MCOE

MARIN COUNTY OFFICE OF EDUCATION

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MARY JANE BURKE
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SUPERINTENDENT OF SCHOOLS

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September 24, 2021

Ross Millerick, Board President
Members of the Novato Unified School District Board
Novato Unified School District
1015 7th Avenue
Novato, CA, 94945

Dear Mr. Millerick and Members of the Board,

In accordance with Education Code Sections 42127, the Marin County Office of Education reviewed the adopted budget of the Novato Unified School District for fiscal year 2021-22 and issued a letter on September 15, 2021, conditionally approving the District's 2021-22 Adopted Budget.

Subsequent to our review, we have continued to gather and analyze data, including the finalization of the 2020-21 fiscal year. In spite of a positive change to the district's ending fund balance, there are other items that further exacerbate the District's deficit spending. **This letter therefore serves as an addendum to the conditional approval of the District's 2021-22 budget.**

The table below summarizes the known impacts and potential risks to the district's budget:

	Impacts and Risks to the 2021-22 Adopted Budget			
	Unrestricted General & Special Reserve Funds Combined			
	2020-21	2021-22	2022-23	2023-24
Deficit spending as adopted	4,493,719	596,040	(1,005,709)	(1,833,694)
Unemployment Insurance rate change		(410,161)	(410,161)	(410,161)
Decline in enrollment		-	2,713,280	3,382,722
Medicare payroll tax is understated			892,580	872,603
Expenditures reduced with closing 2020-21	(3,350,235)			
Revised deficit spending	7,843,954	1,006,201	(4,201,408)	(5,678,858)
Revised ending balance	19,773,591	20,779,792	16,578,383	10,899,525
Ending balance as % of total expenditures		21.2%	17.4%	11.1%

Decline in attendance

We continue to track enrollment and attendance data in an effort to determine the risk to the District's fiscal solvency in the multi-year projection. The District's adopted budget was based on 7,285 students enrolled in district programs (i.e. exclusive of Non Public School and County Office of Education regionalized programs) generating 7,023 units of average daily attendance (ADA) which is equivalent to an attendance ratio of 96.4%. The data we have received so far indicate there are 7,168 students enrolled, however, the attendance ratio is averaging approximately 93%. As a result, current data indicate the District's ADA will be an estimated 300 ADA lower than anticipated for budget projections and therefore the district's revenue is at risk of being overstated by $2.7 million in 2022-23 and $3.4 million in 2023-24.

Due to the potential decline in student attendance and associated reduction to revenues we request monthly enrollment and attendance reports through April 15, 2022. To begin, we request attendance reports on September 27, 2021, and October 4, 2021, prior to the October 8 Conditional Approval deadline.

Medicare payroll tax benefit understated

Subsequent to our review, we confirmed an anomaly in health and welfare benefit expenditures for the 2022-23 and 2023-24 budget projections. District staff were able to confirm that Medicare tax and certain retiree benefits were inadvertently omitted from the budget projections resulting in a total impact of almost $0.9 million in each of the 2022-23 and 2023-24 fiscal years.

Expenditures reduced with closing of 2021-22

We note the District was able to reclassify certain expenditures to better utilize COVID-19 relief funding and as a result the ending fund balance for 2021-22 is $3.3 million higher than anticipated. This increase helps to offset some of the negative impacts to the budget but is one-time in nature whereas the other impacts are ongoing.

Conclusion

We understand the District has begun the process to appoint and convene a Budget Advisory Committee as recommended and will be taking the necessary steps to develop a deficit reduction and reserve recovery plan for implementation in 2022-23.

We thank District staff for their responsiveness to the requests for information made as we continue our review.

Our office is committed to providing support and assistance to the District to ensure the Adopted Budget for 2021-22 is granted full approval by the prescribed date of October 8, 2021. If you have any questions, please do not hesitate to contact Kate Lane at 415-499-5822.

Sincerely,

MARY JANE BURKE
Marin County Superintendent of Schools

KATE LANE
Assistant Superintendent

cc: Jan La-Torre Derby, Interim Superintendent
Lois Standring, Assistant Superintendent
Nancy Walker, Director of Fiscal Services

Enclosure: 2021-22 Adopted Budget Review

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September 15, 2021

Ross Millerick, Board President
Novato Unified School District
1015 7th Avenue
Novato, CA, 94945

Dear Mr. Millerick,

In accordance with Education Code Sections 42127, the Marin County Office of Education has reviewed the adopted budget of the Novato Unified School District for fiscal year 2021-22 in conjunction with the Local Control Accountability Plan (LCAP) and the Budget Overview for Parents pursuant to Education Codes 52070 and 52064.1.

The County Superintendent is required to approve, conditionally approve, or disapprove the adopted budget after examining and determining the following:

- Examine the adopted budget to determine whether it complies with the criteria and standards established pursuant to Education Code 33127 and identify any technical corrections needed to bring the budget into compliance with those standards.
- Determine whether the adopted budget will allow the district to meet its financial obligations during the fiscal year and is consistent with a financial plan that will enable the district to satisfy its multi-year financial commitments.

Prior to approving the adopted budget, the County Superintendent is required to approve the LCAP and the Budget Overview for Parents for each school district after determining all of the following:

- The LCAP and the Budget Overview for Parents adhere to the template adopted by the State Board of Education (SBE).
- The budget includes expenditures sufficient to implement the specific actions and strategies included in the LCAP.
- The LCAP adheres to the expenditure requirements for English Learners, Low-Income and Foster Youth students.

The District's Adopted Budget is **CONDITIONALLY APPROVED**. While our review of the adopted budget, as detailed in the attached Trend Analysis, demonstrates fiscal solvency for the current and two (2) subsequent fiscal years, we note the following factors which potentially threaten the future solvency of the District:

- First and Sixth day student enrollment appears to have significantly declined below the estimates included in the multi-year projections
- Potential reductions in revenue due to enrollment decline will exacerbate the District's projected deficit spending
- The District's parcel tax expires June 2023
- Bargaining unit negotiations have not yet been settled.

A **CONDITIONAL APPROVAL** specifies the conditions necessary for approval by the county superintendent, per Education Code Section 42127(d)(3). The district shall, in conjunction with the county superintendent of schools, review and respond to the recommendations of the county superintendent at a regular board meeting by October 8, 2021. The conditions for approval are:

1. Verify the District's enrollment for the 2021-22 school year and corresponding impact on the projected Average Daily Attendance.
2. If a decline in enrollment has occurred, quantify the impact of the corresponding loss of revenue for the 2022-2023 and 2023-2024 budget projections.
3. Initiate a budget advisory committee to advise the board on a deficit reduction and recovery plan.

MULTI-YEAR PROJECTION/CURRENT ECONOMIC CONDITIONS

Each district faces its own unique set of educational challenges, and there is no "one size fits all" plan. Similarly, each district faces its own set of financial risk factors based on current reserve levels, enrollment trends, bargaining agreements, degree of revenue volatility, stability and experience of key personnel, and various other local and statewide factors. The adopted 2021-22 California state budget includes changes for most school districts as budgets were based on assumptions included in the Governor's May Revise. The adopted budget remains constant for the Local Control Funding Formula (LCFF) entitlement as proposed by the Governor boosting the 4.05% cost of living adjustment (COLA) to provide a 5.07% 'super-COLA'. Selected categorical programs including the special education apportionment are increased by 4.05% COLA, resulting in an increase for the Marin County SELPA. The passage of AB130, the main budget bill for education, seeks to redress the learning loss that occurred in 2020-21 adding both one-time grants as well as multiple ongoing categorical grant funded programs, some of which will require future legislative action and appropriations as well as additional local resources to implement.

While the economic recovery from the pandemic has been more robust than anticipated, the continued state of emergency and the uneven nature of the recovery has implications for the economic outlook. Districts have been awarded an unprecedented amount of stimulus funding to navigate the pandemic, however, the lack of additional funding for known cost pressures including pension rate increases and the underfunding of special education, underscores the need to maintain budget reserves and fiscal flexibility. It is within this context that school districts should exercise caution when considering out-year spending commitments, to ensure they are well positioned for economic volatility over the next few years.

SALARY SETTLEMENTS

We note that the District has not settled negotiations with either bargaining unit for the budget year. Government Code 3547.5 requires the District to publicly disclose costs, as certified by the superintendent and chief fiscal officer. Please provide a Public Disclosure of Collective Bargaining Agreement including the tentative agreement(s) and multi-year projection to our office ten (10) working days prior to Board approval. Budget revisions associated with salary settlements should be approved within 45 days of Board approval.

CASH FLOW

We note the District has prepared for potential cash flow needs by requesting borrowing capacity from the County of Marin through a Tax Anticipation Note (TAN) which has been submitted for approval to the Board of Supervisors. Any District with cash flow needs beyond April 1st should ensure they have an existing TAN in place prior to April and will also need to execute the newly available TAN Addendum. Finally, should a district need cash flow borrowing across the fiscal year into 2022-23, the district will need to execute a promissory note with the County of Marin. The District is well advised to maintain reserve levels at far higher levels than the state required minimums to ensure sufficient cash for operating purposes.

RESERVES

The District's projected budget based on 7,142 ADA maintains the state-required minimum reserve for economic uncertainty of 3% in the current and two (2) subsequent years. We note that the Board approved a policy to establish a fund balance reserve for economic uncertainties equal to two (2) months operating expenditures inclusive of the state required minimum reserve. All school districts, whether state aid or community funded, are well advised to establish higher than minimum reserves in order to provide for the financial flexibility to absorb unanticipated expenditures without significant disruption to educational programs, cash flow deferrals and general economic uncertainties. Higher than minimum reserves allow the District to better ensure a consistent and stable program offering for students.

RESERVE STATEMENT/CAP ON RESERVES

District budgets that include a combined assigned and unassigned ending fund balance in excess of the minimum recommended reserve for economic uncertainties are required to disclose at the adopted budget public hearing the required minimum reserve, the excess amount and substantiate the need for the excess. The district has provided our office with a copy of the reserve statement. All four (4) criteria to require a deposit into the Public School System Stabilization Account were met in 2020-21 and projected to be met in 2021-22. The sum of these two deposits is expected to be sufficient enough to trigger the reserve cap for school districts in 2022-23. Districts may request an exemption from the reserve cap from the county superintendent of schools.

CONCLUSION

At the District's May 4, 2021 meeting of the Board of Trustees, the County Superintendent began providing support to the District by exercising the authority defined in Education Code section 1240 to superintend the District. As part of this support our office prepared a fiscal analysis and made a number of recommendations relative to fiscal stability. We understand the District has begun the process to appoint and convene a Budget Advisory Committee as recommended and will be taking the necessary steps to develop a deficit reduction and reserve recovery plan for implementation in 2022-23.

We thank District staff for the timely submission of the adopted budget, the LCAP and associated statutorily required forms and for their responsiveness to the requests for information made in the course of our review including technical corrections to the LCAP.

Our office is committed to providing support and assistance to the District to ensure the Adopted Budget for 2021-22 is granted full approval by the prescribed date of October 8, 2021. We appreciate your dedication and service to the children of Marin County. Your attention to good fiscal stewardship ensures the children of Marin County will continue to experience quality education now and in the future. If you have any questions, please do not hesitate to contact me at 415-499-5822.

Sincerely,

MARY JANE BURKE
Marin County Superintendent of Schools

Kate Lane

KATE LANE
Assistant Superintendent

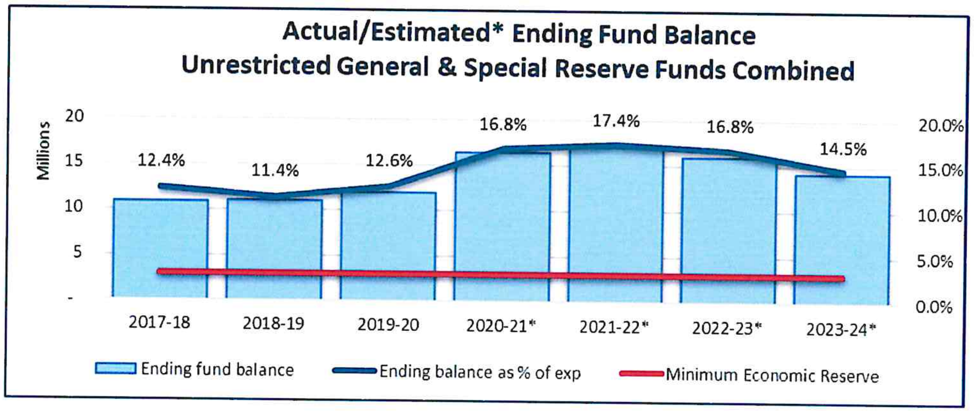
cc: Jan La-Torre Derby, Interim Superintendent
Lois Standring, Assistant Superintendent
Nancy Walker, Director of Fiscal Services
Jennifer Larson, Assistant Superintendent, Education Services

Enclosure: Trend Analysis

Trend Analysis
Budget Adoption 2021-22

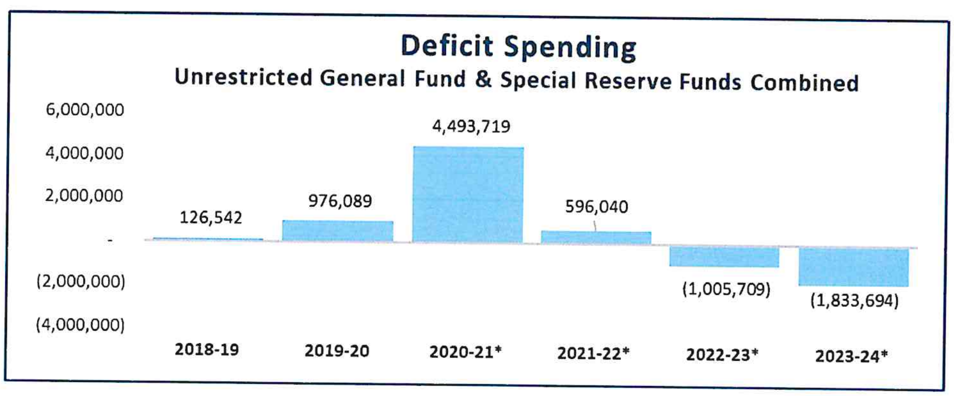
BUDGETARY POSITION FOR NOVATO UNIFIED SCHOOL DISTRICT

The following graph depicts the District's estimated ending balance in the adopted budget and multi-year projection for the unrestricted general fund and special reserve fund combined, with both the state required minimum reserve and the District's actual reserve as a percentage of total expenditures. The District's ending balance meets the minimum reserve requirement for the current and two (2) subsequent years, nonetheless, the decline in fund balance is unsustainable. The District's unaudited actual financial statements for 2020-21 may show an improvement that will help to offset the overall decline but will not cure the ongoing deficits. In particular, we are concerned the apparent decline in student enrollment will reduce revenues and exacerbate the decline in fund balance.



OPERATING DEFICITS

The District's adopted budget reflects operating deficits in the unrestricted general fund in the two (2) subsequent years of the multi-year projection as displayed in the chart below. The cumulative impact of this projected deficit spending is a 16.6% decline in fund balance over the current plus two (2) subsequent years, leaving the District with reserves of $14.1M or less than 15% of general fund expenditures at June 30, 2024. Should enrollment decline further, deficit spending will worsen if unaddressed.

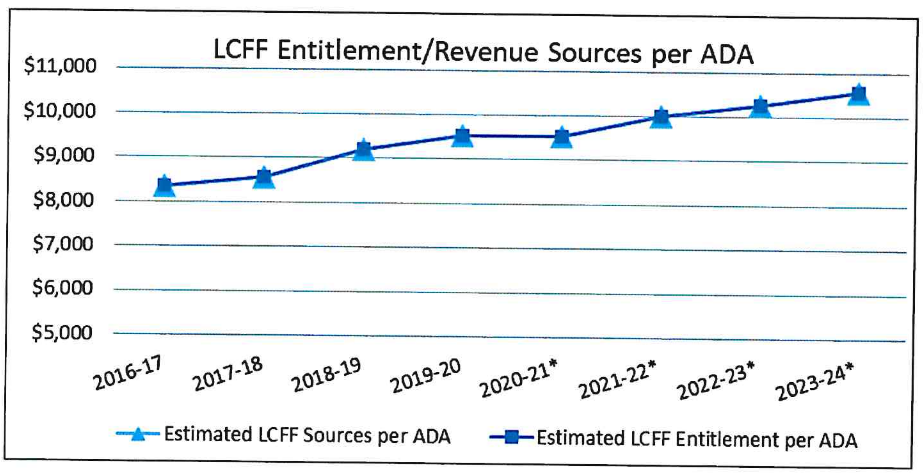


The multi-year projection for 2023-24 is dependent on the renewal of the District's parcel tax which generates approximately $4 million annually. The multi-year projection also appears to have assumed student enrollment would have increased in the current year whereas it would appear actual enrollment has in fact decreased. The District's systems for collecting this critical data do not appear to be well functioning and we are, therefore, unable to fully quantify the potential impact to deficit spending. Our best estimate indicates the District's ending balance could be reduced to 3.5% of total operating expenditures by June 30, 2024.

While some deficit spending may be planned, ongoing structural deficits threaten a school district's future educational programs. Districts that wait too long to address and correct structural deficits are forced to make dramatic corrections all at once. In contrast, carefully planned and phased-in structural corrections lessen the impact on children. **As noted in the accompanying letter, we anticipate the District will convene a Budget Advisory Committee as recommended and will be taking the necessary steps to develop a deficit reduction and reserve recovery plan for implementation in 2022-23.**

LOCAL CONTROL FUNDING FORMULA (LCFF) and LCAP

The final budget holds all Local Educational Agencies (LEAs) harmless at 2019-20 student attendance (ADA) and associated funding levels. The graph below is based on the State's Adopted Budget and shows the District's LCFF entitlement per unit of attendance (ADA) with projections for the adopted budget and multi-year projection. The increase in Proposition 98 funding for schools in the 2021-22 state budget is enough to fund the "super" cost of living adjustment (COLA) of 5.07%. Going forward, based on state projections, Proposition 98 funding will continue to be enough to fund the LCFF entitlement with adjustments for changes in the pupil population and the annual cost of living factor.



The District has an obligation under the LCFF to direct the supplemental grant included in the District's entitlement towards increasing or improving services to pupils of higher need. This requirement applies to all districts, including community funded districts. The District's estimated 2021-22 supplemental LCFF grant as adopted in the District's Local Control and Accountability Plan (LCAP) is almost $5,414,009 and the percentage to increase or improve services is 8.09%.

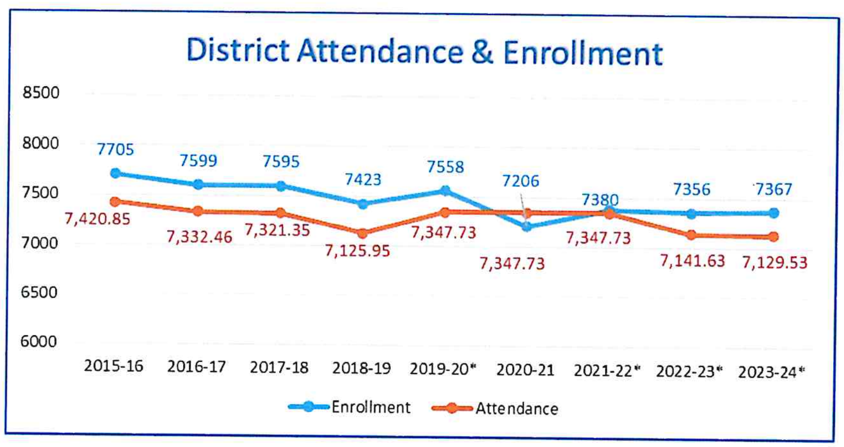
We issued a letter to the District's Governing Board on August 15, 2021 seeking clarification on various elements of the District's LCAP, including the spending requirements related to the LCFF supplemental grant.

The state budget adds new requirements that any unspent supplemental dollars be carried forward and accounted for in the subsequent years' LCAP increasing the District's obligation to serve English Learners, low income and foster youth. These changes required the State Board of Education (SBE) to develop a plan template for the current year as a one-time supplement to the LCAP, which all districts must adopt in February 2022 as part of an update to the annual update. The SBE will also be developing a new LCAP template for use in the 2022-23 LCAP cycle to accommodate these changes on an ongoing basis. Our team stands ready to provide support and guidance in navigating the continually evolving plan design and requirements.

STUDENT ENROLLMENT AND ATTENDANCE

Due to COVID-19, attendance accounting was suspended in 2020-21 with 2019-20 attendance (ADA) serving as the District's ADA for two (2) years. In 2021-22, those districts experiencing declining student enrollment will be funded on prior year ADA, therefore maintaining ADA at 2019-20 levels. As a result, for districts with declining enrollment, the graph below shows attendance as being flat for three (3) years before a decrease in 2022-23 when two years of projected declining enrollment are recognized. The cost of living (COLA) increase in LCFF funding is insufficient to offset the budgeted decline in ADA resulting in declining revenues in the multi-year projection. Furthermore, the estimated enrollment included in the budget is not currently supported by the first or the sixth day enrollment counts.

The District's budget projection is estimating enrollment will remain essentially unchanged as reflected in the chart below, however it appears that ADA will decline below the projections used for the adopted budget, impacting the projection of LCFF revenues in the multi-year projection. The pandemic has exacerbated the difficulty in making accurate enrollment projections, however, staffing and supplies are based on the number of students enrolled. Given the likelihood of excess staff, the District should be able to revisit open positions as a proactive step in keeping the District right-sized. Student attendance (ADA) is derived from enrollment and is a driving factor for almost all District funding including categorical programs such as special education, lottery, and mandate block grant.



PENSION CONTRIBUTIONS

The final state budget did not include any relief for either CalSTRS (teachers retirement system) or CalPERS (classified employees retirement system). As a result, pension contributions will continue to increase for at least the foreseeable future. The following chart reflects the increase in the cost of CalSTRS pensions over the historical rate of 8.25% prior to the pension reform that took effect in 2013.