REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

A REVIEW OF THE OAKLAND UNIFIED SCHOOL DISTRICT'S FINANCIAL POSITION

F-931.2

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Acting Auditor General

January 24, 1990 F-931.2

Honorable Elihu M. Harris, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 2148
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Oakland Unified School District's need to implement a comprehensive plan to reduce its expenditures and to determine if it is applying for and receiving all of the funding for which it is eligible.

Respectfully submitted,

KURT R. SJOBERG
Acting Auditor General

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SUMMARY

RESULTS IN BRIEF

The Oakland Unified School District (district) continues to have financial difficulties and is not applying for or fully utilizing all available funding to improve the education of its students and improve its facilities. Specifically, we noted the following:

- The district ended fiscal year 1988-89 without any reserves for economic uncertainty;

- The district would have ended the year with a deficit if it had not unexpectedly received additional revenues;

- The district will have to reduce its expenditures over the next ten years to avoid general fund deficits, establish and maintain a reserve for economic uncertainty, and have sufficient cash to meet its obligations;

- The amount of interest earned on the proceeds from the district's issuance of certificates of participation is restricted, and the certificates may be considered unconstitutional debt;

- The district failed to fully implement its Voluntary Integration Program, forfeiting at least $4.8 million annually over the life of the program;

- The district declined to participate in a state-funded reading program, forfeiting at least $63,000 annually;

- The district has not applied to the State for an estimated $61.7 million of school construction and modernization and asbestos removal funds that the district could be eligible to receive; and

- The district forfeited approximately $100,000 available to it from the State for structural repairs at two schools.

BACKGROUND

During the 1988-89 school year, the district was the sixth largest in California, with an average daily attendance of approximately 53,000 pupils and approximately 6,900 employees. In fiscal year 1988-89, the district had a general fund operating budget of approximately $206 million. The district is administered by a superintendent in accordance with policies approved by the district's seven-member board of education (board). From December 1988 to January 1990, a series of superintendents directed the district's operations. On November 27, 1989, the district appointed an interim superintendent for a two-year term beginning January 1, 1990, because it was unable to find any acceptable candidates to serve as a permanent superintendent. Effective November 27, 1989, as mandated by Assembly Bill 2525, the state superintendent of public instruction appointed a trustee to advise the district on its fiscal operations.

PRINCIPAL FINDINGS

The District Continues To Have Financial Difficulties

The district continues to have financial difficulties. Although the district ended fiscal year 1988-89 with a positive general fund balance, it did not have any reserves for economic uncertainty. In addition, the district would have ended the year with a deficit of approximately $1.8 million if it had not unexpectedly received additional revenues at year end from Proposition 98 and the state lottery. We project that the district will end fiscal year 1989-90 with a $8.6 million general fund balance. This projection is based on the district using $10 million of the proceeds from its sale of certificates of participation in its general fund. Nevertheless, the district will have to reduce its expenditures over the next ten years to avoid general fund deficits, establish and maintain a reserve for economic uncertainty, and have sufficient cash to meet its obligations. Finally, we noted some concerns about the district's issuance of certificates of participation. Specifically, the amount of interest earned on the certificates' proceeds is limited, and the certificates may be considered unconstitutional debt.

The District Has Not Taken Advantage of Funding Available To Assist Its Educationally Disadvantaged Students and To Improve Its Facilities

The district has not always participated in programs that could provide additional funds for the district to improve the education of its students and improve its facilities. For example, despite the poor academic achievement of the district's students, the district forfeited at least $4.8 million annually over the life of its Voluntary Integration Program because the district failed to fully implement its program in fiscal year 1988-89. Further, the district is not participating in at least one other educational program for which it may be eligible to receive funds.

Further, funds are available to the district from the State to improve or construct school buildings. However, the district has not applied to the State for $12.6 million for new construction, $42.8 million for facilities modernization, and $6.3 million for asbestos abatement, all of which the district should be eligible to receive. As a result, the district's students and teachers may sometimes be unnecessarily housed in overcrowded, outdated, and potentially hazardous facilities. Moreover, the district failed to collect approximately $100,000 that had already been granted to it by the State for construction projects. At least $94,000 of these funds would have reimbursed the district for expenditures it has already made in making structural repairs to one of its facilities.

Finally, the district has suffered delays in receiving state funding for deferred maintenance projects because it did not comply with state laws regarding the use of funds generated from the sale of real properties.

RECOMMENDATIONS

To avoid deficits in its general fund, the Oakland Unified School District should implement a comprehensive plan to reduce its expenditures, increase its revenues, or both. The district's plan should encompass the qualitative aspects of its education program as well as the financial aspects.

The district should apply for all funding for programs that it determines would be cost beneficial to the education of the students and the district as a whole.

AGENCY COMMENTS

The Oakland Unified School District generally agrees with our conclusions, outlining actions that it will take to reduce its expenditures and increase its revenues. However, the district believes that we overstate its employee benefits costs for fiscal year 1989-90.

INTRODUCTION

The Oakland Unified School District (district) is administered by a superintendent in accordance with policies approved by the district's seven-member board of education (board). The board members, elected officials serving staggered four-year terms, appoint the superintendent, who is responsible for preparing and submitting to the board a budget for each fiscal year. Since December 1988, a number of individuals have acted as superintendent and directed the district's operations. After Superintendent Coto left the district on December 7, 1988, the district contracted with Edna Washington to be interim superintendent. However, she has been absent from the district since August 10, 1989. In August 1989, the interim deputy superintendent, Carolyn Getridge, began acting as superintendent. On November 20, 1989, the district contracted with Vera Pitts to act as interim superintendent. Finally on November 27, 1989, the district appointed Richard Peter Mesa as superintendent for a two-year term beginning January 1, 1990, because it was unable to hire an acceptable candidate to serve as a permanent superintendent.

During the 1988-89 school year, the district was the sixth largest in California, with an average daily attendance of approximately 53,000 pupils. During the same school year, the district operated 59 elementary schools, 16 middle and junior high schools, and 11 senior high and vocational education schools. The district also maintained 20 child development centers, 4 opportunity schools and centers for redirection, and 4 adult education schools. The district currently employs approximately 6,900 people. In fiscal year 1988-89, the district had a general fund operating budget of approximately $206 million. On September 13, 1989, the board adopted the district's budget for fiscal year 1989-90, which projected general fund expenditures of approximately $206 million.

On September 15, 1989, the district issued $13.5 million worth of certificates of participation. The certificates are tax-exempt securities. According to the terms of the certificates, the district has leased facilities to a nonprofit corporation for a ten-year period and leased back the property at annual lease payments equal to the principal and interest payments on the certificates. A trustee was appointed to sell the certificates to investors. The trustee pays the investors their principal and interest from the lease payments made by the district. Approximately $3.5 million of the proceeds are needed to establish reserves and pay the costs of issuance. Therefore, the district will actually receive approximately $10 million of proceeds from the certificates.

The Alameda County superintendent of schools (county superintendent) reviews and approves the district's final budget each year. However, on October 31, 1989, the county superintendent rejected the district's budget because, among other things, it included the approximately $10 million in revenue from the certificates. The county superintendent stated that he objects to certificates as a source of funds to replenish reserves and to provide operating revenue. Further, he questioned the district's ability to make payments on the debt as the payments become due.

On October 2, 1989, the State enacted Assembly Bill 2525. This new law required the state superintendent of public instruction to appoint a trustee to advise and assist the district in preparing its budget, in developing plans to improve the educational achievement of all district students, and in resolving the financial and management problems of the district. Effective November 27, 1989, the state superintendent of public instruction appointed such a trustee. The law also requires the district, no later than 30 days after the appointment of the trustee, to submit a revised 1989-90 budget to the state superintendent of public instruction for approval. Further, the law requires the state superintendent of public instruction to either approve the district's budget or develop an alternative budget to be imposed upon the district for fiscal year 1989-90 .

Assembly Bill 2525 also provides for a $10 million emergency loan for the district. If the district requests this loan, the State Controller's Office will reduce the district's annual apportionment from the State Department of Education until the loan is paid back.

On December 15, 1989, the district submitted its revised budget to the state superintendent of public instruction. This revised budget projects general fund expenditures of approximately

$208 million. As of January 17, 1990, the state superintendent of public instruction has not approved the district's revised budget nor has it imposed an alternative budget for fiscal year 1989-90.

The district has experienced financial difficulties for a number of years. In May 1986, we reported that the district's budgeted expenditures exceeded its anticipated revenues for fiscal year 1985-86. At that time, we did not recommend that the district obtain an emergency loan from the State because it had sufficient cash balances to meet its existing needs. However, we reported that, unless the district received additional revenues or substantially reduced its expenditures, it would have general fund deficits in fiscal years 1986-87 and 1987-88. We identified similar problems in March 1987. The district's actual general fund balances at June 30, 1986, 1987, and 1988, were approximately $4.9 million, $4.4 million, and $452,000, respectively.

In March 1989, Deloitte Haskins & Sells, an accounting firm, reported to the county superintendent that the district continued to experience financial difficulties. The report stated that the district could end fiscal year 1988-89 with a general fund deficit of up to $5.2 million. The report also predicted that at the end of fiscal year 1989-90, the district may have insufficient cash to meet its obligations and may have a deficit in its general fund of up to $12 million.

On August 21, 1989, we reported to the Legislature that the district's unaudited financial report showed that the district had a general fund balance of approximately $1.8 million at June 30, 1989. At that time, we projected that the district will have a general fund deficit of approximately $2.6 million by June 30, 1990.

On January 16, 1990, we reported to the Legislature that the district needed to improve its internal controls over payroll, personnel, purchasing, and asset management. Specifically, we discussed management weaknesses at the district that have contributed to unnecessary expenditures and losses of assets in the past and that continue to make the district vulnerable to additional losses.

In addition to the district's financial difficulties, the educational achievement of the district's students, as measured by the California Assessment Program, has been among the lowest in the State. For example, third graders at the district had test scores in school year 1988-89 that ranked in the twenty-second percentile for reading, the twentieth percentile for written expression, and the eighteenth percentile for mathematics. In addition, the district's twelfth graders had test scores that ranked in the third percentile for reading and direct writing and the fifth percentile for mathematics.

Further, the district has suffered some apparent management problems. As of January 18, 1990, nine current or former district employees have been arrested on charges including grand theft and receiving stolen goods--all related to their activities at the district. On November 29, 1989, one employee pleaded guilty to grand theft and receiving stolen property. In addition, on January 3, 1990, a former employee pleaded guilty to grand theft. As of January 18, 1990, charges are still pending against the seven other individuals.

Assembly Bill 2525 also requires the district to obtain and submit to the county superintendent a report issued by an independent auditor on the financial conditions and budgetary controls of the district and a written management review conducted by a qualified management consultant. Our report on the district's management weaknesses, in conjunction with a report by Deloitte & Touche, fulfilled the management review requirements. This report will fulfill the requirements for the review of the district's financial condition.

SCOPE AND METHODOLOGY

As stated above, this report will address the district's financial condition. In addition, we reviewed state and federal funding programs to determine whether additional funding might be available to the district for which it has not applied.

We reviewed the district's audited financial statements for fiscal year 1987-88; the report from Deloitte Haskins & Sells issued in March 1989 and related working papers regarding the district's financial status; the district's first and second interim reports for fiscal year 1988-89; the district's unaudited actual financial report for fiscal year 1988-89; and the district's audited financial statements for fiscal year 1988-89. Moreover, we analyzed the district's proposed budget for fiscal year 1989-90 to project an ending fund balance for that year. We used all this information to identify trends and project the district's ending fund balances and cash balances through fiscal year 1999-2000.

In addition, we contracted with outside legal counsel to assist us in our review of the district's issuance of certificates of participation. Our analysis of the certificates of participation is based on the outside legal counsel's opinions.

During the audit, we contacted staff at the State Department of Education, the State Controller's Office, the Department of General Services' Office of Local Assistance, the Alameda County Office of Education, and the district. We also contacted staff at other California school districts.

We reviewed the district's Voluntary Integration Program to determine what effect this program would have on the district's revenues. We based our conclusions related to the Voluntary Integration Program on work of auditors from the State Controller's Office.

We compared the district's revenues from state and federal programs with those of similar districts to determine whether other districts were receiving proportionally more than the district. We further reviewed those programs of the district identified as receiving less than similar districts to determine whether the district might be eligible to apply for additional funds.

Also, we reviewed funding programs offered by the State Allocation Board for constructing and improving facilities to determine whether the district could participate in these programs. The Office of Local Assistance provided estimates of the amount of funding the district might be eligible to receive if it applied.

Because the procedures cited above were not sufficient to constitute an examination of the financial statements made in accordance with generally accepted auditing standards, we do not express an opinion on any of the financial statements referred to in this report.

AUDIT RESULTS

I

THE OAKLAND UNIFIED SCHOOL DISTRICT CONTINUES TO HAVE FINANCIAL DIFFICULTIES

The Oakland Unified School District (district) continues to have financial difficulties. Although the district ended fiscal year 1988-89 with a positive general fund balance, it did not have any reserves for economic uncertainty. In addition, the district would have ended the year with a deficit of approximately $1.8 million if it had not unexpectedly received additional revenues at year end from Proposition 98 and the state lottery. We project that the district will end fiscal year 1989-90 with a $8.6 million general fund balance. This projection is based on the district using $10 million of the proceeds from its sale of certificates of participation in the general fund. Nevertheless, the district will have to reduce its expenditures over the next ten years to avoid general fund deficits, establish and maintain a reserve for economic uncertainty, and have sufficient cash to meet its obligations. Finally, we noted some concerns about the district's issuance of certificates of participation. Specifically, the amount of interest earned on the certificates' proceeds is restricted, and the certificates may be considered unconstitutional debt under Article XVI, Section 18, of the Constitution of the State of California.

The District Ended Fiscal Year 1988-89
With a $1.778 Million General Fund Balance

According to the district's audited financial report for the year ending June 30, 1989, the district ended the year with a general fund balance of $1.778 million. (See Table 1 on page 13, which, among other things, presents the district's actual general fund balance as of June 30, 1989, as determined by the district's external auditor.) However, the district would have ended the year with a $1.822 million deficit if it had not received an additional $3.6 million in unexpected revenues at the end of the year. This $3.6 million consisted of $900,000 from state lottery revenues and $2.7 million from Proposition 98 revenues. Proposition 98 was passed by California voters in November 1988 and requires the State to distribute to public schools and community colleges any tax revenues in excess of its appropriations rather than return them to taxpayers. Proposition 98 revenues should be considered one-time revenues to the district since the district cannot be assured that the State will have excess revenues each year.

The state lottery, which California voters approved in 1984, provides additional revenues to public education in the State. The State Department of Education provides the school districts with estimates of the amount of revenues expected to be generated by the lottery in a given year. The school districts may budget lottery revenues using these estimates. In fiscal year 1988-89, actual state lottery revenues exceeded the district's estimates. As a result, the

Oakland Unified School District received $900,000 more in state lottery revenues at the end of fiscal year 1988-89 than it expected.

Furthermore, the district has not reserved any funds for economic uncertainty. In our report titled "A Review of the Financial Condition of School Districts, County Offices of Education, and Community College Districts in California" (Report F-637), dated March 1987, we recommend that school districts maintain prudent financial reserves. The State Department of Education recommends that school districts reserve an amount equal to 2 percent of total expenditures and other uses for fiscal year 1989-90. Therefore, using the State Department of Education's recommendation for a 2 percent reserve, the district should have reserved at least $4 million as of June 30, 1989. However, the district was unable to establish such a reserve because it nearly ended fiscal year 1988-89 with a deficit in its general fund.

Finally, a report from Deloitte Haskins & Sells, issued in March 1989, discussed the district's need to establish an adequate reserve for self-insurance. The report recommended that the district obtain a study to determine the amount of funds that should be maintained in the reserve. As of January 9, 1989, the district has not obtained such a study. Therefore, we could not determine whether the district's self-insurance reserve as of June 30, 1989, or its budgeted self-insurance reserve for fiscal year 1989-90 is adequate to meet the district's self-insurance needs.

TABLE 1

OAKLAND UNIFIED SCHOOL DISTRICT
AUDITED AND PROJECTED GENERAL FUND BALANCES
FOR THE YEARS ENDING JUNE 30, 1989 AND 1990
(IN THOUSANDS)

	1989	1990		
	District Audited Actual	District Projection as of 12-13-89	Auditor General Adjustment	Auditor General Projection
Revenues				
State apportionment	$136,021	$148,296	$ (464)	$147,832
Federal revenues	14,332	17,030	(1,169)	15,861
Other state revenues	53,108	48,032	(3,296)	44,736
Other local revenues	1,990	2,811		2,811
Total Revenues	205,451	216,169	(4,929)	211,240
Expenditures				
Salaries	139,657	139,890		139,890
Employee benefits	36,726	38,018	1,276	39,294
Books and supplies	6,418	7,431		7,431
Contracted services and other operating expenses	16,956	21,685		21,685
Capital outlay	1,466	1,757		1,757
Other outgo	1,595	1,574		1,574
Direct support and indirect costs	(2,000)	(2,111)		(2,111)
Total Expenditures	200,818	208,244	1,276	209,520
Other Financing Sources (Uses)				
Other financing sources		13,535	(3,492)	10,043[1]
Transfers in	253			
Transfers out	(3,560)	(3,250)	(1,015)	(4,265)
Total Other Financing Sources (Uses)	(3,307)	10,285	(4,507)	5,778
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	1,326	18,210	(10,712)	7,498
Fund Balance, Beginning of Year	452	1,778	(681)	1,097
Fund Balance, End of Year	$ 1,778	$ 19,988	$(11,393)	$ 8,595[1]

[1] The fund balance is significantly larger than the prior year's because of the proceeds from the district's issuance of certificates of participation. However, it should be noted that the liability for this issuance is not reflected in the general fund and that the district will pay lease payments totaling at least $16 million over the next ten years.

The District's Projected General
Fund Balance as of June 30, 1990

On December 13, 1989, the district's board adopted a budget for fiscal year 1989-90 that projected revenues of $216 million, expenditures of $208 million, and an ending balance of approximately $20 million in its general fund. We reviewed the district's revenue and expenditure projections for fiscal year 1989-90 and project that the district will have a general fund balance of approximately $8.6 million by June 30, 1990.

Among other things, Table 1 on page 12 presents the district's projection of the general fund balance as of June 30, 1990, and our projection of the district's general fund balance as of June 30, 1990. Table 2 on the following page presents the district's actual general fund balance reserves as of June 30, 1989 (as determined by the district's external auditor); the district's projection of general fund balance reserves as of June 30, 1990; and our projection of the district's general fund balance reserves as of June 30, 1990. Our projections are based on an analysis of the viability of the district's projection and underlying assumptions. For example, the State Department of Education is examining the district's budget for fiscal year 1989-90 and is analyzing the legal issues associated with the district's certificates of participation. However, because the district assumes the proceeds from the certificates will be included in the general fund, we did not adjust the district's projection. We only adjusted the district's projection in those instances where we considered the district's projection to be materially misstated. In the following paragraphs, we explain those instances where we did adjust the district's projection.

TABLE 2

OAKLAND UNIFIED SCHOOL DISTRICT
AUDITED AND PROJECTED GENERAL FUND BALANCE RESERVES
FOR THE YEARS ENDING JUNE 30, 1989 AND 1990
(IN THOUSANDS)

	1989	1990		
			Auditor General	
	District Audited Actual	District Projection as of 12-13-89	Adjustment	Projection
Reserves of Fund Balance				
Economic uncertainty		$ 2,000	$ 2,276	$4,276
Self-insurance	$1,870	1,444		1,444
Improvement reserve		260		260
Long-term debt		1,865	(1,865)	
State and federal programs	1,011	4,464	(4,464)	
Certificates of participation		7,715	(6,659)	1,056
Nonvested tax sheltered annuity		681	(681)	
Miscellaneous reserves	1,559	1,559		1,559
Total Reserves of Fund Balance	4,400	19,988	(11,393)	8,595
Undesignated Fund Balance	(2,662)	0	0	0
Fund Balance, End of Year	$1,778	$19,988	$(11,393)	$8,595

Differences Between the District's
Projection of the June 30, 1990,
Fund Balance and Our Projection

Revenues Decreased by $4.929 Million. According to the district, its state apportionment projection as of December 13, 1989, was overstated by approximately $464,000. Therefore, we reduced the district's projection by that amount. In addition, the district's projections of federal revenues and other state revenues are overstated by $1.169 million and $3.296 million, respectively. These revenues are overstated because the district projected revenues for restricted programs that exceed the projected expenditures for restricted programs. The district designated these excess revenues in its fund balance as a reserve for state and federal programs. The California School Accounting Manual does not allow restricted program revenue to be recognized until the district actually spends the funds. Accordingly, we reduced the projected revenues for the restricted programs to equal the projected expenditures. Further, we eliminated the reserve for state and federal programs.

<u>Expenditures Increased by $1.276 Million</u>. We increased the district's projected employee benefit expenditures by $1.276 million for fiscal year 1989-90 because of the increasing costs of health insurance and workers' compensation insurance that were not reflected in the district's projection. Approximately 50 percent of the district's employees and retirees are covered by the district's health insurance plan with a health maintenance organization (HMO). The HMO increased the district's cost of the premiums by 15 percent for fiscal year 1989-90. The district is self-insured for the remainder of district employees and retirees who are not covered by the HMO. The district pays these employees' health care costs directly. According to the director of the district's Integrated Personnel and Financial System (IPFS), these costs are also expected to rise by an additional

15 percent in fiscal year 1989-90. Finally, the district's IPFS director also expects the district's costs for workers' compensation insurance to increase by an additional 20 to 25 percent.

Other Financing Sources Decreased by $3.492 Million. The district included in its general fund budget for fiscal year 1989-90 $13.535 million from the issuance of certificates of participation. However, approximately $3.492 million of the proceeds are not available to the district. The official statement for the certificates of participation stipulates that a portion of the proceeds are to be retained by the trustee to make the first two years' payments and to establish a reserve fund. In addition, the costs of issuance must also be paid from the proceeds. Therefore, we reduced the budgeted proceeds by the amount retained by the trustee and the amount for the costs of issuance. Further, the district treated the funds retained by the trustee and the costs of issuance as a reservation of fund balance for certificates of participation. Thus, we reduced this reserve by $3.492 million since the funds are not available to the district or have already been spent. Also, we reduced this reserve by an additional $3.167 million to avoid the district having an undesignated fund deficit.

Other Financing Uses Increased by $1.015 Million. In a letter to the State Department of Education dated January 9, 1990, the district indicated that its long-term debt reservation of fund balance had been established to provide general fund monies to the district's cafeteria and child development funds in fiscal year 1989-90. These transfers should be accounted for in "transfers out," not in a reserve. Thus, we reduced the district's reserve and increased transfers out by $1.865 million. Further, we combined the self-insurance fund with the general fund for our fund balance projection for fiscal year 1989-90. The district's general fund budget showed a $850,000 transfer to the self-insurance fund. However, because we combined the two funds, we eliminated the $850,000 transfer out from the general fund. Therefore, the two adjustments resulted in a net increase to other financing uses to $1.015 million.

Beginning Fund Balance Decreased by $681,000. According to the report from Deloitte Haskins & Sells, dated March 1989, over the past several years, the district has paid monies into an annuity plan for employees. However, some employees left the district without being fully vested in the annuity plan. As a result, the employees forfeited the benefits that were paid on their behalf. The district decided these forfeited benefits, which had accumulated to approximately $681,000, should be returned to the district and had recorded the entire $681,000 as a receivable in its June 30, 1989, financial statements. The Oakland School Employees Association (OSEA) filed an unfair practice charge with the Public Employment Relations Board (PERB). Specifically, the OSEA did not believe that the district could unilaterally decide how the forfeitures were to be used. On December 29, 1989, a PERB administrative law judge issued a proposed decision, which effectively prevents the district from using the forfeitures to reduce its payments to the annuity plan. The decision will become final 20 days from the date of the proposed decision unless one or both of the parties files a statement of exceptions with the PERB. However, at this point in time, it does not appear probable that the district will be able to collect this money. According to generally accepted accounting principles, an entity should not recognize a receivable unless collection is probable. Because the district had previously recognized the receivable, thus, increasing fund balance, we reduced the district's beginning fund balance by $681,000. In addition, because the district created a reservation of fund balance for the $681,000 related to the tax sheltered annuity, we also reduced this reservation of fund balance.

Reserve for Economic Uncertainties Increased by $2.276 Million. In its budget for fiscal year 1989-90, the district failed to provide an adequate reserve for economic uncertainties. As discussed earlier, the State Department of Education recommends that at least 2 percent of the district's budgeted expenditures and other uses should be reserved for economic uncertainties. Based on our budget projections, the reserve for economic uncertainties for fiscal year 1989-90 should be $4.276 million. However, the district has only reserved $2 million. Thus, we increased the district's reserve by $2.276 million.

The District's Budget Projection Does Not Include Cost-of-Living Adjustments. The district's budget for fiscal year 1989-90 does not include cost-of-living adjustments (COLAs) to the salaries and benefits for most of its employees. As of January 18, 1990, the district had settled its negotiations for fiscal year 1989-90 with only one of the 12 employee bargaining units at the district. This bargaining unit received a 4.14 percent COLA increase for fiscal year 1989-90. The district has not granted similar COLAs to its other bargaining units. In our report dated August 21, 1989, our projection included COLAs for the other bargaining units totaling approximately $5.7 million. However, we did not adjust the district's projected salary expenditures in this report to reflect similar COLAs because the district has not granted any other COLAs as of January 18, 1990.

Additional Considerations Related to the District's Certificates of Participation

Although we included the proceeds from the district's certificates of participation in our projections of general fund balances, we have noted several areas of concern related to the certificates. For example, the district will have to exercise prudence in using and investing the funds. According to a legal counsel with whom we contracted to review the district's certificates, all of the proceeds from the district's certificates are yield restricted except those that are in the debt service reserve fund. Specifically, the district cannot earn a rate of interest on the proceeds that exceeds the rate it pays on the certificates plus one-eighth of one percent.

If the district earns more than this limit on the funds that are yield restricted, the certificates may lose their tax-exempt status. If the district failed to restrict the yield earned on these funds, the failure could not be resolved by rebating the excess to the federal government.

Moreover, according to the outside legal counsel, the district cannot escape the restrictions on the yield earned on the funds by using the funds for anything other than capital projects or repaying the certificates. Specifically, if the district spends proceeds that it has deposited to its general fund for anything other than capital projects or repaying the certificates, any additional general fund monies the district receives from other sources are considered to have replenished the certificate proceeds and are subject to the same yield restrictions. Further, the district would not escape the restrictions on the yields earned on the funds by establishing an irrevocable trust or by depositing the funds to a reserve for contingencies.

In addition, when the Alameda County superintendent of schools (county superintendent) rejected the district's budget on October 31, 1989, he raised the question of whether the lease payments to be made by the district represented the fair rental value of the facilities leased. According to the outside legal counsel, the primary reason certificates of participation are used is to avoid the constitutional debt limitations and restrictions on school districts issuing bonds. Specifically, Article XVI, Section 18, of the

Constitution of the State of California states that, in a year, a school district must not incur any indebtedness that exceeds the district's unencumbered revenues in that year without approval by two-thirds of the voters in an election held for that purpose. Because the district's certificates represent the right to receive payments under a lease and because, by the creation of the lease, there allegedly is no immediate obligation to pay the entire amount of the lease payments, the lease does not constitute a debt. However, if it can be shown that, through the lease, the district actually incurred a debt that exceeded the district's unencumbered revenues in fiscal year 1989-90, the lease would be considered unconstitutional debt and, therefore, a subterfuge.

According to the outside legal counsel, one indicator that the lease constitutes debt would be if the lease payments exceeded fair rental value. Another indicator that a court might consider in deciding whether the district's lease constitutes debt is the market value of the sites leased in relation to the total amount of the lease payments. For example, the appraisal of the leased sites that the district included in its documents related to the certificates estimates a value of less than 35 percent of the principal amount of the certificates--$13.5 million. If a court were to find that the lease was invalid, the court could prohibit the district from paying the lease payments or prohibit it from paying more than a reasonable rental for the facilities. Moreover, any interest payments made with respect to the certificates could lose their tax-exempt status.

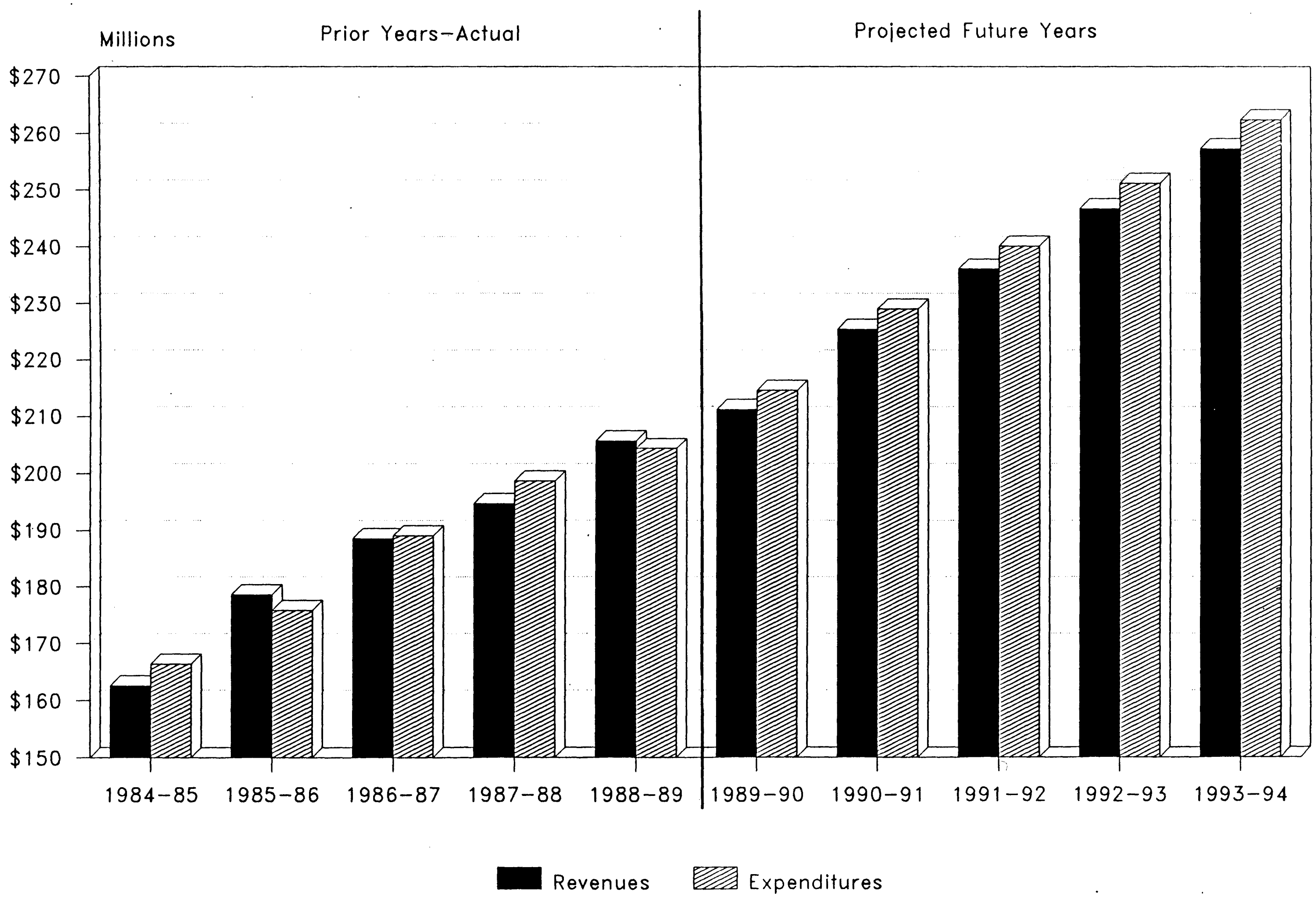
Further, the district could be subject to law suits brought against the district for securities fraud.

The District Must Reduce Expenditures Over the Next Ten Years

We analyzed the district's revenues and expenditures from fiscal year 1981-82 through fiscal year 1988-89. Using these prior years' revenues and expenditures and our projected revenues and expenditures for fiscal year 1989-90, we projected the district's revenues and expenditures from fiscal year 1989-90 through fiscal year 1999-2000. Chart 1 on the following page shows the district's actual revenues and expenditures for fiscal year 1984-85 through 1988-89 as well as our projection of the district's revenues and expenditures from fiscal year 1989-90 to fiscal year 1993-94. As shown on Chart 1, the district's actual revenues and expenditures have risen consistently since fiscal year 1984-85. Based on the trends of the prior years, we projected the district's revenues and expenditures in the future years.

CHART 1

ACTUAL REVENUES AND EXPENDITURES FROM FISCAL YEAR 1984-85 THROUGH FISCAL YEAR 1988-89 AND PROJECTED REVENUES AND EXPENDITURES FOR FISCAL YEAR 1989-90 THROUGH FISCAL YEAR 1993-1994



Using our projected revenues and expenditures, we estimated the amount of annual reductions in expenditures the district must make to avoid a general fund deficit and establish or maintain a reserve for economic uncertainty. As we discussed earlier, the district has not obtained an actuarial study to determine the amount of funds that should be maintained in a self-insurance fund. Therefore, we could not determine whether the district's budgeted reserve for self-insurance is adequate to meet the district's self-insurance needs. Accordingly, we did not include in our projection additional funds that may be required to establish an adequate reserve for self-insurance. However, it should be noted that if an actuarial study finds the district's reserve for self-insurance inadequate to meet the district's needs, the district may have to reduce expenditures by even more than is shown in our projection.

We projected the district's revenues and expenditures under three assumptions. First, we projected revenues and expenditures under the assumption that the proceeds from the certificates would not be included in the district's general fund. Instead, we assumed the district would set aside the proceeds in a special fund, only using the interest and principal from that fund to pay back the certificate holders.

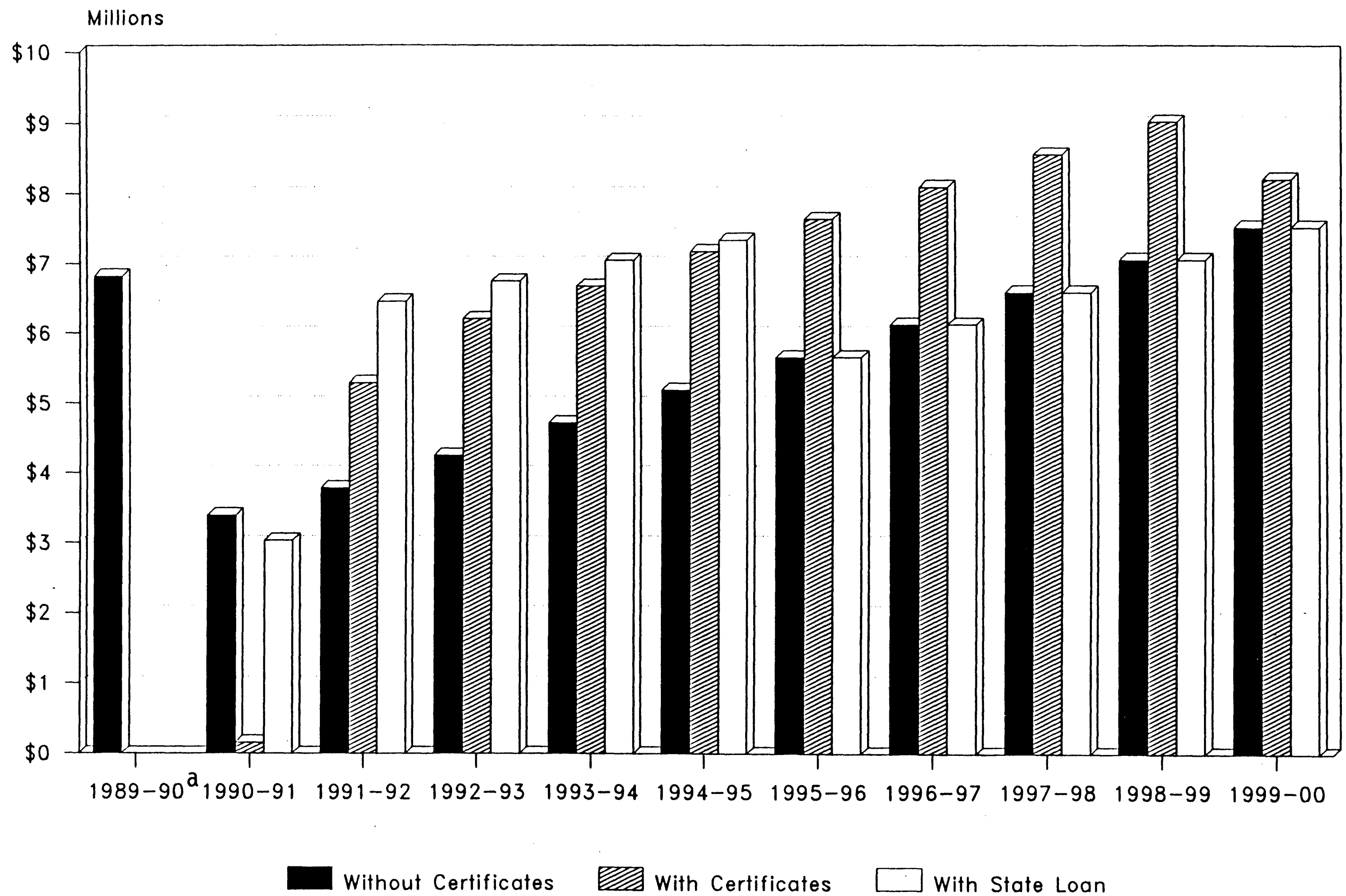
Second, we assessed the consequences of the State Department of Education's possible decision to allow the district to use the proceeds from the certificates in the general fund. Specifically, the district plans to use the proceeds from the certificates in its general fund to establish several reserve funds and for other expenditures. The district plans to pay back the certificate holders by reducing expenditures in the general fund to make those general fund monies available for the repayment.

Third, we assumed the district, again, would not use the proceeds from its certificates in its general fund but would instead request the $10 million emergency loan from the State.

For all three of the assumptions discussed above, Chart 2 on the following page shows the amount of expenditures that must be reduced over the next ten years to avoid a deficit in the general fund and establish and maintain a reserve for economic uncertainty.

CHART 2

PROJECTED AMOUNT OF EXPENDITURES THE DISTRICT WILL HAVE TO REDUCE ANNUALLY FISCAL YEAR 1989-90 THROUGH FISCAL YEAR 1999-2000



[a] The district would not have to reduce expenditures in fiscal year 1989-90 if it chose to use the proceeds from the certificates in its general fund or requested a state loan.

As shown on Chart 2, regardless of which option the district chooses, the district will have to significantly reduce its projected expenditures over the next decade to establish financial solvency. An alternative to reducing expenditures is to find additional sources of revenue beyond the district's current sources or to use a combination of expenditure reductions and revenue increases. However, for the purposes of our discussion, we assumed the district would rely on a reduction of its expenditures to meet its financial needs.

Assuming the district does not use the proceeds from the certificates in its general fund, we project that the district would have to reduce its expenditures by a total of $61.1 million over the next 11 years. As Chart 2 shows, the district would have to reduce its expenditures by approximately $6.8 million in fiscal year 1989-90 under this assumption. The majority of the cuts in expenditures in the first year, approximately $4.3 million, are necessary to establish a reserve for economic uncertainty. However, once the reserve is established, the district would only have to add enough each year to maintain a minimum reserve of 2 percent of total expenditures and other uses for the year. We project the remaining $2.5 million in expenditure reductions are necessary to avoid an undesignated fund balance deficit in the general fund. To minimize the impact of large cuts in expenditures needed in the first year under this option, the district could consider negotiating with the State Department of Education to allow the district to develop its reserve for economic uncertainty over several years.

In fiscal year 1990-91, assuming the district does not use the certificates of participation, we project that the district would have to reduce expenditures by approximately $3.4 million. This year's and all following years' projected figures are lower than the first year's because the reserve for economic uncertainty has already been established. Accordingly, we project that the district will only have to add approximately $296,000 to its reserve fund in fiscal year 1990-91. The remaining $3.1 million in expenditure reductions are necessary to avoid a projected general fund deficit.

The second option assumes the district uses the proceeds from the certificates in the general fund and repays the certificate holders with general fund monies. Under this assumption, we project that the district will have to reduce its general fund expenditures by approximately $67.0 million over the next 11 years. The primary difference in the costs between the two options over the next 11 years is attributable to the costs for principal and interest paid to the certificate holders. The interest cost is paid with general fund monies under the second option whereas the interest is paid from the interest earned on the proceeds under the first option.

Another difference between the first two options is the timing of the reductions of expenditures. Under the second option of using the proceeds in the general fund, no reductions in expenditures are required until fiscal year 1990-91. Because approximately $10 million from the proceeds of the certificates are added to the general fund in fiscal year 1989-90, the district has sufficient fund balances to establish a reserve and avoid a deficit in 1989-90. However, based on our projection, we conclude that the district will have to reduce its expenditures by approximately $161,000 in fiscal year 1990-91 and by $5.3 million in fiscal year 1991-92. Approximately $3.6 million of the cuts in expenditures in fiscal year 1991-92 are necessary to avoid a projected general fund deficit. In addition, the district's payments to its certificate holders begin in fiscal year 1991-92 and continue through 1999-2000. As a result, approximately $1.5 million of the reductions in expenditures are necessary to make the first payment from the general fund to the certificate holders. The remaining $222,000 of expenditure cuts are attributable to maintaining the reserve for economic uncertainty at the minimum level.

The third option assumes the district will not use the proceeds from the certificates in the general fund but will request an emergency loan from the State. Under this assumption, we project that the district will have to reduce its general fund expenditures by approximately $63.6 million over the next 11 years.

In calculating the cost of a $10 million state loan, we assumed that the district would receive the proceeds no earlier than June 1, 1990. We also assumed that the State Controller's Office would not begin to reduce the district's annual apportionment from the State Department of Education to repay the loan until February 1991. Since the district has five years to repay the loan, the apportionment reduction would end in May 1995.

For the first six years, the costs of this option are similar to the costs of the second option, which uses the proceeds from the certificates in the general fund. The main difference between the certificates and the state loan during the first six years is the timing of the reductions of expenditures. The district's payments to its certificate holders begin in fiscal year 1991-92 whereas the reductions in the district's apportionment from the State Department of Education begin in fiscal year 1990-91. Therefore, under the state loan option, the district would have to reduce its expenditures by approximately $3.0 million in fiscal year 1990-91 whereas, under the certificates option, the district would only have to reduce its expenditures by $161,000 in fiscal year 1990-91 to maintain the reserve for economic uncertainty and avoid a projected deficit in the general fund.

However, under the third option, since the state loan would be completely repaid in the sixth year, the district would not have to make the additional reductions to its expenditures for the state loan repayments in the last five years. Therefore, the expenditure reductions required under the state loan option for the last five years are the same as the reductions required under the first option, which does not use the proceeds from the certificates in the district's general fund.

The district's reductions in expenditures discussed earlier are also necessary to avoid depleting the district's cash balances. Using our revenue and expenditure projections, we estimated the district's cash sources and uses through fiscal year 1999-2000. Based on our projections, we conclude that the district will run out of cash within five years unless the district reduces expenditures. The district will have to cut expenditures regardless of whether or not it uses the proceeds from its certificates in the general fund and whether or not it requests the emergency state loan. For example, we project that without reductions in expenditures, the district would run out of cash by fiscal year 1991-92 without using the proceeds from the certificates, would run out of cash by fiscal year 1992-93 when using the proceeds from the certificates, and would run out of cash by fiscal year 1991-92 when using the proceeds from the state loan. In contrast, we project, regardless of whether or not the district uses the proceeds from the certificates and whether or not it requests a state loan, that the district would have adequate cash balances to meet its needs through fiscal year 1999-2000 if the district reduces expenditures as discussed earlier.

CONCLUSION

The Oakland Unified School District continues to have financial difficulties. Although the district ended fiscal year 1988-89 with a positive general fund balance, it did not have any reserves for economic uncertainty. In addition, the district would have ended the year with a deficit of approximately $1.8 million if it had not unexpectedly received additional revenues at year end from Proposition 98 and the state lottery. We project that the district will end fiscal year 1989-90 with a $8.6 million general fund balance. This projection is based on the district using the proceeds from its certificates of participation in the general fund. Nevertheless, the district will have to reduce its expenditures over the next ten years to avoid general fund deficits, establish and maintain a reserve for economic uncertainty, and have sufficient cash to meet its obligations. Finally, we noted some concerns about the district's issuance of certificates of participation. Specifically, the amount of interest earned on the certificates' proceeds is restricted, and the certificates may be considered unconstitutional debt.

RECOMMENDATION

To avoid deficits in its general fund, the Oakland Unified School District should implement a comprehensive plan to reduce its expenditures, increase its revenues, or both. The district's plan should encompass the qualitative aspects of its education program as well as the financial aspects.

II

THE OAKLAND UNIFIED SCHOOL DISTRICT HAS NOT TAKEN ADVANTAGE OF FUNDING AVAILABLE TO ASSIST ITS EDUCATIONALLY DISADVANTAGED STUDENTS AND TO IMPROVE ITS FACILITIES

The Oakland Unified School District (district) has not always participated in programs that could provide additional funds for the district to improve the education of its students and improve its facilities. For example, despite the poor academic achievement of the district's students, the district forfeited at least $4.8 million annually over the life of its Voluntary Integration Program because the district failed to fully implement its program in fiscal year 1988-89. Further, the district is not participating in at least one other educational program for which it may be eligible to receive funds.

Furthermore, funds are available to the district from the State to improve or construct school buildings. However, the district has not applied to the State for $12.6 million for new construction, $42.8 million for facilities modernization, and $6.3 million for asbestos abatement, all of which the district should be eligible to receive. As a result, the district's students and teachers may sometimes be unnecessarily housed in overcrowded, outdated, and potentially hazardous facilities. Moreover, the district failed to collect approximately $100,000 that had already been granted to it by the State for construction projects. At least $94,000 of these funds would have reimbursed the district for expenditures it has already made in making structural repairs to one of its facilities. Finally, the district has suffered delays in receiving state funding for deferred maintenance projects because it did not comply with state laws regarding the use of funds generated from the sale of real properties.

The District Has Not Taken Advantage
of All Available Sources of Funds
<u>for Improving the Education of Its Students</u>

The educational achievements of the district's students, as measured by the California Assessment Program (CAP), are among the lowest in the State. For example, in the 1988-89 school year, the district's twelfth graders ranked in the lowest 3 percent in reading and the lowest 5 percent in math compared with the rest of the State. Despite this poor academic achievement, we found that the district was not applying for or fully participating in at least two funding programs designed to improve the education of its students.

For example, school districts that establish a Voluntary Integration Program to remedy the harmful effects of racial segregation may be reimbursed by the State for the costs of such a program pursuant to the California Education Code, Section 42249. The Oakland Unified School District planned for a Voluntary Integration Program to be implemented in the 1988-89 school year. The major component of the plan was a program to reduce class size in the district's racially isolated schools by hiring 202 new teachers. The plan, provisionally approved by the State Controller's Office (SCO), called for expenditures of approximately $9.8 million in fiscal year 1988-89. The State will reimburse the district for up to 80 percent of those costs, approximately $7.8 million. The State advanced the district $5.7 million to assist the district in implementing the program. However, the district did not fully implement its integration program in fiscal year 1988-89 and still has not as of January 5, 1990.

Personnel from the SCO visited the district in May 1989 to determine what costs the district had incurred for its integration program and which of these costs would be reimbursable by the State. The SCO determined that the district hired only 30 new teachers instead of the 202 called for in the plan. Therefore, the SCO estimated that the district probably had only $1.5 million in allowable expenditures. The district submitted a claim to the SCO for its fiscal year 1988-89 integration program expenditures totaling approximately $3.8 million. The SCO is auditing the claim to determine how much of the $3.8 million claimed by the district is eligible for the program and will offset those eligible expenditures against the monies advanced to the district. Thus, the district probably only spent between $1.5 million and $3.8 million on its integration program in fiscal year 1988-89 rather than the $9.8 million called for in the district's plan.

As a result of the district's failure to fully implement its integration program in fiscal year 1988-89, the district will only be eligible for a maximum of $3 million (80 percent of the $3.8 million claimed) plus cost-of-living adjustments in annual reimbursements from the State for any future expenditures on this program. The first year of a district's program is considered its base year. According to the State Department of Finance, all future reimbursements from the State will be limited to 80 percent of a district's base year expenditures adjusted annually for applicable cost-of-living and average daily attendance adjustments. Consequently, the district has forfeited at least $4.8 million annually over the life of its integration program that it could have received from the State.

Furthermore, the district will have to repay the State for the monies advanced to it but not used on its integration program. Depending on the results of the SCO's audit of the district's claim for fiscal year 1988-89, the district will owe the State anywhere from $2.7 million to $4.5 million.

Finally, the State's budget act for fiscal year 1989-90 does not allocate any funds for the district's Voluntary Integration Program. The State Department of Finance stated that it requested the district not receive any allocation because the State Department of Finance learned from a private CPA audit report that the funds advanced to the district had been used for purposes other than an integration program. Therefore, the district cannot receive funding for its Voluntary Integration Program expenditures for fiscal year 1989-90 without legislation to provide an appropriation of funds. Furthermore, the State Department of Finance stated it would probably oppose legislation to provide such funds to the district before repayment of the funds advanced to the district in 1988.

As a result of the district's failure to fully implement its integration program, students in the district's racially isolated schools are not receiving all the benefits from the funds they were entitled to under the program, such as a reduction in their class size and the integration of their schools.

Another program that could have provided funds to the district for the advantage of improving its students' education is the Miller-Unruh Reading Program. This program was enacted to prevent and correct reading disabilities at the earliest possible time in the educational career of the pupil. Specifically, this program will partially pay the salaries of reading specialists to assist pupils with reading disabilities.

The district's third grade reading CAP scores have been in the lowest 25 percent of the State since 1985-86. However, according to the State Department of Education (SDE), the district declined to participate in the Miller-Unruh Reading Program when it first became eligible in fiscal year 1988-89. The SDE offered the district funding of up to $63,000 for three reading specialists with the State paying $21,000 of each specialist's annual salary. According to the SDE, salaries for elementary school teachers average $34,500 statewide. Therefore, we estimate the district would have to contribute an average of $13,500 annually for each specialist hired through the program.

However, the districts already admitted to the program have first priority for funds in the future. Therefore, unless districts currently in the program decline to continue in the program or funding is increased over its current levels, the Oakland Unified School District may never again have the opportunity to participate.

The district stated that it is not participating in the program because general purpose funds would have to be used for salary and benefits not paid by the State's contribution, as well as additional monies for supplies, administration, and training.

The District Has Not Taken Advantage of All Available Sources of Funds for Improving School Facilities

Funds to construct or improve school facilities are available to the district from the State through programs offered by the State Allocation Board. These programs, which are administered by the Department of General Services' Office of Local Assistance (OLA), are collectively known as the lease-purchase programs and include funds for new construction, modernization, and asbestos abatement. However, the district has not always applied for or collected all the funding available to it through these programs.

For example, the new construction program provides funding for construction of new school facilities. Although the district applied for approximately $12 million in new construction funds in May 1988, it later requested a delay in any further processing of its application.

According to the OLA, the application's justification document was approved, and the OLA was gathering additional information for the Phase I approval. Phase I is the preliminary planning stage of a project. According to the OLA, if the district's application was approved by the State Allocation Board, the district would have received approximately $123,000 for appraisals, escrow and title reports, boundary surveys, and architectural fees. However, in April 1989, the district requested a delay in any further processing of its application. According to the OLA, state funding for Phase I was available at the time of the district's application. However, those funds are no longer available. As a result, the district forfeited approximately $123,000 that would have been available to it from the State for preliminary planning of the project.

In addition, at our request, the OLA reviewed the district to determine its potential eligibility for the lease-purchase program. The OLA estimates that the district could be eligible to receive approximately $12.6 million from the lease-purchase new construction program. (The appendix provides the OLA's estimates of the district's eligibility for the lease- purchase new construction and modernization programs. The appendix shows the amount of funds each school is estimated to be eligible to receive under the programs.) However, until the district submits an application for new construction funding, the district will not be eligible to receive any portion of the estimated $12.6 million from the State. The State will contribute the difference between the total construction costs and developer fees that can be collected from builders issued building permits during a specific period.[1] The district can pay its share of the construction costs from the developer fees levied on building permits. Therefore, the district's out-of-pocket construction costs could be zero since the district's share of the costs could be paid entirely with developer fees. However, the district has not taken any steps to initiate the collection of developer fees. If the district does not want to pursue developer fees, it may use its own funds to pay an amount equivalent to the developer fees that could have been collected.

In addition, the district has not applied for approximately $42.8 million of modernization funds that the OLA estimates the district may be eligible to receive. These funds are available to the district to renovate its buildings over 30 years old that meet certain criteria. The OLA reviewed the district's facilities and determined that 61 schools throughout the district are eligible for modernization funds. The matching share requirement for the modernization program is the same as for the new construction program. Therefore, the district's out-of-pocket costs for its modernization projects could also be zero if the district paid its matching share with developer fees. However, as stated earlier, the district has not taken any steps to initiate the collection of developer fees.

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[1]The California Government Code, Section 53080, authorizes the governing board of any school district to levy a fee against development projects within the boundaries of the district for the purpose of funding construction or reconstruction of school facilities.

Furthermore, the district has not applied for state funding for removal of asbestos in its schools through the Lease-Purchase Asbestos Abatement Program. A report prepared by a consultant hired by the district identified potentially hazardous asbestos covering pipes and ducts throughout many of the district's schools. Based on data from that report, the OLA estimates that approximately $12.7 million of the costs to remove the potentially hazardous asbestos appears to qualify for the State's asbestos abatement program. The State will reimburse large school districts for approximately 50 percent of the eligible costs of removal. As a result, the OLA estimates that the district may be eligible to receive approximately $6.3 million from the State for removal of asbestos from the district's schools and other buildings. However, the district has not applied for these funds.

Finally, the district forfeited approximately $100,000 available to it from the State for structural repairs at two sites. In 1981, the district applied to the State Allocation Board for funding to repair structural deficiencies at King Estates Junior High School. The State Allocation Board approved approximately $94,000 to fund this project with the provision that the district provide additional documentation before the release of any funds to the district. The district completed the work and paid the costs with its own funds. However, the district never submitted the documentation to be reimbursed by the State for the costs of the project. In fact, the district received written notice dated December 11, 1986, stating that the allocations would be rescinded in 60 days if the district did not submit the documentation. Consequently, in 1987, approximately six years after the initial allocation, the State Allocation Board rescinded the allocations.

In another instance, the district applied to the State Allocation Board for funding to repair structural deficiencies in the athletic field bleachers at McClymonds High School. In June 1981, the State Allocation Board allocated approximately $6,800 for the preliminary planning phase of the project. In June 1985, the OLA wrote to the district asking for written notification within 30 days of the date of the letter stating when the district intended to proceed with the project. However, the district did not inform the OLA of any action taken by the district on the project. As a result, the State Allocation Board rescinded the district's allocation in January 1986. District officials could not explain why the district did not collect the state funds allocated for these projects.

As a result of the district's failure to apply for and collect funds for which it has been eligible and, in other cases, may still be eligible to receive from the State for new construction, modernization, and asbestos abatement, the students and teachers of the district may sometimes be unnecessarily housed in overcrowded, outdated, and potentially hazardous facilities.

We reviewed the district's files to determine why it was not pursuing funding from the State's lease-purchase programs. A note handwritten by a district official on a letter from the OLA to the district indicates the district wanted to avoid state controls over the district's property income. Specifically, the handwritten note states that "to date, the application has been put on hold since all property income would be subject to state OLA controls." The OLA stated in the letter that when the district receives funds from the lease-purchase program, any proceeds from the sale of surplus property become subject to the provisions of the California Education Code, Section 17732. Specifically, these provisions may, in effect, encourage the district to use proceeds from the sale of surplus properties for capital outlay projects. Therefore, if the district did not use the proceeds for capital outlay projects, the OLA could collect an amount equivalent to the proceeds from the district.

The district stated that some of the reasons why it is not actively pursuing funding from the State's lease-purchase program is that the district is attempting to maximize its use of existing buildings through year-round schools and magnet schools and by adjusting school boundaries to more effectively use surplus space. The district also utilizes over 800 portable classrooms to meet the changing housing needs and demographic movements within the district in a flexible manner without building new facilities. In addition, the district states that "substantial temporary housing may be required" when undertaking a modernization project because it is unlikely that all such work could occur in a summer session. Finally, the district notes that it has made dramatic nonclassroom staff reductions and, therefore, does not have staff such as architects, engineers, surveyors, and inspectors to enter all phases of a major project.

While the district's efforts to maximize the use of its existing facilities are in the best interests of the district and the State, the district needs to plan for the future. The OLA establishes eligibility for new construction funds by comparing the district's projected needs for facilities with existing facilities. Therefore, the OLA's estimate that the district may be eligible to receive approximately $12.6 million for new construction indicates that the district has or is projected to have significant need for additional school facilities. However, if the district intends to utilize its existing facilities rather than build new ones, the best interests of the students and teachers occupying those facilities would be served by modernizing the buildings and removing potentially hazardous asbestos wherever possible.

The District Did Not Comply With State Requirements for Depositing Funds From The Sale of Real Property

The California Education Code, Section 39363, requires the district to use proceeds from the sale of real property for capital outlay or for maintenance, unless the district's governing board and the State Allocation Board have determined that the district has no anticipated need for additional sites or building construction for five years following the sale and the district has no major deferred maintenance requirements. If both the district's board and the State Allocation Board have made such a determination, the district may deposit the proceeds in its general fund. However, the district has an ongoing need for deferred maintenance. Specifically, the district spent over $2.4 million on deferred maintenance in fiscal year 1988-89 and has budgeted $2.7 million for deferred maintenance in fiscal year 1989-90.

Despite the restrictions on the use of proceeds from the sale of real property and the district's ongoing need for deferred maintenance, on December 22, 1988, the district deposited $84,500 in proceeds from the sale of three pieces of surplus property in its general fund. The district did not apply to the State Allocation Board for its concurrence in making this deposit but expected to receive over $512,000 from the State for its fiscal year 1988-89 deferred maintenance program.

Similarly, on September 7, 1989, the district deposited in its general fund $1.6 million in proceeds from the sale of another piece of surplus property, again without following the required procedures. In fact, according to the district's budget for fiscal year 1989-90, the district expects to receive another $850,000 from the State for deferred maintenance in fiscal year 1989-90.

We notified the district on July 26, 1989, that it had violated the California Education Code in 1988 by depositing the $84,500 in proceeds from the sale of surplus property in its general fund without first obtaining approval from the State Allocation Board. Similarly, on November 9, 1989, we notified the district that it had again violated the California Education Code on September 7, 1989, by depositing the $1.6 million in proceeds from the sale of surplus property in its general fund. Further, on November 14, 1989, we notified the OLA, which also administers the deferred maintenance program on behalf of the State Allocation Board, that the district had deposited these funds to its general fund. As a result, the OLA placed a hold on the district's fiscal year 1988-89 deferred maintenance funds.

On December 15, 1989, the district transferred $1.6 million and $36,423 in interest income on the $1.6 million from its general fund to a newly established special reserve fund for capital projects. Further, on January 5, 1990, the district transferred the $84,500 in proceeds from the sale of surplus property and $7,587 interest earned on those proceeds from its general fund to the special reserve fund for capital projects. As of January 9, 1990, the OLA had not released deferred maintenance funds to the district for its fiscal year 1988-89 deferred maintenance program. However, according to the manager of fiscal services at the OLA, it will now release the fiscal year 1988-89 funds to the district, and the district will now be eligible to participate in the deferred maintenance program for fiscal year 1989-90.

CONCLUSION

The Oakland Unified School District does not always participate in programs that could provide additional funds to improve the education of its students and improve its facilities. For example, despite the poor academic achievement of the district's students, the district forfeited at least $4.8 million annually over the life of its Voluntary Integration Program. Furthermore, the district has not applied to the State for an estimated $12.6 million for new construction, $42.8 million for facilities modernization, and $6.3 million for asbestos abatement, all of which the district should be eligible to receive. As a result, the district's students and teachers may sometimes be unnecessarily housed in overcrowded, outdated, and potentially hazardous facilities. Moreover, the district failed to collect approximately $100,000 that had already been granted to it by the State for construction projects. At least $94,000 of this amount would have reimbursed the district for expenditures it has already made in making structural repairs to one of its high schools. Finally, the district has suffered delays in receiving state funding for deferred maintenance projects because it did not comply with state laws regarding the use of funds generated from the sale of real properties.

RECOMMENDATION

The Oakland Unified School District should apply for all funding for programs that it determines would be cost beneficial to the education of the students and the district as a whole.

We conducted this review under the authority vested in the auditor general by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Kurt R. Sjoberg

KURT R. SJOBERG
Acting Auditor General

Date: January 24, 1990

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STATE OF CALIFORNIA

GEORGE DEUKMEJIAN, *Governor*

DEPARTMENT OF GENERAL SERVICES
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January 5, 1990

Ms. Sally Filliman, Audit Manager
Financial Division
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

SUBJECT: Lease-Purchase Program Eligibility Status - Oakland Unified School District

Dear Ms. Filliman:

The following data regarding potential Lease-Purchase Program projects is being submitted at your request.

The number and extent of these projects are estimates only. Their eligibility, in the majority of cases, is based on data submitted by the District. This data may not be in full compliance with the rules and regulations of the Lease-Purchase Program. As mentioned in our letter to you dated December 12, 1989, for those schools where proposed modernization projects exist, complete dimensioned schematic diagrams are required. In several instances, dimensioned diagrams were not submitted. Therefore, the project eligibility for those schools can not be determined at this time. These schools are, however, noted on the attached lists.

This information has been compiled to provide the Auditor General with a determination of potential eligibility for project apportionments available to the District through the Lease-Purchase Program. Attached are lists identifying these projects by type - either new construction or modernization. An estimate of each project's total cost has been provided. In addition, funding eligibility is based, in part, on a priority point computation. Those projects which do not meet current priority point thresholds are noted.

As always, please contact Florence King at (916) 322-1049 or J. Michael Williams at (916) 322-5551 if you should have any further concerns with the information provided.

Sincerely,

D Brent Koff for
Art S. Kevorkian
Local Assistance Officer

ASK:JMW:FK:abk

Attachments

cc: Mr. Fred Forrer, Auditor, Office of the Auditor General
Ms. Elizabeth Yost, Chief Deputy Director, Department of General Services
Mr. Rich Gillam, Manager, Audit Section, Office of Management Technology & Planning

OAKLAND UNIFIED

ESTIMATED NEW CONSTRUCTION ELIGIBILITY

High School Attendance Area	Number of Projects	Total Estimated Apportionment
Castlemont	0	$ 0
Fremont	0	0
Mc Clymonds	0	0
Oakland	0	0
Oakland Tech	7	12,604,864*
Skyline	0	0
Districtwide	7	$12,604,864

* This figure does not include any costs associated with site acquisition. In urban areas, site acquisition costs may be substantial.

OAKLAND UNIFIED

ESTIMATED MODERNIZATION ELIGIBILITY

High School Attendance Area	Number of Projects	Total Estimated Apportionment
Castlemont	16	$14,545,550
Fremont	11[a]	8,406,589
Mc Clymonds	5	2,427,566
Oakland	6	5,567,054
Oakland Tech	11[b]	5,897,681
Skyline	12	5,988,875
Districtwide	61	$42,833,314

[a] Actual building area at 4 school sites unavailable and therefore not included in this figure.

[b] Actual building area at 3 school sites unavailable and therefore not included in this figure.

CASTLEMONT HIGH SCHOOL ATTENDANCE AREA

NEW CONSTRUCTION PROGRAM

The District has no eligibility for any new construction projects using either a 3/4 year or 5/6 year enrollment projectio

MODERNIZATION PROGRAM

School	Building Area (S.F.)	Phase I Feasibility Studies	Phase 2 Preliminary Planning	Phase 3 Construction	Total Estimated Apportionment
Brookfield Elementary	42,640	$ 38,376	$ 63,690	$1,177,134	$1,279,200
Burkhalter Elementary	24,688	22,219	37,032	681,389	740,640
Cox Elementary	71,239	64,115	106,859	1,966,196	2,137,170
Grass Valley Elementary	13,379	12,041	20,069	369,260	401,370
Highland Elementary	40,340	36,306	60,510	1,113,384	1,210,200
Howard Elementary	28,780	25,902	43,170	794,328	863,400
Lakewood Elementary	46,420	41,778	69,630	1,281,192	1,392,600
Melrose Elementary	22,479	20,231	33,719	620,420	674,370
Parker Elementary	45,057	40,551	67,586	1,243,573	1,351,710
Sobrante Elementary	29,801	26,821	44,702	822,507	894,030
Toler Heights Elementary	5,235	4,712	7,853	144,485	157,050

Castlemont High School Attendance Area (Continued)

Webster Elementary	50,781	45,703	76,172	1,401,555	1,523,430
Elmhurst Jr. High	54,025	48,623	81,038	1,491,089	1,620,750
Havenscourt Jr. High	47,402	42,662	71,103	No Eligibility*	113,765
Kings Estates Jr. High	46,740	42,066	70,110	No Eligibility*	112,176
Castlemont High	81,877	73,689	No Eligibility*	No Eligibility*	73,689
		$585,795	**$853,243**	**$13,106,512**	**$14,545,550**

* The number of priority points associated with this project does not meet the funding threshold for this phase.

FREMONT HIGH SCHOOL ATTENDANCE AREA

NEW CONSTRUCTION PROGRAM

The District has no eligibility for any new construction projects using either a 3/4 year or 5/6 year enrollment projection.

MODERNIZATION PROGRAM

School	Building Area (S.F.)	Phase I Feasibility Studies	Phase 2 Preliminary Planning	Phase 3 Construction	Total Estimated Apportionment
Sherman Elementary	18,046	$ 16,241	$ 27,069	$ 498,070	$ 541,380
Maxwell Elementary	35,102	31,592	52,653	968,815	1,053,060
Allendale Elementary	33,780	30,402	50,670	932,328	1,013,400
Markham Elementary	30,885	27,797	46,328	852,425	926,550
Jefferson Elementary	29,976	26,978	44,964	827,338	899,280
Whittier Elementary	38,366	34,529	57,549	1,058,902	1,150,980
Hawthorne Elementary	40,836	36,752	61,254	1,127,074	1,225,080
Burbank Elementary	18,581	16,723	27,872	512,835	557,430
DCH	Not Available[1]	---	---	---	---
Horace Mann Elementary	32,324	29,092	48,486	892,142	969,720
Lazear Elementary	Not Available[1]	---	---	---	---

Whitton Elementary	28,295	25,466	42,443	Not Eligible	67,909
Frick Jr. High	Not Available[1]	---	---	---	---
Simmons Jr. High	Not Available[1]	---	---	---	---
Fremont High	2,000	1,800	Not Eligible[2]	Not Eligible[2]	1,800
		$277,372	$459,288	$7,669,929	$8,406,589

(1) Actual building area unavailable.
(2) The number of priority points associated with this project does not meet the funding threshold for this phase.

MC CLYMONDS HIGH SCHOOL ATTENDANCE AREA

NEW CONSTRUCTION PROGRAM

The District has no eligibility for any new construction projects using either a 3/4 year or 5/6 year enrollment projection.

MODERNIZATION PROGRAM

School	Building Area (S.F.)	Phase I Feasibility Studies	Phase 2 Preliminary Planning	Phase 3 Construction	Total Estimated Apportionment
Cole Elementary	38,818	$ 34,936	$ 58,227	$1,071,377	$1,164,540
Lafayette Elementary	37,395	33,656	56,093	1,032,101	1,121,850
Longfellow Elementary	16,445	14,801	24,668	Not Eligible*	39,469
Lowell Jr. High	21,930	19,737	32,895	Not Eligible*	52,632
Mc Clymonds High	54,528	49,075	Not Eligible*	Not Eligible*	49,075
		$152,205	$171,883	$2,103,478	$2,427,566

* Not Eligible - The number of priority points associated with this project does not meet the funding approval level for this phase.

OAKLAND HIGH SCHOOL ATTENDANCE AREA

NEW CONSTRUCTION PROGRAM

The District has no eligibility for any new construction projects using either a 3/4 year or 5/6 year enrollment projection

MODERNIZATION PROGRAM

School	Building Area (S.F.)	Phase I Feasibility Studies	Phase 2 Preliminary Planning	Phase 3 Construction	Total Estimated Apportionment
Bella Vista Elementary	42,658	$ 38,392	$ 63,987	$1,177,361	$1,279,740
Franklin Elementary	34,824	31,342	52,236	961,142	1,044,720
Garfield Elementary	36,442	32,798	54,663	1,005,799	1,093,260
Glenview Elementary	39,034	35,131	58,551	1,077,338	1,171,020
Manzanita Elementary	29,286	26,357	43,929	808,294	878,580
Roosevelt Jr. High	41,556	37,400	62,334	No Eligibility*	99,734
		$201,420	**$335,700**	**$5,029,934**	**$5,567,054**

* The number of priority points associated with this project does not meet the funding threshold for this phase.

OAKLAND TECH HIGH SCHOOL ATTENDANCE AREA

NEW CONSTRUCTION PROGRAM

School	Building Area (S.F.)	Phase 1 Feasibility Studies	Phase 2 Preliminary Planning	Phase 3 Construction	Estimated Apportionment
Conventional Application[1]					
Future Elementary I	$45,726	$ 164,614	$ 274,356	$ 5,048,150	$ 5,487,120
Future Elementary II	46,662	167,983	279,972	5,151,485	5,599,440
Advance Site Plans Application[2]					
Oakland Tech Addition	$66,744	$ 240,278	$ 400,464	N/A[4]	$ 640,742
Future Jr. High	30,734	110,642	184,404	N/A[4]	295,046
Future Sr. High	67,804	244,094	No Eligibility[3]	N/A[4]	244,094
Future Elementary III	45,360	163,296	No Eligibility[3]	N/A[4]	163,296
Future Elementary IV	48,646	175,126	No Eligibility[3]	N/A[4]	175,126
		$1,266,033	$1,139,196	$10,199,635	$12,604,864[5]

[1] 3/4 year enrollment projection

[2] 5/6 year enrollment projection

[3] Priority points associated with this project does not meet the funding threshold for this phase

[4] Advance site/plans projects (5/6 year enrollment projection) must be justified as a conventional project (3/4 year enrollment projection) prior to the Phase 3 construciton apportionment

[5] This figure does not include any costs associated with site acquisition

MODERNIZATION PROGRAM

School	Building Area (S.F.)	Phase I Feasibility Studies	Phase 2 Preliminary Planning	Phase 3 Construction	Total Estimated Apportionment
Peralta Elementary	Not Available[1]	$ ---	$ ---	$ ---	$ ---
Lakeview Elementary	36,191	32,572	54,287	998,871	1,085,730
Hillcrest Elementary	12,905	11,615	19,358	356,177	387,150
Golden Gate Elementary	46,797	42,117	70,196	1,291,597	1,403,910
Emerson Elementary	Not Available[1]	---	---	---	---
Chabot Elementary	25,378	22,840	38,067	700,433	761,340
Arts Elementary	6,280	5,652	9,420	173,328	188,400
Piedmont Avenue Elementary	28,718	25,846	43,077	792,617	861,540
Santa Fe Elementary	31,519	28,367	47,279	869,924	945,570
Washington Elementary	42,290	38,061	63,435	No Eligibility*	101,496
Claremont Jr. High	53,153	47,838	79,730	No Eligibility*	127,568
Oakland Tech High	Not Available[1]	---	---	---	---
Westlake Jr. High	21,611	19,450	No Eligibility*	No Eligibility*	19,450
Grant High	17,252	15,527	No Eligibility*	No Eligibility*	15,527
		$289,885	$424,849	$5,182,947	$5,897,681

(1) Actual building area unavailable.
* The number of priority points associated with this project does not meet the funding threshold for this phase.

SKYLINE HIGH SCHOOL ATTENDANCE AREA

NEW CONSTRUCTION PROGRAM

The District has no eligibility for any new construction projects using either a 3/4 year or 5/6 year enrollment projection

MODERNIZATION PROGRAM

School	Building Area (S.F.)	Phase I Feasibility Studies	Phase 2 Preliminary Planning	Phase 3 Construction	Total Estimated Apportionment
Fruitvale Elementry	35,305	$ 31,775	$ 52,958	$ 974,417	$1,059,150
John Swett Elementary	11,787	10,608	17,681	325,321	353,610
Joaquin Miller Elementary	25,350	22,815	38,025	699,660	760,500
Laurel Elementary	20,576	18,518	30,864	567,898	617,280
Montclair Elementary	25,295	22,766	37,943	698,141	758,850
Redwood Heights Elementary	22,180	19,962	33,270	612,168	665,400
Sequoia Elementary	26,670	24,003	40,005	736,092	800,100
Thornhill Elementary	20,436	18,392	30,654	564,034	613,080
Tilden Elementary	12,779	11,501	19,169	No Eligibilty*	30,670
Bret Harte Jr. High	44,103	39,693	66,155	No Eligibilty*	105,848
Montera Jr. High	84,515	76,064	126,773	No Eligibilty*	202,837

Skyline High School Attendance Area (Continued)

Skyline Sr. High	23,944	21,550	No Eligibilty*	No Eligibilty*	21,550
		$317,647	$493,497	$5,177,731	$5,988,875

* The number of priority points associated with this project does not meet the funding threshold for this phase.

OAKLAND UNIFIED SCHOOL DISTRICT

OFFICE OF THE SUPERINTENDENT

ADMINISTRATION BUILDING
1025 Second Avenue
Oakland, California 94606
(415) 836-8200

January 23, 1990

Mr. Kurt Sjoberg, Acting Auditor General
Office of the Auditor General
State of California
660 J Street, Suite 300
Sacramento, CA 95814

Re: Report on the Financial Position of the
Oakland Unified School District

Dear Mr. Sjoberg:

I would like to thank you and your staff for your report on the financial position of the Oakland Unified School District. This report will assist the District in developing its budgets for the 1990-91 fiscal year and on into the future. It will also help us identify areas where our budget planning and implementation process has not been sound, and in developing the recovery plan required by Assembly Bill 2525.

In this letter I will respond briefly to the principal findings made in your report.

Response to Finding I:

"THE OAKLAND UNIFIED SCHOOL DISTRICT CONTINUES TO HAVE FINANCIAL DIFFICULTIES."

The principal conclusion in this section of the report is that the District must reduce its expenditures over the next ten years in order to avoid a series of unbalanced budgets. As I hope to indicate herein, the District is cognizant of this problem and has already taken what I consider to be sound steps to avoid a budget deficit for the 1989-90 fiscal year and to insure a balanced budget for succeeding years.

The report indicates the District ended the 1988-89 fiscal year with a general fund balance of $1.778 million. You point out that the District attained this position as a result of the receipt of "unexpected revenues" in the amount of $3.6 million. This $3.6 million consisted of $900,000 from state lottery revenues and $2.7 million from Proposition 98, which was passed in November 1988. While it is true that the District received more lottery funds that it anticipated, it is not quite true that the Proposition 98 funds were unexpected. Although the ultimate disposition of the Proposition 98 funds was not accomplished until close to the end of the 1988-89 fiscal year and therefore could not be included in budget projections, District administrators did assume that Oakland would receive several million dollars of such funds. In fact, this District, like some others, actually received less Proposition 98 funds than had been anticipated, because it wrongly assumed that such funds would be allocated on a student per capita basis. Nonetheless, the funds the District did receive allowed it to end the year with a surplus.

The report also indicates that the District did not establish a reserve for economic uncertainty for the 1988-89 school year. The District is in the process of establishing such a reserve for the 1989-90 fiscal year and future years. Likewise, the report points out that the District has not established an adequate reserve for self-insurance. The District agrees with this point and has begun the process of analyzing its risk in the areas of potential property damage, third party liability, and personnel costs. As a result of that study, the District will determine whether and how to appropriately insure itself against such losses.

Fiscal Year 1989-90 Budget

You have analyzed the District's budget for the 1989-90 fiscal year and have concluded that the District will end that year with a fund balance of $8.6 million, a sum almost equal to the $10 million which the District will realize through the sale of certificates of participation. While we agree with your office that the District will end the 1989-90 fiscal year with a healthy fund balance, we think the balance may be somewhat larger than you have concluded.

First, you have estimated that the District's expenditures for employee benefits will be $1.28 million greater than projected by the District. (p. 16) We think that this figure may be reduced for two reasons. First, it is based in part upon prior year experience which is distorted as a result of two extraordinary cases for which the District paid out benefits of over $1 million in calendar year 1989. 1* In addition, the District is in the process of instituting cost containment measures which are estimated to result in meaningful cost savings.

* Office of the Auditor General's comments are on page 71.

Secondly, you have included in your figures a transfer out in the amount of $1.87 million from the District's general fund to the cafeteria and child development funds. (pp. 17-18) The District has undertaken measures to eliminate or reduce transfers from the general fund to these funds, and hopes to reduce the current year's figure to no more than $1.2 million. In fact, the cafeteria fund's outstanding long-term debt to the general fund is being liquidated. In the 1988-89 fiscal year the cafeteria fund repaid $500,000 to the general fund, and it is anticipated that an identical amount will be repaid this year. 2

Finally, although this is a relatively minor matter, you have adjusted our revenue from state apportionment to reflect a projected decrease of $464,000. Our most recent figures indicate that that adjustment should be only $405,000, resulting in an increase to the District of $59,000.

As a result of the points mentioned above, we believe that the fund balance may reach $10 million at the end of this fiscal year. Of course, this figure is subject to change, as we develop more timely projections of both revenues and expenditures.

The report also indicates (p. 18) that the District included in its beginning fund balance $681,000 previously paid into its annuity plan for certain classified employees which the District claims should be credited against its future obligations. The District agrees that this sum should no longer be included in the fund balance because its entitlement to these funds is contingent. The District is presently attempting to vindicate its position before the Public Employment Relations Board. An administrative law judge has recommended that PERB rule against the District. The District has contested this recommendation and believes that its chances of succeeding in this matter are substantial. If so, these funds would be used to reduce the District's future liability for the annuity plan.

The report points out that the District has not established an adequate reserve for economic uncertainty, and that the $2 million set aside is substantially less than two percent of the District's budget or $4.278 million. (p. 19) However, the District is in the process of negotiating with the State Department of Education to allow it to establish an appropriate reserve over a period of more than one year. If these negotiations are successful, the $2 million allocated during the 1989-90 fiscal year will augmented during the next fiscal year.

The report indicates (p. 20) that the District's salary expenditure projection does not include cost of living adjustments. These matters remain under negotiation with the appropriate employee collective bargaining units.

Certificates of Participation

The report discusses the District's issuance of certificates of participation at some length. As you know, the District has been in virtually constant communication with the fiscal oversight division of the California State Department of Education with respect to these issues, and we have recently submitted an expenditure proposal for the 1989-90 fiscal year which we believe will satisfy SDE's concerns. In the District's most recent proposal, it indicated its plans to spend approximately $4.5 million from the proceeds of the certificates of participation on capital projects. Specifically, these projected uses include asbestos abatement work, the development and purchase of an integrated personnel and financial computer system which will allow the District to modernize its financial and personnel procedures, and deferred maintenance. We are confident that this use of the proceeds from the certificates of participation is consistent with the concerns raised by both SDE and your office. In addition, this use of the proceeds from the certificates will leave substantial funds to be utilized for capital projects in succeeding years. This factor will have some impact on the budget deficits projected in the next section of your report.

The Next Ten Years

Your report indicates that the District must reduce its expenditures over the next ten years in order to avoid continuing budget deficits estimated by you to range from 1.5 percent to 2.5 percent in the years 1990 through 1994. To eliminate these deficits the District will take the following actions:

1. We will adopt a policy requiring all categorical and special programs, except for special education, to pay for themselves. The use of general purpose funds to subsidize the cafeteria program, transportation, child development centers, and compensatory education programs such as bilingual education and special education will be reduced and hopefully eliminated.

2. We will develop a fiscally sound relationship between the facilities used and District enrollment. We will either phase out the use of underutilized facilities or develop approaches which increase their use and enrollment and thereby create economies of scale.

3. We will insure that salary increases for certificated and classified personnel are generally limited to annual cost of living adjustments in state allocations to school districts.

4. We will increase the productivity of our staff through appropriate deployment which maximizes direct services to children.

5. We will enforce controls on the hiring of staff and the creation of positions to insure that actual staffing is within budgetary allocations.

6. Each spring we will project our staff for the following fall on a conservative basis so as not to create unfunded surpluses in various categories.

7. We will carefully examine our staffing needs in all classified categories and where possible eliminate unneeded positions by attrition.

8. We will reduce our dependence on contract services, increase the efficiency of the services that we do use, and carefully control hiring and costs in these areas, all as indicated in our response to your previous management report.

9. We will implement a risk management program to reduce the District's costs in its property loss, personnel benefit programs, and third party liability cases.

10. We will also seek to increase revenue coming into the District. We have already begun efforts to improve the accounting of average daily attendance. By adopting procedures designed to maximize the efficiency of such accounting we will increase state revenues. We also anticipate the increase of such revenues as improvements in our educational program attract more students to the District in future years.

We believe that the District can take effective measures to eliminate budget deficits in future years. As we understand it, your projections are based upon current levels of revenue and expenditures. However, we plan to reduce expenditures from the current level, both as a result of the measures mentioned above, and as a result of the one-time issuance of the certificates of participation in this fiscal year. The use of the proceeds from the certificates of participation in this fiscal year and in future years will reduce expenditures budgeted for capital outlays, including the purchase and development of the District's new computer system and some deferred maintenance costs. If we eliminate expenditures associated with such items from the current budget and therefore from projections based upon the current budget, then anticipated future expenditures will also be reduced. Even if this reduction is as little as $2 million annually, a conservative estimate, it will have a significant effect on the deficits you project. 3

Your report outlines several options for reducing District expenditures in years ahead. As you note, the use of the certificates of participation allows the District some space before it must implement significant reductions in expenditures for the 1991-92 fiscal year. The use of this option will allow the District to rationally implement the proposals mentioned above over a period of time so as not to cause radical disruptions in existing programs.

Response to Finding II:

"THE OAKLAND UNIFIED SCHOOL DISTRICT HAS NOT TAKEN ADVANTAGE OF FUNDING AVAILABLE TO ASSIST ITS EDUCATIONALLY DISADVANTAGED STUDENTS AND TO IMPROVE ITS FACILITIES."

The report points out that the District mismanaged its voluntary integration program during the 1988-89 school year and therefore forfeited funds that it might otherwise have obtained during that year and in subsequent years pursuant to California Education Code Section 42249. The 1988-89 year provides the base year for that program, so that lowered District eligibility for funds during that year will severely restrict its eligibility during all subsequent years of the program. The loss to the District could be as great as $4.8 million for the 1988-89 school year and greater amounts for subsequent years.

The loss of voluntary integration program funds for the 1988-89 fiscal year and for subsequent years is a matter of vital concern to the District. Our goal is to establish a viable program and to seek the assistance of officials in the State Department of Education as well as members of the legislature to allow the District to establish a new base year. We are pursuing two initiatives in this regard. First, we are working with members of the State Assembly who will introduce legislation to allow Oakland to establish a new base year. Second, we believe that existing law allows Oakland to establish a new base year and are seeking recognition of this interpretation by appropriate state officials. We are hopeful that the responsible public officials will look favorably upon the District's recovery plan and its new leadership in considering a request that is critical to the interests of Oakland's children.

The report also points out that the District has failed to participate in the Miller-Unruh Reading Program. Under that program the District had the opportunity to obtain funding of up to $63,000 to pay the partial salaries of three reading specialists during the 1988-89 school year. The District understands that its failure to participate in the reading program may disable it from ever receiving funds under the relevant statutes. Nonetheless, the District will submit an application for participation in this program in future years.

Finally, the report indicates that the District has not sought all available funding for improving school facilities. In particular, the District has not taken advantage of programs administered by the Department of General Services' Office of Local Assistance for new construction, modernization, and asbestos abatement. As a result of an inquiry from your office, the Office of Local Assistance has indicated that the District could be eligible to receive approximately $12.6 million for new construction and $42.8 million in modernization funds. The District's cost of such programs could be zero, if it were able to levy developer fees against new construction projects within the boundaries of the District.

Additionally, the District may be eligible for approximately 50 percent of the cost of abating potentially hazardous asbestos in the District schools. The Office of Local Assistance has estimated that the cost of such cleanup could total $12.7 million, with the District eligible for reimbursement in the amount of approximately $6.35 million.

In response to your report the District will re-examine its approach towards applying for state funds for the construction of new facilities, modernization of existing buildings, and asbestos removal. As part of this process the District will work with the City of Oakland to determine its eligibility for Redevelopment Agency funds and will explore the potential for levying developer fees against new construction in Oakland. During the next year it will develop a long range plan for the use and improvement of all facilities.

Once again I would like to thank you and your staff for your careful examination of District policies and practices and recommendations for improvement in the future. We are confident that the reports prepared by your office as well as those in preparation by a private firm as required by Assembly Bill 2525 will provide the District with the guidance necessary to develop a successful recovery plan leading to the marked improvement of the educational opportunities offered to the students of Oakland.

Very truly yours,

Richard P. Mesa
Superintendent

RPM:DS:cm
018.LTC90

THE OFFICE OF THE AUDITOR GENERAL'S COMMENTS ON THE RESPONSE FROM THE OAKLAND UNIFIED SCHOOL DISTRICT

1 Our estimate of the district's employee benefits was based on interviews and information obtained from the director of the district's Integrated Personnel and Financial System. During an interview, the director told us about these two "extraordinary" cases and the cost containment measures the district had implemented. However, as we state in our report, he estimated that the district was underbudgeting health care costs by 15 percent in the fiscal year 1989-90 budget. In addition, as the district states, these cases required the district to make expenditures related to these cases in both fiscal years 1988-89 and 1989-90. Further, it is our understanding that the district is still incurring some of these expenses.

2 The district states that it repaid $500,000 from the cafeteria fund to the general fund in fiscal year 1988-89. However, it should be noted that the district transferred $621,000 from the general fund to the cafeteria fund during the same year.

3 We believe that the actions the district states it will take can result in cost savings. However, the district will have to reduce its general fund expenditures by more than $2 million annually to establish financial solvency.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps