



Los Angeles County Office of Education

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Debra Duardo, M.S.W., Ed.D.
Superintendent

March 29, 2019

**Los Angeles County
Board of Education**

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

Dear Ms. Garcia:

Under Education Code (EC) Section 42131, the Los Angeles County Office of Education (LACOE or County Office) has completed a review of the Los Angeles Unified School District's (District) 2018-19 Second Interim Report. Our analysis of the data submitted indicates that the District may not meet its financial obligations for the current fiscal year or two subsequent fiscal years without implementing budget reductions and a Board-approved Fiscal Stabilization Plan (FSP) that restore and maintain the required minimum Reserve for Economic Uncertainties (REU) for 2020-21. **We therefore concur with the District's qualified certification** and offer our comments and concerns.

LACOE FISCAL EXPERT TEAM

Due to the distressed financial condition of the District, EC Section 42131(b) allows the County Superintendent to intervene and to compel the District to implement measures to improve the financial condition of the District. On January 9, 2019, a team of fiscal experts, led by Dr. James Morris, was assigned to the District. We expect the District will continue to work with the LACOE Fiscal Expert Team to implement actions necessary to stabilize and improve the financial condition of the District. The County Office expects the Governing Board to provide the leadership necessary to restore the ongoing financial stability of the District, and to provide quality services to the students served.

FISCAL STABILIZATION PLAN

In our previous letters, we have expressed our concerns with the continued deterioration of the District's fund balance and reserve levels. We have also expressed concern with the District's continued use of one-time funding to cover ongoing expenditures without addressing significant deficit spending.

Ms. Monica Garcia, Board President
Los Angeles Unified School District
March 29, 2019
Page 2

In our letter dated January 9, 2019, we directed the District to develop an FSP that addresses the projected deficit spending. In our review of the District's 2018-19 Second Interim Report and FSP, we noted that the Governing Board approved a financial report that does not maintain the minimum 1.00 percent reserve level in 2020-21 fiscal year as required by the State Criteria and Standards (EC Section 33127).

The District's multiyear projections reflect a two-year decrease in the projected reserve levels without an adequate plan to address the significant deficit spending. The District continues to demonstrate indicators of fiscal distress that must be addressed. Our concerns align with the Fiscal Crisis and Management Assistance Team's (FCMAT) Indicators of Risk or Potential Insolvency. The indicators of notable concern are:

- Inability to consider long-term effects of collective bargaining agreements;
- Deficit spending and failure to maintain adequate reserves and fund balance;
- Lack of control and monitoring of total compensation as a percentage of total expenses; and
- Inattention to unfunded liabilities [OPEB].

As required, the District submitted its 2018-19 Second Interim Report with an updated FSP with Board Resolution. We noted the District's updated FSP includes the following reductions, which are incorporated in the multiyear projections:

- \$42.9 million, or approximately 15 percent, for Central Office Reduction in each of the two subsequent fiscal years;
- \$5.0 million for Change in Procurement Cycle for uniforms in 2018-19 and 2019-20; and
- \$3.0 million for Attendance Incentive Program additional allocation discontinuance in each of the two subsequent fiscal years.

However, with this updated FSP, the Governing Board failed to adequately address deficit spending and to restore reserves to the minimum level in all fiscal years. As a result, the District filed a qualified certification of financial condition.

The County Office acknowledges that the District has authorized a June 2019 parcel tax ballot measure. As we have requested, the District has not included this contingent revenue in its 2018-19 Second Interim multiyear projections pending passage of the measure. We recommend the District not budget this contingent revenue until the resulting revenues are known and measurable.

DEFICIT SPENDING AND RESERVES

The District projects operating deficits of \$576.6 million and \$415.1 million, representing 11.28 percent and 8.28 percent, for fiscal years 2019-20 and 2020-21, respectively. Based on our review of the District’s 2018-19 Second Interim Report data and assumptions, 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, increasing contributions to Special Education programs and facilities maintenance required minimum contribution.

The District’s unrestricted General Fund ending balance and reserves are projected to decrease because of deficit spending, which is illustrated in the table below.

Unrestricted General Fund Projection			
(\$ millions)			
	<u>2018-19</u>	<u>2019-20</u>	<u>2020-21</u>
Beginning Fund Balance	\$1,875.0	\$1,896.2	\$1,319.5
Projected Surplus/(Deficit) Spending	\$21.2	(\$576.6)	(\$415.1)
Ending Fund Balance	\$1,896.2	\$1,319.5	\$904.4
Non-spendable	(\$27.6)	(\$27.6)	(\$27.6)
Commitments to Settlements	(\$174.6)	(\$87.6)	(\$0.0)
Assignments per Board	(\$807.3)	(\$747.1)	(\$802.4)
Reserve Amount	\$886.7	\$457.2	\$74.4
Reserve Percent	11.81%	5.80%	0.96%

We remain concerned that the Governing Board has not taken the necessary actions to address the long-term effect of the District’s ongoing deficit spending. The District’s unrestricted General Fund ending balance is projected to decrease from \$1,896.2 million in 2018-19 to \$904.4 million in 2020-21, a decrease of approximately 52 percent over the two-year period.

The District projects reserves of 11.81 percent for 2018-19, 5.80 percent for 2019-20, and 0.96 percent for 2020-21. As a result of deficit spending, the reserve level in 2020-21 is projected to be below the minimum of 1.00 percent, as required by the State Criteria and Standards.

Ms. Monica Garcia, Board President
Los Angeles Unified School District
March 29, 2019
Page 4

Therefore, the County Office requires that the District work with the LACOE Fiscal Expert Team to address deficit spending in an updated FSP with Board Resolution to be submitted with its 2019-20 Adopted Budget, due to our office on or before July 1, 2019. The District is required to incorporate the necessary adjustments in its 2019-20 Adopted Budget and multiyear projections to restore and to maintain the minimum reserve levels in all fiscal years.

CALSTRS RATES AND RESERVES

In our Informational Bulletin No. 4944, dated February 1, 2019, and titled “2018-19 Second Interim Financial Reporting”, we recommended that districts use the current California State Teachers’ Retirement System (CalSTRS) approved rates and not the proposed lower rates as reflected in the Governor’s 2019-20 Proposed Budget. Districts that elected to include these proposed lower rates were required to adopt a plan to address any budget shortfalls that may occur if the proposed rates are not approved. The District used the lower proposed CalSTRS rates for 2019-20 and 2020-21 in its 2018-19 Second Interim multiyear projections, but did not include an alternate plan. We are concerned about the potential significant adverse effect on the District’s reserves should the lower rates not be realized. **Therefore, we request that the District use caution and re-evaluate its spending priorities to ensure minimum required reserves are maintained in case the lower CalSTRS rates are not approved.**

DECLINING ENROLLMENT AND REDUCED STATE FUNDING

The District’s 2018 19 Second Interim Report reflects declining enrollment from traditional schools and locally funded/affiliated charter schools with projected funded average daily attendance (ADA) of 470,066 for 2018 19, 451,102 for 2019 20, and 444,744 for 2020 21. The estimated effect of the declining enrollment on the District’s projected funded ADA reflects a two year loss totaling 25,322 ADA, representing a 5.4 percent decrease from the District’s 2018 19 ADA. This rate of decline in enrollment, if continued as projected, represents a loss of revenue for the District in the current and future fiscal years. As previously recommended, the District must continue to assess and take immediate steps to adjust its staffing needs and permanently close school sites commensurate with projected ongoing declining enrollment.

Declining enrollment districts with charter schools must also 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.

Ms. Monica Garcia, Board President
Los Angeles Unified School District
March 29, 2019
Page 5

LABOR CONTRACT NEGOTIATIONS

According to the information provided in the District's Second Interim Report, the classified Associated Administrators Los Angeles labor contract negotiations for 2018-19 remain unsettled and potential changes have not been calculated and incorporated into projected salary and benefit expenditures. Because labor costs make up much of the District's budget, we are concerned that any salary and benefit increase, if paid from reserves or other one-time resources, could adversely affect the financial condition of the District.

This letter is a reminder that, 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:

<http://www.lacoe.edu/BusinessServices/DocumentsForms.aspx>

FISCALLY INDEPENDENT CHARTER SCHOOLS (FICS) 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, and to monitor the fiscal solvency of those charter schools. The FICS's 2017-18 Unaudited Actuals reports included 15 FICS with a combined negative ending net position of over \$26 million. EC Section 47604(d) specifies an authorizing entity is not liable for the debts or obligations of an insolvent charter school if it has complied with all oversight responsibilities required by law. We therefore remind the District of their oversight responsibilities and the potential negative effect of charter school liabilities on the District's General Fund reserves.

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.

Ms. Monica Garcia, Board President
Los Angeles Unified School District
March 29, 2019
Page 6

We remind the District to submit any such documents to this office that are commissioned by the District (e.g., reports completed by FCMAT, 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.)

We have obtained the District's Projected Financial Position Analysis, dated September 26, 2018, prepared by Houlihan Lokey Financial Advisors, Inc., and the District's Factfinding Panel Report, dated December 17, 2018, as it related to the contractual dispute with United Teachers Los Angeles. We have also received the District's most recent Efficiencies Discussion Document with Materials Addendum, dated December 2018, prepared by Ernst & Young LLP.

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).

DISTRICT END OF YEAR FINANCIAL STATEMENT

Pursuant to the provisions of EC Section 42131(e), any school district that files a qualified 2018-19 Second 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.

COUNTY OFFICE ANNUAL REPORT

Pursuant to the provisions of EC Section 1240(e) under Assembly Bill (AB) 139, the County Superintendent is required to present an annual report to the school district's governing board and the Superintendent of Public Instruction regarding the fiscal solvency of any school district with a disapproved budget, a qualified or negative interim certification, or that has been determined at any time during the year to be in a position of fiscal uncertainty as identified in EC 42127.6. This County Office report will be issued to the District prior to the statutory due date.

DISTRICT FOLLOW-UP REQUIREMENTS

Due to the District's 2018-19 Second Interim Report qualified certification, the Governing Board is required to take the following actions:

Ms. Monica Garcia, Board President
Los Angeles Unified School District
March 29, 2019
Page 7

- **Continue to work with the LACOE Fiscal Expert Team;**
- **Address deficit spending in an updated FSP with Board Resolution to restore and maintain the minimum reserve requirement for all fiscal years;**
- **Incorporate the necessary Board-approved adjustments to the 2019-20 Adopted Budget and multiyear projections to restore and to maintain the minimum reserve levels for 2020-21 and beyond;**
- **Continue to monitor and to maintain sufficient documentation of charter school oversight and to resolve any negative ending net positions;**
- **Submit the End of Year Financial Statement to the County Office.**

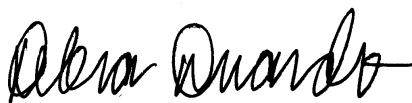
Each of the above requirements will be a crucial factor in our review and approval of the District's 2019-20 Adopted Budget, **due to the County Superintendent no later than July 1, 2019.**

CONCLUSION

Should the Governing Board fail to address all concerns identified in this letter, or fail to submit a 2019-20 Adopted Budget that meets the minimum reserve in any fiscal year, the County Superintendent is prepared to take further action that may include identifying the District as not a going concern and assigning a Fiscal Advisor with stay and rescind authority over Governing Board actions.

The Governing Board is ultimately responsible for ensuring that all local decisions support and promote the fiscal health of the District. The LACOE Fiscal Expert Team will work closely with the District's Governing Board, Administration and staff to support the District's commitment to fiscal solvency. If there are questions regarding the District's qualified certification, please call Dr. James Morris, Certificated Contract Consultant, at (562) 922-6130 or Mr. Keith Crafton, Director, Business Advisory Services, at (562) 922-6131.

Sincerely,



Debra Duardo, M.S.W., Ed.D
Superintendent

DD/KDC/BSC:tss:vb

Ms. Monica Garcia, Board President
Los Angeles Unified School District
March 29, 2019
Page 8

Cc: Kelly Gonez, Board District 6 Member, Los Angeles Unified School District (LAUSD)
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Nick Melvoin, Board District 4 Member, LAUSD
Scott M. Schmerelson, Board District 3 Member, LAUSD
Dr. Richard A. Vladovic, Board District 7 Member, LAUSD
Tyler Okeke, Student Board Member, LAUSD
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