

Emery Unified School District

Comprehensive Fiscal Assessment

Presented by
The Fiscal Crisis and Management Assistance Team

Table of Contents

Introduction and Historical Background 1

Executive Summary 5

Internal Controls Review 17

Bond Fund Review 37

Appendix 53

Introduction and Historical Background

The Fiscal Crisis and Management Assistance Team (FCMAT) was created in 1991 through Assembly Bill 1200 to assist local educational agencies in complying with fiscal accountability standards. Since 1992, FCMAT has performed 250 reviews for local educational agencies, including school districts and county offices of education, with tasks ranging from fiscal crisis intervention to management consultations and assistance. FCMAT is an organization created by the state legislature and administered by the Kern County Superintendent of Schools.

Emery Unified began to identify financial difficulties early in the 1999-2000 fiscal year. In March 2000, the district submitted a qualified Second Interim Financial Report projecting a negative fund balance of \$92,521. A qualified Second Interim Report indicates that the district may not be able to meet its financial obligations in the current or two subsequent fiscal years.

Because of the district's qualified status and the departure of the district's business manager, the Alameda County Superintendent of Schools required a third interim financial report and appointed a fiscal advisor. On June 3, 2000 with the assistance of the county office fiscal staff, the district reported a projected negative ending fund balance of \$638,000.

The district and the Alameda County Superintendent of Schools decided the county needed to make an emergency loan of \$650,000 to the district so the district could meet its current financial obligations. To obtain the loan, the county office required the district to devise a financial recovery plan that provided for repayment. Ultimately, the district and the Alameda County Superintendent of Schools executed a memorandum of understanding (MOU) regarding the loan's terms and conditions. The MOU granted certain authority to the County Office and to the fiscal advisor who had been appointed by the County Superintendent. Those terms included the authority to:

- Stay and rescind board actions inconsistent with the budget and recovery plan.
- Review and approve all contracts prior to implementation by the district superintendent or board.
- Review and approve employee changes prior to implementation by the district superintendent or board.
- Provide reports directly to the board in financial matters.
- Charge the district for the costs of the fiscal advisor.

The loan's original call date was September 30, 2001. The Alameda County Superintendent of Schools recently extended the call date to June 30, 2002.

FCMAT began its work with Emery Unified School District in late September of 2000. The initial tasks included assisting the district in closing the general ledger for the 1999-2000 fiscal year and assessing the district's financial condition.

On October 2, 2000, the Superintendent of Public Instruction (SPI), and the Alameda County Superintendent of Schools requested the FCMAT Board of Directors to declare a fiscal emergency in the Emery Unified School District pursuant to Education Code section 42127.8(e). On October 22, 2000, the FCMAT board took formal action to declare that a fiscal emergency existed in the district.

Because of serious concerns about the district's solvency, the county office disapproved the district's 2000-2001 fiscal year budget on November 13, 2000. Subsequently, at the request of the SPI and in accordance with the county's authority under the loan MOU, the county appointed FCMAT as the district's fiscal advisor with authority to rescind any board action deemed to be inconsistent with the revised budget.

The district's June 30, 2000, audited undesignated fund balance (account 9790) was negative \$1,482,525. This undesignated amount reflected the net ending balance of negative \$1,342,742, including certain required reserves but not including a reserve for economic uncertainties. The net ending negative fund balance became the carryover fund balance on each of FCMAT's financial forecasts.

In December 2000, FCMAT presented the district's 2000-2001 first interim report with the board's negative certification. The report forecast an undesignated fund amount of negative \$1, 800,390. This undesignated fund amount reflected the net ending fund balance including recommended reserves for economic uncertainty and for certain unavailable assets, such as revolving funds. FCMAT also forecast a similar negative balance on the second interim report, but by the third interim report the forecast had increased to negative \$2,308,215 to reflect an adjustment of negative \$943,797 for payments from the bond funds that should have been paid from the general fund. Both the second and third interim reports continued with the negative certification. (See Chart 1)

As of June 30, 2000, the districts audited financial statements showed that reserves had been completely depleted. FCMAT, the district, and the Alameda County Superintendent of Schools implemented procedures to begin restoring reserves as soon as possible. Considerable progress has been made in the restoration process and, certainly, more needs to be done. For example, while the district ended fiscal year 2000 with a negative \$1.34 million fund balance, the forecast fund balance as of the third interim report for fiscal year 2001 was only a negative \$1.97 million even though nearly \$1 million in improper prior year bond payments were charged back to the general fund. This represents nearly a \$.4 million improvement in spite of the large charge back. Nevertheless, the forecast ending undesignated amounts of negative \$2.3 million continue to show a complete lack of reserves.

Chart 1
Components of Forecast General Fund Balances
June 30, 2000 and 2001

	6-30-2000 Audited	1st Interim Report	2nd Interim Report	3rd Interim Report
Reserves for Stores Revolving Cash and Restricted Funds	\$139,783.00	\$15,000.00	\$15,000.00	\$15,000.00
Reserve for Economic Uncertainty	320,842.00	319,269.00	323,174.00	
Undesignated Amount	(1,482,525.00)	(1,800,390.00)	(1,731,157.00)	(2,308,215.00)
Forecast Ending Fund Balance	(\$1,342,742.00)	(\$1,464,548.00)	(\$1,396,888.00)	(\$1,970,041.00)

In an effort to ensure that the district continues to provide a financially stable and effective academic environment, Assembly Bill 96 was introduced on January 11, 2001 by Assembly Member Aroner and coauthored by Senator Perata. This bill would appropriate a \$1.3 million loan and a \$1 million line of credit. The bill would require the SPI to immediately appoint a State Administrator to manage the district and require the State Controller to conduct audits of the district's financial records and accounts until the SPI determines that the district is financially solvent. The bill also provides for the SPI to appoint FCMAT to be the fiscal advisor pursuant to Education Code Section 42127.6.

The purpose of the following report is to provide the SPI, the Alameda County Superintendent of Schools, Emery Unified and other interested community stakeholders with findings and recommendations from FCMAT. The report is a comprehensive independent assessment of the district's financial condition in accordance with existing legal and professional standards applicable to California public school districts. The financial assessment focuses on the following components:

- Multi-Year Financial Forecast to determine fiscal solvency
- Internal controls
- Bond fund audit
- Cafeteria fund audit
- Allegations of Abuse

In FCMAT's analysis and assessment, the primary objective was to determine for the SPI and the Alameda County Superintendent of Schools the financial solvency of the district. Other concerns included allegations of fraud and financial mismanagement that may have been linked to the district's deficit spending.

FCMAT's analysis of the district was based upon a sampling of the district's records and operations, and accordingly, not every instance of fraud, abuse, or poor management may have come to our attention. However, FCMAT's analysis did not indicate instances of fraud other than those already prosecuted or alleged by the Alameda County District Attorney. Nevertheless, the findings of this report do indicate that the district is unable to meet the state's recommended reserve requirements for economic uncertainties. The findings also indicate that the district's financial operation does not meet certain other basic standards, including adequate internal controls. Those circumstances warranted immediate intervention from outside agencies.

Study Team

The study team was composed of the following members:

General Report

Thomas E. Henry, FCMAT Chief Executive Officer
Joel Montero, FCMAT Deputy CEO

Internal Control Review

Marshall H. Wiley, CPA, FCMAT Chief Operations Officer
Gilbert Accountancy Corporation, Certified Public Accountancy*

Multi-Year Financial Forecast

Anthony L. Bridges, FCMAT Director of Management Assistance
Barbara Dean, FCMAT Director of Management Assistance
Patricia Feldpouch, Consultant*

Bond Fund

Office of Public School Construction*
FCMAT staff

Cafeteria Fund

JoAnn Smith, Consultant*
Susan Mauri, Consultant*

Fiscal Advisor

Ron Kuntz, FCMAT Consultant*

*As members of this study team, these consultants were not representing their respective employers but were working solely as independent contractors for FCMAT.

Executive Summary

On October 2, 2000, the Superintendent of Public Instruction (SPI) and the Alameda County Superintendent of Schools (County Superintendent) requested the FCMAT board to declare a fiscal emergency at Emery Unified School District. On October 22, the FCMAT board formally declared under Education Code section 42127.8(e) that a fiscal emergency existed at Emery Unified School District. This provided for immediate assistance from FCMAT. As a result of FCMAT's initial assignment and the board's subsequent declaration of a fiscal emergency, FCMAT currently functions in multiple roles including serving as the fiscal advisor to the district. In this capacity, FCMAT continues to evaluate and monitor the district's financial condition on a daily basis.

The district's audited financial statements for the 1999-2000 fiscal year show a negative ending fund balance of \$1,342,742. This report's findings conclude that the district is unable to meet basic industry and legal standards in its financial operations. The district has filed a negative certification for the 2000-2001 fiscal year first for the second, and third interim reports. In addition, material uncertainties regarding the financial condition and operations in the bond and cafeteria funds exist. At this point, FCMAT projects that the district requires an emergency loan apportionment of \$1.3 million and a line of credit of an addition \$1 million in order to restore the general fund balance and establish adequate reserves.

The district's internal control weaknesses are of particular concern. Effective internal controls are critical, provide the basis for a solid financial structure and ensure that the district's limited financial resources are prudently managed. However, the district lacks the policies and procedures to provide reasonable assurance that financial operations and information are effective and reliable.

Multi-Year Financial Forecast

FCMAT's first priority upon beginning work in Emery Unified School District was to obtain reliable financial information to use as a basis in forecasting the district's financial condition. Therefore, FCMAT worked closely with the district staff, the County Superintendent's staff, and the district's auditors in adjusting and closing the district's books for the 1999-2000 fiscal year so that the results could be used as a basis for a forecast. Because the books were not in good order, this process lasted several months. Ultimately, the books were closed and the district's audit completed on January 10, 2001.

The district's auditors, Vavrinek, Trine, Day & Co., LLP, included the following paragraph in their report on the district's June 30, 2000, financial statements :

The accompanying financial statements have been prepared assuming the District will continue as a going concern. As discussed in...(notes)... to the financial statements,

the District's General Fund had an unrestricted reserve deficit of \$1,482,525 at June 30, 2000. In addition, in November 2000, a Fiscal Crisis Management Assistance Team (FCMAT) (sic) was appointed to serve as the Fiscal Advisor to the District. These matters raise substantial doubt about the District's ability to continue as a going concern. ... The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In order to evaluate the district's forecasted financial condition and operations, FCMAT prepared Multi-Year Financial Forecasts (MYFF) for the current and two subsequent fiscal years. FCMAT considered future economic trends, demographic trends, and other assumptions in developing budget assumptions used in the financial forecast. Although the forecast considered these trends, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. Readers of any forecast must consider this inherent characteristic of the forecast process.

FCMAT's final forecast for 2001 shows a negative ending general fund balance of \$1,970,041. Also, a reserve of \$323,174 for the State's recommended four percent Reserve for Economic Uncertainties is also recorded. With this reserve recorded, the district's general fund Undesignated Amount totals a negative \$2,308,215.

The forecast assumes no cost of living increase for salaries and wages. It also assumes that the district's enrollment will decline slightly or remain relatively level during each year of the forecast. This enrollment trend, coupled with the district's precarious financial position, will ultimately require an emergency loan from the state. When that happens, the district will be managed by a State Administrator with complete authority to ensure that district financial decisions are within the limited resources of the budget.

Internal Control Weaknesses

A material weakness is a deficiency in the internal control structure serious enough to cause errors or lead to acts of fraud. Due to these weaknesses, employees in the normal course of business may not detect the errors within a timely period. A material weakness also may exist in the violation of laws and regulations. During FCMAT's internal control review, 18 areas of the district's operation were identified as having material weaknesses, reportable conditions or needed management improvement. In addition, during FCMAT's review of allegations of fiscal abuse, 4 more areas of material weakness were identified. (See Chart 2)

Bond Fund Review

A 1986 voter-approved amendment to Proposition 13 permits school districts to seek approval for local general obligation bonds for school construction or renovation, to be repaid through property taxes. A two-thirds vote was required for passage. In 1995, Emery Unified

Chart 2 – Summary of Internal Control Weaknesses			
General Financial	Material Weaknesses	Reportable Conditions	Management Improvement
<i>Board policies and administrative regulations</i>		1	
<i>Staff training</i>		1	1
<i>Procedures manual</i>			1
<i>Performance evaluations</i>			
Personnel			
<i>Periodic legal and managerial financial reporting</i>	1		
<i>Recruitment and selection</i>			1
<i>Employee retention</i>			1
<i>Staffing</i>			1
Budget Monitoring			
<i>Periodic Budget Monitoring</i>	1		
Cash Management			
<i>Cash reconciliation</i>	1		
<i>Cash disbursement</i>	1		
Grants Accounting			
<i>Federally funded employee time sheets</i>	1		
<i>Compliance with state requirements</i>	1		
Associated Student Body			
<i>ASB organization, policy and supervisor</i>	1		
Attendance			
<i>Reporting, Supervision and verification of attendance</i>		1	
Credit Card Payments and Use			
<i>Documentation of charges and regulation of use</i>	1		
Construction Projects			
<i>Actual and budgetary accounting for projects</i>	1		
Cafeteria Fund			
<i>Long-range financial planning</i>			1
Subtotal from Internal Control Review	9	3	6
Exceptions from Abuse Review	4		
TOTALS	13	3	6

passed a general obligation bond by a 71.7 percent majority vote in order to make \$8,070,000 in health and safety improvements and renovations.

General obligation bond covenants detail the types of projects and expenditures a district proposes to fund. During the course of FCMAT's review, allegations surfaced that Emery Unified made inappropriate expenditures for personnel and certain related project costs. The Office of Public School Construction (OPSC) assisted FCMAT in reviewing and evaluating the bond fund. As a result, FCMAT identified inappropriate costs charged to the bond fund in the amount of \$943,797. Most of these expenditures were for equipment and unauthorized personnel costs. These costs were considered as adjustments to the general fund's ending balance on FCMAT's most recent financial forecast.

Cafeteria Fund Review

The district's cafeteria fund has been reviewed several times by the State Child Nutrition Services Division. They determined that the district is underclaiming its available student eligibility for state and federal reimbursements.

In closing the 1999-2000 fiscal year financial records, FCMAT identified interfund loans to the cafeteria fund amounting to \$297,538 dating to the 1996-97 fiscal year. It was determined that the district's cafeteria fund had no ability to repay the temporary loans from the general fund. These loans were recorded as permanent transfers when the 1999-2000 books were closed.

Finally, the district executed a contract with the Berkeley Unified School District for the preparation and delivery of student meals. The cost for this service is estimated at \$210,000 for the current fiscal year. At the same time, the district retained most of its food service employees who had formerly prepared meals for the district's students. The cost of this contract was disadvantageous to the Emery USD. The district should terminate this contract and hire its own full-time food service director and resume preparing its own meals.

Allegations of Fiscal Abuse

FCMAT's analysis did not identify instances of fraud other than those already prosecuted or alleged by the Alameda County District Attorney. However, since fraudulent transactions by their nature are hidden, there is no set program or analysis that can be followed to give complete assurance that fraud has not occurred.

Nevertheless, several control weaknesses were identified that increase the possibility that fraud could occur and not be identified and reported. These items identified represent additional material weaknesses not reported in the general study of internal control.

Multi-Year Financial Forecast

Introduction

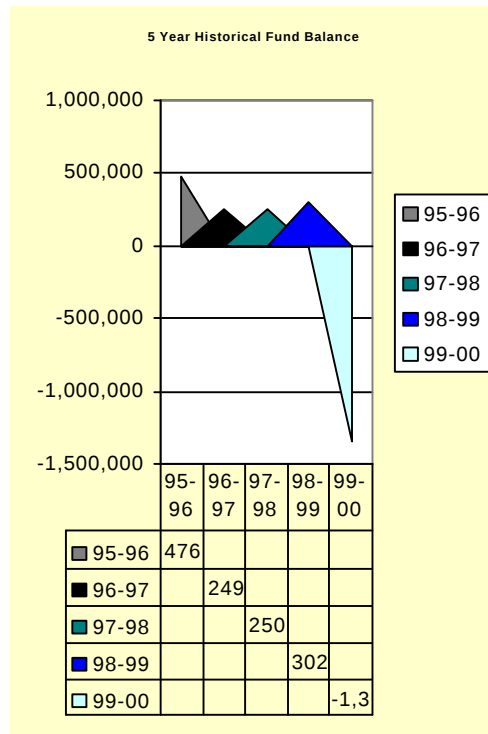
The main component of FCMAT's financial assessment of Emery Unified School District was a Multi-Year Financial Forecast to reflect the district's financial condition for the current and two subsequent fiscal years. FCMAT's forecast is based upon a review and examination of historical financial and budget data, current budget information, and upon assumptions regarding future economic and demographic trends. The forecast was prepared by collecting data from district financial records, consulting with the county office staff, consulting with the district's auditor, and verifying information recorded in the district's financial reporting system.

Whenever a financial forecast is prepared, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. Readers of any forecast must consider this limitation and inherent characteristic of the forecast process.

These limitations include issues, such as unanticipated changes in enrollment trends and changing economic conditions. Therefore, the Multi-Year forecasting model should be considered a trend based on assumed criteria and other assumptions rather than a prediction of exact numbers. Forecasts should be periodically updated, usually at each interim financial reporting period in an effort to maintain the most accurate data

The District's Financial Condition

FCMAT's forecast of Emery Unified School District used the district's audited financial statements as of June 30, 2000, as the baseline data for forecasting. The audit reported that the district's 1999-2000 general fund ending balance was a negative \$1,342,742. The following graphic illustrates the historical trend and decline of the district's ending fund balance over the past five years:



To better understand the Multi-Year Financial Forecast and the district's financial condition, a review of the district's actual 1999-2000 expenditures compared to the latest approved budget for 1999-2000 is useful. The following table shows the district's operating budget compared with audited actual revenues and expenditures and fund balances as of June 30, 2000.

General Fund Statement of Revenues, Expenditures and Changes in Fund Balance as of June 30, 2000			
REVENUES			
	Budget	Actuals	Variance Favorable (Unfavorable)
<i>Revenue Limit Sources</i>	3,649,372	3,110,902	(578,470)
<i>Local Apportionments</i>	1,247,665	1,601,605	353,940
<i>Total Revenue Limit Sources</i>	4,897,037	4,712,507	(184,530)
<i>Federal Revenues</i>	211,768	439,342	227,574
<i>State Revenues</i>	955,638	1,241,932	286,294
<i>Other Local Revenues</i>	311,000	485,383	174,383
<i>TOTAL REVENUES</i>	6,375,443	6,879,164	503,721
EXPENDITURES			
<i>Certificated Salaries</i>	3,552,670	3,903,604	(350,934)
<i>Classified Salaries</i>	662,771	674,611	(11,840)
<i>Employee Benefits</i>	880,220	897,247	(17,027)
<i>Books & Supplies</i>	251,642	628,803	(377,161)
<i>Services & Operating</i>	958,554	1,860,198	(901,644)
<i>Capital Outlay</i>	13,100	163,671	(150,571)
<i>Other Outgo</i>	83,744	98,271	(14,527)
<i>TOTAL EXPENDITURES</i>	6,402,701	8,226,405	(1,823,704)
EXCESS REVENUES OVER/(UNDER) EXPENDITURES	(27,258)	(1,347,241)	(1,319,983)
TRANSFERS IN/(OUT)	(25,000)	(297,538)	(272,538)
EXCESS REVENUES OVER EXPENDITURES	(52,258)	(1,644,779)	(1,592,521)
FUND BALANCE AS OF JULY 1, 1999	302,037	302,037	—
FUND BALANCE AS OF JUNE 30,2000	<u>249,779</u>	<u>(1,342,742)</u>	<u>((1,592,521))</u>

This review reveals that the district did not correctly budget revenues and overexpended every major expenditure category. It also shows that the district's budget anticipated a positive ending balance of \$249,779, but instead ended with an actual negative balance of \$1,342,742, a \$1,592,521 negative difference. This reflects the poor budget and expenditure controls implemented by the district. For example, the general fund included actual expenditures that exceeded the budget by \$1,823,704 and transfers out that exceeded the budget by \$272,538. Clearly, the staff did not effectively monitor actual expenditures compared with the approved budget. This happened even though Education Code section 42600, requires districts to expend funds within the major object codes budgeted by the Board of Education.

Some of the causes of these poor controls were that staff members had not been trained on the financial reporting software used by the district, internal controls were weak, and the business manager departed in November 1999.

Because of the district's large negative ending balance from 1999-2000, the district lacked the state recommended general fund reserves (\$320,842 for Emery) of four percent of its annual expenditures, transfers, and other uses for a district of this size. As a result, the district filed negative certifications for its first, second, and third interim financial reports for the 2000-01 fiscal year.

These issues and other material uncertainties regarding the bond and cafeteria funds prompted the district to request an emergency loan apportionment from the state. At the time of FCMAT's initial assessment, FCMAT projected the loan amount needed was between \$2 million to \$3 million. As of the third interim report, FCMAT is recommending an emergency state loan of \$1.3 million and a line of credit of \$1 million

Forecast Format

FCMAT's forecast is presented in three formats utilizing the School Services of California Multi-Year Projection Software for Windows release 4.1. The software complies with the Standardized Account Code Structure (SACS). The following reporting formats are presented in the report:

1. A summary J-200 format that reflects the general fund unrestricted and restricted totals.
2. An unrestricted J-200 format that reflects only the general fund unrestricted totals
3. A restricted J-200 format that reflects only the general fund restricted totals.

Restricted funds are not necessarily self-supporting. Some restricted programs may encroach upon unrestricted funds to make up shortfalls in funding levels. For example, special educa-

tion programs usually encroach upon unrestricted funds in most districts. Whenever restricted programs require support from unrestricted funds, the support is reflected on the unrestricted forecasts as an outgo on the line entitled “Contributions to Restricted Programs.” On the restricted forecast, a corresponding inflow is shown. The two amounts completely cancel each other, and are reflected as zeros on the summary forecast of unrestricted and restricted totals.

Budget Assumptions

FCMAT adopted the following budget assumptions in preparing the Multi-Year Financial Forecast. The budget assumptions depict conservative economic factors and estimates addressed in the governor's budget proposal presented in May of 2001 and outlined by School Services of California in its Financial Dartboard matrix. Snapshots of the budget assumptions and financial forecast variables utilized to forecast the district's budget are listed below:

FACTOR	2000-01	2001-02	2002-03
Statutory COLA for Revenue Limit	3.17%	3.87%	3.4%
K-12 Revenue Limit Deficit	0.00%	0.00%	0.00%
Special Education Base Deficit	0.00%	0.00%	0.00%
State Categorical COLA	3.17%	3.87%	3.4%
Transportation COLA & Growth	4.4%	5.3%	4.5%
Mega-Item Per ADA Block Grant	\$12.17\ADA	\$12.00\ADA	\$11.90\ADA
California CPI	4.3%	4.0%	2.5%
Lottery	\$122 + 14	\$118.90 + 12.10	\$118.30 +12.70
Interest Rates for 10 year Treasuries	5.1%	5.2%	5.3%
Health & Welfare Benefit Increase	Included	10%	10%
Salary Compensation	None	None	None
Increase for Utilities	20%	20%	20%

Financial Forecast Analysis

Highlights and Key Findings

The Multi-Year Financial Forecast analysis, which is included in its entirety as an appendix to this report, forecasts a negative fund balance for the 2000-01 fiscal year and the subsequent two fiscal years. The district's audited financial records for the 1999-2000 fiscal year show a negative ending general fund balance of \$1,342,742. This negative amount became the beginning fund balance for FCMAT's forecast.

The following issues further exacerbate the district's poor financial condition:

- Inappropriate expenditures from the bond fund
- Potential encroachment from the cafeteria fund

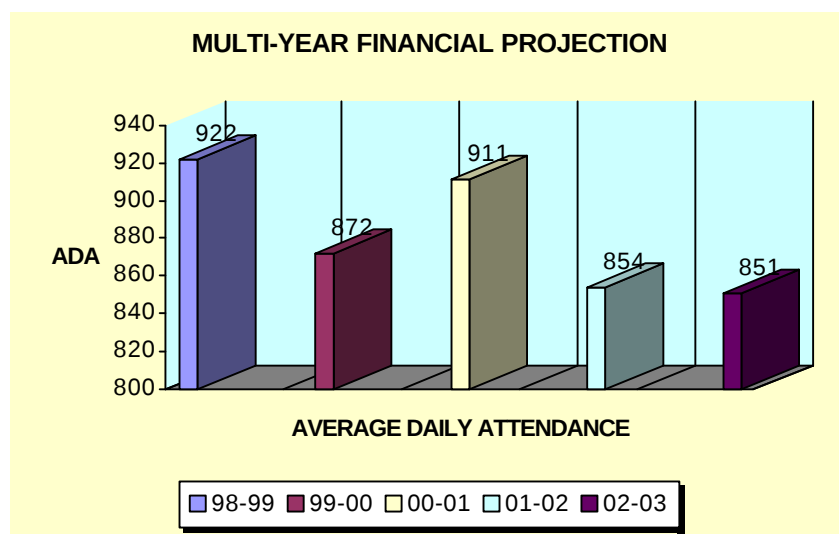
- Declining enrollment
- Increasing costs for utilities and health benefits

Based on our financial forecast and considering the above factors, FCMAT believes that the district will require an emergency state loan to meet its current and future financial obligations. FCMAT's current forecast as to the amount of the emergency loan is \$1.3 million as a loan and a line of credit of \$1 million.

The line of credit is being recommended to allow for fiscal uncertainties. Pending issues include continuing audits of the district's bond and cafeteria funds and potential adverse litigation. FCMAT also believes some transactions involving bond proceeds were inappropriate and some issues concerning the cafeteria fund require transfers of resources from the general fund to these funds, thereby worsening the financial condition of the general fund.. Other uncertainties that may have an impact on the fund balance include declining enrollment and increases in the cost of employee benefit programs and utility rates.

The district's average daily attendance (ADA) trends demonstrate a slight decline from 1998-99 to the 2000-01 fiscal year, but then remain relatively flat for the balance of the forecast. This area must be closely monitored and will be a critical factor for future decisions about staffing and technology needs.

The following graph shows the district's average daily attendance trends. ADA is defined as the total approved days of student attendance in the district divided by the number of days school is in session for the required minimum day.



Most readers of financial forecasts tend to focus on fund balance. In the case of Emery Unified School District, FCMAT's latest financial forecast shows an Undesignated Amount of negative \$2,308,215. This represents the net ending fund balance plus recommended reserves. This deficit balance represents the amount that needs to be recovered in order to move the district to an acceptable financial condition.

In conclusion, the district's financial condition can be linked to specific events and trends, such as excessive spending in 1999-2000, a lack of attention to the budget, poor internal controls, poor staff training, staff resignations, and to inaccurate financial reporting during critical financial reporting periods. FCMAT believes that with the introduction of new staff members and a primary focus on fiscal oversight and short-term assistance, the district can recover and sustain its operating budget in a positive status. The community of Emeryville has been very interested in the district's well being and is engaged in efforts to find solutions to assist in the financial recovery of the district.

Internal Controls Review

Introduction

Scope of the Work

Internal controls are the validation processes designed to provide reasonable assurance that:

1. The operations of the school district are effective and efficient;
2. The financial information produced is reliable and accurate; and
3. The district is operating in compliance with all the applicable laws and regulations.

The internal control structure includes the policies and procedures utilized by the staff, accounting and financial information systems, work environment, and the attitudes of the employees employed by the school district.

In school district operations, each employee in the organization has some responsibility for the internal control standards and framework, but the ultimate responsibility lies with the Board of Education, Superintendent and management staff. The district must promote adherence to prescribed managerial policies and develop an internal control consciousness. Promoting this type of mentality and developing internal control methodologies will ensure that the district's assets are safeguarded against waste, loss and abuse.

FCMAT's evaluation of the internal control structure at Emery Unified included a review of the district's policies, regulations, manuals, procedures, financial reports, and other business related documents. Reviewing and analyzing the staff's responses to internal control questionnaires obtained information regarding the district's current internal control procedures. Members of the district staff also were interviewed to determine how well they understood current internal control processes and compliance issues. Site visits were conducted at Anna Yates Elementary, Emery Middle School, and Emery High School to discuss the topics of internal control procedures and compliance for the cafeteria, grant accounting, student body and attendance accounting areas.

The internal control review included the financial transactions, policies and procedures in the following sixteen areas:

- General financial
- Cash management
- Disbursements
- Budget development and monitoring
- Purchasing

- Payroll
- Personnel
- Revenues
- State and federal grant accounting
- Attendance (district and site level)
- Debt management
- Cafeteria accounting
- Construction accounting
- Fixed assets
- Inventory

Format for Reporting Internal Control Weaknesses

For each area where a significant internal control weakness was identified, FCMAT has reported the finding in the following format:

Internal Control Standard

This is the normal industry standard that should occur in the school district. This qualification is based on standard business practices in other California school districts, or laws and regulations, and is consistent with prudent business practices.

Finding

This is the current practice of the district and identifies issues that do not meet the minimum internal control standard, resulting in a weakness in the district's internal controls.

Recommendation

This is the change or recommendation required in the district's operation to provide a reasonable and cost-effective solution to the issues identified.

Internal Control Classifications

In each of the internal control findings, any weakness or problem is classified as a material weakness, a reportable condition or an area for management improvement. These classifications are provided to assist the district in developing a corrective plan regarding the specific findings. The plan should be constructed to prioritize the material weaknesses first, the reportable conditions second, and any management improvement recommendations last. The following definitions are provided:

Material Weakness

A material weakness is defined as a deficiency in an internal control process that is so serious that errors or fraud may occur and not be detected within a timely period by employees in the normal course of business. This may also include violations of laws and regulations. A material weakness is the most serious type of reportable condition.

Reportable Condition

A reportable condition is defined as a significant deficiency in the design or operation of an internal control that could adversely affect the district's ability to record, process, summarize, and report financial data.

Management Improvement

Any finding categorized as a management improvement is not considered a material weakness or reportable condition, but a suggestion for improving the operations of the district to conform to industry standards.

Section I. General Financial

A. Financial Information

INTERNAL CONTROL STANDARD

The Board of Education has the responsibility to provide financial oversight for the district. In order to effectively perform this oversight function, the Board of Education needs periodic and timely financial information regarding the district's financial condition. The minimum requirements are set forth below:

1. Annual Budget: Education Code sections 42122-42129 provide legal requirements for the components of the budget, prescribed forms and statutory due dates.
2. Report of Budget Adjustments, Transfers: Education Code section 42600 requires that the board adopt a resolution for transfers between major object codes in the adopted budget, or between the fund balance and the expenditure accounts.
3. First and Second Interim Reports: Education Code section 42130 requires the Superintendent to submit two reports to the Board of Education during each fiscal year. These reports are required to be submitted on the forms prescribed by the Superintendent of Public Instruction.
4. Unaudited Financial Information: Education code section 42100 requires the Board of Education to approve an annual statement of all receipts and expenditures of the preceding fiscal year no later than September 15. The annual statement is required to be presented on the prescribed forms. (J-200)
5. Annual Audit Report: Education Code section 41020 requires the Board of Education to receive an audit of all funds for the preceding fiscal year by December 15.

The district's Superintendent or Business Manager is responsible for submitting these items to the Board of Education for review, discussion, and action. These statutory deadlines ensure that the board will receive the necessary financial information in time to make any necessary adjustments to avoid issues of financial insolvency.

Findings (Material Weakness)

The Board of Education is not receiving adequate and accurate financial information, and in some instances, the staff has not submitted the legally required documents to the board for approval. The district's financial reporting process is significantly deficient. The following problem areas are identified:

1. Report of Budget Revisions, Adjustments and Transfers: The staff has not submitted timely reports to the board regarding budget adjustments and transfers affecting the district's fund balance. The district did not effectively monitor actual expenditures against the adopted budget and present revisions to the board. The general fund had actual expenditures and other uses that exceeded budgeted amounts by \$2,096,242 at year-end for the 1999-00 fiscal year.
2. Unaudited Financial Information: The unaudited financial information was not completed and submitted to the board. The plan for closing the district's financial records or "books" was not met.
3. Annual Audit Report: Due to the district's inability to close the 1999-00 financial records, the annual audit for this fiscal year was not completed and presented to the board until February 19, 2001.

The information provided to the Board of Education was inaccurate and not timely.

Recommendation

The district should:

1. Take the appropriate steps to develop and implement a comprehensive budget system to track, monitor and update all budget modifications on a monthly basis.
2. Focus on immediate improvements in the accounting and finance functions in the following areas:
 - Evaluate the staffing requirements and increase the quantity and quality of accounting staff in order to ensure that the district has the appropriate resources for an efficient and timely internal and external financial reporting process.

- Implement a more formal review process to ensure that higher risk analyses and reports are reviewed by someone other than the preparer.
- Ensure the district's business manager adheres to financial reporting requirements on a monthly, quarterly and annual basis and oversee the process to ensure the timeliness and accuracy of the budget.

B. Board Policies and Administrative Regulations

INTERNAL CONTROL STANDARD

The board policies and the district's administrative regulations provide guidance to the district's staff on the implementation of laws and regulations. The policies and regulations also allow the board and administration to implement policies and procedures that are more stringent than those required by law.

Findings (Reportable Condition)

The district board policies and procedures for business operations were not updated and are inadequate. FCMAT reviewed section 3000 of the board policies and noted that the only recent addition was in 1997 regarding investment policy. Following are examples of sections that need to be updated:

1. The district lacks a written policy or procedure on conflict of interest. The key management officials and Governing Board members were not required to complete a related party questionnaire (Form 700). This form requires the full disclosure of business ownership and affiliations. It is intended to prevent conflict of interest in any business dealing with the district, and to ensure that all resources were used appropriately. FCMAT noted significant transactions entered into by the former district superintendent with people/firms related to or affiliated with him.
2. The district lacks board policy and guidelines regarding fraud. There were no directions for staff to address the types of fraud, improprieties, and irregularities that may occur in the district, nor were there investigative and reporting procedures to be followed in the event of a suspected fraudulent act.
3. The district lacks a comprehensive debt policy. The Government Finance Officers Association (GFOA) recommends that all state and local governments have a comprehensive debt policy that includes the purpose for which debt may be issued, the types of debt permitted, the structural features of the debt, the authorized methods of sale, and other relevant information.

Recommendations

The district should:

1. Direct the staff to review all administrative regulations and board policies related to business functions and internal controls to determine whether they are in compliance with federal and state law, and whether they provide adequate controls to safeguard the district's resources.
2. Ensure board policies and procedures are reviewed regularly to determine whether all aspects of the district's operations, programs, goals and missions are adequately covered. The California School Boards Association provides policy reviews and should be contacted to determine whether its assistance would be a cost-effective alternative for the district.

C. Staff Training

INTERNAL CONTROL STANDARD

Employees require sufficient training in all areas that impact their work to ensure the accuracy of related reports and compliance with laws, rules, and regulations. The annual budget should include a line-item component for staff training, and the amount should be equitably allocated among all departments. A training budget communicates to the employees the value of learning and improving the work product as well as the district's commitment to invest in its greatest resource, its employees.

To ensure efficient operations when employees are on vacation or when there are employee turnovers, the district should cross-train staff to perform critical functions.

Findings (Reportable Condition)

There are several new employees at the district office and the school sites who have not had the necessary training for the proper performance of their duties. These new employees are responsible for essential job functions such as attendance, grant accounting, associated student body, accounts payable, food service and school administration. Due to their lack of training in these areas, the employees are concerned that some transactions and activities may not have been properly recorded and reported, which could further result in revenue loss or exposure to potential financial liabilities and obligations. Following are examples of these problematic areas:

1. The staff members in charge of attendance at Emery Middle School Academy and Emery High School were not submitting reports to the business office because they

were not aware of the state reporting requirements and deadlines. The reports were generated only after a request by the Business Manager.

2. At two school sites, the attendance clerks were not familiar with the SASI attendance system, and did not know its full capabilities, which could have assisted the school in its attendance-related responsibilities. The only report that the staff printed from the system was the monthly attendance summary, which was required by the Business Manager for state reporting purposes. Other reports, such as the daily absence reports could have been printed from the system to help the school administrators monitor a student's attendance for tardiness and truancy, and ensure that all students attend school regularly and punctually.
3. FCMAT interviewed grant administrators, program managers and school principals who were responsible for monitoring their budgets. Several of these staff members indicated that they were not trained on how to interpret the financial reports. A school Principal indicated that the business office recently started providing the school sites with a monthly budget report for the programs that they were supposed to administer and monitor. However, the school Principal indicated that there was no instruction on interpreting the figures.
4. The food service personnel did not seem to be knowledgeable about state and federal laws and regulations for child nutrition programs. The district office staff member who was assigned as the Food Service Manager since December 2000 admitted that she was not aware of district policies and procedures, state and health regulations, or food service program reporting requirements.
5. One of the staff members at the business office also indicated that when an employee was on vacation or on emergency leave, the pending jobs did not get completed until the employee returned.

Recommendations

The district should:

1. Encourage more awareness and participation in staff training. The most important element of sound internal control processes is the personnel who execute the transactions and carry out the activities of the district. Explore staff development courses that may assist program managers and the staff improve performance.
2. Provide cross training for the staff. There should never be only one person who has the training to perform a specific job function. Furthermore, each staff member should be required to take a periodic vacation, and another staff member should be able to perform the vacationing employee's duties.

D. Procedures Manual

INTERNAL CONTROL STANDARD

Procedures manuals preserve the institutional memory of the district, provide greater assurance that the procedures of the district are clear, and serve as important tools in training new employees. An updated business procedures manual provides a handy reference and assists new or temporary staff in expediting and processing various jobs.

Findings (Management Improvement)

The district lacks comprehensive written desk manuals and business policies and procedures. District staff expressed the need for an updated business procedure manual. There were no written procedures for accounts payable, purchasing, personnel, payroll, associated student body and attendance. The state of California manuals utilized in many areas of the district are out of date. Following are examples of areas for which there should be new or updated procedures:

1. The staff at two school sites referred to the district teacher's manual for issues regarding attendance and student body activities. This teacher's manual was inadequate. It did not address questions regarding reporting requirements, appropriate activities for student body, and other important matters.
2. The Accounts Payable Clerk was unaware of the proper procedures for monitoring district funds. The bills were paid without determining whether there were adequate funds to cover the expenditure. The clerk indicated that he had not seen a budget report since he assumed the position in November 2000.
3. There were no guidelines for record-keeping and proper documentation for expenditures. The site personnel did not know what supporting documents were required to be provided and to whom the documents needed to be sent. Some bills were past due because no one could determine whether they reflected valid district expenditures due to the lack of proper documentation.

Recommendations

The district should:

1. Vigorously pursue the development of an up-to-date and comprehensive business services manual that provides written guidance on the significant procedures for operations and the forms used by each department and business office position/desk. This would assist staff, especially when an employee is out on sick leave, vacation, or in a job transition.

2. Assign the Business Services Manager to ensure that the manual is reviewed and updated each year and that all necessary employees are appropriately trained annually.

E. Performance Evaluations

INTERNAL CONTROL STANDARD

The district should periodically review and document the performance of employees. Performance evaluations are an important tool in improving staff's efficiency and effectiveness on the job. Evaluations provide employees with an opportunity to discuss problems and concerns with their supervisors.

Findings (Management Improvement)

Performance evaluations were not completed on a regular basis. Some staff members interviewed were evaluated during the current year, while others had not been evaluated for two years.

Many school site and program administrators also complained about the service provided by the business office. Some school site personnel indicated they did not receive updated information from the business office, which prevented them from making well-informed and meaningful decisions, or providing proper directions to their own staff.

Recommendations

The district should:

1. Complete performance evaluations on at least an annual basis. Performance evaluations are a critical communication tool in monitoring job effectiveness and productivity. The evaluation process provides employees the opportunity to discuss job related issues and concerns with their respective supervisors.
2. Develop a board policy/regulation on performance evaluations. The policy should address how often the evaluations will be performed, who will perform the evaluations, and what the performance standard will be. The district also should consider conducting periodic surveys to ensure that the business office meets the needs of the school sites.

Section II. Personnel

A. Recruitment and Selection Procedures

INTERNAL CONTROL STANDARD

Hiring the most qualified and capable employees is necessary to ensure the efficient and effective operations of the district activities. This can be accomplished by wide-range dissemination of position vacancies, and the identification of the best candidate for the position.

Although the selection of competent personnel does not guarantee that errors and fraud will not occur, competent staff could help ensure that operations will be more efficient and internal controls will function effectively.

Findings (Management Improvement)

The school principal positions for the three district school sites were recently filled. However, it did not appear that the vacancies were advertised and disseminated on a wide range. Therefore, the district did not necessarily have the opportunity to identify the best possible candidates for the positions. The incumbent school principals indicated that they were holding various positions in the district prior to being assigned as school principals. The new assignments were in a permanent capacity. Accordingly, they were verbally notified that they would be assuming the school Principal position when the vacancy arose. One of them was displeased with the designation because the new position resulted in a lower monetary compensation. This person was considering filing a case against the district for damages.

Recommendation

The district should:

1. Disseminate the need to fill vacancies and advertise for these positions on a wider range. FCMAT did not fully assess the background and qualifications of the school principals. Each employee hired may have been the most qualified person for the position. However, the district could have missed opportunities to interview and hire the best-qualified applicants for the positions by not following this recommendation.
2. When possible, assign these new staff members the positions initially on an interim status in order to maintain the continuity of the educational programs while the advertisements and recruitment processes are completed.

B. Employee Retention

INTERNAL CONTROL STANDARD

Internal control policies and procedures generally are executed successfully if adequately trained personnel are retained. The usual risks and implications of high turnover in staffing are the lack of leadership, coordination and effective communication. High turnover may also result in errors in the processing of transactions, resulting in inaccurate financial information, and the loss of historical/institutional knowledge that may be critical to operations in a district like Emery Unified.

Findings (Management Improvement)

Significant turnover has occurred in key management positions within the district. The Superintendent, the Business Services Manager and the school principals from the elementary, middle school and high school resigned during the 1999-2000 fiscal year. Several nonmanagement staff at the sites also left the district. The Director of Personnel indicated that the district was experiencing difficulty in recruiting staff.

Recommendation

The district should:

1. Hire a consultant to conduct a performance audit in order to identify the causes for the turnover and to provide options/strategies for improvement.
2. Perform a job reclassification study to determine whether the personnel workload is manageable, and whether the salaries and benefits are competitive with other government jobs in the area. Upgrading some of the key positions may be necessary to reduce the high turnover ratio of employees.

C. Staffing

INTERNAL CONTROL STANDARD

School districts should establish operating procedures that ensure efficient and effective operations, thereby keeping labor costs to a minimum.

Finding (Management Improvement)

The district has contracted with Berkeley Unified School District to purchase food items and cafeteria supplies so that the current staff no longer prepares meals at the school site. At the high school, the staff consisted of three employees assigned to food service who were working six hours a day. It did not appear that the operation and workload required three six-hour job positions.

Recommendation

The district should:

1. Review the job responsibilities and work hours of the staff working in the child nutrition programs
2. As noted in the section on cafeteria fund financial issues, terminate the food service contract with Berkeley Unified School District as of June 30, 2001 and set up all sites as modified, self operating kitchens with simplified menus until a Food Service Director is hired.

Section III. Budget Monitoring

INTERNAL CONTROL STANDARD

The district budget should be monitored each month to determine if funds are sufficient to cover the district's anticipated expenditures, and that the revenues are received as anticipated. The budget monitoring process serves as an early warning indicator to enable staff to anticipate potential fiscal issues. The staff in the business office must have the appropriate training and technical skills necessary to develop and monitor the budget.

Findings (Material Weakness)

Significant monitoring of the budget was not performed during the 1999-00 fiscal year. Most of the staff in charge of monitoring the budget, such as the school principals and program managers, had no access to the budget information. The Accounts Payable Clerk paid the district bills without determining whether there were adequate funds within the budget to cover the expenditure. Also, the district was not using the encumbrance system, therefore, unpaid purchase orders were not shown in the budget report.

The condition of the budget indicates that the business office staff did not have the appropriate training and technical skills to develop or monitor the budget. The budget's status also indicates that the necessary leadership skills to evaluate the district's financial status and direct the work of the staff were ineffective.

Recommendation

The district should:

1. Provide appropriate training for all staff members involved in the budget monitoring process to ensure that everyone has a clear understanding of the budget process and full comprehension of the corresponding staff responsibilities.
2. Implement the encumbrance system so that the budget can be monitored properly. The financial reports should reflect not only the actual expenditures incurred but also the purchase orders and other encumbrances not yet paid.

Section IV. Cash Management

A. Cash Reconciliation

INTERNAL CONTROL STANDARD

The district staff should reconcile each bank account and the county treasury account each month. This reconciliation ensures that all transactions posted to the account are correct. A second staff person should review the reconciliations to determine that they have been carefully and accurately prepared.

Findings (Material Weakness)

No one at the district reconciled the cash in the county treasury account. The interim Business Manager mentioned that reconciliation of the county treasury account was done at the county office of education. However, no one at the district level reviewed the reconciliation. There was also significant delay in the reconciliation process because the monthly statement from the county treasury was not received for six to eight weeks after the end of the month. The bank accounts for the revolving fund, cafeteria funds, student body account and payroll taxes were not reconciled on a monthly basis. According to the interim Business Manager, the cafeteria account had not been reconciled since June 2000.

Recommendation

The district should:

1. Assign the Business Manager or the manager's staff to reconcile each bank account and the county treasury account on a monthly basis, normally within two weeks but no longer than by the end of the following month.

2. Assign a second staff person to review the reconciliation and to sign off the review. Considering that the district is in financial crisis, it is critical that cash accounts be monitored to ensure availability of funds.

B. Cash Disbursement

Internal Control Standard

No single employee should handle a transaction from its initiation to its completion because a person could create a fictitious transaction resulting in payment. This concept is called segregation of duties and is considered a primary deterrent to fraud and abuse.

Finding (Material Weakness)

There was no segregation of duties in the cash disbursement area. One person was in charge of opening the mail, sorting and coding the bills for payment, recording the expenditure in the general ledger system, initiating warrant processing, maintaining custody of the signed check, and mailing the check payments to the vendors.

Recommendation

The district should:

1. Establish a system of checks and balances so that no single person handles incompatible functions, such as custody and records keeping. The custody of the signed checks should be handled by someone independent of disbursements and the general ledger recording functions in order to avoid potential financial abuses and unauthorized payments.

Section V. Grants Accounting

A. Time Sheet for Federally Funded Employees

INTERNAL CONTROL STANDARD

The Office of the Management and Budget (OMB) Circular A-87 requires that district employees who are partially or totally paid from federal funds prepare additional time documentation to support the charges to federal programs. Employees who are funded solely from one federal program are required to prepare a certification twice a year, which states that the employee worked only in the federal program during the year. The employee's supervisor may prepare this certification in lieu of the employee.

Employees who are multifunded from one or more programs that include a federal program are required to prepare time documentation each month that supports the charges of their salary and benefits to the programs. Under certain conditions, this documentation may be maintained for four months a year and used to account for allocations for the entire year.

The district is required to reconcile the multifunded time documentation to the time charges, based on the budget percentages, and prepare adjusting entries for any differences between the budgeted allocations of salary and benefits and the actual time worked based on the time documentation prepared by employees.

Finding (Material Weakness)

District employees who are solely funded or multifunded from federal programs were not maintaining semiannual or monthly activity reports as required by Federal Cost Principles, OMB A-87. The district's independent auditor had informed the district of the necessity of compliance with these requirements since the 1998-99 fiscal year audit, but compliance had not been implemented at the time of the interview with the district office staff.

Recommendation

The district should:

1. Ensure that all program staff and the accounting office staff are trained on the requirements of OMB A-87 and that procedures are established to ensure compliance with the law.

B. Compliance with State Reporting Requirements

INTERNAL CONTROL STANDARD

School administrators have the responsibility to protect and prudently manage the district's financial resources and to be more accountable in ensuring compliance with reporting requirements.

Finding (Material Weakness)

The district had not been filing the required state reports on time. The staff indicated the district received notices from the Department of Education and/or grantor agencies warning the district of possible loss of funds because of noncompliance with reporting requirements. One specific example is the Technology Literacy Challenge Grant. This grant was approved by the state and an advance payment of the award was paid to the district. However, due to failure to comply with the reporting requirements, the program was terminated, and the district was required to refund \$17,267 to the state.

Recommendation

The district should:

1. Devote more time to monitoring categorical programs and the financial reporting process. At the beginning of the fiscal year, the Business Manager should provide all site personnel with a well-planned calendar indicating the due dates, the individual or department responsible, and the tasks to be completed to ensure that all participating parties are informed of the appropriate timelines.

Section VI. Associated Student Body

INTERNAL CONTROL STANDARD

The California Education Code section 48930 allows any group of students to organize an associated student body (ASB) organization within the public schools with the approval and subject to the control and regulation of the Governing Board of the school district. The district staff has the responsibility to ensure that the ASB funds are accounted for and controlled in accordance with laws, regulations, and district policy.

To meet the district's fiduciary responsibility, the board and the district staff should ensure that:

- There is a detailed board policy that addresses the use of ASB funds, the accounting records that staff will maintain to support the receipt and spending of funds, and the appropriate internal controls for ASB funds.
- The site staff is provided annual training on the laws and regulations related to ASB funds and the board policy.
- The district staff periodically reviews the accounting and internal controls for ASB funds as well as for compliance with laws, regulations, and the board policy.

Findings (Material Weakness)

The teachers and student body advisors did not maintain any source documents that showed how much money was collected for fundraising events. When the fundraising event was completed, the teacher or advisor turned in the funds collected to the ASB Bookkeeper at the district office without any supporting documentation. The ASB Bookkeeper was unable to verify or reconcile to any source document that the amount turned in was the amount actually collected for the event.

Someone other than the bookkeeper did not review the general ledger.

The site staff have not attended training on ASB funds and there had been no in-house training provided by the district.

Recommendation

The district should:

1. Adopt a comprehensive ASB policy that addresses internal controls, allowable and prohibited expenditures, appropriate fundraising events, and accounting and reporting of ASB activities. For the collection of cash from associated student body fundraising events, the district should establish a procedure that provides sufficient documentation of how much was collected, how many items were sold, cost per item and other information. The site staff responsible for ASB funds should then compare this documentation with the amount of cash that is submitted for deposit. This provides assurance that all cash collected is properly recorded and deposited in the bank.
2. Assign the Principal to review the general ledger on a monthly basis to ensure the accuracy and proper recording of student body activities. Cash receipts and disbursements should be carefully reviewed and any discrepancies or unusual transactions investigated.

Section VII. Attendance

INTERNAL CONTROL STANDARD

It is important for school districts to thoroughly verify and record student absences because of its financial implications. The attendance is the basis for apportionment of revenues to school districts from the state educational funds. School districts are also required by law to keep track of attendance for compliance with the state compulsory attendance law.

Findings (Reportable Condition)

Several new staff members at the school sites were in charge of attendance accounting, but were not adequately trained or supervised. These new employees did not have a clear understanding of the importance of properly recording and reporting attendance information.

There were no comprehensive reference materials available for the staff, and there were no training sessions provided to assist staff members in the performance of their duties.

The school principals did not review attendance reports submitted by the staff to the district office.

Recommendations

The district should:

1. Emphasize the importance of properly recording attendance to all the staff involved in attendance accounting. The staff should be encouraged to attend workshops and training necessary to assist them in their jobs.
2. Assign the school Principal to review and sign the attendance reports before they are submitted to the district office to determine whether the monthly totals are reasonable, and whether there is excessive absenteeism during certain periods that needs to be verified and studied. Knowing ADA trends is also an important tool for budgeting, planning and other financial decision-making processes.

Section VIII. Construction Projects

INTERNAL CONTROL STANDARD

The business office staff or the business manager should develop a multiyear budget for each new construction project that includes ongoing information on the ongoing revenues and expenditures on a fund basis. The projects should be identified during the budget development process and include setting up and identifying the proper fund for accounting purposes.

Findings (Material Weakness)

There is inadequate information and coordination between the Business Manager and the Facilities Clerk, resulting in district capital projects funds that do not accurately reflect the appropriate revenues and expenditures required to complete the construction projects. The district's bond fund had been charged more than \$900,000 dollars for costs that should have been charged to the district's general fund or capital facilities fund.

The Office of Public School Construction funds various types of construction projects for school districts. Many of these projects require setting up a new fund and also require a matching contribution by the district. The proper state school building fund was not established to receipt state funding and subsequently was received into the roof replacement fund. Additionally, charges were made against the bond monies because the appropriate fund was not set up.

Recommendation

The district should:

Assign the Business Manager to identify and evaluate the budgets for capital projects during the budget development process and perform a year-end reconciliation for each project by fund. This should include the actual deferred revenue and the required matching share requirement for each funded project.

Section IX. Cafeteria Fund

INTERNAL CONTROL STANDARD

The Business Manager or Food Service Director should develop a long-range plan for the operations of the cafeteria fund that depicts the financial solvency of the cafeteria fund.

Finding (Management Improvement)

The Business Manager or Food Service Director had not prepared a long-range financial plan that addresses the financial solvency of the cafeteria fund. The district engaged in a contract with the Berkeley Unified School District for the preparation and delivery of meals for each of its three schools. The average monthly costs range from \$19,000 to \$26,000. In addition to the new contract, no analysis regarding labor was performed for current staffing. As a result, the district retained all of its current employees for the 2000-01 fiscal year. This additional expense could result in a necessary subsidy from the district's general fund.

Recommendation

The district should:

1. Develop a long-range financial plan that projects the cafeteria fund revenues and expenditures over a three to five-year period. Additionally, the district should obtain information from other comparable school districts to evaluate labor and other associated costs that impact the cafeteria's fund balance.

Section X. Data Processing

FCMAT did not review the internal controls in the data processing area. The district contracts with CBEX Technology for its computer system maintenance and technical assistance and utilizes IFAS through the county office as the accounting and general ledger system. The SASI system is being used for attendance reporting.

Conclusion

In general, the findings of the internal control review demonstrate that the district has an internal control structure that is significantly deficient. The district has failed to establish the proper internal control processes and identify the related risks associated with the decision-making process and financial accounting system. In the absence of strong internal controls, the resultant risks and exposure have contributed to potential fraud and embezzlement, unauthorized transactions, inaccurate financial reporting, excessive costs, legal sanctions, faulty management decisions, loss of assets, and unacceptable accounting and record keeping.

These serious internal control weaknesses have culminated in the district becoming financially insolvent. The district's operation is inefficient, and has produced financial information that has proved to be unreliable and untimely and caused the district to seek financial assistance in the form of a state emergency loan. The following issues are summarized:

- Staff members in key positions did not possess the necessary skills to perform competently at the level they were assigned
- Staff members were not adequately trained or provided with adequate supervision
- Timely financial information was not available to the Board of Education for critical decision-making
- Critical functions such as account reconciliations, budget development and monitoring for the 1999-00 and 2000-01 fiscal years were not performed
- Significant weaknesses existed in the internal control process that increased the risk of fraud or abuse occurring.

The present management team has a formidable task to accomplish. Strong and effective internal controls are critical to provide the basis for a solid financial structure that will ensure the accountability required for the district to maintain effective academic programs for its students.

Bond Fund Review

Introduction

General obligation bonds (GO bonds) are voter-approved long-term debt instruments to which the full faith and credit of the issuing district are pledged.

GO bonds are payable from a voter-approved increase in ad valorem property taxes. The ad valorem general property taxes in the school district are increased by the amount of debt service on the GO bonds, thus creating a financing technique that incorporates a tax revenue generation feature. GO bonds are self-supporting and normally cause no reduction in other school district financial resources.

In accordance with Education Code section 15,000 et. al., school districts may issue GO bonds to finance the acquisition and improvement of real property including new construction, expansion, restoration, remodeling or improvement of school facilities and grounds. They may not be used to finance ordinary operations and maintenance expenses or to acquire furnishings, vehicles or equipment (unless the equipment is affixed to real property and is treated as real property for legal purposes).

A 1986 voter-approved amendment to Proposition 13 permits school districts to seek approval for local general obligation bonds for school construction or renovation, to be repaid through property taxes. A two-thirds vote was required for passage.

Findings

In 1995, Emery Unified School District passed a GO bond with a favorable vote of 71.7 percent to make \$8,070,000 in health and safety improvements and renovations.

In the covenants of the GO bond, the ballot language detailed the types of projects and expenditures that the district proposed to fund. During the course of FCMAT's review, allegations surfaced regarding inappropriate expenditures for personnel and certain related projects. The Office of Public School Construction (OPSC) assisted FCMAT in reviewing and evaluating the following funds:

- Fund 18 Deferred Maintenance Fund
- Fund 49 State School Building Fund
- Fund 51 State School Lease Purchase Fund\Modernization
- Fund 54 Bond Interest and Redemption Fund
- Fund 55 Building Fund
- Fund 63 Capital Facilities (Developer Fees)

In reviewing the district's bond fund, it was determined that expenditures in the amount of \$943,797.46 should not have been charged to the fund. The major cause for these inappropriate charges can be linked to the district's limited experience with bond funds and a lack of proper accounting related to the account code structure and fund accounting requirements. The review included all transactions from January 1996 through February 28, 2001.

The following is a synopsis of the disallowed expenditures made by district personnel from the bond fund by object code:

<i>Bond Fund Analysis</i>		
Description	Object Code	Total Dollars
Teacher Salaries	1000-1999	\$9,922.86
Classified Salaries	2000-2999	286,222.97
Health & Welfare Benefits	3000-3999	87,451.44
Supplies	4000-4999	86,067.44
Other Services	5000-5999	62,210.12
Equipment	6000-6999	411,922.63
Total Disallowed Expenditures		\$943,797.46

Disallowed expenditures totaling \$943, 797.46 will be an adjustment to the district's general fund balance and will appear on the J-200 report on the line titled "Adjustment for Restatement." The adjustment for restatement is to be utilized by the district to correct a material error reported in the financial statements of the prior year that are discovered after the completion of the audit.

Recommendation

The district should:

1. Book an audit adjustment for restatement in the amount of \$943,797.46 to the district's general fund financial statement for the 2000-01 fiscal year to reimburse the bond fund.

Cafeteria Fund Review

Introduction

Emery Unified School District serves approximately 930 students from kindergarten through twelfth grade with approximately 56.2 percent of the student population participating in the Free and Reduced Lunch Program. The district has the potential to identify approximately 85 percent of its student population in this program. The National School Lunch Program is a federally assisted meal program that operates in public and nonprofit private schools and residential child care institutions. The program provides nutritionally balanced, low cost or free lunches to more than 27 million children per day. School districts and independent schools that choose to participate in the lunch program receive cash subsidies and donated commodities from the U.S. Department of Agriculture for each meal served. The participating agencies are required to serve lunches that meet federal requirements, and must offer free or reduced price lunches to eligible students. Current regulations require schools to meet Dietary Guidelines for Americans, which recommend that no more than 30 percent of an individual's calories are derived from fat, and less than 10 percent from saturated fat. Regulations also establish a standard for school meals to provide one-third of the recommended daily allowances (RDA) of protein, Vitamin C, iron, calcium, and calories.

Any student may purchase a meal through the National School Lunch Program. Students from families with incomes at or below 30 percent of the poverty level are eligible for free meals. Families with incomes of from 30 percent to 85 percent of the poverty level are eligible for reduced price meals, for which students cannot be charged more than 40 cents per meal. Students from families with incomes of more than 85 percent of the poverty level are required to pay full price, though meals are still subsidized to some extent. Nationwide, approximately 92 percent of all students participate in the National School Lunch Program.

Findings

At Emery Unified School District, approximately 56.2 percent of the student population is able to eat for free or at a reduced price. This high eligibility status allows the district to participate in a state provisional grant, which eases the paperwork involved at the point of sale in addition to the reporting and claiming processes. This provision will allow all students to eat for free, and the district may claim reimbursement from free, reduced and paid status collected in an established base year.

The district's cafeteria fund has been through multiple reviews by the State Child and Nutrition Office over the past two years. It has been determined that the district is underclaiming its available student eligibility for state and federal reimbursements. Compounding this problem, in closing the 1999-00 fiscal year financial records, FCMAT identified interfund transfers in the amount of \$297, 538 dating back to the 1996-97 fiscal year. After further

evaluation, it was determined that the district was incapable of utilizing the cafeteria fund to repay the temporary loan from the general fund. This occurred primarily because the cafeteria fund executed a one-year agreement with Berkeley Unified School District stipulating that Berkeley Unified would prepare and deliver all meals to the district. However, in analyzing this agreement, the district failed to reduce its current expenditures for labor while engaging in a contract that is estimated to cost the district approximately \$210,000 for the 2000-01 fiscal year.

Recommendations

Personnel

The district should:

1. Hire a full-time Food Service Director to write menus, prepare production records and standardize recipes. Process free and reduced applications and submit claims for reimbursements. Provide commodity procurement. Develop and implement training of staff in sanitation, safety, customer service, portion control and proper cooking techniques. In the area of purchasing, prepare bid requests for food and equipment. Conduct weekly site visits with principals, classrooms and staff.
2. Hire a lead person who can be a floater as well as oversee production as needed, and assist the Food Service Director with computer training, trouble shooting and other areas of operation. The following alternatives are provided in filling the director and lead positions described in recommendations one and two:
 - Hire a full-time Food Service Director (11-month) to fulfill all directorship duties and a six-hour lead person who can assist with training and filling in as required.
 - Hire a part-time Food Service Director and a full-time supervisor. The director would perform overall director duties while delegating the site-to-site business to the supervisor.
 - Hire a full-time supervisor and contract with a neighboring school district to provide directorship support for at least 40 days a year.
 - Hire a full-time supervisor and contract with a consultant to start the year off to provide training and support to staff.
3. Hire a consultant (a retired director) to start the 2001-02 fiscal year until the district can make a determination regarding the director position. The consultant will be

charged with developing simplified menus, maintaining production records, initiating employee staff development, setting up sites for limited on-site cooking, and overseeing the warehouse for weekly food deliveries to sites. (This function is already in the warehouse person's job description.)

4. Evaluate and reassign hours at each site to reflect serving and preparation needs, e.g., at the elementary site only one person is needed for breakfast so the hours could be changed to 9:30 a.m.–1:30 p.m. All sites presently have a total of 10 hours labor, which works out to be 18 meals per hour and reflects an excessive labor cost. A more moderate number would be 30-45 meals per hour served. Increasing the number of meals served would bring the number of meals per hour served to within industry standards.
5. Review employee contracts to consider the number of workdays per fiscal year. The number of days granted for a work year should be in line with the number of days students are in class. Summer school should be considered extra workdays.
6. Assign two people to sell a la carte items in order to maximize the snack bar potential. The second person should be a split position, working at the high school and proceeding to the middle school to assist with that snack bar.

Cafeteria Fund Financial Issues

The district should:

7. Terminate the food service contract with Berkeley Unified School District as of June 30, 2001. In addition, all sites should be set up as modified self-operating kitchens with simplified menus until a Food Service Director is hired.
8. Open a Snack Bar at the middle school that could potentially increase sales without reducing the number of reimbursable meals.
9. Purchase a point-of-sale computer software program to validate and report accurate meal counts.
10. Establish procedures to develop a monthly profit and loss statement as a working tool for program evaluation.
11. Evaluate current banking requirements and evaluate the associated costs.
12. Reevaluate the PERS reduction schedule for the district's revenue limit calculation. The Governing Board can adopt a policy that salaries should first be paid from federal

reimbursement checks before anything else is paid, thus eliminating the PERS reduction costs.

13. Increase both breakfast and lunch meal participation as well as a la carte sales to remain financially solvent. This would bring meals per hour servings more in line with industry standards.
14. Develop portion and production standards to minimize food waste.
15. Offer an after-school snack program to increase revenues.
16. Develop a simple catering brochure for district and student menus.

Menu/Production Recommendations

The district should:

17. Have all sites prepare breakfast (menu attached). Have elementary and high schools prepare their own lunch consisting of simplified menu entrees, including vegetarian options. Initiate a salad bar in the elementary school as well as middle school, and offer a variety of fresh fruits and vegetables.
18. Contract with a consultant as soon as possible to develop and train staff in simplified menus and production records for all sites.
19. Open a snack bar at the middle school without increasing current labor costs.
20. Arrange a meeting with the staff to discuss self-preparation operations prior to the conclusion of the current fiscal year.
21. Develop sample menu and production sheets for September.
22. Send bid requests for price quotes on produce, groceries, milk and bread by July 15.

Sanitation and Safety Issues/Training

The district should:

23. Evaluate pest control requirements at the high school.
24. Initiate food safety training for the staff as soon as possible. Serve Safe equivalent training is available on August 22 at a Northern California Child Nutrition workshop in Hayward. All employees should be required to attend. There is a minimal charge

for attendance, and this training will be extremely beneficial to the district.

25. Develop training standards regarding production, proper oven temperatures and other food preparation techniques.
26. Train the staff in salad bar production to minimize labor costs
27. Immediately train the staff in meal counts for student eligibility and the importance of production records.

General

The district should:

28. Notify parents of changes in the district's Child Nutrition program in an effort to solidify parental support. Hold parent support meetings, and solicit opinions about the program.
29. Initiate a dialogue with student groups to evaluate new menu items and to solicit opinions on the program in general. Start with the leadership class at all three sites to determine student interests on food selections and other menu items.
30. Assign the director to participate in CASBO or CSFSA, Northern Section.

National School Lunch Program CRE Review

From October 2000 through January 2001, representatives of the California Department of Education, Nutrition Services Division performed a Coordinated Review Effort (CRE) of the district's food service program. The scope of the CRE was performed in accordance with the following:

Critical Areas

- P.S. 1: Part one-certification\benefit issuance
 Part two-counting\claiming
- P.S. 2: Meal Components\menu items

General Areas

1. Free and reduced price process\verification

2. Meal patterns\nutrient standards
3. Civil rights\child with special health needs
4. Monitoring site responsibility\sanitation
5. Reporting and record-keeping

Program Areas

6. State meals for needy students
7. USDA donated foods
8. School Breakfast Program
9. After School Snack Program

Technical Assistance Areas

Competitive foods
Pregnant and Lactating Teens
Fiscal management
Other

Summary of the CRE

1. One or more CRE critical areas exceeded PS 1 or PS 2 thresholds
2. A follow-up CRE is required because of noncompliance in critical areas
3. Review findings may result in fiscal action, which may be decreased after submission and review of corrective action documentation (CAD). Failure to submit CAD information on time could result in all payments to the district being withheld.
4. The district will be required to submit all completed forms by June 20, 2001

Certification and Benefit Issuance (Part I)

PERFORMANCE STANDARD

All free, reduced price and paid lunches claimed for reimbursement are served only to children eligible for free, reduced price and paid lunches, respectively; and are counted, recorded, consolidated and reported through a system which consistently yields correct claims.

Findings

Fourteen eligibility applications were missing the required information, and/or miscategorized as free, reduced or paid status on the application. Benefits were not issued correctly on the student roster (the list with the coded eligibility status.).

Verification of a minimum number of eligibility applications was not conducted and documented by the required date of December 15, 2000 (annually).

Recommendations

The district should:

1. Develop and submit for approval a written certification and benefit issuance procedure that ensures accuracy.
2. Complete the verification process for the current school year and submit documentation of all verification activities.

Counting and Claiming (Part II)

PERFORMANCE STANDARD

All free, reduced price and paid lunches claimed for reimbursement are served only to children eligible for free, reduced price and paid lunches, respectively; and are counted, recorded, consolidated and reported through a system which consistently yields correct claims.

Findings

Day of Review

At Anna Yates Elementary, teachers collect lunch orders in the classroom by a show of hands. At breakfast, the food service staff counts and claims students at the beginning of the cafeteria line. During lunch, the teachers accompany each class to the lunch line and turn in a classroom specific checklist of students who are eating that day. Some teachers count students before the food is served while others count students after the food is served.

Month of Review

The daily meal counts for all three sites do not match the October 2000 monthly consolidation summary.

The October 2000 consolidation summary does not match the October 2000 claim for reimbursement. The October 9 through October 31 meals at Anna Yates Elementary are not

included in the total meals placed on the claim. In addition, there were other mathematical and transfer errors.

Daily edit checks were not conducted and documented for the month of review and day of review.

Site monitoring is not conducted and documentation on file by February 1 annually.

Recommendations

The district should:

1. Develop and submit for approval a meal counting and collection procedure that ensures accurate and appropriate counting, consolidation of daily meal counts and claims.
2. Implement the approved procedure for the full month of May 2001 and submit daily meal counts, the May monthly consolidation and a copy of the May 2001 claim for reimbursement.
3. Submit the following to recalculate all 2000-01 school year claims for reimbursement from August 2000 through April 2001.
 - A list of the number of eligible students, by site and month in the free, reduced and paid categories
 - A summary of the meal counts for reimbursement by site and month
 - A copy of all claims for reimbursement
 - A copy of the school calendar denoting all meal service days.
4. Create and submit a copy of the May 2001 daily attendance factor edit check document by site.
5. Conduct the required site monitoring visits for the current school year, one per site minimum and submit copies of the completed documentation.

PERFORMANCE STANDARD

Lunches claimed for reimbursement within the school food authority contain menu items and food components as required by program regulations.

Findings

On January 11, 200, Emery Middle School ran out of the full fruit and vegetable offering prior to all meals being served and claimed for reimbursement. A total of ten meals were offered without the full two servings of fruit and vegetables totaling three-fourths cup minimum.

Six breakfasts served at Anna Yates Elementary on January 10, 2001 were observed to contain fewer than the required minimum three components. These meals are not claimable and therefore will be adjusted in the state's review.

Seven alternative lunches were served and claimed on January 10, 2001 at Anna Yates that did not contain the fruit and vegetable component.

Recommendations

The district should:

1. Submit a copy of the USDA approved child nutrition label for the pizza provided by the Berkeley Unified vendor on January 11, 2001 and the signed certified manufacturer's specification for the nutrient content of the item served.
2. Submit a written plan assuring that all food components are available and on site at all three sites for all meals during operational school days.

General Areas of Review

Meal Patterns\Nutrient Standards

Findings

All three sites visited in January are staffed by employees who clearly do not understand the contribution that the vended meals (particularly entrees) make to the required Traditional Food Based Meal Pattern selected by the district.

The district has opted to utilize the "offer vs. serve" approach to identify a complete reimbursable meal. The staff was unclear about the definition of a reimbursable meal using this method.

The contracted provider's (Berkeley Unified) transport record is incomplete and does not properly document that a complete reimbursable meal is offered each meal and each day for the number of students anticipated for meal service.

The vendor's transport record does not indicate to the Emery Unified food service staff exactly what contribution a combination item makes (example: entrée with multiple components) to the Traditional Food Based Meal Pattern for a particular meal.

Recommendations

The district should:

1. Provide staff training on the requirements of the Traditional Food Based Meal Pattern. Submit a copy of the staff training agenda and sign in sheet for attendance.
2. Provide staff training on the implementation of the "offer vs. serve" claiming option. Submit a copy of the staff training agenda and sign in sheet for attendance.
3. Provide staff training on the completion of the transport record for Emery Unified documentation that a full reimbursable meal is offered for each meal and each day.
4. Arrange with Berkeley Unified a daily, weekly and monthly documentation sheet to communicate the food based meal pattern contribution for all food items purchased through the Berkeley Unified vendor agreement. Submit a written plan for meeting this requirement including a training implementation plan.

Estimated Participation for the 2000-2001 Fiscal Year								
#Days	Paid		Free		Reduced		Total	
	Breakfast	Lunch	Breakfast	Lunch	Breakfast	Lunch	Breakfast	Lunch
86 days	1,299	7,279	8,333	23,862	1,295	5,218	10,927	36,359
Average								
Per Day	15	85	97	277	15	61	127	423
X								
180 days	2,700	15,300	17,460	49,860	2,700	10,980	22,860	76,140

Projected Income for 2000-2001

Breakfast Income	\$32,635
Lunch Income	164,543
Ala Carte Sales	7,680
Total Projected Income	\$204,858

Projected Expenditures for 2000-2001

2000s	Salaries	120,000
3000s	Benefits*	40,000
4000s	Supplies & Other	8,500
4710s	Food	180,000
5000s	Other Services	7,000
		\$(355,500)

Estimated Profit (Loss) Forecast

INCOME	\$204,858
EXPENSES	355,500
PROJECTED LOSS	(150,642)
Less PERS Reduction*	16,000
TOTAL PROJECTED LOSS	(\$134,642)

**16,000 less PERS, if board action taken.*

In summary, the district's cafeteria fund will be required to generate additional sales and stabilize labor cost while terminating the food service contract with Berkeley Unified in order to alleviate any potential encroachment to the general fund for the 2001-02 fiscal year. The staff will require extensive training in all areas of food preparation and the reimbursable claiming process.



Allegations of Fiscal Abuse Review

Introduction

As FCMAT began its review of the Emery Unified School District, FCMAT heard allegations of suspected fraud and abuse from local newspapers and from the comments of district employees and private citizens. FCMAT was aware that certain allegations were under investigation by local criminal investigators, such as the Alameda District Attorney and the Emeryville police. FCMAT cooperated with those investigations by providing any information it could to local investigators as they requested it.

In addition, FCMAT analyzed district operations for possible fraud schemes. This involved reviewing potential schemes, ranking the schemes by likelihood of occurrence, and developing procedures to analyze for the existence of those potential schemes. FCMAT identified four schemes most likely to occur in this or any school district. Those included: ghost employees, falsified hours or salary payments, payments to shell companies, and overpayments.

Findings

FCMAT's analysis did not identify instances of fraud other than those already prosecuted or alleged by the Alameda County District Attorney. However, since fraudulent transactions by their nature are hidden, there is no set program or analysis that can be followed to give complete assurance that fraud has not occurred.

Nevertheless, several control weaknesses were identified that increase the possibility that fraud could occur and not be identified and reported. These items identified represent additional material weaknesses not reported in the general study of internal control. Those weaknesses include:

- Emery Unified does not utilize the termination date field on the master employee database.
- The county reissues warrant numbers. As soon as the warrant number field reaches the maximum allowed by the system, the counter resets and the numbers start to be used over again.
- The district does not use the purchase order database on a consistent basis.
- There is no apparent review of previous payments made to vendors before an invoice is paid. This results in duplicate payments to vendors.

Specific findings include the following:

- A review of the master vendor database revealed 99 vendors to whom almost \$168,000 had been paid, but who showed no vendor address. Complete information, including current addresses, should be recorded for all vendors, employees, etc.
- A review of a sample of 129 vendor payments revealed that 41 of the payments or 31 percent were duplicates. These 129 payments totaled over \$287,000 and the duplicate payments equaled \$41,682 or 14.5 percent of the total payments. Of these 41 payments, 18 payments totaling \$17,381 had been returned to the district by the vendors. The overpaid vendors had cashed twenty-three payments, totaling \$24,301. The cause of the duplicate payments varied, but it appeared that lax procedures mostly accounted for the errors. One vendor accounted for almost 45 percent of the payments.

Recommendations

The district should:

1. The district should enter employee termination dates in the employee termination date field on the master employee database.
2. The district should explore with the county office of education the possibility of stopping the practice of reissuing warrant numbers. This will improve the numerical control exercised over warrants issued by the district.
3. The district should implement policy and regulations requiring that purchases be consistently made using the purchase order database.
4. Procedures should be immediately implemented to preclude duplicate payments to vendors. Those procedures should include reviewing previous payments, canceling invoices as they are paid, requiring original invoices for payment, and other procedures as appropriate.
5. The district should undertake appropriate action, including legal action if necessary, to collect duplicate payments made to vendors. In addition, the district should undertake a larger review of payments to determine if additional payments other than those identified by FCMAT also should be collected.
6. The district should consistently require complete information on all vendors, including names, addresses, and state and federal employee identification numbers, as well as other appropriate information.

Appendix

A. Multi-Year Financial Forecast

