



## *Sacramento City Unified School District*

Because It Has Failed to Proactively Address  
Its Financial Challenges, It May Soon  
Face Insolvency

*December 2019*

**REPORT 2019-108**





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December 10, 2019  
**2019-108**

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As directed by the Joint Legislative Audit Committee, my office conducted an audit of the Sacramento City Unified School District (Sacramento Unified). Our assessment focused on Sacramento Unified's financial condition, and the following report details the audit's findings and conclusions. We determined that Sacramento Unified has not proactively addressed its financial problems.

Sacramento Unified failed to take sufficient action to control its costs in three main areas—teacher salaries, employee benefits, and special education. Sacramento Unified increased its spending by \$31 million annually when it approved a new labor contract with its teachers union in 2017. Despite warnings from the Sacramento County Office of Education that it could not afford the agreement, the Sacramento City Unified School District Board of Education approved the agreement without a plan for how it would pay for it. Sacramento Unified also failed to control the costs of the generous employee benefits it provides, which increased by 52 percent from fiscal years 2013–14 through 2017–18. We also found that Sacramento Unified lacked clear policies to guide staff on what are appropriate expenditures for special education, limiting its ability to control these costs. Consequently, Sacramento Unified projects it will largely deplete its general fund in October 2021 and will likely need to accept a loan from the State to continue operating. If it accepts such a loan, the required loan payments would result in less funding for students and a loss of local control to an appointed administrator.

Although both Sacramento Unified and its teachers union have proposed changes to stabilize the district's finances, we found that the proposals are unlikely to solve the district's ongoing financial problems. In fact, several proposals from the teachers union would increase costs dramatically. Given that accepting state assistance would result in less funds for students, we would have expected Sacramento Unified to develop a detailed plan for resolving its financial concerns, but it has not done so. It states that it needs to make \$27 million in reductions by fiscal year 2021–22, but even that amount may not be sufficient to end its deficit spending. We have identified a number of options the district could take, including making changes to salaries and benefits for different groups of employees; however, if it is to avoid the negative effects of insolvency, Sacramento Unified must act quickly to develop and implement a plan.

Respectfully submitted,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE, CPA  
California State Auditor

## Selected Abbreviations Used in This Report

CalSTRS	California State Teachers' Retirement System
FCMAT	Fiscal Crisis Management and Assistance Team
LCFF	Local Control Funding Formula

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## Summary

### Results in Brief

The Sacramento City Unified School District (Sacramento Unified) is an urban public school district in Sacramento County that serves about 41,000 students and employs 2,200 teachers. Since fiscal year 2016–17, its expenditures have exceeded its ongoing revenue by \$9 million to \$25.9 million each year. During this same time period, it has increased spending in three main areas—teacher salaries, employee benefits, and special education—without taking sufficient action to control these costs. Because its spending has consistently exceeded its ongoing revenue, it has instead had to rely on reserves from its general fund—the primary fund that the district uses—and on one-time funds to cover its expenditures. As a result, its general fund balance has declined by nearly \$30 million over the past three years. Sacramento Unified now projects that by October 2021 it will have largely depleted its general fund and will likely need state assistance in the form of a loan to continue operating. If it must accept such a loan, the resulting loan and interest payments would result in less funding available for students. Further, the terms of the loan would require it to relinquish local control to an appointed administrator who would assume the responsibilities of the Sacramento City Unified School District Board of Education (board) and the district superintendent.

In December 2017, Sacramento Unified significantly increased its ongoing spending when its board approved a new labor contract with its teachers union that increased the amount the district paid for teacher salaries by 15 percent. This labor agreement could ultimately cost Sacramento Unified about \$31 million per year in additional costs, an increase of 5 percent in the district's total spending in fiscal year 2019–20. At the time of the labor negotiations, the teachers union believed that the district's fund balance was steadily increasing and that teacher salaries were relatively low. However, neither of these beliefs was entirely accurate. Although Sacramento Unified did have lower average teacher salaries than comparable school districts before the 2017 agreement, it consistently maintained the highest average total compensation for teachers because it offered more generous and expensive health care benefits. Further, at the time of the labor negotiations, Sacramento Unified had received one-time funds from the Legislature that likely gave the impression that the district was in better financial condition than it actually was. However, the Legislature allocates one-time funds for a specific purpose, such as satisfying potential outstanding state mandate claims, and for a limited term. Consequently, school districts should not rely on them for ongoing expenses, like teacher salaries.

### Audit Highlights . . .

*Our audit of Sacramento Unified's financial condition revealed the following:*

- » *Sacramento Unified has not proactively addressed its financial problems and is close to insolvency—it projects facing a \$19.1 million shortfall in fiscal year 2021–22.*
- » *At the same time that its fund balance and financial condition declined, Sacramento Unified increased spending for teacher salaries, benefits, and special education.*
  - *In 2017 its district board approved a new labor contract that increased teacher salaries by 15 percent, costing an additional \$31 million per year.*
  - *Despite warnings from the Sacramento County Office of Education that it could not afford the labor agreement, the district board approved the agreement without a plan to pay for it.*
  - *Sacramento Unified has failed to control the costs of generous employee benefits it provides, which increased by 52 percent over a five-year period.*
  - *Special education costs have doubled and account for 21 percent of the district's total spending in fiscal year 2017–18.*
- » *Despite the impending risk of insolvency, Sacramento Unified and its teachers union have yet to agree on a solution to the district's financial problems.*
- » *If it is to avoid the negative effects of insolvency, Sacramento Unified should act quickly to develop and implement a plan to address its increasingly precarious financial situation.*

When its current superintendent joined the district in July 2017, Sacramento Unified and its teachers union had been unable to reach an agreement for nearly a year. According to the district superintendent, he reached an agreement with the teachers union in part because he wanted to avert the negative impact a strike would have on students and their families. However, at the board meeting to approve the labor contract in December 2017, the Sacramento County superintendent of schools (county office superintendent) informed the board that Sacramento Unified could not afford the agreement unless it reduced its budget by \$15.6 million. The county office superintendent asked the district to provide a budget reduction plan if it decided to approve the labor contract. Instead of submitting such a plan, the district board chose to rely on one-time funds it anticipated receiving from the proposed January 2018 Governor's Budget to pay for part of the ongoing salary increases in that year. It did not identify a plan to pay for the increases in future years—an omission that has contributed significantly to its current precarious financial situation. However, because Sacramento Unified projected that it could meet its current and future financial obligations at that time, the county office superintendent could not compel the district to make cuts instead of using the one-time funds.

Sacramento Unified also failed to control the costs of generous employee benefits it provides, which represented almost a third of its budget in fiscal year 2017–18. In particular, it offers costly health care benefits, including fully paid health care for its teachers and their families. In contrast, other nearby districts typically pay for the lowest cost health plan for the employee and their family or pay the full cost for only the employee's health care. Despite receiving warnings regarding its health benefit costs from entities that have reviewed its budgets since 2003, Sacramento Unified has not taken sufficient action to control those costs when negotiating any of the six agreements that it has entered into with its teachers union since then. Further, despite the county office superintendent's persistent concerns, Sacramento Unified has not taken sufficient action to control its increasing liability for its retiree health benefits. In part because Sacramento Unified requires teachers to contribute only \$20 per month to their retiree health benefits, its liability increased to \$726 million in fiscal year 2017–18, or 140 percent of the district's total spending that year. Further, its contributions toward its teachers' pension system increased by \$15.2 million from fiscal years 2013–14 through 2017–18, in part because of the higher salaries the district agreed to pay as a result of the 2017 labor contract.

Finally, Sacramento Unified has done little to control its special education costs, which grew by 31 percent from fiscal years 2013–14 through 2017–18, reaching 21 percent of its total expenditures. The district lacks clear policies to guide staff on identifying appropriate



expenditures for special education, which limits its ability to control these costs. In addition, it has not applied for all available funding. Specifically, the State provides reimbursement for extraordinary special education costs, such as the costs of residential treatment for students who receive special education services. However, according to Sacramento Unified's special education director, the district did not apply for this funding because the State caps the total reimbursement amount it will pay statewide. We estimate that Sacramento Unified could have been eligible for up to \$1.4 million over five years if it had applied for these funds.

Despite the impending risk of insolvency, Sacramento Unified and its teachers union have yet to agree to a solution to the district's financial problems. They each recently made proposals regarding the budget, but it is unlikely that either proposal can solve the district's ongoing financial challenges. In fact, several of the teachers union's suggestions would increase the district's costs dramatically. In contrast, Sacramento Unified's proposal could result in significant savings; however, implementing it would require substantial concessions from the teachers union. Given that accepting state assistance would result in the appointment of an administrator for the district and would have significant implications for the district's students and community, we expected Sacramento Unified to have developed a detailed plan for resolving its financial concerns. However, it has not done so. We identified a number of options it could take, including making changes to salaries and benefits for different groups of employees. If it is to avoid the negative effects of insolvency, Sacramento Unified should act quickly to develop and implement a plan to address its increasingly precarious financial situation.

## **Key Recommendations**

### ***Legislature***

To help ensure that county office superintendents can prevent school districts under their oversight from becoming insolvent, the Legislature should consider amending state law to require school district boards to obtain approval from their county office superintendents before considering significant spending actions.

### ***Sacramento Unified***

By March 2020, Sacramento Unified should adopt a detailed plan to resolve its fiscal crisis. The plan should estimate savings under multiple scenarios and include an analysis that quantifies the

impact of potential or proposed reductions the district can make to ongoing expenditures. Specifically, Sacramento Unified should consider the impact of possible salary adjustments for employees in different bargaining units and include the impact those salary adjustments would have on retiree benefits, such as pensions. It should also use the most recently available data to estimate net savings from modifying the health care benefits it provides to employees, as well as the effect those modifications would have on the total compensation of the employees. Finally, it should calculate the impact of possible changes to district and employee contributions to fund future retiree health benefits. The district should use the plan it develops as the basis for its discussions of potential solutions with its teachers union.

#### **Agency Comments**

Both the county office superintendent and Sacramento Unified generally agreed with our recommendations. The county office superintendent questioned its ability to ensure that Sacramento Unified implemented our recommendations. Sacramento Unified noted that implementing some of the recommendations would require negotiated solutions with its teachers union.

# Introduction

## Background

The Sacramento City Unified School District (Sacramento Unified) is an urban public school district in Sacramento County that serves 41,000 students and employs 4,200 individuals, of whom 2,200 are teachers.<sup>1</sup> It operates 83 schools including 59 elementary schools and 12 high schools. The Sacramento City Unified School District Board of Education (board) is the governing and policymaking body for Sacramento Unified. District voters elect its seven members for four-year terms. The board establishes Sacramento Unified's long-term vision and ensures educational and fiscal accountability to the community while providing community leadership. The board is also responsible for employing the district superintendent, who is the general administrator of all of Sacramento Unified's instructional and business operations.

The Sacramento County superintendent of schools (county office superintendent) has fiscal oversight responsibility of Sacramento Unified and all other school districts in the county. As part of his fiscal oversight, the county office superintendent reviews districts' annual budgets and interim financial reports to assess their ability to meet their financial obligations. When a district's budget or financial reports indicate that the district may be unable to meet its financial obligations for the current fiscal year or two subsequent fiscal years, the county office superintendent can take action, such as assigning a fiscal expert to advise the district or requiring the district to submit a proposal for addressing its fiscal deficiencies. If the county office superintendent, in consultation with the state superintendent of public instruction, determines that a school district will be unable to meet its financial obligations for the current or subsequent fiscal year, the county office superintendent can develop and impose a budget revision or can reject any district action it finds to be inconsistent with that district's ability to meet its obligations.

## Funding Sources for School Districts

Sacramento Unified receives the majority of its funding in its general fund—which is the primary fund that it uses to pay for its activities—through the State's Local Control Funding Formula (LCFF). LCFF has three primary funding components,

<sup>1</sup> We refer to certificated nonmanagement employees as *teachers* throughout this report. In addition to teachers, certificated employees include staff, such as counselors, nurses, and librarians, who are not teachers but provide direct services to students.

### LCFF Funding Categories

**Base funds:** Each district receives a funding base amount that is equal to a base rate multiplied by the district's average daily attendance.

**Supplemental funds:** Each district receives an amount equal to 20 percent of the base rate for the percentage of its students identified as low-income, English learner, or foster youth.

**Concentration funds:** When a district's percentage of its students identified as low-income, English learner, or foster youth exceed 55 percent of its total enrollment, the district receives additional funds equal to 50 percent of the base rate for its percentage of students above the threshold.

Source: State law.

which we describe in the text box. Based on its population of students, Sacramento Unified receives base, supplemental, and concentration funds. Because its enrollment has declined in recent years, state law allows the district to use its prior year average daily attendance—an amount that the district submits to the California Department of Education—to calculate the funding it will receive rather than its enrollment in the current year. Despite its declining enrollment, Sacramento Unified's revenue has increased in recent years. The increase is because when the Legislature implemented LCFF in fiscal year 2013–14, it did not fully fund it, as LCFF represented a significant increase in the amount of educational funding the State was providing. However, LCFF reached full implementation in fiscal year 2018–19, so the district should not expect similar increases in funding in future years.

In addition to LCFF funds, school districts also receive state and federal funding to provide special education services. Examples of such services include speech therapy, psychological services, assistance for students with physical disabilities, and aides to assist students. The State bases funding for special education on a district's overall attendance rather than its number of students receiving special education services. According to a study by the Public Policy Institute of California, state law structures funding this way to avoid creating incentives for districts to classify students as needing special education when they do not.

State law requires each school district to maintain a minimum reserve for economic uncertainties. This reserve allows a district to better manage its cash flow, mitigate volatility in funding, and address unexpected costs. The size of a district's reserve depends on its enrollment and level of spending. For a district the size of Sacramento Unified, the required reserve is 2 percent of its general fund expenditures, which for Sacramento Unified would be \$11.6 million for fiscal year 2019–20.

### School District Budget Approval Process

Each year, Sacramento Unified must submit its budget to the county office superintendent for review and approval based on a number of criteria, including the district's projected ability to meet its financial obligations. Sacramento Unified must submit its budget using forms the California Department of Education developed. These forms require Sacramento Unified to project its revenues and expenses for

the budget year and the subsequent two fiscal years. If the county office superintendent disapproves the proposed budget, the district moves forward with a budget that reflects the lesser of its last budget or the disapproved budget. Sacramento Unified must also submit periodic financial reports during the year. As the text box describes, the county office superintendent reviews the information the district submits and confirms the district's status as positive, qualified, or negative. Although qualified and negative statuses are similar, a qualified status describes a situation in which a district may not meet its financial obligations in the future, while the risk is more imminent for a negative status.

#### School District Financial Certification Statuses

**Positive:** A district projects that it will meet its financial obligations in the current fiscal year and two subsequent fiscal years.

**Qualified:** A district projects that it may not meet its financial obligations in the current fiscal year or two subsequent fiscal years.

**Negative:** A district projects that it will not meet its financial obligations in the current or subsequent fiscal year.

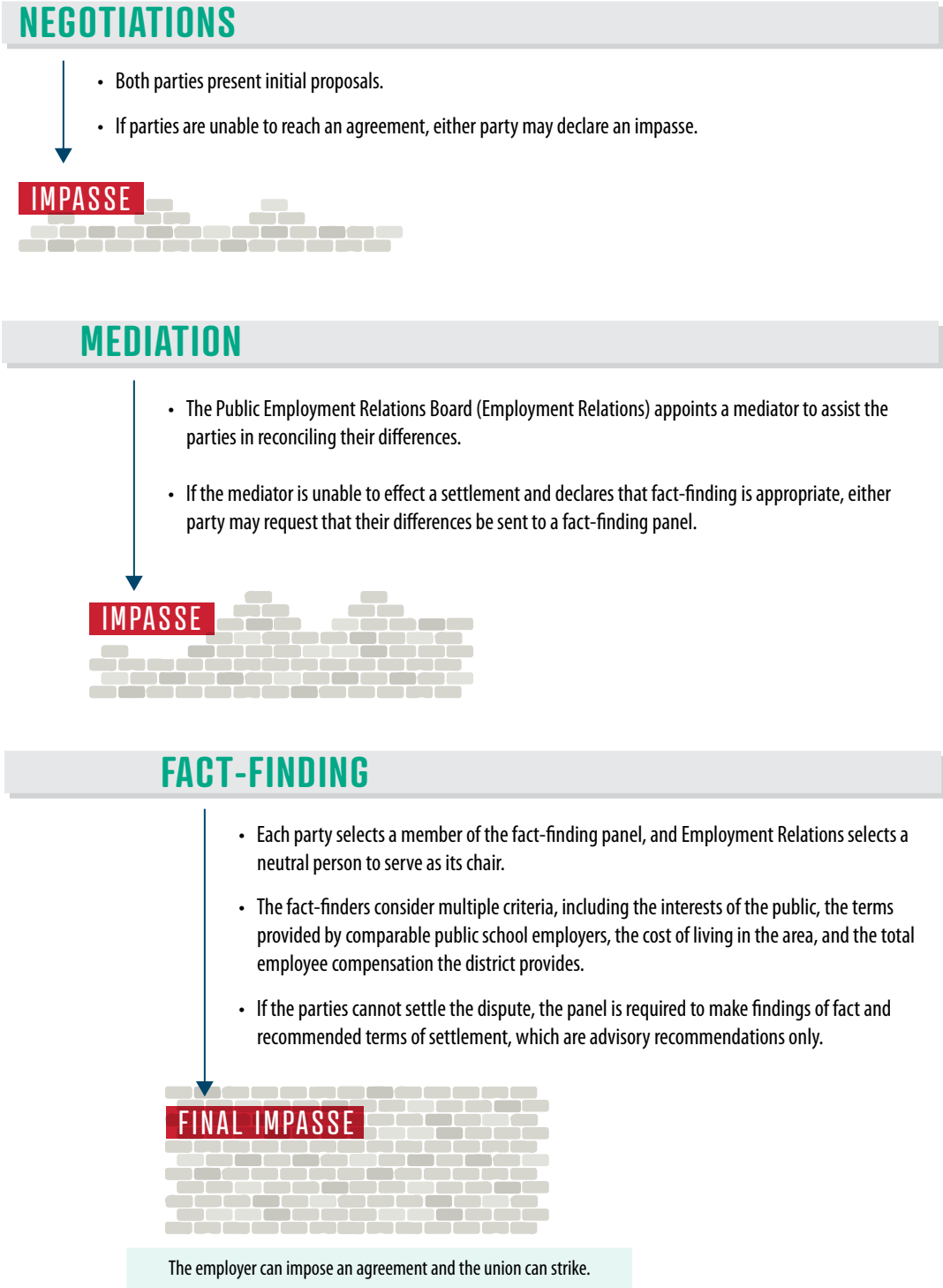
Source: State Law.

#### School District Labor Negotiation Process

The majority of Sacramento Unified's employees are represented by five unions, the largest of which is its teachers union. These unions negotiate with the district to determine, among other items, the salary and benefit structures for their represented employees. Benefits include those that employees receive during employment, such as health insurance benefits, and those that they receive after retirement, such as retiree health insurance and pension benefits. As Figure 1 shows, Sacramento Unified and its unions must follow a negotiation process to agree on any changes to represented employees' terms and conditions of employment. If the parties in one of these negotiations reach a final impasse, state law allows Sacramento Unified—as the employer—to impose an agreement, which allows the union to strike.

A labor agreement may have a significant impact on a school district's budget. As a result, state law requires that before adopting labor agreements, districts at risk of failing to meet their financial obligations in the near future must disclose those agreements to their county boards of education. The Sacramento County superintendent of schools states that he goes beyond the minimum required disclosure and asks all 13 districts in his jurisdiction of Sacramento County, including Sacramento Unified, to disclose all labor agreements 10 days before adoption. This practice enables the county office superintendent to share any concerns with the communities of those districts before the districts adopt labor agreements. Sacramento Unified submitted its most recent labor agreement to the county office superintendent before adopting it.

**Figure 1**  
The State Has Established a Negotiation Process for Public School Employers and Labor Unions



Source: State law.

## Audit Results

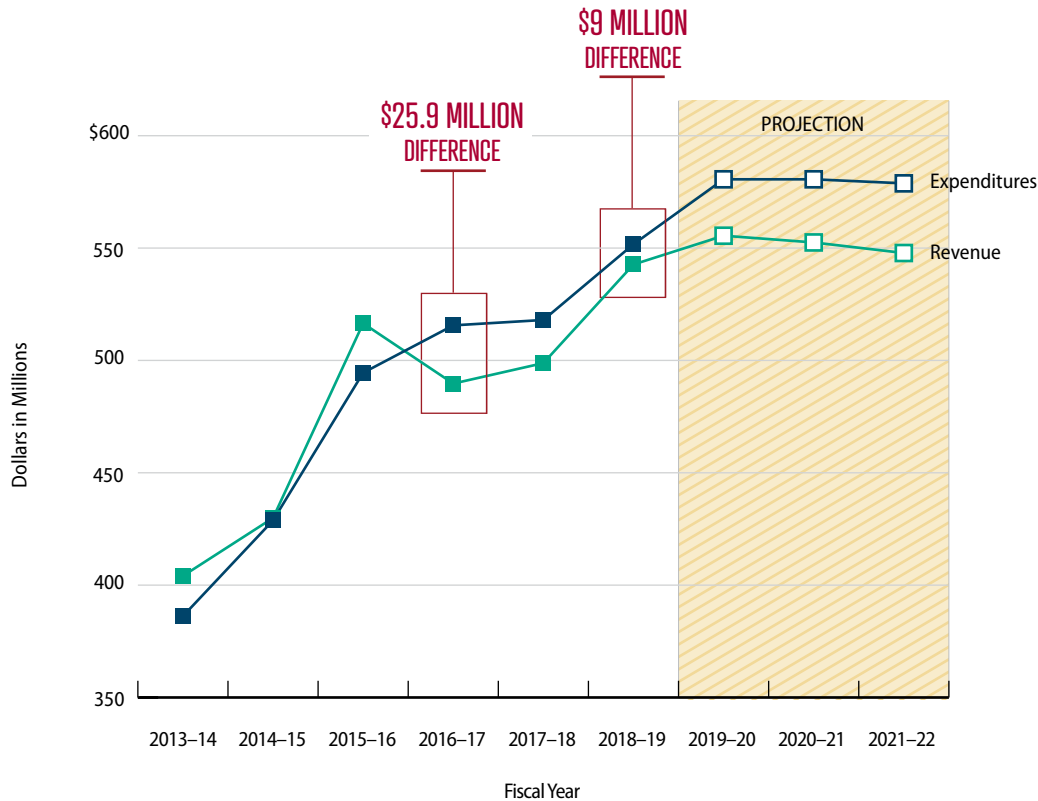
### Sacramento Unified's Finances Are Deteriorating, Increasing the Likelihood of Insolvency

Sacramento Unified's costs, such as salaries and benefits, have increased at a rate that has outpaced the ongoing revenue it receives, leading it to project that it will run out of money in fiscal year 2021–22. Since fiscal year 2016–17, Sacramento Unified has fallen short in paying for its expenditures from its revenue. As Figure 2 shows, from fiscal years 2016–17 through 2018–19, its expenditures each year exceeded its revenue by amounts ranging from \$9 million to \$25.9 million. It used its general fund balance (fund balance) to cover the shortfalls, resulting in its fund balance decreasing from \$97.9 million in July 2016 to \$70.3 million in June 2019. As of October 2019, Sacramento Unified projected that its general fund expenditures would exceed its revenue from fiscal years 2019–20 through 2021–22 by \$77.8 million—which is \$7.5 million more than its current fund balance of \$70.3 million. Moreover, state law requires the district to maintain a reserve of 2 percent of its general fund expenditures. Taking into consideration that it projects that this required reserve will be \$11.6 million in fiscal year 2021–22, Sacramento Unified will face a \$19.1 million shortfall at that time.

Sacramento Unified cannot achieve cost savings significant enough to balance its budget without addressing its three largest categories of expenditures: salaries; benefits; and contracts, services, and other operating expenses. Specifically, 80 percent of Sacramento Unified's fiscal year 2019–20 budgeted expenditures consist of salaries and benefits, as Figure 3 shows. An additional 13 percent of its budgeted expenditures are for contracts, services, and other operating expenditures, which largely consist of special education contracts. To address its ongoing costs related to salaries and benefits, the board voted in February and March 2019 to lay off 12 administrators, 150 teachers, and 157 support staff.<sup>2</sup> The district claimed at the time that these reductions would save \$7.8 million annually. However, according to the district, it had rescinded more than 130 of these layoffs as of October 2019, calling into question whether it realized the full savings. We discuss Sacramento Unified's costs related to salaries, benefits, and special education in greater detail in the sections that follow.

<sup>2</sup> We identify the administrators, teachers, and support staff in terms of the number of full-time equivalents (FTEs) rather than the number of individuals, which might be greater than the number of FTEs. For example, two individuals who worked half-time would be one FTE. Unless we specify otherwise, we describe numbers of employees throughout this report in terms of FTEs.

**Figure 2**  
Sacramento Unified Has Consistently Spent More Than It Received in Revenue Since Fiscal Year 2016–17



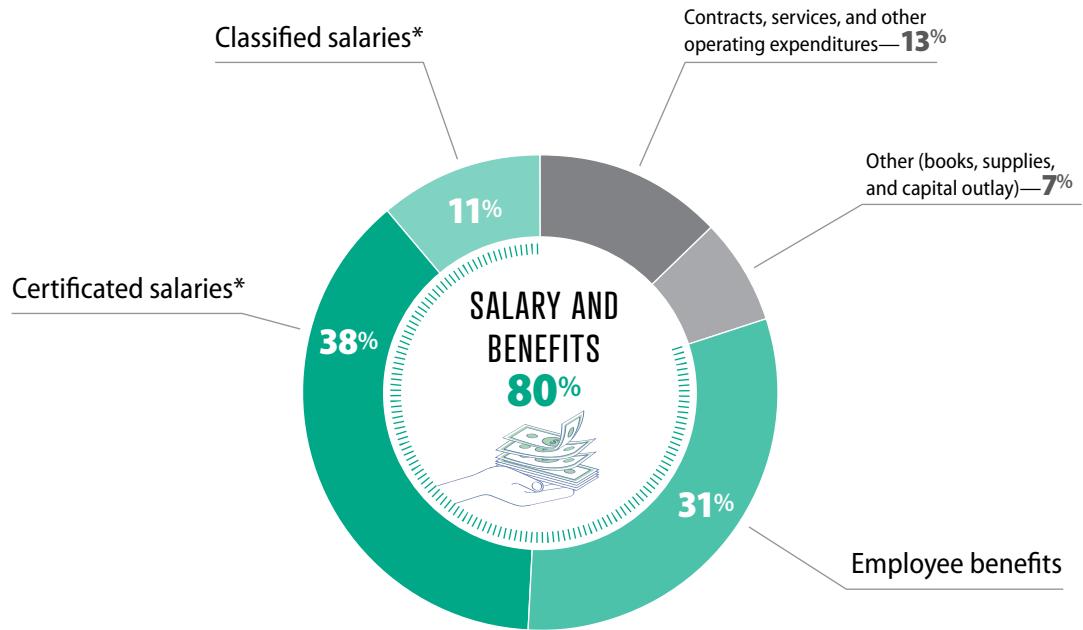
Source: Sacramento Unified's audited financial statements for fiscal years 2013–14 through 2017–18, unaudited actuals for fiscal year 2018–19, and budget documentation for fiscal years 2019–20 through 2021–22.

Note: To better understand Sacramento Unified's financial condition, the amounts above include only operating revenues and expenditures, as they represent what the district spends to run its schools and the revenue it receives based on the services it provides. We have removed one-time revenues received from the State from the revenues presented. As we discuss later in the report, these one-time funds cannot be expected in future years and should not be relied upon to pay for ongoing costs. We also do not include revenues and expenditures from financing sources, such as transfers from other funds, as they generally do not reflect costs or revenues incurred in the operation of the district.

Sacramento Unified's declining enrollment has also contributed to its precarious financial situation. As we discuss in the Introduction, the State bases each school district's funding primarily on student attendance. From fiscal years 2013–14 through 2018–19, Sacramento Unified's enrollment declined by 978 students, or 163 students per year. Based on historical trends, it projects decreases of 378 students per year from fiscal years 2019–20 through 2021–22. A 2013 report from the Boston Consulting Group identifies declining birth rates and shifts to public charter schools as factors that have contributed to shrinking enrollment in urban school districts. The report also notes that classroom costs become harder to manage when enrollment declines because students rarely leave schools in class-size increments. For example, according to a 2018 report from WestEd—a nonprofit educational research organization—a school might lose six students per grade level yet still not be able to decrease the number of teachers it needs.



**Figure 3**  
Most of Sacramento Unified’s Total Budgeted General Fund Expenditures for Fiscal Year 2019–20 Are for Salaries and Benefits

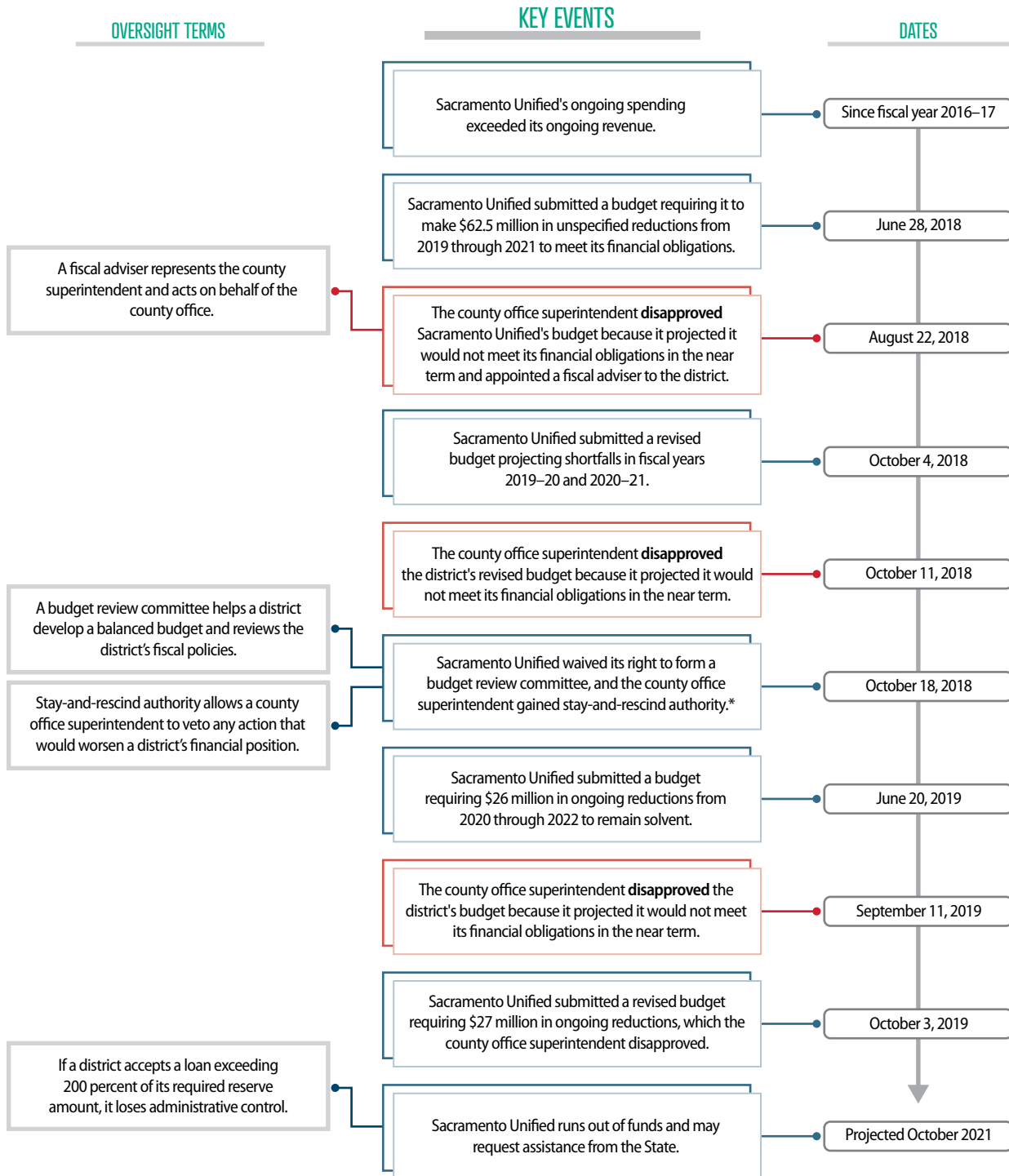


Source: Sacramento Unified’s fiscal year 2019–20 budget.

\* Individuals with teaching certificates, such as district teachers, receive certificated salaries. Certificated employees also include staff who are not teachers but provide direct services to students, such as counselors, nurses, and librarians. Employees without teaching certificates, such as administrators, custodians, and bus drivers, receive classified salaries.

Because it is consistently spending more than it receives in funding, Sacramento Unified is at risk of needing state assistance. As Figure 4 shows, Sacramento Unified’s deteriorating financial condition has prompted the county office superintendent to intervene repeatedly since August 2018. The multiyear projections that the district prepared in October 2019 indicate that it will largely deplete its general fund in October 2021. If Sacramento Unified cannot meet its financial obligations at that time, it may need to request an emergency loan from the State to remain solvent. If the loan exceeds 200 percent of Sacramento Unified’s required reserve—which will be approximately \$23.2 million in fiscal year 2021–22—the county office superintendent will appoint an administrator from a pool identified and vetted by the Fiscal Crisis Management and Assistance Team (FCMAT)—a state-created agency designed to help districts meet and maintain their financial obligations—and agreed to by the state superintendent of public instruction and the chair of the State Board of Education. This action would place the district’s board in an advisory role and replace the superintendent with an administrator.

**Figure 4**  
Sacramento Unified Is Close to Insolvency



Source: State law and letters from the county office superintendent to Sacramento Unified.

\* The county and state superintendents must agree to the waiver, after which the county superintendent gains the duties and responsibilities of the budget review committee.

Appointment of an administrator would significantly affect Sacramento Unified’s finances and functions. According to state law, an appointed administrator is responsible for implementing substantial changes in a district’s fiscal policies and practices and revising its educational program to align with realistic income projections. If a district’s financial condition becomes extremely severe, an administrator also has the authority to file for bankruptcy. Such a filing would permit the administrator to take actions that include voiding collective bargaining agreements. Further, when a district must make loan and related interest payments, it has less funding available for students. As a result, it may need to increase class sizes or reduce programs and opportunities for students.

**Sacramento Unified’s Costs for Employee Compensation and Special Education Have Increased Dramatically in Recent Years**

At the same time that Sacramento Unified’s fund balance and financial condition have declined, it has increased spending for teacher salaries, benefits for all employees, and special education. As of December 2017, Sacramento Unified provided the most generous and expensive employee benefits among nearby school districts. Nonetheless, at that time, it agreed to significant salary increases for its teachers, also making its salaries the highest among nearby districts. In part as a result of this decision, teacher salaries represented 38 percent of Sacramento Unified’s total costs in fiscal year 2018–19, while all employee benefits represented an additional 34 percent. Further, the district lacks policies to guide staff on the types of expenditures that are appropriate for the large portion of its budget that it spends on special education, which could lead to it overpaying for some services. Special education costs, which include expenditures for teacher salaries, employee benefits, and contracted services, represented 21 percent of Sacramento Unified’s total costs in fiscal year 2018–19.

***The School Board Approved Salary Increases for Its Teachers That It Could Not Afford Without Making Offsetting Cost Reductions***

In December 2017, Sacramento Unified significantly increased its ongoing spending obligations when its school board approved a labor contract with its teachers union that contained significant increases in its salary costs. As the text box shows, the 2017 contract terms included general salary increases and a change to the salary schedule, which Sacramento Unified projects will together result in a 15 percent

**Key Terms From the 2017 Teachers Union Labor Contract**

- 7.5 percent in general salary increases.
  - 2.5 percent retroactive increase for fiscal year 2016–17.
  - 2.5 percent increase in fiscal year 2017–18.
  - 2.5 percent increase in fiscal year 2018–19.
- Adjustment of the salary schedule targeting additional pay towards midcareer staff to improve retention and recruitment of experienced teachers.
- Changed required student-to-teacher ratio from 32 to 24 for kindergarten.
- Changed required student-to-teacher ratio from 31 to 24 for grades 1–3.

Source: 2017 teachers union labor contract.

increase in its salary costs. A salary schedule adjustment changes how much a district pays a teacher based on that teacher's combination of experience and educational attainment, as we show in Figure 5. In June 2017, Sacramento Unified calculated that a 1 percent increase in salary and statutory benefits—which are benefits that a public school provider must provide according to law, such as employer pension contributions—would cost it about \$2.1 million. Based on this calculation, we estimate that when fully implemented in fiscal year 2019–20, the 2017 contract's salary increases and adjustment to the salary schedule will add about \$31 million per year in ongoing spending. This amount represents 5 percent of Sacramento Unified's total spending.

**Figure 5**  
Example of the Change to the Salary Schedule Under the 2017 Labor Agreement



Source: Sacramento Unified's salary schedule documentation effective July 1, 2017, and July 1, 2019.

In addition, the agreement solidified the district's past efforts to reduce its student-to-teacher ratios in grades K–3. Before the agreement, Sacramento Unified's budgets had included funds to hire additional teachers to reduce K–3 class sizes. The 2017 agreement made those class size reductions mandatory. State law provides additional LCFF funds for the purpose of lowering class sizes in grades K–3.

The increased labor costs to which Sacramento Unified agreed when it approved the 2017 contract are significant, particularly given its declining financial situation. Negotiations for the labor agreement began in October 2016 as the district anticipated expiration of its existing contract with its teachers union in December 2016. Sacramento Unified and the teachers union met at least 22 times from October 2016 through May 2017 but could not reach an agreement. At that time, the teachers union noted that Sacramento Unified's salaries were lower than nearby districts' salaries and that it believed that Sacramento Unified could afford the increases it was proposing because the district's budget documents showed that its fund balance was steadily increasing. However, neither of these assumptions fully and accurately reflected the situation at the time.

Although Sacramento Unified did have lower average salaries than comparable school districts, it also consistently maintained the highest average total compensation per teacher from fiscal years 2013–14 through 2019–20, as we show in Table 1. Specifically, the district’s generous and expensive health insurance benefits exceeded those of other districts both in aggregate and per capita costs in all seven years. For example, Sacramento Unified’s total cost for health and welfare benefits to its teachers in fiscal year 2017–18 exceeded Elk Grove Unified’s costs that year by about \$13 million, even though Elk Grove Unified employed 950 more teachers. Sacramento Unified’s generous benefits have driven the district’s high total compensation costs, even when the salaries it offered were lower than those of comparable districts. We discuss Sacramento Unified’s health benefit costs further below.

**Table 1**  
**Sacramento Unified Consistently Provided the Highest Total Compensation for Teachers Among Comparable Districts From Fiscal Years 2013–14 Through 2019–20**

DISTRICT	FISCAL YEAR						
	2013–14	2014–15	2015–16	2016–17	2017–18	2018–19	2019–20
<b>Average Salary</b>							
Sacramento Unified	\$65,695	\$67,009	\$70,343	\$73,916	\$73,236*	\$83,148	\$91,250
Elk Grove Unified	\$71,340	\$73,322	\$76,341	\$78,663	\$80,261	\$88,445	\$85,058
San Juan Unified	\$71,583	\$74,317	\$75,808	\$76,908	\$76,673	\$82,211	\$84,433
Stockton Unified	\$61,632	\$65,674	\$68,852	\$72,903	\$75,370	\$86,161	\$86,846
Twin Rivers Unified	\$71,162	\$71,399	\$73,962	\$74,625	\$76,166	\$87,847	\$88,250

DISTRICT	FISCAL YEAR						
	2013–14	2014–15	2015–16	2016–17	2017–18	2018–19	2019–20
<b>Average Total Compensation†</b>							
Sacramento Unified	\$84,626	\$87,645	\$91,233	\$95,189	\$94,889	\$111,259	\$119,036
Elk Grove Unified	\$82,826	\$84,775	\$88,087	\$91,183	\$91,568	\$100,121	\$96,906
San Juan Unified	\$83,468	\$85,838	\$89,674	\$91,613	\$90,789	\$95,856	\$99,080
Stockton Unified	\$74,484	\$78,982	\$82,409	\$89,588	\$91,822	\$101,912	\$101,903
Twin Rivers Unified	\$78,714	\$76,001	\$79,716	\$81,401	\$83,323	\$96,146	\$98,266

Source: California Department of Education certificated salary and benefits data from fiscal years 2013–14 through 2017–18 and district budgets for salary and benefits data from fiscal years 2018–19 through 2019–20.

■ Highest in category

■ Lowest in category

Note: Sacramento Unified’s amounts have been updated to reflect increases from the 2017 labor contract.

\* Sacramento Unified’s average salary declined slightly in fiscal year 2017–18 because the teachers that it employed had relatively less experience in fiscal year 2017–18 than fiscal year 2016–17 and thus received lower salaries.

† Average total compensation includes salary plus health and welfare benefits. It does not include a district’s costs to provide statutory benefits, such as pension and Medicare.

Additionally, Sacramento Unified may have appeared to be in a better financial condition than it actually was at the time of the 2017 labor negotiations, in part, because it had received one-time funds from the State that contributed to its rising fund balance. From fiscal years 2013–14 through 2017–18, Sacramento Unified received between \$1.7 million and \$20.6 million annually in one-time funds. The Legislature appropriates one-time funds for a specific purpose and for a limited term, and subsequent legislation is necessary to renew them. Thus, such funds are fundamentally different from funds that districts generally use for ongoing costs, which consist of appropriations for the same purpose that are funded on an annual basis or continuously appropriated funds that are appropriated from year to year without the need for further authorization from the Legislature. For example, in fiscal year 2017–18, Sacramento Unified received \$5.7 million in one-time funds from the State for the purpose of satisfying potential outstanding state mandate claims. From fiscal years 2013–14 through 2015–16, such one-time funds helped Sacramento Unified to increase its fund balance. However, that fund balance began declining beginning in fiscal year 2016–17, as Figure 6 shows, because of the district’s increasing expenditures.

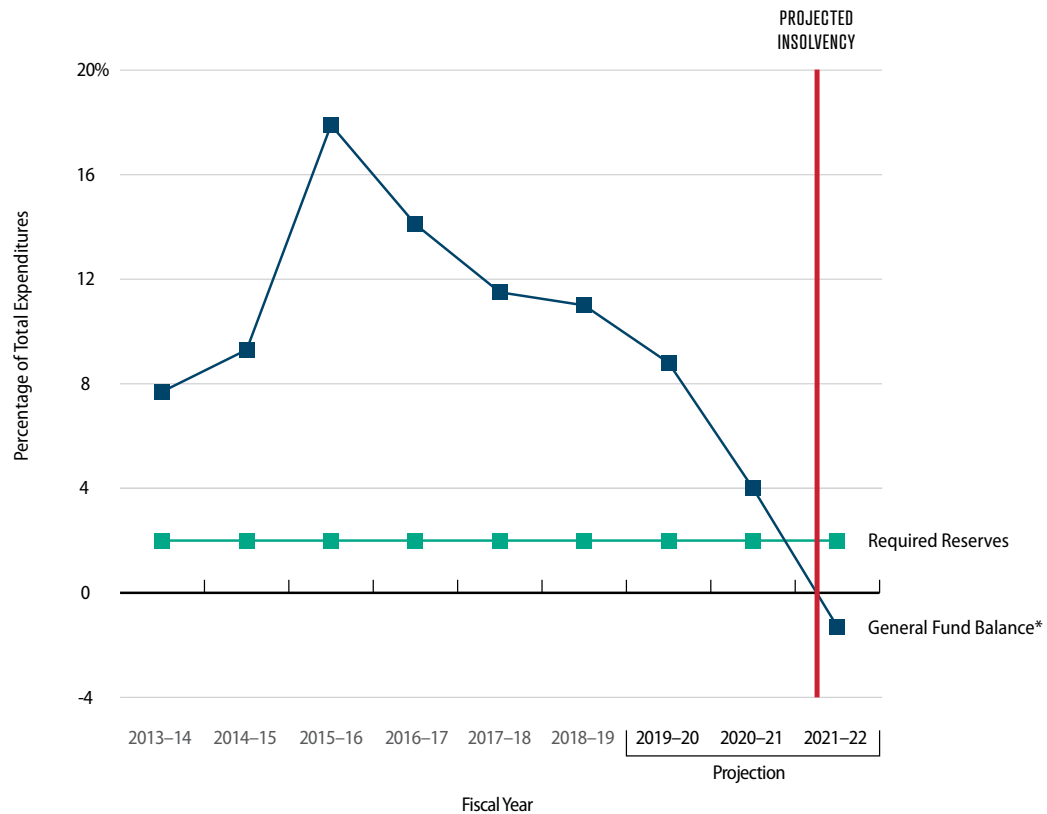
When Sacramento Unified’s current superintendent joined the district in July 2017, the district and its teachers union still had not reached an agreement on salary despite negotiating for nearly a year. In November 2017, Sacramento Unified made a proposal to the teachers union that included a 6.5 percent salary increase and a 2.5 percent salary schedule adjustment over the three-year term of the contract. The teachers union, stating that the agreement was not fair, voted to strike. As the parties reached a final impasse in negotiations, the superintendent met with the union later in November 2017 and brokered the 2017 labor agreement, which provided significantly higher increases than the district’s previous November 2017 proposal. According to the superintendent, he agreed to the higher increases because he wanted to avert the negative impact an impending strike would have on students and families. Further, based on his conversations with the district’s chief business officer at the time, he believed the district could afford the salary increases.

***The superintendent agreed to the higher salary increases because he wanted to avert the negative impact an impending strike would have on students and families and he believed the district could afford the agreement.***

Although Sacramento Unified believed that it could afford the agreement, the county office superintendent warned the district that it could not. At the Sacramento Unified board meeting to approve the labor agreement in December 2017, the county office superintendent told the board that the district could not afford the agreement without reducing its budget by \$15.6 million. Further, in his comments at that meeting and in a letter he sent to the district on the same day, he explained that the \$15.6 million in budget reductions would allow Sacramento Unified to meet its minimum reserve requirements through fiscal year 2019–20 but would

not eliminate its ongoing structural deficit. He emphasized that without making reductions to its ongoing spending, Sacramento Unified could not afford the agreement based on its own financial projections. He further stated that if the board decided to approve the labor agreement, he would request that the board approve a budget reduction proposal within a month.

**Figure 6**  
Sacramento Unified’s Available General Fund Balance Has Declined Since Fiscal Year 2016–17



Source: State law, Sacramento Unified’s audited financial statements for fiscal years 2013–14 through 2017–18, unaudited expenditures for fiscal year 2018–19, and budget documentation for fiscal years 2019–20 through 2021–22.

\* The general fund balance is presented without restricted revenue. Restricted revenue is revenue that is subject to externally imposed or legally enforceable constraints by external resource providers, through constitutional provisions, or through enabling legislation.

However, the board unanimously approved the agreement during the meeting but did not subsequently submit a corresponding budget reduction proposal. According to two board members, the board approved the agreement because it believed that Sacramento Unified would be able to meet its financial obligations based on information from the district’s chief business officer at the time. However, Sacramento Unified’s fiscal year 2017–18 first interim financial report, which the then-chief business officer submitted

***Rather than submitting a budget reduction proposal, the board chose to rely on one-time funds to pay for the ongoing salary increases and it did not propose a plan for covering these ongoing costs in subsequent years.***

to the board for approval at the same meeting, noted that under current projections, the district would exhaust its fund balance and need to make budget adjustments for fiscal years 2018–19 and 2019–20. Nevertheless, rather than submitting a budget reduction proposal, the board chose to rely on one-time funds it anticipated from the proposed January 2018 Governor’s Budget to pay for the ongoing salary increases. It did not propose a plan for covering these ongoing costs in subsequent years.

When it approved the 2017 labor contract without making reductions to ongoing spending, the board failed to uphold its fiduciary duty to ensure that the district is able to meet its financial obligations. In his review of Sacramento Unified’s first interim financial report in January 2018, the county office superintendent told the district that using one-time funds to pay for ongoing expenses was a poor business practice. However, because Sacramento Unified projected that it could meet its financial obligations in the current and subsequent fiscal year, the county office superintendent could not compel the district to make cuts instead of using the one-time funds.

In addition to the expected cost increases we describe above, ambiguity in the 2017 contract has resulted in Sacramento Unified facing even greater costs. The contract included a clause that limited the increase in costs from the salary schedule adjustment to 3.5 percent of its teachers’ salary costs. Sacramento Unified believed that the wording of this clause meant that the salary schedule adjustment was capped at a 3.5 percent increase in its annual teacher salary costs. In its review of the district’s financial disclosure of the contract, the county office superintendent reached the same conclusion. However, in September 2018, the teachers union disputed this interpretation, claiming that the 3.5 percent cap applied to fiscal year 2018–19 only, with no cap for the salary schedule adjustment in subsequent years. In May 2019, an arbitrator agreed with the teachers union’s interpretation that the cap applied to fiscal year 2018–19 only.

Therefore, the contract requires that salaries in fiscal year 2019–20 increase according to the salary schedule without a cap. As a result, Sacramento Unified has had to budget an additional 4 percent of its annual teacher salary costs to implement the salary schedule adjustment, for a total increase of 7.5 percent in annual teacher salary costs. In an October 2019 letter from Sacramento Unified to the teachers union president, the district stated that it had fully implemented the new salary schedule for fiscal year 2019–20. It further explained that it had already paid the first of two retroactive payments for fiscal year 2018–19, and that it anticipates making the second payment in November 2019.



The board approved the contract despite the ambiguity in its terms. The board could have mitigated the risk of adding these significant ongoing spending obligations to the district's increasingly risky financial situation if it had certified the district's ability to meet the costs of the labor agreement before approving it. If such a requirement existed, it might have inquired further into the financial impact of the labor agreement. Although state law requires a school district's superintendent and chief business officer to publicly disclose the costs associated with labor contracts and certify that the school district can afford the cost of the contracts, it does not require its board to certify that the district can afford the costs of the agreement.

***Sacramento Unified's Spending on Employee Benefits Has Increased Significantly Since Fiscal Year 2013–14***

Employee benefits are another growing area of costs for Sacramento Unified. Employee benefits primarily consist of health care benefits and pension benefits for both current and retired employees. From fiscal years 2013–14 through 2017–18, the cost of these benefits increased from \$106 million to \$160.8 million, or 52 percent. As of fiscal year 2017–18, employee benefits represented 31 percent of the district's total expenses. Although Sacramento Unified has a limited ability to control pension costs for its employees because state law establishes the rates it contributes, it has failed to address its high health care costs.

As we indicate previously, Sacramento Unified offers its teachers generous and costly health care benefits. In fact, as the text box demonstrates, one of the plans Sacramento Unified offers is among the costliest in the State. From fiscal years 2013–14 through 2017–18, the district's health care costs grew from \$60.5 million to \$72.7 million, an increase of 20 percent, with \$10.5 million of the increase related specifically to benefits it provided for its teachers. Sacramento Unified offers two health plan options to its teachers and pays the full cost of either plan for employees and their families. In comparison, other nearby districts generally limit the amount that they pay to the cost of the least expensive plan, pay the full cost only for employees, or cover only 80 percent of the least expensive health plan's costs for employees and their families. As a result, as Table 2 shows, Sacramento Unified consistently spent more than other nearby districts on health care benefits both per employee in general and per teacher specifically.

**Top Five Costliest California School District Health Plans in 2018**

The following identifies the annual cost to a district for an employee family plan:

1. \$37,971 - Sequoia Union High (San Mateo County)
2. \$35,694 - Saratoga Union Elementary (Santa Clara County)
3. \$35,052 - East Side Union High (Santa Clara County)
4. \$34,697 - Sacramento Unified (Sacramento County) (HealthNet)
5. \$30,324 - Saddleback Valley Unified (Orange County)

Source: California Department of Education's 2018 form J-90 data report.

**Table 2**  
Sacramento Unified Has Consistently Spent More on Providing Health Care Benefits to Its Employees Than Comparable Districts (Annual Cost Per Employee or Teacher) (in thousands)

DISTRICT	2013-14		2014-15		2015-16		2016-17		2017-18	
	ALL	TEACHERS	ALL	TEACHERS	ALL	TEACHERS	ALL	TEACHERS	ALL	TEACHERS
Sacramento Unified	\$17.4	\$20.1	\$18.1	\$20.9	\$17.7	\$21.1	\$17.7	\$21.0	\$17.4	\$21.2
Elk Grove Unified	9.4	10.9	10.5	11.1	10.0	11.2	10.0	12.4	9.3	10.9
San Juan Unified	8.2	8.8	9.2	8.9	9.3	10.9	9.8	11.4	10.4	11.0
Stockton Unified	7.8	10.6	9.2	10.6	9.3	11.0	11.0	14.1	11.9	14.2
Twin Rivers Unified	6.8	5.1	6.2	2.8	6.2	4.1	6.0	5.1	6.3	5.1

Source: Education Data Partnership district profile information and budget documentation for the Sacramento, Elk Grove, San Juan, Stockton, and Twin Rivers unified school districts.

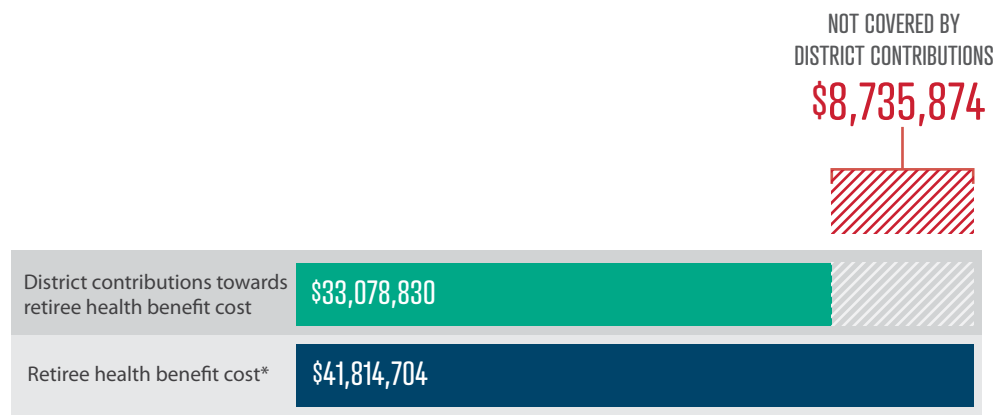
- Highest in category
- Lowest in category

Since 2003 Sacramento Unified has received repeated warnings about the affordability of paying the full cost for all health plans it offers to its teachers. Nonetheless, it did not include a limit on its contributions to health benefits for employees and their families in any of the six contracts it negotiated with its teachers union during these years. The chairperson of a fact-finding panel that reviewed Sacramento Unified's compensation and employee benefits in 2003 identified the district's high health care costs as an area of concern and recommended that it impose a cap on the amount of health benefits it would pay, using the cost of its Kaiser Permanente premium to set the cap because that plan was the less expensive of the two plans the district offered. In a 2006 fiscal review, FCMAT repeated this recommendation to Sacramento Unified, recommending that the district negotiate a cap on health benefit plans with its collective bargaining units. The district followed neither recommendation. However, the district's current leaders note that the district's current contract proposal to the teachers union includes capping the amount the district pays for health care. We discuss the district's contract proposals in a later section.

Further, Sacramento Unified has not taken sufficient action to control its increasing liability for retiree health benefit obligations. The district offers health care benefits to retired employees who meet certain criteria—such as years of service—that vary depending on when the employees retire and whether they are over age 65 at retirement. In particular, retired teachers union members continue to receive fully paid health care benefits until 65 and then receive a managed Medicare benefit. Other nearby districts typically pay only the cost of the lowest cost plan they offer for retired employees who have not yet transitioned to Medicare.

Sacramento Unified’s contributions toward its retiree health benefit obligations ranged from a low of \$19.3 million to a high of \$45.4 million annually from fiscal years 2013–14 through 2017–18. Those contributions fully covered the cost of current retirees’ health care benefits. However, the contributions did not cover the full cost of the retiree health benefits the district has promised employees who have yet to retire; instead they covered only a portion of this cost. As Figure 7 shows, Sacramento Unified should have contributed \$41.8 million in fiscal year 2017–18 towards retiree health benefits for current and future retirees; instead it contributed only \$33.1 million, thus increasing the amount it will have to contribute for future retirees. As its liability increases, so too does the minimum amount it has to contribute each year. Sacramento Unified’s retiree health benefit liability—the amount it projects it will have to contribute for these benefits in the future—totalled \$726 million as of fiscal year 2017–18, or 140 percent of its total general fund spending that year.

**Figure 7**  
**Sacramento Unified’s Retiree Health Benefit Liability Grew in Fiscal Year 2017–18, in Part, Because of Its Limited Contributions Toward Retiree Health Benefits**



Source: Sacramento Unified’s *Government Accounting Standards Board 75 Actuarial Report of Other Post Employment Benefits Liabilities for fiscal year end June 30, 2018 Financial Report*, and Sacramento Unified’s audited financial statements for fiscal year 2017–18.

\* Retiree health benefit cost is the amount Sacramento Unified’s actuary determined the district needs to contribute to fund benefits over time and is greater than the amount needed to cover only current retirees’ health benefits. If the district does not make the full contribution, interest accrues on the unpaid portion.

Despite receiving repeated warnings from external parties, Sacramento Unified has failed to formulate a plan to address its growing liability for these retiree health benefit costs. Since 2007 the county office superintendent has sent at least 24 letters to Sacramento Unified asking it to submit a plan explaining how it will pay for its unfunded retiree health benefit obligations. However, according to the county office superintendent, the district had failed to do so as of August 2019.

*The district's continued unwillingness to require its employees to contribute more to retiree health benefits is puzzling given the fact that its unfunded liability for these benefits increased by nearly \$166 million from 2008 through 2018.*

Similarly, in 2010 the Sacramento County Grand Jury recommended that school district boards in the county find a way to pay for their retiree health benefits without relying so heavily on their general funds and that they negotiate with their employee unions to reduce benefits or increase employee contributions. In its response to the grand jury report, Sacramento Unified noted that it had recently reached an agreement with its teachers union that extended the vesting period to qualify for retiree health benefits and called for employee contributions toward the cost of retiree health care of \$15 per month in fiscal year 2010–11 and \$20 per month beginning in fiscal year 2011–12. However, the fact that its liability continued to grow from fiscal years 2013–14 through 2017–18 demonstrates the inadequacy of these steps.

Further, Sacramento Unified's decision to enter its 2017 labor contract further increased its burden related to retiree health care costs. Specifically, the district agreed to a provision that increased its contributions by an additional 1.5 percent of total bargaining unit payroll, or about \$3 million in fiscal year 2018–19. However, teacher contributions towards the cost of retiree health benefits are currently \$20 per month. We find the district's continued unwillingness to require its employees to contribute more to retiree health benefits puzzling given the fact that its unfunded liability for these benefits increased by nearly \$166 million from 2008 through 2018.

Finally, the 2017 labor contract has also affected Sacramento Unified's pension costs. State law establishes mandatory California State Teachers' Retirement System (CalSTRS) contributions for employers and employees, requiring incremental increases of employers' contributions up to 10.85 percent of teachers' salaries from fiscal years 2014–15 through 2020–21. In part because of these incremental increases, Sacramento Unified's annual contribution to CalSTRS increased by \$15.2 million from fiscal years 2013–14 through 2017–18, to a total of \$29.2 million. Although this growth to date has been largely outside of the district's control, the 2017 contract will result in even higher pension costs. Specifically, because state law bases CalSTRS contributions on teachers' salaries, the salary increases in the 2017 contract will increase the amount Sacramento Unified must contribute toward teacher pensions. When it approved the contract, Sacramento Unified projected that the salary increases would increase its pension costs by \$2 million annually beginning in fiscal year 2018–19, an additional expense the district can ill afford.

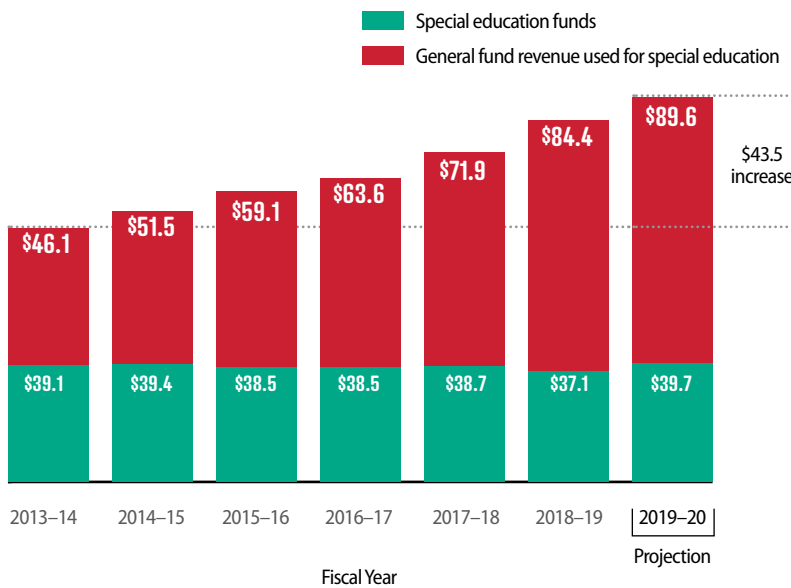
### ***Sacramento Unified Has Not Taken Sufficient Action to Ensure That Its Special Education Costs Are Reasonable***

Sacramento Unified has done little to control special education costs or seek additional revenue available for special education. Special education represented 21 percent of the district's total spending for

fiscal year 2017–18. It has done little to control these costs even though its special education expenditures increased by 31 percent—or \$26.1 million—from fiscal years 2013–14 through 2017–18, accounting for 20 percent of the overall increase in its spending during this period.

Sacramento Unified’s close tracking and monitoring of its special education costs is particularly important because its overall decline in enrollment has limited the funding it receives for special education services. State law bases funding for special education on a district’s average daily attendance, not its number of students enrolled who receive special education services. From fiscal years 2013–14 through 2017–18, Sacramento Unified’s overall attendance declined by 2 percent, and it consequently lost nearly \$700,000 in state and federal funding for special education. During this same period, the number of Sacramento Unified’s students who received special education services increased by 7 percent and its general fund expenditures for special education increased by 56 percent, or \$25.8 million. As Figure 8 shows, Sacramento Unified projects that its general fund spending for special education will nearly double by fiscal year 2019–20 from what it spent in fiscal year 2013–14.

**Figure 8**  
From Fiscal Years 2013–14 Through 2019–20, Sacramento Unified’s General Fund Spending for Special Education Is Projected to Almost Double (in millions)



Source: Sacramento Unified’s accounting system.

Because special education spending represents such a large portion of Sacramento Unified's costs, we expected that it would have taken steps to maximize the value of its spending. State law requires the district to provide an education to students receiving special education services at no cost to their families. Sacramento Unified also has a responsibility to use its limited funds in an efficient and effective manner. However, it has no written policies guiding staff on identifying cost-effective approaches for providing special education services. A failure to have clear policies in this area could lead to Sacramento Unified overpaying for some services. For example, the largest area of increase in its special education costs comes from contracts for specialized services, such as speech therapy. However, the district does not have policies requiring staff to analyze the value of those contracts and determine whether it would benefit from consolidating providers.

When we looked at Sacramento Unified's use of costly residential treatment programs for students receiving special education services, we identified a similar lack of adequate policies. Residential treatment programs involve students living at facilities where they receive special education and related services. These facilities may be in California, but they may also be in other states, depending on the needs of the students. However, Sacramento Unified has not adequately documented its efforts to ensure the residential treatment programs it uses are cost-effective. Specifically, state law requires the district to document its efforts to locate an appropriate residential treatment program within the State before sending a student out of state. Using in-state programs may reduce travel costs and keep children closer to their families. Sacramento Unified must report on its efforts to place students to the California Department of Education and include the costs of the special education that out-of-state facilities provide. However, we found that Sacramento Unified's documentation contained minimal analysis. In fact, in one case, it was evident that the district had copied language for this analysis from a prior form, as the analysis listed a different child's name. Further, although the district prepared the documentation, the California Department of Education confirmed that Sacramento Unified had not actually submitted this required documentation to it.

Finally, despite a decline in its funding for special education, Sacramento Unified has not applied for all the special education funding available to it. Specifically, the State reimburses entities for extraordinary costs of special education placements and has set aside \$3 million annually for this purpose. Although Sacramento Unified has had 12 or fewer students per year requiring such placements since fiscal year 2013-14, these placements have cost an average of more than \$100,000 per year per student. According to the special education director at the district, it has

***Sacramento Unified has not adequately documented its efforts to ensure the residential treatment programs it uses are cost-effective.***

not applied for the available funding because the State caps the total reimbursement amount it will pay statewide. However, we calculated that Sacramento Unified could have been eligible for up to \$1.4 million in reimbursements during the five-year period we reviewed. After we brought this issue to the district's attention, in November 2019, the district applied for reimbursement for three placements from fiscal year 2018–19 that could result in about \$273,000 in additional funds. Considering its deteriorating financial situation, Sacramento Unified cannot afford to fail to request any funding that may be available to it.

*We calculated that Sacramento Unified could have been eligible for up to \$1.4 million in reimbursements during the five-year period we reviewed.*

Sacramento Unified hopes to reduce its special education costs through early intervention, but its efforts are unlikely to have immediate effect on its current financial crisis. According to the district superintendent, increasing efforts to promptly identify students who may require special education services and providing early intervention could deter the classification of students as having special needs. However, increasing the intervention services Sacramento Unified provides will not reduce the number of students to whom it currently provides special education services; thus, it will not realize any immediate cost savings.

### **Sacramento Unified Lacks Consistent Leadership and Adequate Budget Policies, Limiting Its Ability to Effectively Manage Its Finances**

Sacramento Unified has not taken adequate steps to address the organizational issues, such as management turnover, that are limiting its ability to make viable strategic decisions and to manage its finances effectively. According to board leaders, the district's high turnover in key management positions over the last six years has affected its ability to make progress in addressing its financial condition. For example, as we discuss previously, the district has failed to implement changes to its health care costs despite repeated warnings. When key leaders change, established policies can provide guidance to staff in the interim; however, Sacramento Unified lacks such policies. Without consistent leadership and guidance, the district will likely struggle to make the difficult organizational decisions necessary to address its systemic financial problems.

Sacramento Unified has experienced significant turnover of its key leaders and has not used strategies that would help mitigate such turnover. It hired its current superintendent in July 2017, and the former superintendent served for less than three years. During the current superintendent's tenure, Sacramento Unified has had three chief business officers, with the current one hired in September 2019. From April 2019 through September 2019, the district paid a financial consultant to fill a role similar to that

of chief business officer. In comparison, most of the other school districts we reviewed have had only one or two superintendents and chief business officers during the past five years.

To address its high turnover, we expected that Sacramento Unified would have developed a succession plan or other strategies; however, that was not the case. A succession plan helps to ensure that an agency has a talented and competent workforce and that the agency can mitigate the loss of institutional knowledge when it experiences attrition. The U.S. Office of Personnel Management suggests that as part of a succession plan, an agency should develop orientation and mentorship programs that help adapt individuals to its culture. According to Sacramento Unified's chief human resources officer—who is one of its few long-tenured, executive-level staff—the district could increase its retention of key management by improving its onboarding process. For example, to better transition individuals into its culture, Sacramento Unified should, when possible, provide time for new managers to work with the managers whom they are replacing. However, Sacramento Unified has not used a succession plan or mentorship programs to address its turnover. Further, a board member stated that past boards were not clear on their goals, in one case hiring a superintendent who may not have intended to stay long term.

***Sacramento Unified's failure to create and maintain comprehensive budget policies and procedures has exacerbated the problems resulting from its lack of consistent leadership and have contributed to its inability to manage its growing costs effectively.***

Sacramento Unified's failure to create and maintain comprehensive budget policies and procedures has exacerbated the problems resulting from its lack of consistent leadership and has contributed to its inability to manage its growing costs effectively. The Government Finance Officers Association recommends that school districts go through certain steps in their budgeting process, such as developing policies for long-term forecasting and using performance measures to assess how well services are executed. Sacramento Unified has a district budget procedure, a board budget policy, and a board administrative regulation on budget development. However, these documents provide only broad guidance for developing budgets. Specifically, they state that the district shall prepare its budget annually using the best possible estimates that individual schools and administrative staff can provide, that the district shall develop its budget in accordance with standards and criteria for fiscal accountability adopted by the State Board of Education, and that it will use a series of budget assumptions to project the budget. They do not provide details regarding how Sacramento Unified will perform each of these steps, including the reasoning and key assumptions the district will use when making its budget decisions and developing its multiyear projections. For example, in its fiscal year 2019–20 budget, Sacramento Unified included contract savings of \$485,000 from services not needed, but it did not describe what those services were and why they are no longer necessary.



Because Sacramento Unified's broad policies provide only high-level guidance, we asked the individual who served as the district's budget director until July 2019 to provide a description of its budget development practices. As of October 2019, Sacramento Unified did not have a budget manager. According to the former budget manager, its practices include estimating revenue based on attendance and performing a staffing analysis at each school site to determine the necessary number of teachers. She further stated that Sacramento Unified's cabinet, composed of its executive management, also makes budget recommendations, which are subject to board approval. In a December 2018 fiscal health risk analysis of the district, FCMAT identified the inadequacies in Sacramento Unified's budget practices. Specifically, it noted that the district needed to develop a comprehensive budget development process to ensure its management understands all revenues and expenditures and that they direct expenditures to support the district's goals and objectives.

Because Sacramento Unified has not developed guidance regarding the need to document its reasoning and key assumptions for its budget decisions, it lacks a starting point for explaining to the public the differences between its budgets and its spending. In reviewing its budgets, we observed large variances in its budgeted and reported actual revenues and expenditures. For example, in fiscal year 2017–18, Sacramento Unified reported it spent \$16 million, or 64 percent, more on contracted services than it budgeted. We expected that Sacramento Unified would have investigated such variances and incorporated its findings into its budgetary guidance to increase the accuracy of its future revenue and expenditure projections. However, it did not do so, likely in part because it has no procedures requiring staff to determine the causes of large variances. Moreover, it could not provide explanations for many of the variances we identified, further demonstrating its lack of a thorough budget process. If its budget projections are not accurate, Sacramento Unified risks spending more than expected and reaching fiscal insolvency sooner than its current projection. Further, its ability to explain significant variations is critical to ensuring the public's confidence in its projections.

In fact, Sacramento Unified has been unable to provide documentation of the rationale it used to develop many of the revenue and expenditure estimates in its three-year projections. State law requires districts to use a standardized form to submit their budgets to allow for ease of comparison. The form includes a three-year financial projection and asks for the disclosure of assumptions used to determine the projections for the two subsequent fiscal years. For example, the user guide for the standardized form states that districts should identify any significant cost increases that will impact their budgets.

*Sacramento Unified has been unable to provide documentation of the rationale it used to develop many of the revenue and expenditure estimates in its three-year projections.*

***Sacramento Unified's lack of a documented methodology and key assumptions explaining its rationale for its multiyear projections is troubling because flawed assumptions could mean it may become insolvent sooner than it expects.***

Although the district anticipates a \$3.9 million cost increase for books and supplies from fiscal years 2019–20 through 2020–21, it did not identify this increase in its budget assumptions. The district hired a consultant in April 2019 that helped develop its multiyear projections for fiscal years 2019–20 to 2021–22, which the board adopted in October 2019. However, it still has not publicly disclosed many of the assumptions it used to develop the projections. Sacramento Unified's current chief business officer started in September 2019, and the district superintendent stated that he expects she will implement improved policies and procedures for budget development. Without adequate policies and procedures to inform the accuracy of its estimates of revenue and expenditures, the district cannot effectively plan for its future.

Sacramento Unified's lack of a documented methodology and key assumptions explaining its rationale for its multiyear projections is particularly troubling because flawed assumptions could mean it may become insolvent sooner than it expects. Its current three-year projection for fiscal years 2019–20 through 2021–22 indicates that it will largely deplete its general fund in October 2021 and become insolvent in fiscal year 2021–22. However, subsequent events have called that prediction into question. According to a consultant at Sacramento Unified, the district incorporated into its projection salary increases from the May 2019 arbitration we previously discuss. However, she stated that the district's salary costs may still increase as a result of late hires and corrections in individual employees' pay based on their experience and education. These increases in expenditures may move forward the date by which Sacramento Unified becomes insolvent.

Sacramento Unified typically creates its multiyear projections as part of its budget in June, and it updates them when it submits interim financial reports in December, March, and May. However, because the pending insolvency has such a large potential impact on the district, Sacramento Unified should update its multiyear projections when significant events occur, like the May 2019 arbitration results. Such updates will enable it to improve its financial planning and to provide better information to the public about its financial situation.

Consistent leadership and clear budget policies could also help Sacramento Unified to effectively use one-time funds. As we previously discuss, the Legislature appropriates these funds for a specific purpose and for a limited term, and they require subsequent legislation for their renewal. Thus, districts cannot anticipate receiving these funds in future years. However, Sacramento Unified used one-time funds from fiscal years 2016–17 through 2018–19 to pay for ongoing costs. By relying on one-time funds to pay for ongoing expenditures, the district risks being

unable to pay for such costs if these funds are not available in the future. For example, the district received \$7.1 million in one-time funds from the State in fiscal year 2018–19 that were designated for the professional development of teachers, among other uses. However, according to its budget, the district did not receive these funds in fiscal year 2019–20.

Further, in violation of state law, Sacramento Unified frequently failed to disclose its use of one-time funds. State law requires districts to disclose in their budgets if they intend to use one-time funds to pay for ongoing general fund expenditures in excess of 1 percent of their total general fund expenditures. Sacramento Unified used one-time funding in excess of 1 percent of its general fund expenditures in each year from fiscal years 2015–16 through 2018–19. However, it disclosed its use of one-time funds in only one year, fiscal year 2018–19. By not disclosing its use of one-time funds, Sacramento Unified has not ensured that its stakeholders are fully aware of the degree to which it has relied on these funds to pay for its ongoing expenses.

We asked the district superintendent why Sacramento Unified frequently used one-time funds to pay for ongoing expenditures and why it did not disclose their use in its annual budgets. He stated that former superintendents and budget officers might have decided to use one-time funds for ongoing expenses because of a variety of factors; however, he acknowledged that this was not a best practice. He also stated that going forward, he intends to avoid funding ongoing expenditures with one-time revenues.

### **The Current Proposals From Sacramento Unified and Its Teachers Union Are Unlikely to Resolve the District’s Financial Crisis**

Because Sacramento Unified agreed to significant salary increases in its 2017 contract with the teachers union and failed to adequately control its rising health care and retiree benefit costs through negotiations, it must now make more dramatic budget reductions to establish and maintain fiscal solvency. The district has recently made some reductions to its ongoing spending that are not dependent on negotiations, such as layoffs of administrators and teachers in excess of required student-to-teacher ratios. However, it is unlikely that it will be able to resolve its current difficulties without negotiating with its labor partners. In fact, according to Sacramento Unified’s superintendent and board president, it cannot make budget reductions independently of labor negotiations without a catastrophic negative impact on students.

*In violation of state law, Sacramento Unified frequently failed to disclose its use of one-time funds.*

***It is imperative that Sacramento Unified and its teachers union work together to agree to a solution, which they have not yet done.***

Sacramento Unified's options for reducing ongoing expenses without engaging in labor negotiations are limited and unlikely to prove successful in addressing its precarious financial situation. For example, it could close schools and remove bus routes. However, if it closes a school, it may lose students—and the revenue associated with those students—either to other districts or to a charter school that could begin operating in the school's facilities. In 2013 Sacramento Unified conducted an analysis of the fiscal impacts of closing 11 schools and found that it would only save the district approximately \$2.5 million per year, or about \$230,000 per school. Moreover, according to Sacramento Unified, 78 of its 91 bus routes serve students who receive special education services, while it maintains some of the other 13 routes because of safety concerns, such as crossing railroad tracks. As a result, closing schools and removing bus routes are unlikely to generate the savings needed to resolve Sacramento Unified's financial problems and could create new problems for students and their families.

Because it lacks other options, it is imperative that Sacramento Unified and its teachers union work together to agree to a solution, which they have not yet done. The teachers union and Sacramento Unified have each recently made proposals regarding the district's budget; however, these proposals have limitations and are unlikely to fully address the district's financial problems. In June 2019, the teachers union offered a proposal that included suggestions to stabilize Sacramento Unified's fiscal status. However, these suggestions would not resolve the district's long-term fiscal problems, and some would worsen the current deficit. For example, the union suggests rescinding layoffs of teachers, as well as certain classified staff. Doing so would result in dramatic increases in the district's ongoing spending—in this case, an estimated increase of about \$14 million in its ongoing expenditures beginning in fiscal year 2019–20.

Further, the teachers union suggested adopting the nonbinding class size reduction goals for grades 4 to 12 included in the 2017 contract. As Table 3 shows, if Sacramento Unified were to hire additional certificated staff and rehired laid-off teachers to achieve the staffing goals the union proposed, it would add at least another \$26.9 million in ongoing spending starting in fiscal year 2019–20. In total, implementing the union's staffing proposals would increase ongoing district expenditures by at least \$36.7 million—the cost of hiring the additional staff to meet the class size reduction goals plus rehiring classified staff not covered by the class size goals.

**Table 3**  
**In Its 2019 Budget Proposal, the Teachers Union Suggested Lowering Class Sizes, Which Would Result in Additional Costs**

GRADES/SUBJECTS	CURRENT MAXIMUM (STUDENT:TEACHER)	PROPOSED MAXIMUMS (STUDENT:TEACHER)	ADDITIONAL TEACHERS REQUIRED (FULL TIME EQUIVALENTS)	COST OF THE CHANGE (IN MILLIONS)
K-3	24:1	24:1	0.00	\$0
4-6	33:1	24:1	108.82	8.9
7-8	31:1	24:1	65.34	5.4
9-12: English, Math, Social Science, and Science	35:1	28:1	43.16	3.6
9-12: All other subjects	32:1	35:1	(14.16)	(1.2)
Special Day Class: Elementary—Mild to Moderate Needs*	15:1	12:1	3.65†	1.6
Special Day Class: Elementary—Moderate to Severe Needs*	13:1	8:1		
Special Day Class: Secondary*	16:1	12:1		
School Nurses	35.00 FTEs	750:1	19.21	1.6
Librarians	11.60 FTEs	One for every secondary school except opportunity schools	7.40	0.6
Program Specialists	1,100:1	500:1	44.36	4.8
Psychologists	None	1,000:1; no more than two schools per psychologist	7.50	0.8
Behavioral Specialists	None	No more than five schools per specialist	9.60	0.8
<b>Total</b>			<b>310.11</b>	<b>\$26.9</b>

Source: June 2019 teachers union budget proposal and previous teachers union bargaining agreements.

Note: For the purposes of calculating the cost of the increased staffing, we assumed Sacramento Unified would need to hire the full number of teachers between the current and proposed requirements and that the newly hired staff would be at the lowest salary amount.

\* Special day classes provide services to students with more intensive needs whose individual education plans require attendance in special education for the majority of the school day. The students are grouped according to similar instructional needs.

† The additional teachers for elementary special day classes were all calculated at the mild/moderate needs rate.

The teachers union proposal contains other suggestions that could result in some level of savings but are unlikely to be viable in the long term. For example, the union proposed reducing Sacramento Unified’s contributions to retiree health benefit liabilities to only the amount due in the current year. We estimate this would result in savings of about \$7 million from fiscal years 2019–20 through 2021–22—considerably less than the \$25.5 million over the same period the teachers union asserted in its proposal because the union appears to have used outdated information for its calculations. Because Sacramento Unified expects the annual cost of retiree health benefits to increase over the next several years, the amount of savings generated from this proposal would diminish over

time. Moreover, decreasing the amount of its contributions toward retiree health benefits in the short term would increase the amount Sacramento Unified would need to contribute over the long term, making this a poor option for resolving its ongoing budget problems.

We identified concerns with many of the teachers union's other suggestions as well. For example, it suggested reducing pay by 20 percent for those administrators with annual salaries exceeding \$120,000. We estimate that this change, including a 20 percent reduction in the superintendent's salary, could save Sacramento Unified about \$3 million annually, including decreased district contributions toward employee pensions. However, the superintendent stated that he believes such a change may cause employee retention problems. In addition, most of the district administrators with salaries exceeding \$120,000 are represented by United Professional Educators, Sacramento Unified's labor union for certificated management staff. The district would need to negotiate any salary reductions for those employees with their labor union. If one removes represented employees from the calculation above, the union's suggestion would only result in about \$1 million in annual ongoing savings.

Another suggestion by the teachers union might result in savings but involves a greater amount of uncertainty. Specifically, the union suggested reducing contract expenditures by 10 percent, which we estimate could result in savings of \$5 million annually. However, it is unclear whether Sacramento Unified would be able to reduce its contract expenditures by that amount, in part because nearly half of its contracts are for special education services. Although the district has some discretion as to how and where it provides such services, it must provide appropriate facilities, education, or designated instruction and services required by students with exceptional needs, and it may contract with agencies to provide these services when no appropriate public option is available. In addition, reducing its contract services might require Sacramento Unified to hire additional staff to provide the contracted services, potentially further increasing costs.

It is also unclear whether Sacramento Unified could reduce its other contract expenses by 10 percent. In fiscal year 2019–20, it budgeted about \$26 million for services and other operating expenditures. About 40 percent of those costs are for essentials like water and electricity. Although the teachers union's suggestion specifically mentions outside legal expenses, Sacramento Unified budgeted about \$3 million for this type of service. If it were to cut these legal expenditures by 10 percent, it would save only about \$300,000 annually.

***Sacramento Unified made an initial proposal in August 2019 to its teachers union that could result in significant savings, but its suggested actions would require significant concessions from the union.***

Sacramento Unified made an initial proposal in August 2019 to its teachers union that could result in significant savings, but its suggested actions would require significant concessions from the union. For example, the district suggested capping the amount it

pays towards health benefits for employee-only plans at the rate of the lowest-cost health plan and capping contributions for employee-plus-one and family plans at 75 percent of the lowest cost plan rate. This suggestion would cause Sacramento Unified's teachers to contribute an amount similar to the amounts teachers contribute at nearby districts, which generally cover between 75 percent to 85 percent of the lowest-cost employee-plus-one plans and 75 percent to 80 percent of the lowest-cost family plans. We estimate that implementing this change could result in \$15.7 million in annual savings.

Sacramento Unified also suggested that teachers union members increase their monthly contributions to the cost of their future retiree health benefits. However, unless the district reduces the amount it contributes in accordance with the amount of increased employee contributions, this proposal would not result in short-term savings. If Sacramento Unified did reduce its contributions by the total amount of increased employee contributions, this change would result in immediate savings but would be unlikely to decrease its growing liability for retiree healthcare costs.

Both of Sacramento Unified's suggestions require negotiations with its teachers union. The 2017 labor agreement we previously discuss expired in June 2019. From November 2018 through October 2019, Sacramento Unified sent 16 letters to the teachers union requesting a first meeting to negotiate a successor contract; however, as of October 2019, the union had refused to meet. The county office superintendent also noted that the union has not agreed to collaborate or come to the bargaining table to discuss the district's proposals and indicated that the hostile relationship between the union and the district has impeded progress in making the district into a strong, high-functioning organization. However, the teachers union has raised a number of concerns it wants the district to address before beginning negotiations, including staffing concerns and payments related to the 2017 labor agreement. The union has asserted that Sacramento Unified should not expect to negotiate a new agreement when it has not fulfilled its obligations according to the last agreement. As we discuss earlier, the district has stated that it will make outstanding payments for the salary schedule adjustment in November 2019.

Ultimately, the district is responsible for finding a way to work with its teachers union to maintain ongoing fiscal solvency. However, if Sacramento Unified cannot obtain concessions, it may need to take unilateral action to avoid insolvency. State law allows a public school employer to unilaterally implement the last offer made to its union upon reaching an impasse if Employment Relations declares that the parties are at impasse following good-faith efforts

*The teachers union has raised a number of concerns it wants the district to address before beginning negotiations, including staffing concerns and payments related to the 2017 labor agreement.*

to negotiate. However, once an impasse is declared, a union also gains the right to strike if a district attempts to impose terms of employment. Because the length of negotiations can vary, it is not clear when Sacramento Unified would need to impose those terms to avoid insolvency.

### **Unless Sacramento Unified Acts Quickly, It Is Unlikely to Resolve Its Financial Crisis Before the Need for State Assistance**

As a result of agreeing to raises that it could not afford and of repeatedly failing to adequately contain its costs, Sacramento Unified may need to request state assistance in the near future. The district projects that it will run deficits in the next several years and largely deplete its general fund in October 2021. In order to avert the projected deficits, it should have already made the cuts necessary to remain fiscally solvent. However, it has not done so, and it lacks a plan for doing so. If Sacramento Unified determines it has insufficient funds to meet its current obligations, state law allows it to request an emergency loan from the State. If the loan is large enough, an administrator will be appointed who will assume the role of the district's board and superintendent. Under these circumstances, Sacramento Unified's employees and students will both likely face numerous, negative repercussions.

***If Sacramento Unified needs to take state assistance, it will mean fewer funds available for student education because of interest payments on the loan and the cost of hiring an administrator, among other expenses.***

If Sacramento Unified needs to take state assistance, it will mean fewer funds available for student education because of interest payments on the loan and the cost of hiring an administrator, among other expenses. According to the fiscal adviser assigned by the county office superintendent, school districts usually borrow the amount they need to cover their ongoing structural deficits for three years. The loan amounts and the subsequent annual costs vary depending on the district's ongoing deficit spending, fund balance, and cash balances at the time it requests the loan. Further, interest rates at the time a loan is taken may affect annual costs. Based on a loan of \$80 million, which is about the sum of the district's projected general fund deficits over the next three years, and assuming that the district makes no changes in its spending, Sacramento Unified could pay about \$5 million annually toward principal and interest on the loan. Further, the total interest on the loan could amount to \$21 million over the 20-year life of the loan, funds lost to the district.

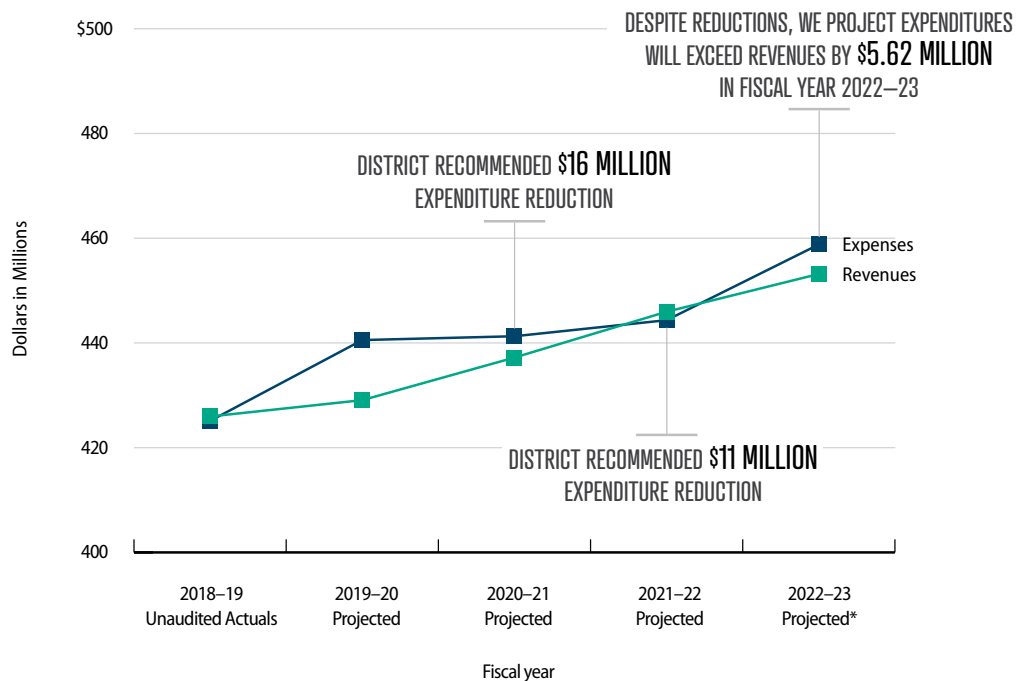
In addition, state law requires the district to take on additional costs if it accepts a loan, including paying for annual reviews by FCMAT and hiring an administrator. According to an intervention specialist at FCMAT, each FCMAT review would likely cost between \$250,000 and \$325,000 while the administrator would likely cost between \$225,000 and \$275,000 annually. However, the costs of hiring the



administrator might be mitigated because state law requires the district to release its superintendent if an administrator is appointed and caps the severance pay for the superintendent at six months.

Given the implications of accepting state assistance, we expected Sacramento Unified to have developed a detailed plan for resolving its financial concerns. In its most recent fiscal year 2019–20 budget, which it submitted in October 2019, Sacramento Unified states that it needs to make \$27 million in ongoing expenditure reductions—\$16 million in fiscal year 2020–21 and \$11 million in fiscal year 2021–22—to eliminate its deficit spending. However, as of October 2019, the only substantial cost-savings proposal it has put forward is reducing teachers’ health benefits through negotiations. As we discuss above, this change would save the district \$15.7 million. Sacramento Unified projects that the \$27 million in reductions it needs to make would result in it having \$20,000 more in ongoing revenue than ongoing expenditures in fiscal year 2021–22. However, as Figure 9 shows, these reductions alone would likely not be sufficient for it to avoid continued deficit spending in fiscal year 2022–23.

**Figure 9**  
**Sacramento Unified’s Recommended Expenditure Reductions May Not Be Sufficient to Prevent Insolvency in Future Years**



Source: Sacramento Unified’s October 2019 budget proposal and auditor calculation.

Note: Expenditures and revenues tend to increase each year regardless of a district’s action. For example, costs rise because employees’ pay increases with additional experience. Revenues may increase because of cost-of-living adjustments included in state funding. Overall, Sacramento Unified’s expenditures are increasing at a faster rate than its revenue.

\* We projected fiscal year 2022–23 by trending the revenues and expenditures Sacramento Unified presented for fiscal years 2018–19 through 2021–22.

Sacramento Unified has not yet adopted a detailed plan to resolve its fiscal crisis. In Figure 10, we present the potential savings of several options that Sacramento Unified could take to eliminate its structural financial problems. For example, Sacramento Unified currently provides higher salaries and health benefits than other nearby districts and it requires teachers to pay only \$20 per month to fund their retiree health benefits. Recently, the Service Employees International Union representing state employees reached a tentative agreement for those employees to contribute a total of 3.5 percent of their salaries to retiree health benefits by July 2020. If Sacramento Unified reduced all employee salaries by 2 percent, capped health benefits for all employees at 90 percent of the cost of the lowest-price plan, and required teachers to pay 3.5 percent of their salaries toward their retiree health benefits, the district could reduce its ongoing costs by \$28 million annually.

However, these changes still may not be sufficient to eliminate Sacramento Unified's deficit spending and avoid insolvency. Sacramento Unified and its board will need to make difficult choices to address the district's structural financial issues, and they will need to act quickly if they wish to avoid the difficulties inherent in accepting an emergency loan from the State and appointment of an administrator. Using the type of analysis we present here as a foundation, Sacramento Unified will also need to negotiate a plan with its teachers union for the benefit of the district, its employees, and—most importantly—its students.

**Figure 10**  
Sacramento Unified Has Options for Avoiding Insolvency

**The information below represents estimated potential savings based on available district documentation**

<b>POTENTIAL CHANGES TO SALARIES</b>	<b>POTENTIAL SAVINGS</b>
→ Cut all salaries by 2%	\$6,854,000
Cut only teacher salaries by 2%	\$4,704,000
Cut only classified salaries by 2%	\$1,361,000
Cut only administrator salaries by 2%	\$789,000
<b>POTENTIAL CHANGES TO RETIREE HEALTH BENEFITS</b>	
→ Teachers pay 3.5 percent of salary toward retiree health benefits*†	\$7,064,000
All staff pay 3.5 percent of salary toward retiree health benefits†	\$9,997,000
<b>POTENTIAL CHANGES TO HEALTH CARE BENEFITS</b>	
<i>CHANGES AFFECTING TEACHERS HEALTH CARE BENEFITS</i>	
Cap district payment at lowest-cost plan for employee-only and family plans	\$7,867,000
Cap district payment at lowest-cost plan for employee-only plans and 75 percent for family plans	\$15,682,000
<i>CHANGES AFFECTING ALL EMPLOYEES HEALTH CARE BENEFITS</i>	
→ Cap district payment at 90 percent of the lowest-cost plan for employee-only and family plans	\$14,078,000
Cap district payment at 80 percent of the lowest-cost plan for employee-only and family plans	\$20,419,000

Source: Sacramento Unified's financial records and health plan rate sheets.

\* Teachers currently pay \$20 per month toward retiree health benefit costs, or about 0.3 percent of their average salary.

† These changes would not result in immediate savings unless Sacramento Unified reduced its contributions by the amount of the increased employee contribution.

## Recommendations

### *Legislature*

To help ensure that county office superintendents can prevent school districts under their oversight from becoming insolvent, the Legislature should consider amending state law to require school district boards to obtain approval from their county office superintendents before considering actions that would result in expenditures that exceed 200 percent of their required reserve amount. County office superintendents should disapprove any district action that they determine would cause school districts to do either of the following:

- Project insolvency within the current fiscal year or two subsequent fiscal years.
- Rely on reserves or other one-time resources, such as one-time funds from the State, to remain solvent within the current fiscal year or two subsequent fiscal years.

To help ensure that school district boards are accountable for the costs they approve, the Legislature should consider amending state law to require those boards to certify the district's ability to meet the costs disclosed in each collective bargaining agreement.

### *Sacramento County Superintendent of Schools*

To ensure that Sacramento Unified takes the steps necessary to address its fiscal crisis, the county office superintendent should do the following:

- Direct Sacramento Unified to submit a corrective action plan by March 2020 that consolidates the district's plans to resolve its fiscal crisis.
- Ensure that Sacramento Unified addresses the issues identified in this report, including its executive management turnover and lack of policies guiding its budget process.
- Ensure that Sacramento Unified implements all of the recommendations detailed below.

### ***Sacramento Unified***

To address its current financial problems, Sacramento Unified should do the following:

- By March 2020, adopt a detailed plan to resolve its fiscal crisis. The plan should estimate savings under multiple scenarios and include an analysis that quantifies the impact of reductions the district can make to ongoing expenditures. Specifically, Sacramento Unified should consider the impact of possible salary adjustments for employees in different bargaining units and include the impact those salary adjustments would have on postemployment benefits, such as pensions. It should also use the most recently available data to estimate net savings from modifying the health care benefits it provides to employees, as well as the impact those modifications would have on the total compensation of the employees. Finally, it should calculate the impact of possible changes to district and employee contributions to fund future retiree health benefits. The district should use the plan it develops as the basis for its discussions of potential solutions with its teachers union.
- Revise its multiyear projections and update them at least quarterly until it has taken action that would cause it to no longer project insolvency. It should disclose these projections to the board.
- The district should adopt and disclose publicly a multiyear projection methodology. This methodology should disclose the assumptions and rationale used to estimate changes in salaries, benefits, contributions, and LCFF revenue—including changes in enrollment and the source and reliability of the data used to make these projections.
- Before it imposes an agreement on its teachers union or accepts state assistance, the district should publicly disclose the likely effects that such actions will have on the district's students, faculty, and the community, and its plans to address these effects.

To prevent a similar fiscal crisis in the future, Sacramento Unified should do the following by July 2020:

- Have the board adopt a budget methodology, including guidance on the use of one-time funds, the use and maintenance of district reserves, and the maintenance of a balanced budget. The methodology should use the Government Finance Officers Association's best practices as a guide and should address at least the following areas:

- Including administrators from different divisions of Sacramento Unified into the budget development process to help ensure the accuracy of projections.
  - Establishing criteria and measures for success in the budget process, such as whether budget decisions were made with adequate input and deliberation and whether the budget was balanced without using reserves or one-time revenues for ongoing expenditures.
  - Developing and adhering to a multiyear funding budget plan, with the goal of realigning resources where necessary to fund ongoing expenses with ongoing revenue.
  - Conducting an analysis of variances in budgeted and actual revenues and expenditures at each interim reporting period. Sacramento Unified should then use this information to inform its estimates for the upcoming fiscal year's budget.
- Develop a long-term funding plan to address its retiree health benefits liability. The plan should include appropriate action necessary to ensure the district will be able to meet its obligations to its employees and retirees.
  - Adopt a policy that guides staff on steps they should take to ensure that special education expenditures are cost-effective. The policy should include consideration of options for offering services, including those provided by district staff or by contracted providers.
  - Annually apply for available state funding for its extraordinary special education costs.
  - Develop and adopt a succession plan that ensures that it has staff who have the training and knowledge necessary to assume critical roles in the case of turnover.
  - Develop effective employee orientation programs, including mentorship, to allow incoming leaders to better adapt to the organization's structure and culture.

We conducted this audit under the authority vested in the California State Auditor by Government Code 8543 et seq. and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE, CPA  
California State Auditor

December 10, 2019

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# Appendix

## Scope and Methodology

The Joint Legislative Audit Committee (Audit Committee) directed the California State Auditor to conduct an audit of Sacramento Unified. Specifically, it directed us to review Sacramento Unified’s fiscal health and budgeting practices. The table below lists the objectives that the Audit Committee approved and the methods we used to address those objectives.

### Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
<p>1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.</p>	<ul style="list-style-type: none"> <li>Reviewed relevant laws, rules, regulations, guidelines, and policies related to the financial and operational administration of school districts.</li> <li>Interviewed key staff at Sacramento Unified who oversee the administration of the district, including staff in the finance, human resources, and special education departments.</li> </ul>
<p>2 Determine the scope of Sacramento Unified’s short-term and long-term financial problems.</p>	<ul style="list-style-type: none"> <li>Reviewed and analyzed Sacramento Unified’s financial information including budgets, interim financial reports, and audited financial statements.</li> <li>Interviewed key staff at Sacramento Unified in the finance department.</li> </ul>
<p>3 Review Sacramento Unified’s revenues, expenditures, and budget projections for the last five years to determine the following:</p> <ol style="list-style-type: none"> <li>Which actions that Sacramento Unified took or failed to take that were the primary causes of its current financial crisis.</li> <li>Which of Sacramento Unified’s key decisions caused the financial crisis, who made those key decisions, and why those decisions were made.</li> <li>Whether Sacramento Unified took reasonable actions to reduce its budget shortfalls.</li> <li>What Sacramento Unified needs to do to resolve both the immediate financial crisis and the root causes of the crisis.</li> </ol>	<ul style="list-style-type: none"> <li>Reviewed documentation and interviewed key staff to identify primary causes and key decisions relating to areas of concern, including labor agreements, employee benefit costs, special education, and executive turnover.</li> <li>Reviewed the actions the district has taken to address its budget shortfalls.</li> <li>Reviewed documentation and interviewed key staff and leadership to identify the root causes of the financial crisis and identify methods to resolve those causes.</li> <li>Reviewed documentation from nearby comparable districts regarding finances, labor agreements, salaries, and benefits, and we compared Sacramento Unified’s actions in these areas with those of the selected districts.</li> <li>Evaluated proposals from Sacramento Unified and its teachers union regarding the district’s budget.</li> <li>To identify options Sacramento Unified could take to help resolve its immediate financial crisis, we made projections of the savings that the district could expect if it implemented certain spending changes.</li> </ul>
<p>4 Determine what financial or budgeting practices Sacramento Unified needs to improve to avoid this situation in the future.</p>	<ul style="list-style-type: none"> <li>Reviewed Sacramento Unified budgeting practices.</li> <li>Reviewed best practices to identify areas where Sacramento Unified should improve its budgeting practices.</li> </ul>
<p>5 Evaluate the recommendations made by the county office superintendent and Sacramento Unified’s response to those recommendations.</p>	<ul style="list-style-type: none"> <li>Although the county office superintendent did not make formal recommendations to Sacramento Unified about how to resolve its financial problems, we reviewed the guidance it provided to the district and whether and how the district implemented that guidance.</li> <li>Reviewed guidance provided to Sacramento Unified by other third-party organizations, including FCMAT, and determined how the district applied that guidance.</li> </ul>

*continued on next page...*

AUDIT OBJECTIVE	METHOD
6 Determine what Sacramento Unified is doing in the short term to minimize the budget reductions impact on its students.	Reviewed actions taken by Sacramento Unified to address its fiscal condition, including layoffs of staff.
7 Review and assess any other issues that are significant to the audit.	<ul style="list-style-type: none"> <li>• Because of the importance of its multiyear projections in guiding Sacramento Unified's decision making, we reviewed its use and preparation of these projections.</li> <li>• Reviewed the impact accepting a loan from the State would have on students.</li> </ul>

Source: Analysis of the Audit Committee's audit request number 2019-108, and information and documentation identified in the table column titled Method.

### ***Assessment of Data Reliability***

In performing this audit, we relied on electronic data files that the California Department of Education makes publicly available. These electronic data files relate to school district salaries and benefits for certificated staff. The U.S. Government Accountability Office, whose standards we are statutorily obligated to follow, requires us to assess the sufficiency and appropriateness of computer-processed information we use to support our findings, conclusions, or recommendations. To perform this assessment, we relied on accuracy and completeness testing that the California Department of Education has completed. In addition, we conducted logic testing to ensure that the data in the electronic data files were appropriate and consistent with information that Sacramento Unified published in its budget and audited financial documents. Based on that assessment, we considered the information sufficiently reliable for our purposes.

We also relied on information from Sacramento Unified's accounting system. To assess the sufficiency and appropriateness of this information, we compared the information to the district's audited financial statements. Based on that assessment, we considered the information sufficiently reliable for our purposes.

# Sacramento Office of Education County

MAILING: P.O. Box 269003, Sacramento, CA 95826-9003  
PHYSICAL LOCATION: 10474 Mather Boulevard, Mather, CA  
(916) 228-2500 • [www.scoe.net](http://www.scoe.net)

David W. Gordon  
Superintendent

November 14, 2019

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California State Auditor's Office  
621 Capitol Mall, Suite 1200  
Sacramento, CA 95814

**SUBJECT: Sacramento County Superintendent of Schools Response  
to Audit Report 2019-108, Sacramento City Unified School District**

Dear Ms. Howle:

I appreciate the opportunity to respond to the California State Auditor's report, entitled "Sacramento City Unified School District." This letter includes my response to the audit report recommendations.

Sincerely,



David W. Gordon  
Sacramento County Superintendent of Schools

DWG/TS/ds



\* California State Auditor's comments begin on page 49.

Elaine M. Howle, California State Auditor  
November 14, 2019  
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## County Superintendent's Response to Recommendations

### Audit Recommendations

*To ensure that Sacramento Unified takes the steps necessary to address its fiscal crisis, the county superintendent should do the following:*

- *Direct Sacramento Unified to submit a corrective action plan by March 2020 that consolidates the district's plans to resolve its fiscal crisis.*
- *Ensure that Sacramento Unified addresses the issues identified in this report, including its executive management turnover and lack of policies guiding its budget process.*
- *Ensure that Sacramento Unified implements all of the recommendations detailed below.*

### Response from the Sacramento County Superintendent of Schools

- ① The recommendation requires legal authority not granted to the County Superintendent. The school district governing board is independent from the County Superintendent of Schools, and the County Superintendent's authority to intervene in district financial matters is extremely narrow. When districts have disapproved budgets or negative interim report certifications, the County Superintendent does have increased authority, but this authority is still specifically limited by statute. The County Superintendent has no legal authority or mandate to "guarantee" or "ensure" that the district implements the report recommendations.
- ②
- ①
- ③ **Response to Bullet #1:** In December 2017, the Sacramento County Superintendent of Schools warned the Sacramento City Unified School District (SCUSD) Board against approval of the July 1, 2016 to June 30, 2019 Collective Bargaining Agreement between SCUSD and the Sacramento City Teachers Association (SCTA), unless the district provided a detailed budget reduction plan for solving the district's on-going structural deficit. Since then, the County Superintendent has requested a corrective action plan from the district nine additional times. Most recently, on October 10, 2019, the County Superintendent again requested a viable board-approved budget, and a multi-year expenditure plan that would reverse the deficit spending trend. The district's response is due on December 16, 2019.

Elaine M. Howle, California State Auditor  
November 14, 2019  
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**Response to Bullet #2:** As noted above, the County Superintendent can request and recommend that the district address the issues identified in this report, including its executive management turnover and lack of policies guiding its budget process, and will monitor the district's progress in these areas. Under current law, the County Superintendent cannot require, mandate, or ensure that the district implement these recommendations.

①

**Response to Bullet #3:** As noted above, the County Superintendent can request and recommend that the district implement all the recommendations detailed below. Under current law, the County Superintendent cannot require, mandate, or ensure that the district implement the report recommendations.

①

In addition, the district has already determined the fiscal impact of potential budget reductions that do not require approval from its employee associations. However, long-term budget solutions on many items cannot be implemented until the district negotiates and reaches agreements with its employee associations. With the expiration of the teachers' contract, the district has initiated proposals for a new agreement. The County Superintendent does not have authority to require or ensure that the parties collaborate or engage in labor negotiations to achieve potential budget savings.

④

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## Comments

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE COUNTY OFFICE SUPERINTENDENT

To provide clarity and perspective, we are commenting on the county office superintendent's response to our audit. The numbers below correspond to the numbers we have placed in the margin of the county office superintendent's response.

The county office superintendent understates its legal authority. If the county office superintendent determines that a school district should receive a negative certification—meaning that the district's budget shows that it is unlikely to meet its financial obligations in the current or subsequent financial year—state law requires the county office superintendent to take certain actions, one of which is assisting the district in the development of a financial plan to meet the district's future obligations. As we note in Figure 4 on page 12, the county office superintendent has disapproved Sacramento Unified's budget several times due to the district projecting that it would not meet its financial obligations in the near future and has placed a fiscal adviser in the district to assist the district with its financial planning.

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The county office superintendent has substantial authority to intervene in district financial matters. For example, in Figure 4 on page 12 we note that the county office superintendent has stay-and-rescind authority and has a fiscal adviser in place to oversee district finances. The fiscal adviser works with the district to address its financial condition and if the district attempts to take an action that would be detrimental to its financial condition, the county office superintendent can use its stay-and-rescind authority to block the action. Because of its authority through the fiscal adviser, the county office superintendent would by necessity be involved in the district's development of a financial plan.

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Our recommendation to the county office superintendent is for it to ensure that Sacramento Unified develops a detailed plan to address its fiscal challenges. If the district does submit a corrective action plan, the county office superintendent should ensure that the plan includes the items we include in our recommendations, such as assessing the impact of changes to salary and benefits. Assisting the district in developing a plan ties directly to the county office superintendent's responsibilities. As we note on page 5, the county office superintendent is charged with reviewing and approving the district's budget. The district will need to have a plan if it is to develop a budget that the county office superintendent can approve.

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- ④ While the county office superintendent cannot compel parties to negotiate, most of the recommendations we ask the county office superintendent to ensure that Sacramento Unified implement do not require negotiations. For example, developing a plan to address the district's financial condition, revising its multiyear projections, and publicly disclosing its methodology does not require negotiations.





**OFFICE OF THE SUPERINTENDENT**

5735 47th Avenue • Sacramento, CA 95824

(916) 643-9010 • FAX (916) 399-2058

*Jorge A. Aguilar, Superintendent*

November 14, 2019

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Elaine M. Howle\*  
California State Auditor  
621 Capitol Mall, Suite 1200  
Sacramento, CA 95814

RE: Audit 2019-108

Dear Ms. Howle,

The Sacramento City Unified School District (“District” or “SCUSD”) wishes to express its appreciation for the work and professionalism of the audit team in conducting its audit of the District.

District leadership accepts many of the Auditor’s findings, including the finding that *“The School Board Approved Salary Increases for Its Teachers That It Could not Afford Without Making Offsetting Cost Reductions.”* The District made the decision to not cut services to its students and families to pay for the salary increases that averted a teachers strike. Addressing the budgetary impact of averting the strike requires bold and long-term solutions that will require us all to act in good faith and agree to make shared sacrifices for the benefit of students. The Auditor has confirmed that the solution is for leaders of both the District and the Sacramento City Teachers Association (“SCTA”) to negotiate a new agreement that will reduce health care and other labor costs and prevent a state takeover. The District remains committed to such a solution. We are ready to start negotiations and have submitted a proposal to SCTA leaders.

The District has also already begun to address many of the recommendations contained in the Audit Report (“Audit”). The State Auditor’s Office analysis is critical to furthering the District’s efforts to address its structural budget deficit, to help avoid a state takeover, and it provides credible independent confirmation of the seriousness of the District’s budget situation. The Audit also validates the fundamental budget data provided by both the District and the Sacramento County Office of Education which have been challenged by some stakeholders.

The following (*citations to Audit section headings in italics*) is the District’s Summary of the most important findings from the Audit which help provide the context and to frame the District’s Responses. In summary, the Audit:

- Confirms the District’s structural deficit projections and the amount of \$27 million in required cost reductions. (*See Unless Sacramento Unified Acts Quickly, It is Unlikely to Resolve Its Financial Crisis Before the Need for a State Takeover; Figure 7.*)

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\* California State Auditor’s comments begin on page 63.

- Confirms that expenditures have exceeded revenues since 2016-2017 and are projected to continue to do so resulting in a negative cash balance of \$7.5 million by 2021-2022, and considering the reserve amount required by state law, “Sacramento Unified faces a \$19.1 million shortfall at that time.” (See *Audit Results*, Figure 2; Figure 5.)
- ⑧
- Confirms that the 2017 Tentative Agreement with SCTA added \$31 million to the District’s ongoing expenditures (*The School Board Approved Salary Increases for Its Teachers That It could Not Afford Without Making Offsetting Cost Reductions.*)
  - States that “Sacramento Unified’s options for reducing ongoing expenses that do not involve labor negotiations are limited and unlikely to prove successful in addressing its precarious financial situation.” (*The Current Proposals from Sacramento Unified and Its Teachers Union Are Unlikely to Resolve the District’s Financial Crisis.*)
  - States that SCUSD cannot achieve cost savings large enough to balance its budget without addressing employee salaries, benefits, and contracts which mainly consist of Special Education service agreements. (*Audit Results.*)
- ⑨
- Confirms that SCUSD’s “enrollment declined by 978 students since 2013-14 through 2018-2019” and that declining enrollment has “contributed to its precarious financial situation.” (*Audit Results.*)
  - Highlights out that the District spends 80% of its total budget - restricted *and* unrestricted general fund - on employee salary and benefits. (*Id.* Figure 3.) This finding is consistent with the previously shared Fiscal Crisis and Management Assistance Team (FCMAT) finding that approximately 91% of the District’s *unrestricted* general fund has been expended on employee salary and health and welfare benefits. (See 2018 FCMAT Report at pg. 17, [https://www.scusd.edu/sites/main/files/file\\_attachments/sacramento\\_city\\_usd\\_fhra\\_final\\_12-12-2018\\_002.pdf](https://www.scusd.edu/sites/main/files/file_attachments/sacramento_city_usd_fhra_final_12-12-2018_002.pdf))
  - Recognizes that SCUSD provides its teachers with the highest salary and total compensation of the comparable districts in the region. Relatedly, the auditors observed that SCUSD’s spending for health and welfare benefits in 2017-2018 to its teachers exceeded that of Elk Grove Unified by \$13 million despite the fact that Elk Grove employs 950 more teachers. (*Sacramento Unified’s Spending on Employee Benefits Has Increased Significantly in the Past Five Years*; Tables 2 and 3.) Further, the auditors found that SCUSD pays the fourth costliest health plan in the State of California. (See *Top Five Costliest California School District Health Plans in 2018.*)
  - Confirms the unfunded liability for retiree health benefits - or “Other Post Employment Benefits (“OPEB”) - and that District employees’ contributions although recently

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established for all District employees - are currently insufficient to address this substantial unfunded liability. (*Sacramento Unified's Spending on Employee Benefits Has Increased Significantly in the Past Five Years.*)

- Highlights that the District has not addressed the critical matters of addressing its uncapped healthcare or insufficient OPEB contributions despite numerous warnings from outside entities in any of the six (6) Collective Bargaining Agreements (“CBA”) with the teachers union since 2003. (*Sacramento Unified's Spending on Employee Benefits Has Increased Significantly in the Past Five Years.*)
- Recognizes that budget solution ideas offered by leaders of the SCTA would not significantly address the District’s budget deficit, and in many cases would add additional millions in expenditures. (*The Current Proposals from Sacramento Unified and Its Teachers Union Are Unlikely to Resolve the District’s Financial Crisis.*)
- Suggests a variety of negotiable options to reduce the District’s structural deficit - namely health plan premium contribution limits, salary cuts, and increased employee contributions to fund retiree healthcare. (*Unless Sacramento Unified Acts Quickly, It is Unlikely to Resolve Its Financial Crisis Before the Need for a State Takeover, Figure 8.*)

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The Audit’s conclusions ultimately align with those of the District - namely that the primary solution to the District’s budget problems exists through negotiations with its labor partners, despite the fact that as the Audit also recognizes, the relationship between the District and its teachers union has not been productive and collaborative for many years.

### **Responses to Recommendations**

In order to provide additional context and clarification of some of these complex matters, the District provides the following response to specific findings and recommendations of the Audit.

The District Agrees With the Audit’s First Recommendation that “By March 2020, [SCUSD] adopt a detailed plan to resolve its fiscal crisis ...”

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The Audit correctly recognizes that any viable plan for the District to achieve fiscal stability and ultimately avoid a takeover will primarily require negotiated items involving employee compensation. The auditors recognize that SCUSD provides its teachers with the highest salary and total compensation of the comparable districts discussed in the Audit, and even observed that SCUSD’s spending for health and welfare benefits in 2017-2018 to its teachers exceeded that of Elk Grove Unified by \$13 million despite the fact that Elk Grove employs 950 more teachers. With regard to healthcare benefits, the Audit states that SCUSD pays the fourth highest healthcare premium rate of all school districts in the state, only slightly exceeded by three Bay Area districts. (*See Sacramento Unified's Spending on Employee Benefits Has*

*Increased Significantly in the Past Five Years; Table 3; Top Five Costliest California School District Health Plans in 2018.)*

In order for the District to bring its healthcare spending in line with comparable districts (as well as other state and local governments), we must overcome significant obstacles in the teachers union Collective Bargaining Agreement (CBA). The Audit observed that SCUSD “offers two health plan options to its teachers and pays the full cost of either plan for employees and their families. In comparison, other nearby districts generally limit the amount that they pay to the cost of the least expensive plan, pay the full cost only for the employee, or cover only 80 percent of the least expensive health plan’s costs for employees and their families.” (*Id.*)

Since the 1970’s the SCTA CBA has contained language requiring that a specific healthcare provider – HealthNet (or its predecessor) - be one of the plans offered to the District’s certificated members. The CBA also provides that the District must cover 100% of the employee and family plans of all plans offered by the District. This results in the District currently paying well over \$30,000 for any members that select the family HealthNet plan. (See Health Insurance Overview Presentation FTAC Committee, October 10, 2019, survey of school districts health care contributions available at: <https://www.scusd.edu/board-education-committee/fiscal-transparency-and-accountability-committee>). Decades ago, when healthcare plans were less expensive, these CBA provisions did not present a significant issue; however, with the rising costs of healthcare, this CBA language severely cripples the District. The Audit correctly observes that SCUSD has been warned repeatedly of its unaffordable health plans since 2003 by Fact Finding Panels and FCMAT, but, “Nonetheless, it did not include a limit on its contributions to health benefits for employees and their families in any of the six agreements it negotiated with its teachers union during these years.” (*Sacramento Unified’s Spending on Employee Benefits Has Increased Significantly in the Past Five Years.*)

The Audit recognizes that solving this problem requires collaboration with the District’s teachers union, noting that “From November 2018 through October 2019, Sacramento Unified sent 16 letters to the teachers union requesting a first meeting to negotiate a successor contract, however, as of October 2019, the teachers union had refused to meet.” (*The Current Proposals from Sacramento Unified and Its Teachers Union Are Unlikely to Resolve the District’s Financial Crisis.*) In fact, under a prior administration in 2014-15, the District sought to unilaterally remove HealthNet and move all bargaining units to the same lower cost plans, but had to halt this change due to a legal challenge by SCTA. As such, the District recognizes that any change to alter the current healthcare structure must go through the negotiations process and, thus, has repeatedly requested for the last twelve months that SCTA come to the bargaining table to discuss these matters, as the Audit notes, sending sixteen (16) letters to the union urging that the parties begin negotiations. Our students deserve a reasonable solution that both honors our employees and allows for sufficient funding to support student learning that does not depend on deficit spending.

It was with the above in mind that the District submitted its proposal to SCTA on August 2, 2019 that identified significant savings through placing a reasonable limit on the District’s healthcare plan premium contribution. (<https://www.scusd.edu/negotiations-updates>). The Audit accurately describes the District’s proposal to SCTA to limit the District’s healthcare premium

contribution to 100% for the individual employee and to 75% of the “plus one” and family plans of the low cost plan offered by the District (currently Kaiser HMO). The Audit estimates that this would provide an annual savings of approximately \$15.7 million to the District from such an agreement with SCTA alone. (Figure 8, outlining cost savings measures.) The Audit also outlines various negotiated savings possibilities, including but not limited to capping District health plan contributions for teacher’s plans to the Kaiser rate (\$7.86 million), capping the District’s contribution to all employee health plans at 80% of the Kaiser rate (\$20.4 million), 2% pay cuts to all employees (\$6.85 million), and increased employee OPEB contributions (\$9.99 million). (Figure 8.) As noted by the Audit, this proposed healthcare contribution is consistent with comparable school districts in the region, including Elk Grove Unified and San Juan Unified.

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The Audit does not consider, however, that in addition to the proposal made to SCTA, the District has also been discussing similar healthcare savings options with its classified employee unions which if agreed to, would further increase healthcare savings. While classified employees do not currently have the same expensive healthcare plan provided to SCTA, additional savings are likely achievable by establishing District premium contributions that are equitable to all District classified and certificated employees. The District estimates that annual savings totaling additional millions are achievable by taking reasonable steps to bring its healthcare costs in line with those of other comparable school districts, as well as state and local governments.

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Importantly, the Audit also recognizes that budget solutions ideas offered by the Sacramento City Teachers Association would not significantly address the District’s budget deficit, and in many cases would add additional millions in expenditures. (*The Current Proposals from Sacramento Unified and Its Teachers Union Are Unlikely to Resolve the District’s Financial Crisis.*) The Audit found that SCTA’s arguments to rescind layoffs of teachers and certain classified staff would “result in dramatic increases in ongoing spending - in this case, an estimated increase of approximately \$14 million in ongoing expenditures beginning in fiscal year 2019-20.” In addition, the Audit addressed SCTA’s proposal to add certificated staff:

*“Further, the teachers union proposed adopting the non-binding class size reduction goals for grades 4 to 12 included in the 2017 contract. As shown in Table 5, if the district were to hire additional certificated staff, including rehiring laid off teachers, to achieve the staffing goals the union proposed, it would add at least another \$26.9 million in ongoing spending starting in fiscal year 2019-20. In total, implementing the union’s staffing proposals would increase ongoing district expenditures by at least \$36.7 million - the cost of the additional staff to meet the class size reduction goals plus rehired classified staff not covered by the class size goals.”*

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Other suggestions offered by SCTA have included reducing the District’s contribution to the OPEB liability which provides an estimated \$7 million in savings between 2019-20 and 2021-22. The Audit recognizes that while “decreasing the amount of district contributions toward retiree health benefits in the short term would likely increase the amount the District would need to contribute over the long term, making this a poor option for resolving its ongoing budget problems.” (*Id.*) The Audit also evaluated SCTA’s idea to reduce pay for administrators making

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over \$120,000 by 20% and reduce contract expenditures by 10%. Reducing administrators pay, as the auditors recognized, would require negotiations with their bargaining group, the United Professional Educators (“UPE”) which represents principals, vice principals, and other administrators to realize a projected annual savings of \$3 million. And, if exclusively directed at the Superintendent’s salary and those of unrepresented administrators, annual savings would result in about \$1 million. (*Id.*) Of course, such a decision would likely also significantly affect the retention of the District’s already under-staffed administration. As noted by the recently issued report by PIVOT and PACE entitled, *The Implications of Sacramento City Unified’s Ongoing Budgetary Challenges for Local and State Policy*, “[i]n 2017-18, SCUSD spent 4.6 percent of its budget on these functions [central office administration], which is just below the county average of 5.3 percent (see Figure 3).” (“PIVOT Report” at pg. 11, <https://edpolicyinca.org/publications/implications-sacramento-city-unifieds-ongoing-budgetary-challenges-local-and-state-policy>.)

Lastly, the Audit recognizes that reducing outside contracts would also result in an uncertain and insubstantial amount of savings because the majority of such contracts are for special education services which the District is required to provide and for utilities such as water and electricity.

Options for reducing the District’s expenses that do not require negotiations are “unlikely to prove successful in addressing its precarious financial situation.” (*The Current Proposals from Sacramento Unified and Its Teachers Union Are Unlikely to Resolve the District’s Financial Crisis.*) Specifically, the Audit notes that “closing schools and removing bus routes are unlikely to generate the savings needed to resolve the district’s financial problems and could create new problems for parents and students.” (*Id.*) It was precisely for this reason that the criticism that the District did not immediately make sufficient budget reductions following the 2017 Tentative Agreement lacks full context and does not tell the complete story because, as the Audit itself recognized, any expenditure reductions that would be sufficient to resolve the District’s structural deficit require negotiations. The District did not implement a budget reduction plan at that time because some of the programs that would have been cut were instrumental in supporting students and staff. Further, the state provided additional one-time funds in the Governor’s January budget which it used to cover the costs of the Tentative Agreement and shield students from the burden of cuts. For example, efforts such as our teacher induction program had been grant-funded and the District was committed to supporting our new teachers. Hence, rather than eliminate the program the District reduced the funding given our financial challenges.

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As the Sacramento County Office of Education (“SCOE”) wrote in their letter of June 25, 2019 in response to a question from SCTA concerning the matter of the District making significant reductions following approval of the 2017 Tentative Agreement:

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*“The district requested a December 15, 2017 extension in an attempt to provide us with a \$15.6 million budget reduction plan. On January 8, 2018, the district provided a list of budget reductions, which was scheduled to go [to] the board for approval on January 18, 2018. The Governor’s Budget was released in early January 2018 providing more than \$20 million in additional funding to the district. Consequently, the district decided*

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*not to take action on the budget reduction list. Our letter to the district dated January 16, 2018 summarized this budget activity (Attachment A).*

*To specifically answer the questions posed by SCTA, the district's budget shortfall was temporarily resolved with the Governor's budget, therefore, SCOE had no requirement for further documentation in response to SCOE's December 7, 2017 request. The district did not fail to comply, as the change in circumstances did not require the district to take any action in response to SCOE's December 7, 2017 request."*

As such, the assertion that the District's Board of Trustees ("Board") failed in their fiduciary duty to ensure that the District was able to meet its financial obligations does not accurately portray the circumstances or context in which these decisions were made and how those decisions would impact students. The Board's primary duty above all else is to serve the District's students. When the Board ultimately recognized that the budget could not be balanced by cutting services to students and that significant budget reductions would have to be negotiated and such negotiations would not commence, the Board committed to making cuts in areas that did not require negotiations and would have minimal impact on students. As the Audit recognizes, the District issued lay off notices and reduced certificated, classified, and management staff in order to "right-size" staffing consistent with the SCTA CBA requirement. Ultimately, however, the Board recognizes that those cuts are also impacted by limits within the CBA and are insufficient to close the deficit.

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The Audit's analysis of the District's healthcare costs and how they compare to neighboring districts is further supported by the recently issued PIVOT Report (See <https://edpolicyinca.org/publications/implications-sacramento-city-unifieds-ongoing-budgetary-challenges-local-and-state-policy>), which found that SCUSD is indeed out of step with comparable districts with regard to its uncapped healthcare contributions. Furthermore, the Audit's findings in this regard are complementary to those issues recently raised by the State Auditor in its report entitled, "*The State's Approach Has Not Ensured That Significant Funding Is Benefiting Students as Intended to Close Achievement Gaps.*" (<https://www.auditor.ca.gov/reports/2019-101/summary.html>) That audit report observed that state LCFE funding intended for direction to specific student populations has instead been used to support school districts' base funds. As such, the District respectfully requests that the Legislature consider appropriate action to address this issue. Creative solutions should be considered to rectify hurdles to the success of our students' education that are created by excessive costs of employee compensation packages embedded in collective bargaining agreements that can no longer be disregarded.

Lastly, the Audit states that the District's budget presentation showed it would seek \$16 million in cost reduction in 2020-21, and an additional \$11 million in 2021-22, however, this was one illustrative scenario presented to the Board. The District understands that the earlier it can realize on-going costs savings will result in compounded savings that would speed up the stabilization of its budget and avoid a state takeover. Therefore, it is the District's intent to seek the greatest amount of savings at the earliest possible time to reduce the future need to make additional and greater cost reductions in future years.

The District Agrees With the Audit’s Recommendation that the District: “Develop a long-term funding plan to address its retiree health benefits liability. The plan should include appropriate action necessary to ensure the district will be able to meet its obligations to its employees and retirees.”

With this recommendation, as well as that contained within the earlier recommendation regarding development of its detailed fiscal plan, the Audit recommends that SCUSD consider increased employee contributions toward funding future retiree health benefits (OPEB). The District agrees with this recommendation, which also requires negotiation with its bargaining partners. In fact, the District agreed to increased OPEB employee contributions in recent rounds of negotiated contracts with employee groups representing classified employees, school administrators and unrepresented employees. The table below shows the current employee contribution amount, as well as the fiscal year that changes to the contribution amount were effectuated:

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Employee Group	Contribution Amount Established	Amount Employee Contribution
SCTA	2010-11	\$200/year
United Professional Educators (i.e. School Administrators)	2017-18	\$500/year
Classified Union Employees (SEIU, Teamsters, TCS)	2018-19	⅓ of 1% of base salary
Unrepresented Employees	2018-19	0.40% to 0.48% of salary, with higher salary ranges contributing higher percentages, increasing in FY 2020-21 from 0.46% to 0.56%

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In part due to these increased employee contributions, as well as the District’s own annual contributions of at minimum \$5,000 per eligible employee, the latest OPEB actuarial report provided to the District for 2018-19 lowers the projected unfunded liability for current and future District retirees to \$526 million. Although few school districts in the state have instituted a program of fully funding its OPEB liabilities (see Legislative Analyst Report of September 25, 2017; <https://www.scusd.edu/board-education-committee/fiscal-transparency-and-accountability->



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committee), the District understands that this unfunded liability remains unacceptably high and intends to continue to develop its plan to address this serious matter in order to safeguard the District and ensure that resources are available for future generations of students. The recent Pivot Report provided that “SCUSD spends 2,859 dollars per pupil on non-pension benefits, with most of this going toward health and welfare benefits and OPEB. [footnote] The district’s total per pupil expenditures in 2017-18 were 13,044 dollars, which means that the district spent 22 percent of its budget on non-pension benefits, with healthcare accounting for most of this. [footnote] By comparison, other Sacramento County districts spend between 9 and 17 percent of their budgets on non-pension benefits (see Figures 5 and 6).” (PIVOT Report at pg. 13-14.)

With this in mind, in its August 2, 2019 proposal to SCTA, the District proposed increasing SCTA employees’ contributions toward funding future retiree health benefits.

(<https://www.scusd.edu/negotiations-updates>).

The District Agrees With the Recommendations Related to Budget Policies and Procedures and Has Already Initiated its Work on These Matters

The Audit recommends that the District adopt a number of improved budget policies and procedures aimed at improved multi-year projections and transparency.

The Audit recommends that the District: **“Revise its multi-year projections and update them at least quarterly until it has taken action that would cause it to no longer project insolvency. It should disclose these projections to the board.”** This recommendation is consistent with the requirements that the District present three interim budgets and a final adopted budget to its board and the Sacramento County Office of Education as a result of its negative budget status.

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The Audit further recommends: **“The district should adopt and disclose publicly a multiyear projection methodology. This methodology should disclose the assumptions and rationale used to estimate changes in salaries, benefits, contributions, and LCFF revenue – including changes in enrollment and the source and reliability of the data used to make these projections.”**

The District agrees with this recommendation and has already begun much of this work through its Fiscal Transparency and Accountability Committee (“FTAC”). The FTAC committee was established by the Board this past year in order to improve the District’s budget policies, procedures and overall budgetary transparency. The committee has worked with District staff and important community stakeholders on these shared goals. The FTAC’s work on these matters including its efforts on the items provided by the FCMAT Fiscal Health Risk Analysis can be viewed at: <https://www.scusd.edu/board-education-committee/fiscal-transparency-and-accountability-committee>.

The Audit also recommends that by July 2020, the District **“Have the board adopt a budget methodology including guidance on the use of one-time funds, the use and maintenance of district reserves, and the maintenance of a balanced budget ...”** The District agrees with this recommendation and is already working on developing appropriate policies and procedures,

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including through the work of the FTAC. The District notes that there will be no use of one-time funds for ongoing expenditures in 2019-2020.

The District Agrees With the Audit’s Overall Findings and Recommendation Regarding Improved Policies and Processes to Analyze and Address Special Education Costs

The Audit’s specific recommendation provides that the District: ***“Adopt a policy that guides staff on steps they should take to ensure that special education expenditures are cost-effective. The policy should include consideration of options for offering services, including those provided by district staff or by contracted providers.”***

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The Audit contains extensive discussion of the District’s Special Education (“SPED”) program and costs, noting that SPED costs accounted for 21% of the District’s total spending for fiscal year 2017-18, and states that it has done little to control these costs, which increased 31% or \$26.1 million between 2013-14 and 2017-18. However, the Audit does not provide necessary context regarding the issue of rapidly rising SPED costs for most school districts across the state of California. The recent report issued by the Legislative Analyst’s Office (“LAO”) on November 6, 2019 explained that the percentage of students qualifying for services rose from 10.8% in the early 2000’s to 12.5% by 2017-2018. (<https://lao.ca.gov/Publications/Detail/4110>). In addition, the average cost to educate a student with a disability is almost triple the cost to educate a student without disabilities (\$26,000 vs. \$9,000). The LAO report also acknowledges that both state and federal funding has decreased during this period (after taking into account inflation-adjustments over time), primarily due to declining overall student enrollment. This has caused an increase in local unrestricted funding towards special education services to meet the growing needs of this student population. As such, it is critical to recognize that the issue of rising SPED costs is a statewide problem that requires further consideration by the Legislature.

Furthermore, the problem of rising SPED costs is further compounded due to the issues involved with the low reimbursement rate for SPED services pursuant to AB602. Although the District, as noted in the Audit, has a high rate of SPED identified students, SCUSD has been reimbursed at one of the lowest rates in the state at \$489.97 per student, while other school districts received approximately \$925 per student. The 2019-2020 state budget improved this situation somewhat by bringing all Special Education Local Plan Areas (“SELPA”) to at least the statewide target rate for AB 602 (SELPA’s are groupings of school districts and SCUSD constitutes its own SELPA). At the time, this was estimated to be \$557.27 for 2019-2020. SCUSD continues to advocate to the Legislature to further increase its AB 602 reimbursement rate which greatly affects the level of services that the District can provide to our students with disabilities.

The District’s Special Education Department continues to seek improvements to services for all students as well as ways to achieve efficiencies where possible – including the work initiated this year with the California Collaborative for Educational Excellence (CCEE). The Audit notes the expensive contracts with outside service providers to provide those services identified as required for its many students with disabilities, and recommends improved policies and procedures to consider their cost effectiveness. The District agrees that improved practices should be developed for review and analysis of the effectiveness of those services that are required for our students, including in the area noted by the Audit regarding expensive

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residential placements for a limited number of students. The process for determination of what additional services are required for the District to provide to its students with disabilities is governed by federal and state law that establish extensive procedures through the Individualized Education Program (“IEP”) for the determinations regarding what reasonable accommodations the District must provide. Cost considerations are imbedded within the sometimes complex analysis of whether a particularly requested accommodation is “reasonable” – but cost alone cannot be determinative. This is generally the case with regard to the need to provide a costly residential placement for a student with disabilities. Moreover, due to the limited capacity of such residential facilities, placements are sometimes required to be located out-of-state at a higher cost. There are very few high level Residential Treatment Center group homes that provide intensive psychiatric services to youth located in California and they are frequently at capacity when a slot is needed. This leads Districts to seek out other Residential Treatment Centers options out of state. All decisions regarding students with disabilities are made through the student’s IEP and services are provided to meet their unique needs. Each SELPA must provide a full continuum of services to be in compliance with state and federal law. For example, as our population has shifted over time and the number of students with Autism has increased, the costs to provide services have also increased. This is due to the multiple related services that a student with Autism might have as a part of their IEP in proportion to a student receiving speech and language services to address an articulation error.

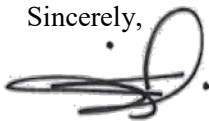
Lastly, these matters would be incomplete without an acknowledgment that litigation plays a significant factor in driving an increase in the District’s SPED costs. The District has been a frequent target of complaints alleging that it has failed to adequately provide reasonable accommodations, including in some instances when residential placements were initially denied by the District.

### **Conclusion**

The District appreciates the State Audit team for its thorough and independent review which confirms SCUSD’s dire financial situation. The Audit provides an important foundation to move forward with critical employee-related cost savings. The District is committed to addressing all of the important issues raised in the Audit and appreciates this opportunity to provide greater context on these matters and update the current work that has been taking place. We look forward to the periodic reports regarding the District’s progress on these important matters.

②0

Sincerely,



Jorge A. Aguilar  
Superintendent

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## Comments

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM SACRAMENTO UNIFIED

To provide clarity and perspective, we are commenting on Sacramento Unified's response to our audit. The numbers below correspond to the numbers we have placed in the margin of Sacramento Unified's response.

Sacramento Unified implies it needed to cut services to pay for its 2017 labor agreement with its teachers union. However, it fails to note that it was warned before approving the contract that it could not afford this agreement and its board approved the agreement anyways. It relied on one-time funds to pay for the salary increases instead of proposing a plan to cover these ongoing costs. Further, the district could have negotiated additional cost savings since the 2017 agreement that did not reduce services, but it has not. Consequently, the district now faces insolvency and the potential for reduced funding for its teachers and students if it accepts a loan from the State due to the need to pay interest on the loan and other related costs that we discuss on pages 34 and 35.

①

Sacramento Unified overstates our conclusions. The report indicates that the district needs to address the three largest drivers of its costs, which are salaries, benefits, and special education costs, and we recommend on page 39 that the district develop a detailed plan that would address its costs.

②

We did not validate the district's budget data. We based our report on sufficient evidence, including audited financial statements. We also used information prepared by the district, such as budgets, and information from the district's accounting system and compared it to audited financial statements and trends from prior years to assess the reasonableness of the information. However, as we note on page 27, we identified significant variances between the district's budget and actual expenditures and on page 39 we recommend that the district develop a budget methodology using best practices.

③

In its attempt to summarize the findings of our audit, Sacramento Unified selectively presents our key findings. The summary fails to note where our report details the district's decisions that led to its current situation. For example, the district board approved the 2017 labor agreement despite being warned it could not afford it.

④

- ⑤ Our audit did not confirm that Sacramento Unified needs to make \$27 million in cost reductions. As we state on page 35, the *district recommended to its board* \$27 million as the amount of cost reductions needed to eliminate deficit spending by fiscal year 2021–22. As we note in Figure 9 on page 35, the district spends more than it receives in revenue and its costs are growing faster than its revenues. Consequently, as Figure 9 shows, these reductions alone would likely not be sufficient for it to avoid continued deficit spending in fiscal year 2022–23.
- ⑥ While preparing our draft audit report for publication, some of the text quoted by Sacramento Unified was changed to remove the term *state takeover*. Recent changes to state law have made the term inaccurate.
- ⑦ While preparing our draft audit report for publication, some of the figure and table numbers quoted by Sacramento Unified changed. Figure 7 is now Figure 9. Figure 8 is now Figure 10, and Table 5 is now Table 3.
- ⑧ Our audit did not confirm that the 2017 labor agreement cost \$31 million. Rather, as we note on page 14, Sacramento Unified calculated in June 2017 that a 1 percent increase in salary and statutory benefits would cost about \$2.1 million. Based on this calculation, we estimate that the 2017 contract's salary increases and adjustment to the salary schedule, which resulted in a 15 percent increase in salary and statutory benefits for teachers, would add about \$31 million per year in ongoing spending.
- ⑨ We developed the decline in enrollment independent of Sacramento Unified based on the district's audited financial statements for fiscal years 2013–14 through 2017–18 and its unaudited financial report for fiscal year 2018–19.
- ⑩ Although Sacramento Unified states that it agrees with our recommendation, its response does not indicate how or when it will implement the recommendation. We look forward to seeing the district's progress at its 60-day update.
- ⑪ As we told Sacramento Unified several times during the audit, our report would not divulge ongoing, nonpublic negotiations between the district and its labor unions. Further, Figure 10 on page 37 does indicate the potential savings the district could incur if it revised its health care options for all employees.

Sacramento Unified’s statement is disingenuous. As we note in the report on page 16, the county office superintendent warned the district before it approved its agreement with its teachers union that the district could not afford the agreement. Yet, its board approved the agreement anyway. In addition, the district’s statement that it could have only made reductions by cutting programs is not accurate. The district board could have proposed offsetting cost reductions, such as to health care costs, before it approved the 2017 labor agreement, but it did not do so. As the district notes in its response, and as we note in our report on page 18, the district instead chose to rely on one-time funds rather than trying to solve its fiscal problems. As such, we stand by our statement that the district board failed to uphold its fiduciary duties because it approved this contract without making necessary cost reductions.

⑫

Sacramento Unified’s quotation of a letter from the county office superintendent is misleading, as it does not fairly represent what the county office superintendent told the district at the time. As we note in our report on page 16, the county office superintendent warned the district before it approved its 2017 labor agreement that it needed to reduce its costs in other areas to afford the cost of the new agreement. Further, as we note on page 18, when the district ultimately decided to rely on one-time funds from the State, the county office superintendent warned the district that such an action was a poor business practice.

⑬

Sacramento Unified’s statement regarding when its board recognized it needed to make cost reductions is misleading. The sentence seems to imply that the board did not realize it would need to make cost reductions until after it had approved the 2017 labor agreement. As we note on page 16, the county office superintendent informed the board before it approved the agreement that it could not afford the agreement without making cost reductions. In addition, as we discuss on pages 17 and 18, the district’s former chief business officer also informed the board of the need to make budget adjustments before the board approved the agreement.

⑭

We did not report that the layoffs Sacramento Unified issued in 2019 were to “right-size” its staff. Rather, we note on page 9 that the district laid off staff in an effort to reduce its costs but that it subsequently rehired many of those it laid off.

⑮

Even though it has recently required some employees to begin contributing toward their retiree health benefits, the district has not developed a plan for how it will pay for these promises to its employees despite repeated requests from the county office superintendent, as we note on pages 21 and 22.

⑯

- ⑰ Sacramento Unified's summary of the OPEB actuarial report (OPEB report) it mentions is misleading. At the time of our exit conference with the district in October 2019, the district's fiscal year 2018–19 independent financial audit that includes information from the referenced OPEB report had not been finalized. Therefore, we did not include this information in our audit. Nevertheless, the district's statement that its liability declined due to district actions is inaccurate. The actuary that prepared the OPEB report reduced the district's projected liability because of favorable changes in assumptions, the majority of which were due to health care premiums not increasing as fast as expected—a factor that had nothing to do with actions of the district. Further, the OPEB report still notes that the district has a \$526 million liability and the district has no plan for how it will pay for it, as we note on page 21.
- ⑱ Although, as we note on page 28, Sacramento Unified submits its budget in June and interim reports in December, March, and May, there is still a six-month gap between submission of its budget in June and the first interim report in December where the district could update its multiyear projections to increase transparency.
- ⑲ We agree there are statewide issues concerning special education that may affect the district. Nonetheless, because the district's special education costs increased significantly over the last several years, we expected the district to have taken steps to control these costs—particularly in light of its deteriorating financial situation. However, as we note on page 23, Sacramento Unified has done little to control its special education costs.
- ⑳ Although Sacramento Unified states that it agrees with many of our recommendations, we are concerned that it fails to address several of our recommendations in its response. Specifically, the district fails to discuss our recommendations regarding any efforts to reduce its executive management turnover, including developing a succession plan and a mentoring program. We look forward to seeing the district's progress in these areas in its 60-day update.