



**OFFICE OF THE SUPERINTENDENT**

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**TITLE:** 2016-17 Budget Crisis Post Mortem Report

**FROM:** Superintendent Kyla Johnson-Trammell

**TO:** The Oakland Unified School District Board of Education

**DATE:** November 8, 2017

**I. INTRODUCTION**

The purpose of the Post-Mortem Report on the 2016-17 Budget is to provide the Board of Education a description of the proximate causes and drivers for the budget crisis that inform proactive attention to deficiencies in order to stabilize the budget and avoid future situations. There are many signs and symptoms of the problems and challenges that have created the structural budget deficit faced by the district, which are captured in audit reports, a review by the Fiscal Crisis Management and Assistance Team (FCMAT), and School Services of California. Furthermore, [Board Resolution No. 1718-0082](#) captures many of the contributing factors through a request for an analysis to understand proximate causes and drivers. The district's financial problems are rooted in a structural imbalance and weaknesses and significant deficiencies in systems (e.g., tools, procedures, and internal controls) related to the management, monitoring, and ability to make timely budget adjustments. This report explains many of these weaknesses and the resulting effect on the district's fiscal condition.

Many of the items identified in Board Resolution No. 1718-0082 relate to findings and recommendations made by FCMAT based on a review completed at the request of the OUSD Board of Education. The [FCMAT Report](#) highlights eight areas of improvement for the District:

- Deficit Spending (spending more funds than revenue received)
- Fund Balance (savings account)
- Reserve for Economic Uncertainty (portion of savings account)
- Bargaining Agreements (labor contracts)
- Contributions (contribution to special programs that are not self supporting due to lack of federal and state funds)
- Position Control and Human Resources (system for tracking, adding, creating and deleting positions)
- Budget Monitoring and Updates
- Leadership/Stability

The district is working in partnership with WestEd to prepare a FCMAT Implementation Plan to present to the board on December 13, 2017 that responds to FCMAT recommendations. The FCMAT Implementation Plan will complement the information contained in this Post-Mortem report and will include additional details to further address the requests contained in the Board's request for this report.

Findings and information for the requested post-mortem are organized in the following areas:

- A. Structural Budget Imbalance and Cash Flow
- B. Revenues
- C. Expenditures
- D. Internal Controls and Budget Management

## **II. KEY DRIVERS IMPACTING 2016-17 BUDGET CRISIS**

For the purpose of this review “key drivers” are defined as major factors contributing to performance or outcome. The drivers are distinct from problems or symptoms of such problems. For example, increased costs for retirement contributions (example of symptom) contributed to the district’s deficit spending (example of problem), which are driven by changes in state PERS and STRS contribution rates unaccounted for in state revenue calculations (example of a key driver). The key drivers are the underlying factors that create the condition associated with the problem or symptom.

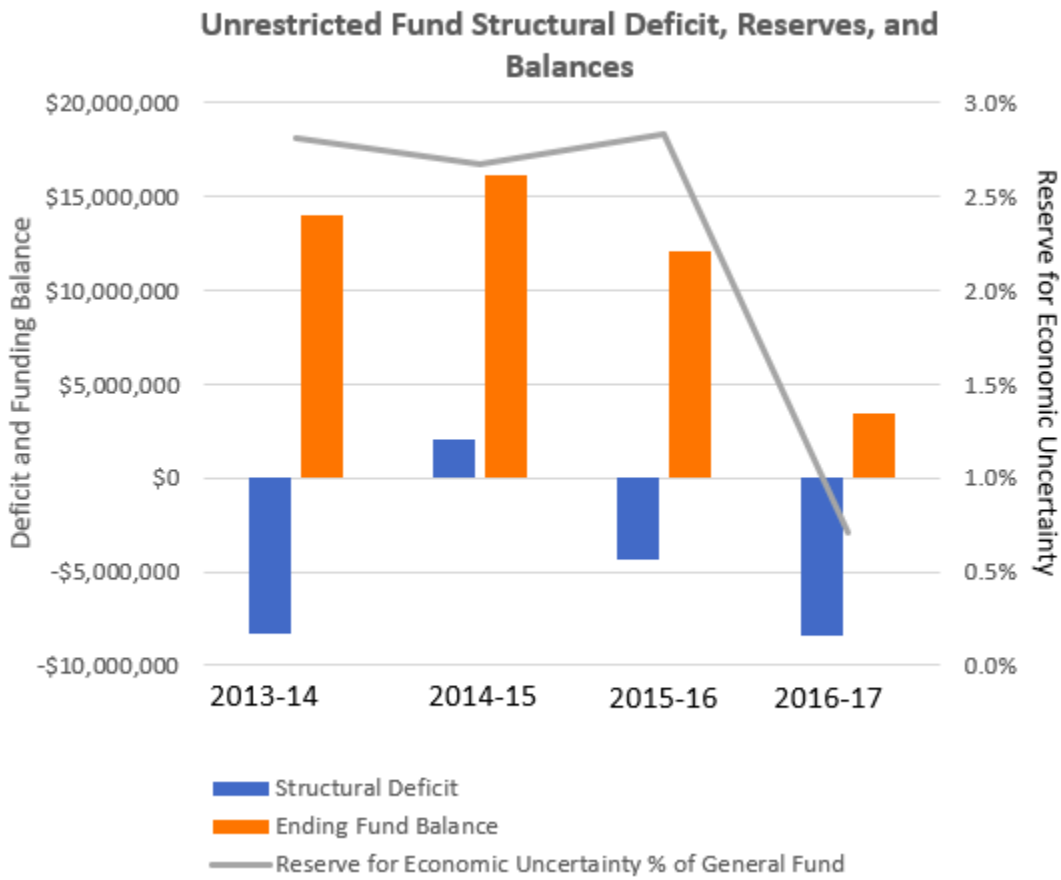
The district’s underlying budget problem is a persistent and challenging structural imbalance, which includes key drivers with internal and external origins. The above PERS and STRS example would fall into the category of an external driver, and are largely outside of the control of the district. The overarching internal driver of the district’s structural imbalance are persistent and historical (1) declining enrollment that has internal control weaknesses: (1) Declining Enrollment for which adjustments in expenditures have lagged or not kept pace, and (2) Internal controls are the systematic measures taken by an organization to conduct its business in an orderly and efficient manner, safeguard its assets and resources, deter and detect, errors, fraud, and theft, ensure accuracy and completeness of its accounting data, produce reliable and timely financial and management information, and ensure adherence to its policies and plans. Virtually every area identified by the Board for this report has a connection to an internal control weakness in one or more district systems. The district has engaged WestEd to help with planning and implementation for internal control improvements and the district will transition to a new financial system, Escape Technology, which is used by over 400 education organizations. Internal control principles and measures that are guiding improvements include:

- Clearly establishing roles, responsibilities, and relationships to complete critical procedures and tasks
- Maintaining documentation and records that are organized and back-up work and assumptions
- Segregate duties to provide for check and balances
- Business systems with embedded quality and control checks
- Regular independent reviews

This section organizes information to address the items referenced in the Board’s Resolution, concluding with a discussion about internal controls.

**A. Structural Imbalance and Cash Flow**

The Board’s resolution requested further analysis of deficit spending, ending fund balances, reserves, and cash flow. As noted above, the underlying problem for the district is a structural imbalance in its budget. To address gaps between revenues and expenditures the district has relied on ending funding balances and adjustments to reserves. The end result has been significant reductions in balances and fluctuations in reserves. Another effect of the reduction is in reserves as a need to increase borrowing to maintain adequate cash flow. The following table and figure capture the structural imbalance and relationship to ending funding balances and reserves.



	2013-14	2014-15	2015-16	2016-17
<b>Beginning Fund Balance</b>	\$22,369,544	\$14,111,634	\$16,367,289	\$11,794,376
<b>Revenue</b>	\$299,940,498	\$331,441,095	\$398,158,563	\$407,470,557
<b>Expenses</b>	\$308,272,203	\$329,419,004	\$402,461,999	\$415,844,861
<b>Ending Fund Balance (EFB)</b>	\$14,037,839	\$16,133,725	\$12,063,853	\$3,420,072
	<b>Components of EFB</b>			
<b>Reserve for Economic Uncertainty</b>	\$8,427,424	\$8,850,590	\$10,326,831	\$2,906,899
<b>Designations for Other Purposes</b>	\$5,610,413	\$7,263,134	\$1,737,021	\$513,173
<b>Reserve for Economic Uncertainty % of General Fund</b>	2.81%	2.67%	2.83%	0.71%

Source: Oakland Unified School District Unaudited Actuals, 2013-14 to 2016-17

### **Key Drivers**

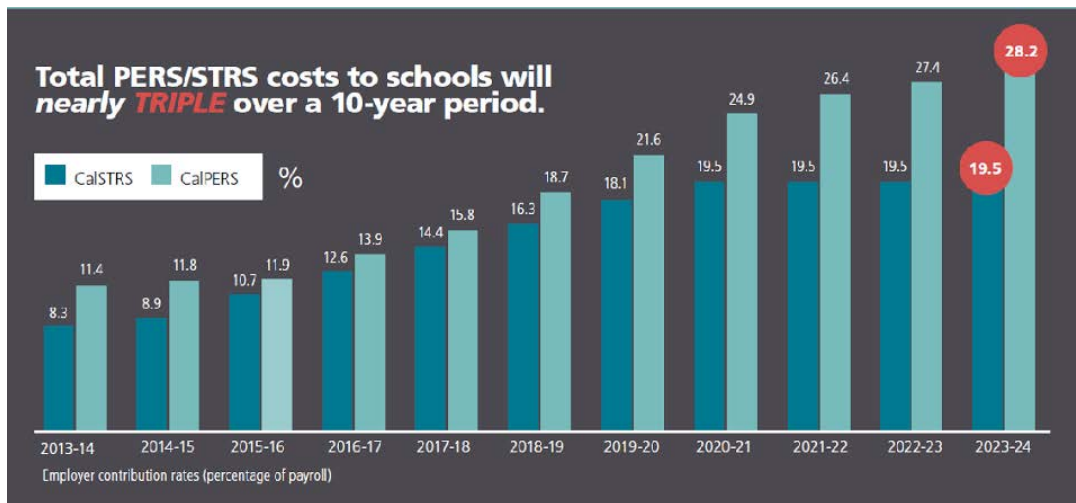
- Large increases in state revenues due to the Local Control Funding Formula led to significant increases in expenditures without sufficient controls in place to manage for long-term balance and sustainability. In other words, while LCFF increases are ongoing, the additional commitments, which largely included personnel, were made with a short-term view and did not necessarily include full consideration of declining enrollment and increasing costs related to retirement and other factors.
- Weaknesses in internal controls resulted in corrections to reported attendance counts, affecting restricted and unrestricted revenue; difficulty accurately reporting and controlling personnel expenses; and lack of controls enforce and implement budget adjustments to realize cost reduction/management. Over the period reviewed, the district made significant one-time payments to correct audit findings (\$4.6 million in 2013-14, \$5.1 million in 2014-15, \$233,568 in 2015-16)
- Although there was awareness of increasing contributions (i.e., encroachment) from the unrestricted general fund to programs (e.g., special education, child development, transportation, and child nutrition) and in many cases plans to implement program changes to control costs, program adjustments were not enacted leading to growth rather than reduction in contributions over this period.

### **B. Revenues**

Approximately two-thirds of the district's total budget and 87% of unrestricted general funds are from LCFF sources. In 2013-14 California overhauled its approach to funding local education agencies, greatly simplifying the structure of funding, establishing performance expectations across multiple priority areas, and allowing for significant local control over the decisions made about how to use resources. The LCFF also addressed long-standing concerns regarding the equity of past funding approaches by eliminating most state categorical programs and providing funding based on the number of students at each local

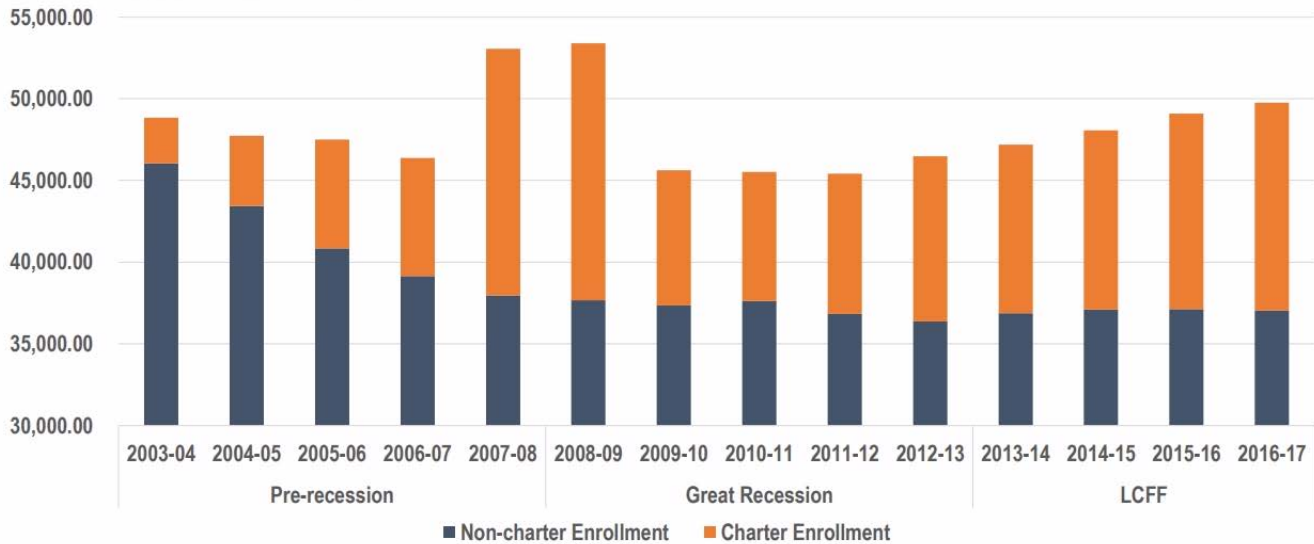
education agency with additional funding generated by students that are low-income, English Learners, and foster youth. The changes in the formula were favorable to the district’s per pupil funding and a major driver of increases in overall revenue from 2013-14 to the present. While overall per pupil funding increased, there are some important facts about the design of LCFF that demonstrate a link to the budget challenges that occurred in 2016-17 and that continue for the district.

- The targets for per pupil funding established under LCFF were created based on building back spending power by local education agencies and are based on 2007-08 per funding levels adjusted for repayment of deficits and withheld cost of living adjustments (COLA) made by the state from 2008-09 through 2012-13. LCFF was intended and operates as an equity formula and is not designed to adequately fund California public education.
- LCFF funding increases are based on the long-standing state COLA calculation, which is tied to changes in the overall government services price index and does not necessarily track to California-specific changes in expenditures. Notable areas where expenditure increases have outpaced the statutory COLAs include health and welfare benefits and retirement (e.g., PERS and STRS) costs. The figure below shows how PERS and STRS rates have risen in recent years and are projected to nearly triple over the next decade. Oakland is significantly impacted by these rate adjustments, which amplify challenges related to declining enrollment. Fully one-quarter of school districts and county offices who reported a positive budget certification in 2016-17 are now reporting a qualified or negative budget certification in 2018-19.



Most state and federal revenues are tied in some way to student population and demographics. The district is highly sensitive to small changes in enrollment and average daily attendance because of the longstanding trend as a district with declining enrollment. As shown below, the district’s enrollment has significantly declined since 2003-04. While enrollment has been somewhat stable in the last few years, current projections call for continued decline over the next several years. There are several factors that affect the enrollment projections including growth in charter school enrollment and shifting demographics

in the community driven by rising housing prices and lower birth rates throughout the county and surrounding areas.



**Key Drivers**

- The district largely builds its budget based on the prior year, commonly referred to as a roll-over budget. Using this approach the district has not been able to carefully review the multi-year impact of expenditure decisions and revenue changes because it lacks a clear articulation of changing budget assumptions. The best course of action to correct this problem is to rebuild the district budget using a zero-base budgeting process with clear documentation of assumptions and a process to check for implementation of changes. The Superintendent has requested that WestEd assist with such a process for the 2018-19 budget development.
- There are multiple offices involved in creating the enrollment projections and translating such projections into revenue estimates. This is an area where stronger internal controls are needed to support the accuracy, timeliness, and follow-through needed to create and maintain accurate enrollment and revenue projections.
- There are several external drivers that make it reasonable to expect some variance between enrollment projections and actual attendance. One major factor has been the growth of charter schools, which can now be judged to predictably affect the district’s enrollment in regular, public schools, but it can be challenging to accurately predict how many students will attend charter schools because they are schools of choice and can enroll students from throughout the district and there is some volatility to the number of charter schools each year as their can be new ones in any year as well as closures by choice or lack of renewal. The other external factor is the changing demographics of Oakland and surrounding Bay Area cities related to the lack of affordable housing. As costs have risen, families are moving out of the area and/or delaying starting families. While the

long-term enrollment projections used by the district attempt to factor this into the analysis, it does lead to a fairly wide range of possible enrollment figures.

**C. Expenditures**

Salary and benefits account for over 86% of unrestricted general funding spending. From 2013-14 to 2016-17 salary and benefit expenditures increased by 40% with a consistent trend of the actuals exceeding the adopted budget.

<b>Total Salary and Benefits (Certificated and Classified)</b>		
<b>Fiscal Year</b>	<b>Budgeted</b>	<b>Actual</b>
2013-14	\$199,753,116	\$211,414,632
2014-15	\$231,257,374	\$231,350,281
2015-16	\$237,522,834	\$274,587,226
2016-17	\$285,644,605	\$295,501,600

Over the past four fiscal years, total spending for Certificated Supervisors & Administrators has steadily increased by 43%, and has exceeded its original budgeted amount each year for the last three years.

<b>Total Salary and Benefits, Certificated Supervisors &amp; Administrators</b>		
<b>Fiscal Year</b>	<b>Budgeted</b>	<b>Actual</b>
2013-14	\$13,844,243	\$13,906,595
2014-15	\$13,983,354	\$15,261,544
2015-16	\$15,715,182	\$19,773,226
2016-17	\$18,997,774	\$20,010,231

Over the past four fiscal years, total spending for Classified Supervisors & Administrators has increased by 69%, and has exceeded its original budgeted amount by over 100% each year over the past two years.

<b>Total Salary and Benefits, Classified Supervisors &amp; Administrators</b>		
<b>Fiscal Year</b>	<b>Budgeted</b>	<b>Actual</b>
2013-14	\$12,193,285	\$13,141,477
2014-15	\$11,093,287	\$15,139,680
2015-16	\$9,661,823	\$20,167,289
2016-17	\$10,404,809	\$22,285,807

Management and understanding of what contributes to salary and benefits are therefore critical to effective resource management. The district has historically struggled to put in place a system where hiring only occurs after a known funding source is identified and encumbered for this purpose. Under the current process the Finance Department creates a position and the Human Resources Department posts it once it receives a form verifying that funds are available. Under normal circumstances this works sufficiently, but there are many exceptions that have strained and tested this rule, including, but not limited to the following:

- Once funding is verified there can be delays between verification and signoff on the form. This creates gaps where other expenses or positions may be requested and while it appears funds are available, this may not reflect the request that's made its way to Human Resources for creation and posting.
- Sites are allowed to make adjustments or swap positions to different types. The process to manage such adjustments includes several manual steps, which has contributed to delays and inaccuracies.
- There is an overall lack of confidence in the completeness and accuracy of information, which allows for a level of imprecision in the process that makes it possible for an accumulation of breakdowns that cumulatively has a significant impact on the district's fiscal condition.

Ultimately there are too many ways that a position can get created, adjusted, and filled. Furthermore, the information within IFAS does not accurately and completely track vacancies nor is there a consistent approach to encumbering funds for commitments. The transition to Escape provides the district with a much more robust financial system that should address this problem.

Two additional areas where expenditures tend to fluctuate are Professional and Consulting Services and Books and Supplies. The variances in these areas occur for different reasons. In the case of professional and consulting services, outside services and non-public schools and agencies related to special education programs are often a driver of costs in this area. The largest single contract is for First Students, transportation for students with disabilities. For books and supplies, this is generally treated as a line item balancer that is allocated to specific uses over the course of the fiscal year and wide range of uses that varies from year-to-year. Over the past four fiscal years, total spending in Professional & Consulting Services has steadily increased, and has always exceeded its original budgeted amount.

<b>Total Professional and Consulting Services</b>		
<b>Fiscal Year</b>	<b>Budgeted</b>	<b>Actual</b>
2013-14	\$7,109,479	\$22,692,840
2014-15	\$20,698,679	\$23,802,726
2015-16	\$20,479,321	\$29,396,665
2016-17	\$21,452,717	\$28,298,078



Over the past four fiscal years, total spending in Books & Supplies has fluctuated, but has never met or exceeded its original budgeted amount.

<b>Total Books and Supplies</b>		
<b>Fiscal Year</b>	<b>Budgeted</b>	<b>Actual</b>
2013-14	\$12,551,643	\$12,364,422
2014-15	\$10,060,946	\$8,323,758
2015-16	\$18,649,331	\$12,366,086
2016-17	\$20,116,023	\$6,817,615

The trends with Books and Supplies suggest that there are some reductions to be made in initial budgeting and potential reductions can be made to be more consistent with 2014-15 and 2016-17 levels of spending.

The Board also has requested information about unanticipated expenditures and program contributions/encroachment. Both of these issues were called out in the FCMAT Report and are among the areas for further analysis by WestEd and will be included in the FCMAT implementation plan.

**Key Drivers**

- The district’s most significant expenditures are for personnel. The current financial and human resource management systems are inadequate to ensure there is a robust position control process and system. The process of zero-base budgeting can incorporate a full reset of position information accompanied with a clearly defined process that eliminates gaps and delays that have eroded the quality of data and the enforcement of true controls.
- Balancing staffing levels with student counts and revenue availability is noticed, but frequently undermined by lack of systems to follow through with adjustments. A major factor contributing to the district’s structural deficit is that the district has identified needs for staff reduction and for a variety of reasons fails to follow-through with needed cuts. For instance, in 2016-17 the district projected that lower student enrollment equated to a potential reduction of 42 FTEs. The final reductions totalled 6 FTE. This variance amounted to a \$3.2 million cost to the district. There are a variety of contributing factors including misalignment between policy and full understanding of financial implications when making decisions about staffing and an overall mistrust of the accuracy of financial and personnel information.

**D. Internal Controls and Budget Management**

As noted at the onset of this report, nearly every item identified by the Board’s resolution has as its source of problem and resolution internal controls. This includes:

- Creation of positions for which there was not an adequate budget
- Approval of contracts for which there was not an adequate budget
- Site and department spending during the spending freeze
- Lack of resolution of most audit findings
- Lack of consistent enforcement for budget reductions

The district is taking seriously the FCMAT recommendations and has engaged WestEd to assist with planning and implementation of changes in our policies, procedures, and practices that will address the myriad of internal weaknesses. The drivers mentioned throughout this report are virtually all related to internal controls, and provide a way to organize next steps.

### III. NEXT STEPS AND COMMITMENT TO ACTION

A FCMAT Implementation Plan will be presented to the Board of Directors on December, 13, 2017 and will provide more detailed information on the steps the district will take to address the issues that are detailed in this report and to ensure we are on the path to fiscal vitality.

Kyla Johnson-Trammell, our Superintendent as of July 1, 2017, has made a commitment to lead the district to fiscal vitality by addressing the areas of improvement that were identified in the FCMAT Report. Several steps she has already taken include:

- **Creating cross-divisional leadership teams to work collectively to problem solve and create systems for fiscal vitality.** Two of those teams include the Advisory Team and the Budget Strategy Team which are made up of members from the Finance, Operations and Academic divisions.
- **Monitoring all school and central site budgets on a monthly basis.** The Superintendent is committed to ensuring that all central office and school site leaders will be held accountable to monitor site dollars.
- **Seeking additional professional guidance and support from West Ed** to produce multi-year budget projections and to support staff in best practices for budget prioritization and development.

### IV. APPENDIX

Past Presentations and relevant information to the review are linked below.

[2013-14 Closing of the Books](#)

[2014-15 Closing of the Books](#)

[2015-16 Closing of the Books](#)

[2016-17 Closing of the Books](#)

[Multi-Year Fund Balance](#)

[Unbudgeted Position Information](#)

Historical Budgets ECE, SPED Nutrition Services