, it appeared that the district would meet its 2% unrestricted reserve requirement for the current fiscal year, but would fall short in 2019-2020 by approximately \$2.2 million, by \$50.1 million in

2020-2021, with a negative unrestricted ending fund balance of \$37.8 million in 2020-2021.

The multi-year projections submitted projected that the unrestricted General Fund balance would decrease by approximately \$20.8 million in 2018-2019, by \$29.7 million in 2019-2020, and by \$47.6 million in 2020-2021. The district projected a decrease of 180 ADA in 2018-2019, a decrease of 1,071 ADA in 2019-2020, and a decrease of 254 ADA in 2020-2021. On March 19, 2019, our office questioned the budgeting for instructional materials and the projected enrollment estimates. On April 1, 2019, the district confirmed to our office that \$6 million needed for instructional materials was not included in the 2019-2020 budget, and district enrollment projections for 2019-2020 and 2020-2021 did not include students from specialty schools in the district.

On March 7, 2019, the district approved a Fiscal Recovery Plan identifying \$35 million in prospective budget reductions to be made for 2019-2020. Of those reductions, \$6.3 million were included in the Second Period Interim Report. The remaining reductions of \$28.7 million required negotiations, and therefore could not be included as budget reduction savings in the Second Period Interim Report.

On May 2, 2019, an arbitration ruling regarding the cost of the district's salary schedule adjustments, included in the 2017 bargaining agreements, drastically changed the district's financial condition. Based on the ruling, the cost of the revised salary schedule increased by more than double (from approximately \$7 million to \$15 million) what the district had budgeted, and what was disclosed to my office in the required November 2017 disclosure document.

Pursuant to Education Code section 42231, any school district that files a qualified or negative Second Period Interim Report must provide the County Superintendent, the State Controller's Office, and the Superintendent of Public Instruction with a financial statement projecting the district's fund and cash balances through June 30, 2019 for the period ending April 30, 2019 (Third Period Interim Report) due to our office by June 1, 2019. We requested that the Third Period Interim Report include cash flow statements for 2018-2019, 2019-2020, and 2020-2021.

The district submitted a Third Period Interim Report to our office on May 21, 2019. Based on the projections and assumptions provided by the district, it appears the district will meet its 2% unrestricted reserve requirement for the current fiscal year and first subsequent fiscal year, but will fall short by approximately \$15.3 million in 2020-2021, and will have a negative unrestricted ending fund balance of approximately \$3.1 million in 2020-2021. The multi-year projections submitted project that the unrestricted General Fund balance would decrease by approximately \$9 million in 2018-2019, by

\$19.7 million in 2019-2020, and by \$34.7 million in 2020-2021. This report included all reductions made in 2018-2019, and any board-approved reductions for future years. The cash flow projections submitted show that without further budget reductions, the district will run out of cash in October 2020. The district projects it must make ongoing budget reductions of \$29 million no later than July 1, 2020, and an additional \$5 million in reductions no later than July 1, 2021, to eliminate deficit spending and maintain a district-recommended 4% reserve level.

Since the district's Adopted Budget was submitted, the district has made considerable progress toward stabilizing its budget. However, the above-mentioned arbitration ruling created a budget set-back for the district, and the gains that had been made were greatly reduced. The cuts thus far are not enough to eliminate the structural deficit, and although the date the district projects it will become cash insolvent has been delayed, that risk has not been eliminated. The district has informed us that they will continue to scour the budget seeking additional budget savings that do not require negotiations, but expect that the large dollar items have already been identified, and any additional items found would not be enough to solve the structural deficit that has persisted for many years in the district.

Throughout the year, my office has encouraged the district and its bargaining units to be diligent in meeting so that negotiated budget reductions could be identified in time to implement the savings by July 1, 2019, and prevent the district's financial situation from worsening. It now appears unlikely that the district will be able to complete negotiations in time to benefit from an entire year of implemented savings. This delay only increases the budget reductions needed going forward. We again encourage the district and its bargaining units to immediately accelerate their negotiations process, so that all possible savings to the budget can be realized as soon as possible.

We note that with the submission of the Third Period Interim Report the district is considering a reserve policy above the minimum requirement of 2%. We commend the district for this consideration, and we strongly recommend a higher reserve level, especially for districts with chronic deficit spending issues. The district's proposal of a 4% reserve is a good first step, and we would recommend an even greater reserve as part of a long-term plan to improve the fiscal health of the district.

The 2019-2020 Adopted Budget is due to our office no later than July 1, 2019. In order for our office to approve the budget, future budgets should include multi-year projections that meet the 2% unrestricted reserve requirements for all years, and reverse deficit spending. The budget should support ongoing expenditures from ongoing revenue sources, and not rely on one-time solutions to eliminate the structural deficit. We will continue our assignment of a fiscal advisor to assist the district during this process.

Jessie Ryan, Board President
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We would like to thank your staff for their cooperation during our 2018-2019 financial report review process. If our office can be of further assistance, please call Debra Wilkins at (916) 228-2294.

Sincerely,



David W. Gordon
Sacramento County Superintendent of Schools

DWG/TS/ds

cc: Jorge A. Aguilar, Superintendent, SCUSD
Roland F. Fortson, Interim Chief Business Officer, SCUSD
Jacquie Canfield, Fortson Consulting
Tamara Sanchez, Associate Superintendent, SCOE
Debra Wilkins, District Fiscal Services Director, SCOE
Terri Ryland, Fiscal Advisor, SCOE
Michael Fine, Chief Executive Officer, FCMAT
Nick Schweizer, Deputy Superintendent, CDE
Betty T. Yee, California State Controller