

September 4, 2013

Management Assistance Confirmation Letter

Mr. William Covington, Chief Business Officer
Birmingham Community Charter High School
17000 Hayes Street
Lake Balboa, CA 91406

Dear Mr. Covington:

The purpose of this letter is to provide an analysis and subsequent calculations based on new financial information supplied by the Los Angeles Unified School District (LAUSD) through the law offices of Young, Minney & Corr, LLP, requested by the governing board in January 2013.

The Birmingham Community Charter High School (BCCHS) requested that FCMAT review additional documentation supplied by LAUSD following the original FCMAT report dated April 25, 2012. The calculation in question is the basis upon which the converted charter school initiated its base revenue funding for the 2009-10 fiscal year.

The base revenue limit calculation is an ongoing calculation that provides future year revenue to support the educational programs offered at the charter school pursuant to Senate Bill (SB) 319. Specifically, the study agreement specifies that the scope and objectives of this study are as follows:

Birmingham Community Charter High School (BCCHS) is requesting the team to continue and assist with its previous review regarding the calculations utilized to convert the charter by the Los Angeles Unified School District (LAUSD) as of July 1, 2009 pursuant to Education Code section 47660(c). The general purpose entitlement of a charter school established by conversion in the 2008-09 fiscal year is calculated by the school district losing the school.

The team will evaluate the calculations performed by LAUSD to determine if they are in compliance with the intent of Education Code Section 47660(c) and may have incorrectly reduced BCCHS' entitlement per pupil by over \$4 million per year. The team will continue to assist and review the district's documented actual expenditures for Birmingham High School for the 2008-09 fiscal year and the district's calculation of BCCHS' general fund entitlement for the 2009-10 fiscal year and make recommendations.

FCMAT originally requested documentation on February 10, 2012 to support LAUSD's certification to the California Department of Education that became the basis of Birmingham High School's 2008-09 fiscal year actual unrestricted revenues expended per unit of average daily attendance (ADA). Subsequent

FCMAT

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to the April 25, 2012 FCMAT report, LAUSD complied with the request for information used in the subsequent calculation included in this report.

For purposes of this report, FCMAT reviewed the LAUSD assumptions and actual calculations for the conversion of Birmingham High School for the 2008-09 fiscal year; SB 319 requires these calculations to be made in the year prior to conversion to determine the actual unrestricted revenues expended per unit of ADA. Once LAUSD calculates the actual unrestricted revenues expended per unit of ADA and certifies it to the California Department of Education, the amount is adjusted for each future fiscal year in accordance with Education Code section 47660 (c) (1) (A).

FCMAT reviewed the following additional documents supplied by LAUSD and used in this analysis:

1. Districtwide Special Education Encroachment by SACS code
2. Contributions From Unrestricted General Fund to Other Programs Fiscal Year 2008-09
3. Birmingham Excluded Costs – 2008-09 Funding Base - SUMMARY
4. Birmingham Excluded Costs – 2008-09 Funding Base – Detailed by program code
5. 2008-09 LAUSD Special Education Actual Districtwide Revenues and Expenses
6. Report of School District Attendance, Fiscal Year 2008-09, P-2
7. Various unnamed examples of conversion calculation models, marked “Draft”

Background

Since the 2009-10 school year when it converted from a district high school to a charter school, Birmingham Community Charter High School continues to disagree with the actual unrestricted revenues expended per unit of ADA calculation prepared and certified by LAUSD. This calculation is critical because it forms the base dollar amount of funding per ADA passed through LAUSD to the newly formed charter school. Any adjustment to this base calculation has a compounding effect in all future fiscal years.

Laws governing the calculation of funding for a school in a unified school district that is converted to a charter school have changed three times. When Birmingham High School converted to Birmingham Community Charter High School on July 1, 2009 for the 2009-10 school year, SB 319 was in effect. However, SB 319 was repealed on January 1, 2010.

SB 319 was intended to make the financial impact of a charter school conversion on unified school districts neutral by calculating the amount of base revenue limit funding using actual expenditures of unrestricted revenues in support of the school in the year prior to conversion. However, SB 319 created inequities in funding from site to site and district to district based on unrestricted revenues expended directly on the particular campus in question, and it failed to provide guidance regarding methods for calculating districtwide costs for indirect services, overhead, and contributions to restricted programs from unrestricted funds, all of which support the school site.

The California Department of Education (CDE) stated in a letter dated February 13, 2007, “There are no standardized instructions or guidance to determine expenditures at the school level.” With no instructions or guidance from CDE, school districts were authorized to “use cost allocation methods,

if appropriate, for an accounting of actual unrestricted revenues expended in support of the school,” in accordance with Education Code Section 47660 (c) (2) (g).

Findings and Recommendations

SB 319 (Chapter 355/2005), as amended by Assembly Bill (AB) 1967 (Chapter 730, Statutes of 2006).

Prior to the passage of SB 319, a high school in a unified school district that elected to convert to a charter school received Charter School Block Grant funding for ADA that was reported to the state via the school district’s revenue limit information.

The Charter School Block Grant funding rate for charter schools is higher than the revenue limit rate that a unified school district is entitled to receive from the state. The difference between the two rates affected the school district’s net funding negatively, and as a result SB 319 was passed to end this inequity. Education Code (EC) 47660 offers the only guidance available for the calculation of SB 319 and leaves much to interpretation.

EC Section 47660 (c) (1) states:

The amount of the actual unrestricted revenues expended per unit of average daily attendance for that school in the year prior to its conversion to, [emphasis added] and operation as, a charter school, adjusted for the base revenue limit per pupil inflation increase adjustment set forth in Section 42238.1, if this adjustment is provided, and also adjusted for equalization, deficit reduction, and other state general-purpose increases, if any, provided for the unified school district in the year of conversion to, and operation as a charter school.

EC Section 47660 (c) (2) states:

For a subsequent fiscal year, the general-purpose entitlement shall be determined based on the amount per unit of average daily attendance allocated in the prior fiscal year adjusted for the base revenue limit per pupil inflation increase adjustment set forth in Section 42238.1, if this adjustment is provided, and also adjusted for equalization, deficit reduction, and other state general-purpose increases, if any, provided for the unified school district in that fiscal year.

EC Section 47660 (c) (2) (g) states:

A school district may use the existing Standardized Account Code Structure and cost allocation methods, if appropriate, for an accounting of the actual unrestricted revenues expended in support of a school pursuant to subdivision (c).

Expenditure Classifications

The fundamental issue between LAUSD and Birmingham Community Charter High School is the cost allocation method LAUSD used to prepare the calculation, including the allocation methods used for districtwide overhead and indirect cost expenditures, and whether the method used meets the spirit and intent of the legislation.

SB 319 was in effect for 3¹/₂ years. During that time, lacking any direction from the state, districts in which a district high school converted to a charter school were forced to decide which indirect costs went into the calculation and which costs were not considered based on unique circumstances.

Under this circumstance, indirect costs include many restricted programs that the school districts have to consider. Some district programs need a contribution of unrestricted dollars (sometimes also called encroachment) to cover their total actual expenditures, yet not all of these programs are carried out at or benefit a particular campus. Districts should use an approach that includes consistent cost treatment for each category.

The California School Accounting Manual (CSAM) provides guidance and examples for school district accounting. Procedure 915 states that local education agency expenditures are classified as either direct or indirect based on the type of *activity* (instruction, administration, human resources, etc.), and within those categories are either unrestricted or restricted based on the type of *expenditure* (books, supplies, salaries, etc.).

Direct costs are expenses that can be directly identified with a particular program and are essential to maintain the program. These costs are measurable and charged directly to the campus or department. The costs of teachers, classroom aides and supplies for classrooms are all considered direct costs.

Indirect support and overhead costs, on the other hand, are more global and include general administration services and functions such as budgeting, accounting, human resources, centralized data processing, and purchasing.

Unrestricted and Restricted Funding

School districts have funding sources that are either unrestricted or restricted, in accordance with CSAM Procedure 105-5. Unrestricted sources are available for any educational use. This is a broad category that funds salaries, benefits, books, supplies, utilities, consultants and capital outlay. Unrestricted funds may also be used to fund a portion of expenses for some federal or state programs that are not fully funded from other sources; this is known as a contribution.

According to CSAM Procedure 105-5, restricted program funding is limited to specific uses. Restricted funding is derived from federal, state and/or local sources, usually in the form of grants or entitlements. Examples include special education, Title I, and home-to-school and special education transportation. The expenditure of funds is limited by the regulations that govern each funding source.

To determine the funding for a newly converted charter school under SB 319 per unit of unrestricted revenues, a district must first convert the unrestricted expenditures into a base dollar amount per ADA, but only for expenditures funded by unrestricted dollars for the school campus prior to the year of actual conversion. What goes into this calculation is subject to certain assumptions, primarily because not all indirect and support expenditures can be directly attributed to a particular campus.

For example, many costs that districts incur are districtwide, such as central office administration; maintenance and operations; transportation services; and contributions from the unrestricted fund for restricted programs such as audiologists, psychologists, and itinerant special education teachers. A portion of these expenditures must be allocated as part of the conversion calculation. In addition to districtwide expenditures, the district makes contributions of unrestricted dollars for programs that are not fully funded, such as special education, transportation, food services and others. This occurs when a program's actual expenditures exceed actual revenues to which the district is entitled for these restricted programs.

The calculation is inherently inequitable from school to school and district to district because SB 319 does not take into account variances that naturally occur between school sites that have unique cost features. For example, one high school with the exact same number of students as another may have teachers that have longevity of service and therefore will have higher costs for salary and benefits; or

specialized programs, often referred to as magnet programs, may be located on one campus but may draw and serve students from several district schools.

Thus many different specialized program configurations throughout a district may cause the actual expenditures for a particular campus to differ from those of another campus of similar size and type (elementary, middle or high school). To provide a viable and concentrated program in one location, magnet programs usually draw and serve students from several schools' boundary areas within a district. Because of these nuances, the calculation for each converted school and for each school district will differ under SB 319, making it problematic to compare one calculation to another.

Daniel Pearl Journal Magnet Program

Before its conversion to a charter school, Birmingham High School operated on its campus a specialized program called the Daniel Pearl Journal Magnet that offered students a unique opportunity to attend journalism classes. The students involved in this program were otherwise fully integrated in Birmingham High School's class offerings in all other subject areas, extracurricular activities and sports. The school principal and other site administrators were fully responsible for this program.

The district's calculation separated some campus expenditures based on the ratio of students attending the magnet program to the total number of students on the campus, and deducted administrative and clerical support costs from the total campus expenditures based on this ratio even though there was no separate allocation of administrative and clerical support exclusively for the Daniel Pearl Journal Magnet.

LAUSD applied to make the magnet program a separate school in the district for the subsequent fiscal year, 2009-10. The CDE issued county-district-code (CDS) # 19 64733 0120360 on September 9, 2009 effective for the 2009-10 school year. This code is the official unique identification number assigned to a school in California. According to the CDE, CDS codes are not assigned to programs such as the magnet program on the Birmingham High School campus. The CDE stated, "Evidence that the entity is a school rather than a program is provided by the governing board action approving formation of the school and board action establishing the school." FCMAT verified that the Daniel Pearl Journalism & Communications School recorded academic performance index (API) testing results for the first time as a new school following the 2009-10 school year.

When LAUSD made the SB 319 calculation basing expenditures on the 2008-09 school year, the year prior to conversion, the ratio of Birmingham High School students to Daniel Pearl Journal Magnet students was determined to be 84 to 16. Based on this ratio, 16% of the campus's ADA and direct unrestricted expenditures were deducted from Birmingham High School's total expenditures even though Daniel Pearl was not a separate school.

For purposes of the SB 319 calculation, all of the unrestricted expenditures and student ADA should be in the base calculation.

Contributions to Restricted Programs

Special education, transportation and food service programs all typically require contributions from the unrestricted general fund.

Because such contributions come from the amount of unrestricted revenue available districtwide, the district must allocate a portion of the general fund contribution to be included in the SB 319 calculation. Education Code Section 47660 (c) (2) (g) authorizes the district to use an allocation method, if

appropriate. However, before calculating the per-pupil amount, the total district contribution should be reduced for any programs in which the new charter school did not participate before the conversion.

Recent information provided by LAUSD and shown in the table below lists the programs and amounts of contribution from unrestricted general fund dollars for the 2008-09 fiscal year but does not specify any programs that should not be considered in the SB 319 calculation.

LAUSD, Contributions From Unrestricted General Fund to Other Programs, Fiscal Year 2008-09

Program	Amount
Continuation Education	\$12,043,614
Community Day School	7,670,903
CalSAFE	44,269
Class Size Reduction – Facilities Funding	97
Pupils With Disabilities	66,426
School Safety and Violence Prevention Act	202,960
Special Education	657,566,955
Home-to-School Transportation	(4,787,480)
Special Education Transportation	6,888,155
Ongoing Major Maintenance Acct.	204,045,381
Other Local	4,254,725
Total	\$887,996,005

Of particular concern is the home-to-school transportation amount showing (\$4,787,480). This indicates that the home-to-school transportation program was profitable, thereby offsetting district contributions from other programs; however, districts statewide are severely underfunded in this area. According to certified information posted on the CDE website (<http://www.cde.ca.gov/fg/aa/ca/pupiltransport.asp>) for the 2008-09 fiscal year, LAUSD incurred a \$47,153,899 shortfall in home-to-school transportation programs and a \$6,717,234 shortfall in Severely Disabled/Orthopedically Impaired (SD/OI) transportation programs, as shown in the table below.

LAUSD, Pupil Transportation Apportionment and Approved Costs, Fiscal Year 2008-09

Program	April 2009 Certified Entitlement	Approved Transportation Expenses – TRAN Report	Shortfall in Funding
SD/OI	\$50,076,839	\$56,794,073	\$6,717,234*
HS	\$45,092,117	\$92,246,016	\$47,153,899
Total Shortfall			\$53,871,133

*The district’s contribution information shows \$6,888,155 in the preceding table; however, the information in this table is certified based on the district’s financial reports to the CDE.

The spreadsheet prepared by LAUSD staff, “Birmingham09ExpendituresFINALRATE(2),” lists only three programs: special education (including extended day), special education transportation, and restricted routine maintenance. Other restricted programs listed on the table above do not appear on the spreadsheet prepared by LAUSD.

Special Education and Special Education Transportation Costs

Education Code Section 47600 (c) (1) states that “unrestricted revenues expended per unit of average daily attendance” are used in the calculation.

Starting in the 1998-99 fiscal year, the special education funding model changed to what is now called the AB 602 Special Education Reform Act. This was a fundamental change in how each special education local plan area (SELPA) was funded. This locally-distributed funding model allocation is based on an amount per *total K-12 ADA* (emphasis added) for each SELPA. LAUSD is its own SELPA and receives the AB 602 funding based on the total districtwide K-12 ADA basis, yet LAUSD calculated the percentage of districtwide contributions of unrestricted funds to special education and special education transportation costs and applied that percentage to the restricted special education and special education transportation expenditures on the Birmingham campus.

This cost allocation method is inconsistent with SB 319, which states that the district must calculate the unrestricted *revenues per unit of ADA*, not the percentage of districtwide contribution applied to the direct restricted special education and special education transportation expenditures on Birmingham’s campus.

New information provided by LAUSD identified as “Request No 5.xlsx” shows how staff derived the districtwide percentages of 53.93% and 12.09% as follows:

LAUSD, Districtwide Contribution to Special Education by SACS Code, Fiscal Year 2008-09

SACS Code	Total Expenditures	General Fund Contribution	Encroachment %
6500	\$1,219,224,971.07	\$657,566,955.05	53.93%
7240	\$56,964,994.45	6,888,155.45	12.09%
Total:	\$1,276,189,965.52	\$664,455,110.50	52.07%

Note: The calculation to support 53.93% and 12.09% allocations of resources 6500 and 7240 does not include Pupils With Disabilities listed in the preceding table of contributions totaling \$66,426.

In a letter dated July 20, 2011, LAUSD contends that the restricted expenditures represent the contribution for Birmingham High School and include a portion as an “add-on” to the direct unrestricted expenditures. The percentage in the table above includes expenditures and contributions districtwide; however, when the same percentage is applied to the actual expenditures identified on the Birmingham campus, it does not include districtwide expenditures that also affect BCCHS. Districtwide expenditures that should be considered in the SB 319 calculation include overhead to operate the special education programs including administration, clerical support, and specialized services such as psychologists, program specialists and audiologist, as well as other services.

In the document titled “2008-09 LAUSD Special Education Actual Districtwide Revenues and Expenses,” LAUSD lists \$700,300,000 as the special education encroachment. This number is different than the number included in the table above. Using this number, LAUSD identifies \$23,487,350, or 3.4%, of the total contribution to special education as non-school expenditures for 2008-09. Of this amount, the district applied a blended districtwide percentage of 52.07% of costs to the Birmingham campus. The list of expenditures totaling \$23,487,350 below is based on selected programs and does not include several costs previously mentioned that would normally be included in the districtwide contribution.

LAUSD did not provide an explanation or describe the basis for including some costs and excluding others. This method uses a ratio of districtwide expenses applied to selected programs rather than a districtwide ADA calculation for other overhead expenses.

LAUSD, Special Education Portion (Unrestricted Non-school) By Program for the 2008-09 Fiscal Year

Program Number	Program Name	Sum of Expense Amount
2001	DESIGNATED INSTRL SERV-SCHS	\$0
2002	RESOURCE SPECIALIST PROG-SCHS	93,103
2005	SPEC DAY CLSS-SAL/TRANSP-SCH	337,376
2015	MANDATED COST-CSMITH-IMPL 18	43,202
2023	MANDATED COST-CSMITH-ADM COS	167,698
2035	MANDATE COST-CSMITH-IMPL3-SUF	1,818,922
2041	MANDATE COST-CSMITH-MISC	121,365
2044	SP ED-INSTRL ADM-SAL/BEN-SUPP	14,131,406
2049	MANDATE COST-CSMITH-IMPLMNT	2,123,750
2081	SPEC EDUC-CSMITH PROG-SUP	860,279
2091	MANDATE COST-CSMITH IMPL10-SU	243,837
2102	SP ED-SUPP SERV-SAL/BEN/BF/TRANSP	96,302
2105	DIS-SAL/BEN/TRANSP-SUPP	132,080
2121	MANDATE COST-CSMITH-IMPL 15	10,770
2122	MANDATE COST-CSMITH-IMPL 16	29,340
2125	SP ED-DIST ADM-SAL/BEN/TRSP-SU	790,335
2181	ADVISORY COMM EXP-SPEC ED-SUP	0
2217	LOW INCIDENCE-SE DIV-ADMN SUPP	213,654
2220	ITD-ADMV SYS & PROG BR-SPEC ED	67,373
2227	INDIRECT SUPPORT-SAL/BEN-SUPP	91,815
2560	SP ED-INSTRL ADM-OTHER EXP SUP	1,201,057
2579	SP ED-PRESCH EXPAN PROG-SUPP	30,448
2818	SP ED-CHANDA SMITH-ADM-SAL/OE	893,238
7515	PRG SPCLTS-INSTRL SERV-SUPP	0
Total		\$23,497,350
Districtwide Blended Percentage	Special Education and Special Education Transportation Costs Divided by Total Special Education Encroachment	52.07%
Unrestricted Portion	Applied to Birmingham CCHS	\$12,234,020.41*

*The sum of the programs listed above multiplied by 52.07% equals \$12,235,070.15.

Recalculation Using Consistent Methods

LAUSD used two different methods to calculate the charter school's costs. Using a districtwide ADA method for a portion of overhead costs and a ratio method for campuswide costs for selected programs is inconsistent in its application and is not in conformance with the language of SB 319. The district's calculations should be based on unrestricted revenues per unit of ADA, not a percentage of districtwide expenditures divided by districtwide contributions that ultimately produces an ADA allocation.

Using the LAUSD's ratio method for all district overhead costs would lead to an extremely complex calculation. For example, using this method for accounts payable processing expenses would force the district to charge a percentage of accounts payable overhead costs based on the total number of transac-

tions or checks processed districtwide to the total number of transactions or checks processed just for that campus. This would be a cumbersome and difficult calculation. Best practice is to use one method for each cost allocation involved in the SB 319 calculation.

The district should recalculate the total district general fund contribution divided by total district ADA to arrive at a per-pupil amount, then multiply this by Birmingham High School’s total ADA in the year prior to conversion, in accordance with SB 319.

Not including the total contribution from the district’s unrestricted revenues and instead calculating a percentage for the actual cost of selected programs running on the campus makes the costs presented as an “add-on” for this calculation considerably lower and does not indicate total costs attributable to the Birmingham campus in the year prior to conversion. In addition, \$2,445,254.58 of campus expenditures were not considered in the district’s ratio approach; no explanation was provided for this, although FCMAT was able to ascertain that the excluded costs were additional special education-related expenditures that were coded to Birmingham High School in 2008-09.

The method used by LAUSD is atypical. Contributions from unrestricted funds are not calculated by school site or department but districtwide, and the LAUSD calculation disregards the fact that many restricted programs are concentrated on various campuses. Further, special education programs operated by the district, which functions as its own SELPA, have an enormous impact on total districtwide contributions, which affects funding that would otherwise be available to support regular education programs districtwide.

FCMAT prepared a recalculation using an ADA method, district-supplied financial information and various spreadsheets prepared by district staff to arrive at a base funding amount of \$7,032.88 per unit of ADA, as demonstrated in the table below.

FCMAT Recalculation – Base Funding Per Unit of ADA for Birmingham High School, Information Provided by LAUSD For Fiscal Year 2008-09

Description	Amount	ADA	Amount
Total General Fund Contribution to Other Programs	\$887,996,005*	615,420.29	\$1,442.91
Total Unrestricted Expenditures on BCCHS Campus 2008-09	15,022,716	2,924.1	\$5,137.55
Total district overhead-Central Office	261,841,710	615,420.29	425.47
Total Cafeteria encroachment	\$16,587,485	615,420.29	26.95
Total			\$7,032.88

* Represents LAUSD total contributions listed on spreadsheet titled “Contributions from Unrestricted General Fund to Other Programs Fiscal Year 2008-09.” However, the contribution to home-to-school transportation programs should be corrected to agree with certified transportation reports LAUSD has submitted to the CDE.

According to School Services of California’s dartboard for the 2008-09 fiscal year, the estimated statewide average base revenue limit per ADA for high schools was \$7,069 and the charter school general purpose block grant rate was \$6,813. FCMAT’s recalculation is between those numbers and the district’s calculation of \$6,654 is lower than both the statewide average and the block grant rates.

Based on the observations identified in this report that LAUSD included restricted expenditures, subtracted expenses for Daniel Pearl Journal Magnet program, and inconsistently applied districtwide costs, FCMAT recommends that the base revenue limit funding per unit of ADA be adjusted to \$7,032.88.

The district should recalculate the base funding as follows:

- Include direct unrestricted Daniel Pearl Journal Magnet expenditures.
- Include Daniel Pearl Journal Magnet ADA.
- Remove the direct campus restricted program costs for special education, extended day special education, special education transportation, and restricted routine maintenance.
- Include districtwide contributions from unrestricted funds per ADA.
- Include direct unrestricted Birmingham expenditures.
- Include districtwide contributions of unrestricted funds per ADA to the cafeteria fund.
- Include the districtwide overhead allocation for central office costs per ADA.

The new Local Control Funding Formula (LCFF) signed into law by Governor Brown on July 1, 2013 through Assembly Bill (AB) 97 will have yet another effect on this calculation for BCCHS. LCFF creates a base level of funding and adds supplemental and concentration grant funding for students classified as English learners, foster youth, or eligible for free or reduced-priced meals. This funding model is designed to equalize school districts' and charter schools' funding over eight years, starting with the 2013-14 fiscal year, depending on how far each individual local educational agency is from the legislation's target. The difference between the base and the target is called the gap and represents the amount of funding needed to fully equalize each entity. The size of the gap for BCCHS will determine how long it will take the state to backfill current general purpose funding for the school.

Conclusion

FCMAT reviewed the impact on the district's costs based on a defined set of assumptions. As these assumptions change, so will the base revenue limit per ADA. The issues identified in this report can have a profound financial impact on the charter school's daily operations and academic support for students. It is imperative that the methods applied are appropriate, reasonable, and meet the intent of SB 319.

For purposes of the SB 319 calculation, LAUSD should have included all the Birmingham campus expenditures and students in the base revenue limit calculation and used consistent methods in the various cost allocations applied to districtwide expenditure categories and contributions from the unrestricted general fund.

Sincerely,



Debi Deal, CICA, CFE
Fiscal Intervention Specialist
FCMAT

- c: Joel Montero, Chief Executive Officer, FCMAT
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