



CSIS *California School Information Services*

New City Public Schools

Financial Operations Review

May 7, 2013



Joel D. Montero
Chief Executive Officer





CSIS California School Information Services

May 7, 2013

Sabrina Bow, Executive Director
New City Public Schools
1637 Long Beach Boulevard
Long Beach, CA 90813

Dear Executive Director Bow:

In November 2012, New City School and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement for a review of the financial operations at New City School. Specifically, the agreement states that FCMAT will perform the following:

1. Financial Reporting, Budget and Accounting:
 - a. Review policies addressing budget, accounting, financial reporting and board approval.
 - b. Evaluate the process to review and revise the budget for changes to student enrollment and operations.
 - c. Review budget revisions to determine the level of board approval/ratification
 - d. Determine if all financial obligations are included in the budget and interim financial reports.
 - e. Review the charter's financial software to determine if separate accounts are maintained for restricted revenues or expenditures either by resource or class.
 - f. Evaluate the timeliness of the financial reporting and validate that all financial reporting requirements are being met and provided to the authorizing district.
 - g. Review the cash flow projections to ensure sufficient funds are available to meet the charter school's financial obligations.
 - h. Evaluate the charter school's accounting practices and financial reporting to ensure that they meet generally accepted accounting principles (GAAP).
2. Audit:
 - a. Identify the independent auditor's time line and schedule to meet the annual deadline of December 15, 2012.
 - b. Determine if a copy of the prior year audit has been accepted by the county office.
 - c. Review the auditor selected to determine if the firm meets the state approved list and criteria.
 - d. Identify the charter school's corrective action plan regarding prior year audit findings and recommendations.
3. Payroll:
 - a. Evaluate the salary placements or schedule, if any and determine if sample test data reconciles with payroll.

FCMAT

Joel D. Montero, Chief Executive Officer

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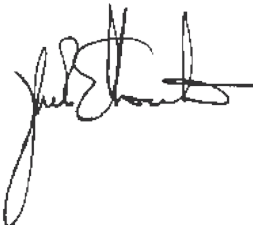
Administrative Agent: Christine L. Frazier - Office of Kern County Superintendent of Schools

- b. Review federal and state tax deposits to determine if they are made on time and no penalties are being assessed.
 - c. Identify earnings recorded for retirement reporting to Social Security, PERS and STRS.
 - d. Validate that systems are in place to provide STRS data is available to the county office.
 - e. Review processes that systems are in place for earnings records for preparation of W-2 information.
 - f. Evaluate the segregation of duties between employee data, salary placements and payroll.
4. Financial Condition:
- a. Determine if the charter school maintains prudent level of reserves for economic uncertainties.
 - b. Review the preparation of multi-year financial projections and assumptions
 - c. Identify all long term debt obligations.
 - d. Provide summary findings regarding the charter school's ability to sustain their financial solvency for the current and two subsequent fiscal years.
5. Cash Receipts:
- a. Review the policies and procedures for cash receipts, deposits and disbursements
 - b. Evaluate the segregation of duties for the receipt of funds, deposit of monies and reconciliation of bank statements.
 - c. Review test sample of transactions to determine if receipts are issued for all monies received.
6. Disbursements:
- a. Review the policies and procedures for disbursements.
 - b. Review the signature authorization process.
 - c. Evaluate the segregation of duties between purchasing, receiving and accounts payable, if any.

This report contains the study team's findings and recommendations.

We appreciate the opportunity to serve you and extend our thanks to all the staff and administrators of New City Public Schools, the Long Beach Unified School District and CharterWorks for their cooperation and assistance during fieldwork.

Sincerely,

A handwritten signature in black ink, appearing to read "Joel D. Montero", with a stylized flourish at the end.

Joel D. Montero

Chief Executive Officer

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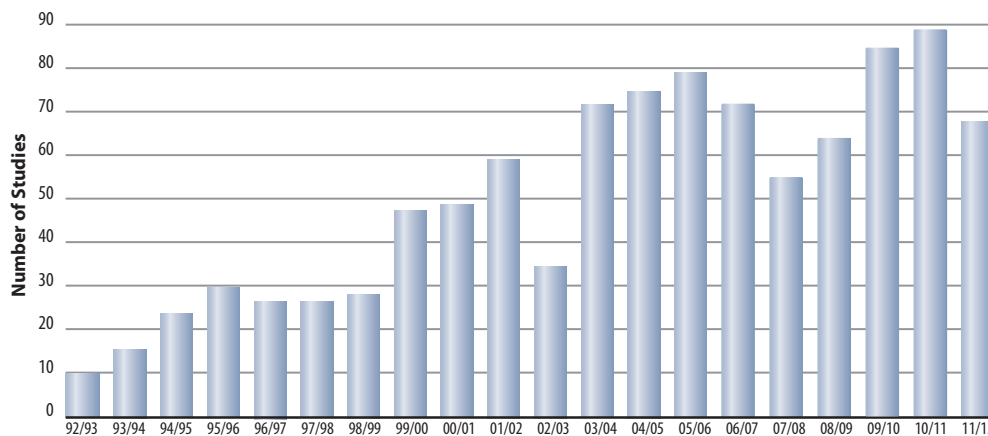
About FCMAT

FCMAT's primary mission is to assist California's local K-14 educational agencies to identify, prevent, and resolve financial and data management challenges. FCMAT provides fiscal and data management assistance, professional development training, product development and other related school business and data services. FCMAT's fiscal and management assistance services are used not just to help avert fiscal crisis, but to promote sound financial practices and efficient operations. FCMAT's data management services are used to help local educational agencies (LEAs) meet state reporting responsibilities, improve data quality, and share information.

FCMAT may be requested to provide fiscal crisis or management assistance by a school district, charter school, community college, county office of education, the state Superintendent of Public Instruction, or the Legislature.

When a request or assignment is received, FCMAT assembles a study team that works closely with the local education agency to define the scope of work, conduct on-site fieldwork and provide a written report with findings and recommendations to help resolve issues, overcome challenges and plan for the future.

Studies by Fiscal Year



FCMAT also develops and provides numerous publications, software tools, workshops and professional development opportunities to help local educational agencies operate more effectively and fulfill their fiscal oversight and data management responsibilities. The California School Information Services (CSIS) arm of FCMAT assists the California Department of Education with the implementation of the California Longitudinal Pupil Achievement Data System (CALPADS) and also maintains DataGate, the FCMAT/CSIS software LEAs use for CSIS services. FCMAT was created by Assembly Bill 1200 in 1992 to assist LEAs to meet and sustain their financial obligations. Assembly Bill 107 in 1997 charged FCMAT with responsibility for CSIS and its statewide data management work. Assembly Bill 1115 in 1999 codified CSIS' mission.

AB 1200 is also a statewide plan for county office of education and school districts to work together locally to improve fiscal procedures and accountability standards. Assembly Bill 2756 (2004) provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans.

In January 2006, SB 430 (charter schools) and AB 1366 (community colleges) became law and expanded FCMAT's services to those types of LEAs.

Since 1992, FCMAT has been engaged to perform nearly 850 reviews for LEAs, including school districts, county offices of education, charter schools and community colleges. The Kern County Superintendent of Schools is the administrative agent for FCMAT. The team is led by Joel D. Montero, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

Introduction

Background

The New City School was authorized by the Long Beach Unified School District numbered by the State Board of Education on April 12, 2000 and opened in August 2000. New City School is a classroom-based, direct-funded, charter school serving approximately 430 students in kindergarten through grade eight in a classroom setting.

California Education Code Section 47600, also known as the Charter Schools Act of 1992, was enacted “to provide opportunities for teachers, parents, pupils, and community members to establish and maintain schools that operate independently from the existing school district structure.” Charter schools are a part of the public school system, but differ from traditional public schools because they are exempt from many state laws relating to specific educational programs. Specific goals and operating procedures are detailed in an agreement, or charter, between the authorizing agency and the charter school organizers. Charter schools may elect to operate as corporations organized under the Nonprofit Public Benefit Corporation Law of the Internal Revenue Code [26 U.S.C. Section 501(c)(3)].

While charter schools offer a more flexible school governance model, they are still accountable for student achievement and fiscal management, similar to traditional public schools. The chartering agency is responsible for adequate and appropriate oversight, including determining if a charter is following prudent business practices and generally accepted accounting principles in accounting for revenues and expenditures and preparing financial reports. The chartering agency may be a school district, county office of education, or the California Board of Education.

New City Public Schools (New City) is comprised of the following three entities:

- The New City School serves the K-8 student population as described above and is operated as a California nonprofit benefit corporation.
- NCPS I LLC (NCPS1) was formed during 2010 for charitable purposes under Section 501(c)(3) of the Internal Revenue Code and receives lease payments from New City School.
- New City Public Schools is a California nonprofit public benefit corporation incorporated on December 27, 1999 and operates New City School. New City had operated a program for grades nine through 12 known as Colegio New City; however, that entity closed effective June 30, 2012.

New City has entered into various debt financing agreements. The largest was a mortgage note agreement entered into by NCPS1 to acquire real estate at 1637 Long Beach Boulevard, Long Beach, California in May 2010. This facility serves as New City School’s classroom facilities as well as the combined entity’s business office. NCPS1 defaulted on the note on or about February 7, 2012 with its lender issuing a notice of default to commence proceedings for a trustee’s sale; however, before the issuance of a notice of sale, the parties were able to enter into standstill, forbearance and modification of loan-term agreements.

While New City was negotiating with its lender, the Long Beach Unified School District issued a notice of violations, and the parties entered into a memorandum of understanding (MOU) on August 30, 2012 addressing many issues including the requirement that FCMAT conduct an audit of New City School’s financial operations.

In October 2012, New City School requested that FCMAT conduct a review of its financial operations, including the following:

1. Financial Reporting, Budget and Accounting:
 - a. Review policies addressing budget, accounting, financial reporting and board approval.
 - b. Evaluate the process to review and revise the budget for changes to student enrollment and operations.
 - c. Review budget revisions to determine the level of board approval/ratification
 - d. Determine if all financial obligations are included in the budget and interim financial reports.
 - e. Review the charter's financial software to determine if separate accounts are maintained for restricted revenues or expenditures either by resource or class.
 - f. Evaluate the timeliness of the financial reporting and validate that all financial reporting requirements are being met and provided to the authorizing district.
 - g. Review the cash flow projections to ensure sufficient funds are available to meet the charter school's financial obligations.
 - h. Evaluate the charter school's accounting practices and financial reporting to ensure that they meet generally accepted accounting principles (GAAP).
2. Audit:
 - a. Identify the independent auditor's time line and schedule to meet the annual deadline of December 15, 2012.
 - b. Determine if a copy of the prior year audit has been accepted by the county office.
 - c. Review the auditor selected to determine if the firm meets the state approved list and criteria.
 - d. Identify the charter school's corrective action plan regarding prior year audit findings and recommendations.
3. Payroll:
 - a. Evaluate the salary placements or schedule, if any and determine if sample test data reconciles with payroll.
 - b. Review federal and state tax deposits to determine if they are made on time and no penalties are being assessed.
 - c. Identify earnings recorded for retirement reporting to Social Security, PERS and STRS.
 - d. Validate that systems are in place to provide STRS data is available to the county office.
 - e. Review processes that systems are in place for earnings records for preparation of W-2 information.
 - f. Evaluate the segregation of duties between employee data, salary placements and payroll.
4. Financial Condition:
 - a. Determine if the charter school maintains prudent level of reserves for economic uncertainties.
 - b. Review the preparation of multi-year financial projections and assumptions
 - c. Identify all long term debt obligations.
 - d. Provide summary findings regarding the charter school's ability to sustain their financial solvency for the current and two subsequent fiscal years

5. Cash Receipts:
 - a. Review the policies and procedures for cash receipts, deposits and disbursements
 - b. Evaluate the segregation of duties for the receipt of funds, deposit of monies and reconciliation of bank statements.
 - c. Review test sample of transactions to determine if receipts are issued for all monies received.
6. Disbursements:
 - a. Review the policies and procedures for disbursements.
 - b. Review the signature authorization process.
 - c. Evaluate the segregation of duties between purchasing, receiving and accounts payable, if any.

Because of the severity of New City's debt issues, FCMAT issued a management letter on January 11, 2013, which is attached as Appendix B to this report. This report discusses the remaining scope points of the study agreement.

Study Team

The study team was composed of the following members:

Julie Auvil, CPA, CGMA	Kim Sloan, CPA, CIA*
FCMAT Fiscal Intervention Specialist	Financial Operations Officer
Bakersfield, CA	Kern County Superintendent of Schools
	Bakersfield, CA
Leonel Martínez	
FCMAT Technical Writer	
Bakersfield, CA	

*As a member of this study team, this consultant was not representing his employer but was working solely as an independent contractor for FCMAT.

Study Guidelines

FCMAT visited New City Public Schools, the Long Beach Unified School District (the charter's authorizing agency) and CharterWorks (the charter school's office services provider) on December 10 and 11, 2013 to conduct interviews, collect data, and review documents. This report is the result of those activities and is divided into the following sections:

- I. Executive Summary
- II. Financial Reporting, Budget and Accounting
- III. Audit
- IV. Payroll
- V. Financial Conditions
- VI. Cash Receipts
- VII. Disbursements
- VIII. Appendices

Executive Summary

New City Public Schools (New City) is composed of three entities with similar names; New City School which serves its current K-8 student population, the NCPS I LLC (NCPS1) which was formed during 2010 for charitable purposes under Section 501(c)(3) of the Internal Revenue Code and to which New City School makes lease payments, and New City Public Schools which is a California nonprofit public benefit corporation which was incorporated on December 27, 1999 and operates New City School. This similarity has caused confusion regarding which entity is responsible for reporting what information to the charter's authorizing agency, the Long Beach Unified School District. It is also difficult to determine whether the information originates only from the charter school, includes either NCPS1 or New City School, or comes from the combined entity. As a result, it is important to emphasize clarity when the party or parties enter into agreements; however, because New City School is operated as a California nonprofit benefit corporation, New City School and New City Public Schools are legally considered to be the same entity. Additionally, when FCMAT refers to information from New City or interviews with New City administrators, staff or directors in this report, it is referring to the personnel holding positions within New City School.

New City School has no written board policies or administrative regulations and New City only recently authored a general accounting and procedures manual. However, internal controls and segregation of duties are fairly well developed, with FCMAT providing only a few recommendations for improvement in this report.

New City School's problems are primarily in the areas of financial reporting, including cash flow and multiyear financial projections, ensuring all financial obligations are included in those financial reports, and making these submissions according to agreed-upon deadlines.

The most serious issue identified during fieldwork is the amount of debt the combined entity has entered into over the past two to three years. This debt has a maturity date of June 30, 2013, and while the majority is not owed by the charter school (New City School), the amount due in a few months threatens New City's fiscal solvency for the current and two subsequent years. This subject is discussed briefly in this report and more thoroughly reviewed in FCMAT's January 11, 2013 management letter, which is attached as Appendix B to this report.

Findings and Recommendations

Financial Reporting, Budget and Accounting

Board policies and administrative regulations are based on laws and regulations in numerous documents, including the California Constitution, Education Code, Code of Regulations, Government Code, federal regulations, case law and industry practice. Although charter schools are exempt from many Education Code requirements, they must also adhere to many rules and regulations. Board policies and regulations provide guidelines and directives for the operation of the charter and its personnel and are a key component of internal controls. Because they are based on frequently revised laws and regulations, it is important to ensure the board policies are updated to reflect changes in legislation.

New City's general ledger is complicated by the fact that it recognizes more than one entity under the consolidated entity of "New City Public Schools." This entity includes the following:

- The New City School for K-8 students, which is operated as a California nonprofit benefit corporation.
- Colegio New City (Colegio) serving grades 9-12.
- NCPS I LLC, which was formed for charitable purposes under Section 501(c) (3) of the Internal Revenue Code and receives lease payments from The New City School and Colegio.
- New City Public Schools, a California nonpublic benefit corporation that operates New City School (the charter management organization).

New City operated Colegio from August 2008 until its voluntary closure on June 30, 2012.

This report refers to the consolidated entity as "New City" and its specific components by their proper name or abbreviation to avoid confusion. However, because New City School is "operated as a California nonprofit benefit corporation," New City School and New City Public Schools are legally considered to be the same entity. Additionally, when FCMAT refers to information from New City or interviews with New City administrators, staff or directors in this report, it is referring to the personnel holding positions within New City School. As a part of this study, FCMAT requested copies of New City School's board policies and administrative regulations; however, none exist. This indicates that the charter does not have guidelines and directives for such areas as business office procedures, and public records act requests. Guidelines and directives for admissions, student discipline, and human resources issues (its hiring process or workplace/environmental issues) are contained in other documents such as the charter and employee handbook. Implementation of a comprehensive set of policies and regulations can be time-consuming for the charter staff and expensive because of the need to involve legal counsel in numerous areas. Many school districts avoid these issues by utilizing a policy subscription service such as the California School Boards Association's GAMUT service, which has recently launched a charter school version.

New City provided FCMAT with its January 1, 2013 general accounting policies and procedures manual containing procedures for the monthly fiscal review, budget process, and monthly/year-end financial procedures. However, it does not include changes to the California Public Employees' Retirement System enacted under Assembly Bill 340 and effective January 1, 2013.

Charter schools are not subject to the California Code of Regulations - Title 5, Commercial Code and Government Code that establish records retention guidelines for California school agencies, but these can still serve as best practices in handling a charter school's records. The California Department of Education (CDE) states in its charter school closure process that "[p]rovisions for the authorizing entity to maintain all school records, including financial and attendance records, should reflect the timelines stated in 5 CCR, sections 16023-16026." Under California Code of Regulations -- Title 5, Sections 16020-16027, records are categorized as either Class 1 - permanent records, Class 2 - optional records or Class 3 - disposable records based on the following criteria:

- Class 1 - Permanent Records: The original or one exact copy, unless microfilmed, of these records is required to be retained indefinitely. These records are specified in Section 16023 of the Education Code and include, but are not limited to, items such as all J-Forms, most payroll records and the summary of expenditure and construction progress.
- Class 2 - Optional Records: These are not required by law to be retained permanently but deemed worthy of further preservation as specified In Section 16024. This classification includes, but is not limited to, the consolidated application, architect agreements, and vendor files.
- Class 3 - Disposable Records: The required retention periods and procedures for destruction or transfer of these records are specified in Section 16025 and include items such as purchase orders, requisitions, and garnishments.

New City's accounting manual states that it will maintain all accounting records for a minimum of seven years and includes the following in "accounting documents."

- Cancelled checks (where applicable) and supporting documentation for all check requests
- Deposits
- Bank reconciliations and supporting documentation
- Journal entries
- Payroll registers and pay records, including quarterly and annual tax filings
- Capital additions schedules and supporting documentation
- Depreciation schedules
- Grants and other pertinent financial correspondence from third parties
- Year-end working papers and audit correspondence
- IRS correspondence

However, records related to payroll and property (capital additions) would be considered Class 1 and maintained permanently under Title 5, Section 16023 of the California Administrative Code. Other records that are not listed above such as audits and financial reports would also be classified as Class 1. Additionally, accounts payable records can include items relating to the charter's special education payments/reimbursements, an area that can have extensive litigation with students enrolled in the district for as many as 18 years. As a result, a standard seven-year retention period may not apply to all records retained by New City and should not include financial and attendance records because of potential future problems.

For example, if New City destroys payroll records after seven years, they cannot be used to assist in the correction of errors related to the wages of a retired/retiring teacher as reported to State Teacher's Retirement System (STRS). This can affect the teacher's retirement benefit payments.

FCMAT's review of New City's board minutes for 2010-11, 2011-12 and 2012-13 found that the board reviewed budget changes in the form of budget revisions or monthly financials nine times during the 2010-11 fiscal year and six times in 2011-12. Board meeting minutes show that two of the 15 budget/financial reports had revisions regarding enrollment changes. Minutes were not posted to New City's website showing either budget revisions or presentation of financial reports to the board during the 2012-13 fiscal year. The chart below provides details of the revisions presented to the board.

Review of Board Meeting Minutes

Board Meeting Date	Financials Reviewed	Board Action
2010-11		
07/15/10	2010-11 Revised Budget	Approved
09/16/10	July 2010 Financials	Deferred to next Board meeting
10/28/10	July 2010 Financials	Approved
11/18/10	2010-11 Revised Budget*	Approved
12/16/10	2010-11 Revised Budget	Approved
02/17/11	December 2010 Financials	Approved
03/17/11	January 2011 Financials	Approved
04/28/11	March 2011 Financials	Approved
06/16/11	May 2011 Financials	Approved
2011-12		
08/18/11	2011-12 Revised Budget	Approved
09/15/11	June 2011 Financials	Approved
11/17/11	September 2011 Financials	Presented; No Board Action
01/19/12	November 2011 Financials	Presented; No Board Action
02/03/12	2011-12 Revised Budget*	Approved
05/03/12	2012-13 Updated Budget	Approved
2012-13		
None		
*Revision based on changes to enrollment		

FCMAT was unable to determine from New City's administration the process utilized to revise the budget for changes in enrollment. Board meeting minutes do not elaborate on the process or the extent of the discussion in the two meetings that dealt with budgetary revisions regarding enrollment changes. Further review of board meeting minutes found that the board has a limited amount of discussion when budget revisions are reviewed or monthly financial presentations are made.

New City's organizational structure complicates its interim and financial reports regarding whether all financial obligations are being reported. New City is composed of several entities, and its MOUs with the Long Beach Unified School District do not require submission of the combined entity's financial reports. The district's June 2010 MOU with New City requires New City School to provide budgetary, cash flow and interim financial reports, and the August 2012 MOU also requires monthly financial information from New City School.

However, large amounts of debt are held by the other entities under New City's umbrella which are affecting the operations of New City School. NCPS I LLC entered into the construction mortgage debt and secured the Green Opportunity Fund Loan, which threaten New City's financial solvency. New City Public Schools, which operates New City School, is listed as the lessee on New City's lease of Apple computer equipment, iPads and Canon copier. As indicated in FCMAT's January 11, 2013 management letter, the capital leases for this equipment were not reported in New City's audited financial statements for the year ending June 30, 2012. This omission would have caused the charter's assets and liabilities to be understated; however, New City's auditors determined that they would not be included due to either immateriality or that they deemed the leasing structure to more closely resemble that of a short-term operating lease.

Adding to these complications is the fact that New City's accounting system does not utilize the component that encumbers purchase orders as they are issued. Under normal local educational agency (LEA) accounting practices, funds are encumbered when a purchase order is issued so that budgets can be reduced to reflect the entity's legal commitment to the purchase. This prevents overspending and helps an LEA determine its accounts payable obligations during the year and at year-end. Without this component, New City is depends on either a manual system of tracking purchase orders or the receipt of an invoice to determine its accounts payable obligations. Neither approach is optimal nor a best practice, and both leave New City's financial reporting vulnerable to underreporting accounts payable obligations.

In early November 2011, New City retained Ford Research & Solutions (Ford) to conduct a comprehensive analysis of its academic performance, institutional and school leadership capacity and financial liability. Ford's work included review of documents, a two-day site visit and classroom observations in December of 2011 and discussions with various New City staff, administration and board members. On January 12, 2012, Ford issued An Analysis Of: New City Public School's Academic Performance, Institutional and School Leadership, and Financial Viability (the Ford report), which stated the following:

Historically, financial management, accounting, and reporting at NCPS have been inadequate. In addition, the Board and leadership of NCPS have, for years, been reluctant to make tough financial decisions. It appears, though we cannot state unequivocally, that enrollment targets driving budgets have been habitually and unrealistically projected. Cuts in staff have never been made after the start of a school year, even when actual enrollment proved to be significantly lower than projected. In addition, until about a year ago, the network's previous Controller was providing inaccurate if not falsified financial reports to organizational leadership and the Board.

The district's concerns regarding which financial obligations are reported centered primarily on liabilities such as accounts payable and other forms of debt. Those concerns are well founded in that large amounts of debt are not required to be reported by New City School to the district as they are the legal obligations of other entities under the New City umbrella and accounts payable obligations of New City School are based on a system that is subject to human error. According to New City's audited financial statements, it is operated as a nonprofit public benefit corporation. As such and as a way for the district to be informed of the decisions made by New City, Education Code Section 47604 entitles the chartering authority's governing board to a single representative on the board of directors of the nonprofit benefit corporation.

The California School Accounting Manual (CSAM) was written to provide LEAs with policies, procedures and implementation guidance in accounting. LEAs are required to follow the definitions, instructions and procedures in the CSAM according to Education Code Section 41010.

Title 5, Section 15701 of the California Code of Regulations, also requires charters to follow the guidelines in the CSAM; however, those that are nonprofit public benefit corporations according to Section 501(c)(3) of the Internal Revenue Code, utilize the Financial Accounting Standards Board (FASB) as their authoritative accounting guidance. Since CSAM primarily uses the Governmental Accounting Standards Board (GASB) for generally accepted accounting principles guidance, the manual provides limited guidance to nonprofit benefit corporations. Whether GASB or FASB is followed, the CSAM provides extensive guidance on the chart of accounts.

The CSAM's chart of accounts corresponds to the standardized account code structure (SACS) used for all LEA financial reporting to the county and state, including charters and nonprofit benefit corporation charters. The SACS account string includes seven numerically coded fields; fund, resource, project year, goal, function, object, and school. This study focuses on the resource and object codes. The resource codes provide information on the funding source and whether it is unrestricted (account codes 0000-2999) or restricted (account codes 3000-9999) based on the account code. The object account coding reflects what has been purchased or received and is also used to identify balance sheet accounts.

New City provided FCMAT with its chart of accounts and a report from its general ledger. Both demonstrated the ability to use funds, resources, objects and locations in the coding of its transactions and their use.

New City School and the district entered into two MOUs that outline its obligations regarding various items including financial reporting. The MOU signed at the time of the charter's petition renewal in June 2010 requires New City School to provide the following:

- A preliminary budget to the district and the Los Angeles County Office of Education for review no later than July 1 of each year. All key budget variables, including revenue, expenditure, debt, beginning and ending balance variables are to be defined, with the budget accompanied by summary employee salary data and health benefit plans and policies as supporting documents.
- A copy of the adopted budget to the district each year by April 26.
- Budget revisions to the district within two weeks of revision, upon approval of the New City School's board of directors.
- The first interim financial report to the district by November 25 and to the county office each year by December 15. The first interim financial report is to reflect changes through October 31.
- The second interim financial report to the district by February 19 and to the county office each year by March 15. The report is to reflect changes through January 31.
- The unaudited actuals financial report to the district by August 15 and to county office each year by September 15.
- A copy of the audited financial report to the district, county office, the State Controller's Office and the California Department of Education (CDE) each year by December 15.

A review of the language regarding deadlines for New City School's preliminary and adopted budgets found that these deadlines appear to have been reversed. The submission of an adopted budget by April 26 would mean the district could not conceivably receive this document until approximately 10 months into the fiscal year.

The second MOU between New City School, New City and district was entered into on August 30, 2012 and requires New City School to provide monthly budget and financial statements by the 30th day of each month for the preceding month.

FCMAT reviewed the dates for submission of New City School's financial reports to the district comparing them to the MOU deadlines for the 2011-12 and 2012-13 fiscal years, and was unable to obtain information regarding submissions to the county office.

For the 2011-12 fiscal year, district personnel informed FCMAT that preliminary budgets were not required, and New City School's adopted budget was submitted on May 31, 2011, well before the April 26, 2012 MOU submission date.

The district indicated that New City School provided an incomplete 2011-12 first interim report, with the multiyear financial projection (MYFP) submitted 12 days after the deadline. New City School's second interim report deadline was extended to March 9, 2011; however, the submission was 13 days late and lacked an MYFP. The 2011-12 unaudited actuals and audited financial statements were received by their respective deadlines.

For the 2012-13 fiscal year, the district once again did not require the charter's preliminary budget, and the adopted budget was submitted on June 11, 2012, well in advance of the April 26, 2013 MOU submission date.

New City School's 2012-13 first interim financial report was reportedly submitted three days before the deadline. However, two of the four monthly budget and financial statements due as of the writing of this report were submitted after the 30th of the month. LBUSD's log of reports omitted the July submission and those that were late were filed within one to three days after their due date.

For its 2012-13 first interim report, New City School provided a cash flow report (January 2013) with actuals through October 2012. The report's expenditures matched the charter school interim financial report's total year-end projection column for the 2012-13 fiscal year (CY first interim), but the revenues did not and increased by \$272,000 in local revenues, which represented an audit adjustment of SB 740 revenues noted below.

The cash flow report includes other New City School noncash items that should balance to the June 30, 2012 audited financial report. FCMAT's review of these items found the following:

- Some belong to New City School and match those reported for the entity in the 2012 audited financial statements.
- Others are for New City School and Colegio and come from the 2012 audited financial statements.
- Yet others reflect all or a portion of items attributable to New City Public Schools.
- Some amounts changed between the cash flow prepared for the 2012-13 first interim report and the one prepared in December 2012.

As a result, it is difficult to determine which entity is reflected in the cash flow report and answer questions related to accuracy. Additionally, all the cash for New City is reported as that of the nonprofit benefit corporation. However, the beginning balance possibly represents cash from the operations of Colegio. This entity was voluntarily closed as of June 30, 2012 and it is unknown if all of its obligations have been settled as well as whether the remaining cash is available to the nonprofit benefit corporation or must be returned to the state or another entity.

The first interim cash flow report indicated that New City School was exempt from the July, August, October, March and June deferrals, yet the apportionment schedule for March showed a 0% apportionment instead of the 9% that would be expected in an undeferred schedule. The cash flow report also required adjustments in the apportionment schedule for three other months. By incorporating the change in beginning balance as well as apportionment changes from the CDE's principal apportionment payment calculator into the first interim cash flow report, FCMAT found that all months of the 2012-13 fiscal year had a positive ending cash balance assuming no changes (other than the apportionment) to the months of January through June. However, the nonprofit benefit corporation has entered into a forbearance agreement as the guarantor with the Low Income Investment Fund (LIIF), which specifies that all revenues are to be deposited into a lock box, used to make loan payments on the LIIF indebtedness and all other withdrawals are controlled by LIIF. At the end of the 2012-13 fiscal year, any operating income in excess of New City Public School's budget is to be applied to the principal of the LIIF loan and other indebtedness. Based on these contract terms, it is unknown how much of the cash reported as inflows in the 2012-13 first interim cash flow report have been or will be actually be provided to New City School for its operations. This calls into question the financial sustainability of New City School.

Adding to this situation is the \$6.2 million in debt owed to lenders including the Low Income Investment Fund, which is due by June 30, 2013. While some payments for this debt are included in the first interim cash flow report, \$5.9 million is due to the fund from the LLC. This amount is therefore not shown in the cash flow report because it only reflects the activity of New City School. However, the remaining New City entities do not have sufficient cash for repayment, and this could bring New City to insolvency as discussed in FCMAT's January 11, 2013 management letter. New City's cash problems were also noted in the January 12, 2012 Ford report as follows: "NCPS appears to be in a perpetual state of financial cash flow crisis and financial scrambling."

The Accounting Principles Board's Statement 4 indicated that GAAP "encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. The standard of 'generally accepted accounting principles' includes not only broad guidelines of general application but also detailed practices and procedures."

The principals selected and used by the charter are disclosed in the Notes to Financial Statements section of each audited financial report issued by the charter's auditors. The same auditors also provide an opinion on the financial statements and their conformity with accounting principles generally accepted in the United States of America. However, while the audited financial statements comply with GAAP once issued, the underlying financial information and the rules and processes used to record that information in the charter's books of record may not.

FCMAT's review of New City's 2010-11 audited financial statements as well as the 2010-11 adjusting journal entries report from the charter's auditors found that 16 entries were made to conform New City's records to financial statements in conformance with GAAP:

1. Two entries dealt with adjusting federal and state child nutrition revenue that had previously been written off. Accounting has two ways to write off uncollectable accounts, the allowance method and the direct write-off method. The first method estimates an amount of the accounts receivable that will not be collected. This estimated amount is posted as an expense to a bad debt expense account and creates a contra account for the total accounts receivable called the allowance for uncollectible account. For example, if the accounts

receivable is \$24,000 and the allowance account is \$2,000, the balance sheet or statement of net assets will reflect both, with a net accounts receivable of \$22,000. The direct write-off method is a direct posting of the uncollectable amount to bad debt expense and reduction to accounts receivable at the time it is deemed to be uncollectable. According to GAAP, the direct write-off method is unsatisfactory since it mismatches revenues and expenses and allows the direct write-off method to be used only in limited circumstances. Because the New City chart of accounts includes one for bad debt expense but not for the allowance for uncollectible accounts, the direct write-off method was apparently used. Additionally, since New City's auditors had no findings in their 2010-11 audited financial report, the auditors apparently found that the use of the direct write-off method was restricted as per GAAP guidance.

2. Four adjusting entries net intercompany accounts payable and amounts due from other locations. These intercompany payables and receivables should be eliminated under the rules of consolidation. Otherwise, the reporting entity could artificially inflate accounts payable/receivable, and this is properly eliminated because the parent entity cannot owe itself funds.
3. Two entries reclassify items originally posted into fixed asset accounts to noncapitalized equipment expenditures, presumably because the purchase did not meet the charter's capitalization threshold. New City's policy for fixed assets is included in note two to its financial statements and states that individual property and equipment purchases of more than \$500 will be capitalized (placed in fixed assets and depreciated, or expensed, over their useful lives). The same note also establishes that New City uses the straight-line method of depreciation for its furniture and equipment. Generally Accepted Accounting Principles on fixed or long-lived assets involve determining the appropriate cost used to record the asset and the appropriate depreciation method. New City's disclosure of its capitalization threshold and its use of the straight-line method of depreciation meet those standards regarding furniture and equipment. Note six to the 2010-11 audited financial statements includes amounts for site and leasehold improvements, but no disclosure of the depreciation method(s) attached to those assets.
4. Three adjusting entries record the expense for state unemployment insurance, with the credit side of the entry recording "all other state revenues." These entries are unusual because an expenditure normally does not affect revenue. The credit side of an expenditure entry is usually either cash or some form of a liability. FCMAT's calls to the charter's auditors to gain additional information on these entries were not returned, so further analysis was not possible.
5. Two journal entries reclassify Title I, Title II and Title III revenue from the state aid – prior years account to the proper federal revenue accounts.
6. Two entries record space rental/lease expense and the intercompany payable for The New City School and Colegio, which is due to New City LLC. Because these were adjusting entries, the full amount of rental/lease expense was recognized at the time of the audit. GAAP requires an expense to be recognized when the payment is made or becomes payable for the lessee (The

New City School and Colegio). For the lessor (New City's LLC), the revenue should be recognized in the period the revenue is received or becomes receivable. Under the rules of consolidation, intercompany receivables and payables as well as intercompany revenues and expenses are eliminated in consolidated financial statements.

7. The entry for New City's LLC recognizes the rental income from the two space rental/lease expense entries in item number 6 above as well as the corresponding due from other locations. Again, GAAP requires the revenue to be recognized in the period it is received or becomes receivable, and this transaction will also be among those eliminated in the consolidation process.

FCMAT's review of New City's 2011-12 audited financial statements as well as the 2011-12 adjusting journal entries report from the charter's auditors found that six entries were made to conform New City's records to financial statements in conformance with GAAP:

1. The charter's general ledger had recorded lease payments payable to NCPS I LLC from The New City School and Colegio, which were not due as a result of the forbearance agreement. GAAP requires an expense to be recognized when the payment is made or becomes payable for the lessee (The New City School and Colegio). For the lessor (New City's LLC), the revenue is recognized in the period the revenue is received or becomes receivable. Under the rules of consolidation, intercompany receivables and payables as well as intercompany revenues and expenses are eliminated in consolidated financial statements.
2. A correction was made to the calculation of accrued interest under a note payable and reclassifying debt interest from its posting into fund balance/net assets to an expense. Under GAAP, the interest paid on a note payable is categorized as an expense that flows to the statement of activities. The statement of activities calculates the increase or decrease to net assets and applies that number to the net assets at the beginning of the year to provide the resulting net assets at the end of the year. Proper accounting would not apply an expense directly to fund balance/net assets.
3. Accrued interest on the Westbrook loan was reclassified from accounts payable. While both accounts payable and accrued interest are liabilities shown on the statement of financial position, they each represent a different form of current liability. Under GAAP, accounts payable arise from the acquisition of materials and supplies or in conjunction with the providing of services while accrued interest payable comes from an end-of-period adjustment process required by accrual accounting.
4. The interest paid on two loans was moved from the charter management organization to NCPS I LLC, which is the entity that entered into the loan transaction (the lender) and whose accounts reflect the long-term debt. The entity that enters into the loan transaction is obligated to repay the loan and its books should reflect those transactions. If another entity loans funds to the lender, this should be reflected as an intercompany payable/receivable and would be eliminated in the consolidated financial statements.

5. The accrued interest due on the Green Opportunity Fund loan was moved from the CMO to NCPS I LLC, which is the entity that entered into the loan transaction (the lender) and whose accounts reflect the long-term debt. The entity that enters into the loan transaction is obligated to repay the loan and its books should reflect those transactions. If another entity loans funds to the lender, this should be reflected as an intercompany payable/receivable and would be eliminated in the consolidated financial statements.
6. SB 740 revenue was recorded as an accounts receivable item. GAAP requires revenues to be recognized when earned. In the case of SB 740 funding, the charter earns the funds by providing students with classroom-based instruction. The auditor's adjustment indicated that the revenue was not properly calculated at the closing of New City's books.

Recommendations

The charter school should:

1. Develop board policies and administrative regulations.
2. Revise the accounting manual to comply with the changes to the PERS system effective January 1, 2013 and records retention classifications included in the California Code of Regulations as well as changes in law as they occur.
3. Revise its budget as changes to enrollment are known at reporting periods.
4. Increase the board's involvement and understanding of revisions to the charter's budget.
5. Disclose all forms of debt to the charter's auditors.
6. Investigate implementing the encumbrance module in the financial software.
7. Work with the district to revise its MOUs so that New City provides financial reporting based on its combined entity and not just New City School.
8. Invite the Long Beach Unified School District to include a board member to sit as a director of New City's nonprofit public benefit corporation per Education Code Section 47604.
9. Continue to utilize accounting codes to recognize funds, resources, objects and locations in its transactions.
10. Revise the deadlines for submitting its preliminary and adopted budgets to the district.
11. Revise its procedures and processes on production of budget and financial reports so that all deadlines agreed to in MOUs with the district can be met.
12. Determine if the cash balance reported by the nonprofit benefit corporation at June 30, 2012 is available for the operations of New City School or is to be repaid to the state or another entity due to the closure of Colegio.

13. Revise cash flow report to strictly reflect one entity, and revise the assumptions as changes occur.
14. Confer with its auditors regarding adjusting entries that are needed to conform New City's general ledger with GAAP, and adjust its procedures accordingly.

Audit

The MOU between New City School and the Long Beach Unified School District signed at the charter's June 2010 renewal requires New City School to provide a copy of its audited financial report to the district, the Los Angeles County Department of Education, the State Controller's Office (SCO) and the CDE each year by December 15 to comply with Education Code Section 47605(m).

NCPS had two auditors for fiscal years 2007-08 through 2011-12. Both firms were listed on the SCO's CPA list at January 25, 2013. This list contains the certified public accountants or public accountants that the SCO considers qualified to conduct annual audits of local educational agencies and is published each December 31 in compliance with Education Code Section 41020(f).

CPA firms make it a standard practice to visit their educational clients more than once to perform compliance and year-end testing to meet the December 15 deadline. According to the scheduled provided by NCPS, the auditor performed fieldwork for the 2011-12 audit at NCPS on August 3, 2012 and at Charter School Management Company, NCPS's former office services provider, the week of October 8, 2012. The final audit report has an ending fieldwork date of October 24, 2012. This date is when the auditor completes the testing and review of the client's books. It does not indicate when the financial statements were issued although that date typically is one to two months after fieldwork. The Long Beach Unified School District indicated it received the 2011-12 audited financial statements before the December 15, 2012 deadline; however, New City was unable to provide FCMAT with evidence that the county office accepted the 2011-12 audit due to the county office not providing written confirmation.

New City School's charter renewal MOU with Long Beach Unified requires audit deficiencies identified in the report to be addressed by New City School through a remediation plan. The 2011-12 audited financial statements included one finding related to the Class Size Reduction Program. NCPS erroneously used enrollment numbers at April 15, 2012 instead of the average from the first day of school through April 15, 2012. The report was prepared by the prior office services provider, which was unable to provide NCPS's auditors with support for these calculations. The 2011-12 audit states that NCPS will work with the new office service provider to recalculate the average enrollment for the applicable period in 2011-12. At the time this report was being written, the status of the error correction and the calculation of the correct average enrollment were unknown.

Recommendations

The charter school should:

1. Continue to utilize certified public accountants or public accounts listed on the State Controller's CPA list to perform the charter's annual audit.

2. Continue to file its audited financial statements with its authorizing agency, the county office of education, the CDE and the State Controller's Office each year by December 15.
3. Provide Long Beach Unified with its remediation plan regarding the Class Size Reduction audit finding.

Subsequent Event

Following complete of FCMAT's fieldwork, New City received a letter from its current auditors dated March 1, 2013 that they had reviewed New City's amendment to its J-7 CSR Report for fiscal year 2011-12 in conjunction with Finding 2012-1 in the June 30, 2012 audit report. The auditors traced the corrections in the amendment through to source documentation and concluded that the amendment was properly calculated.

Payroll

Payroll is supervised by New City School's executive director and is processed by CharterWorks via Paychex, a third-party payroll processing company. All salaried employees are paid on a 12-month cycle with 24 pay periods. Teachers are paid on either an 11- or 10-month cycle, from August to June or September to June, each year while other salaried employees are paid on a 12-month cycle from July to June. Hourly employees are paid based on hours actually worked, and the time is recorded on time cards. New City School's pay dates are as follows:

Salaried Employees

Pay Date	Pay Period Covered
15th	1st to 15th of current month
30th	16th to 31st of current month

Hourly Employees

Pay Date	Pay Period Covered
15th	16th to 31st of previous month
30th	1st to 15th of current month

A sound internal control structure requires job duties to be segregated to adequately protect the charter school's assets. No single employee should handle a transaction from initiation to reconciliation, and no single employee should have custody of an asset (such as payroll checks) and maintain the records of related transactions.

For the 2012-13 fiscal year, New City School began with 19 full time equivalent (FTE) teachers, 2 FTE office coordinators, 2 FTE custodians and 16 part-time support staff. As new employees are hired, a personnel file is created and maintained in a locked file cabinet by the administrative coordinator. All employees are paid based on a salary schedule except for New City School's four administrative positions: the executive director, the administrative coordinator, the director of educational programs and the assistant director of educational programs. At-will employment agreements with the director and assistant director of Educational programs provide in Paragraph B.1. that "[e]mployee will serve as a 'Director of Education Programs' " even though each serves in a different capacity.

A random sample of 20 staff members was selected for testing from the payroll register for November 16, 2012 to November 30, 2012. Each employee's monthly salary or hourly rate was compared to the master personnel file approved by the governing board on September 25, 2012 to ensure the rates paid match those approved by the board. The rates for 19 employees were matched to those in the master personnel file, but because one employee had an employment start date that was after the board-approval date, information for that employee was not in the file and therefore not matched. Additional master personnel files could not be provided to FCMAT to confirm the date this employee's pay rate was approved by New City's board.

Hourly employees are responsible for completing a time card, obtaining the appropriate supervisor's signature, and submitting the card to the administrative coordinator by the last day of the pay period. Late time cards are held until the next pay period, and salaried employees are required to sign a log book to verify working days for accuracy. Substitute teachers must sign in at the front office each day on a substitute teacher timesheet, which is processed in the same manner as an hourly employee's time card. Any substitutes from staffing agencies must also sign

in at the front office to confirm the hours; however, they are paid through the agency, and New City School pays the agency's invoice after comparing it with front office information.

The administrative coordinator reviews all time cards for accuracy, and those that are incomplete are returned to the signature supervisor for completion. The time card information is entered on the payroll schedule, which summarizes the payroll information for the pay period including all employees to be paid (salaried, substitutes and hourly), hourly employee time, extra pay, overtime and time off. The executive director must approve any overtime in advance. The time cards are then submitted to either the director or assistant director of educational programs for review and a signature and returned to the administrative coordinator. Any changes made in the time card approval process are entered onto the payroll schedule, which is then forwarded to the executive director for approval and submitted to CharterWorks in accordance with the payroll calendar established at the beginning of the fiscal year.

The CharterWorks accounting manager oversees the payroll process for New City School with the assistance of one payroll technician. CharterWorks reviews, verifies and forwards the payroll schedule to Paychex, a payroll company, for semimonthly processing. CharterWorks maintains electronic access to all payroll records prepared by Paychex.

Paychecks are couriered directly from Paychex to New City School's administrative coordinator, who documents receipt and distributes them. Most New City School employees have direct deposit and receive their pay stubs in their mailboxes. The administrative coordinator personally delivers paychecks to any employee who receives a paper check that needs to be negotiated at a bank. To increase operational efficiency, New City School discontinued the practice of having employees sign to receive their checks and has instead encouraged direct deposit.

Federal and state regulations require employers to withhold income taxes from the salaries and wages paid to their employees based on information provided by the employee from Form W-4 (Employee's Withholding Allowance Certificate) and DE 4 (Employee's Withholding Allowance Certificate). The amounts withheld are to be treated as a trust fund and deposited with the Internal Revenue Service (IRS) (for federal tax payments) and the California Employment Development Department (EDD) (for state tax payments). Employers are then required to complete and timely file quarterly wage and payroll tax information.

The IRS requires Form 941 – Employer's Quarterly Federal Tax Return to be filed by the last day of the month following the end of the quarter. The EDD requires Form DE 9 – Quarterly Contribution Return and Report of Wages to be filed by first day of the month following the end of the quarter, but it is considered delinquent only when it is not filed by the last day of the month following the end of the quarter. FCMAT reviewed quarterly federal and state tax filings for New City School for third quarter 2011, fourth quarter 2011, first quarter 2012, and second quarter 2012, and verified that Paychex filed all reports timely with no indication that penalties were assessed.

Retirement earnings are recorded for certificated and classified employees in the California State Teachers Retirement System (CalSTRS), California Public Employees Retirement System (CalPERS), and Social Security. Certificated employees contribute 8 % of their earnings towards STRS while the employer contributes 8.25%, and qualifying classified employees contribute 7% of their earning towards CalPERS while the employer contributions 11.41%. Employees not qualifying for CalSTRS are required to contribute to Social Security. CharterWorks prepares CalSTRS and CalPERS retirement reporting information monthly. The Los Angeles County Office of Education requires local educational agencies to provide CalSTRS and CalPERS retire-

ment payments by the first of each month with attendant reports by the third of each month. New City School contracts with Hess & Associates, a third-party contractor, to convert CalSTRS and CalPERS retirement data into a format compatible with the county office's retirement reporting system, and the county office reports any errors are to New City School.

The Internal Revenue Service requires employers to distribute Form W-2s each year by January 31 to report various items regarding wages and benefits paid to employees. Employers are considered to have met this requirement as long as the form is properly addressed and mailed on or before the due date.

CharterWorks handles the payroll function for NCPS via Paychex, and all earnings records are maintained in Paychex's electronic payroll system. W-2s are generated annually based on Paychex's electronic payroll records and forwarded to New City School for distribution to employees by the IRS established deadline.

Segregation of duties is an essential internal controls component and one of the most effective in preventing and deterring fraud. This type of segregation also contributes to an organization's system of checks and balances, and duties should ideally be separated by control of employee data, salary placement and payroll. New City School maintains adequate segregation of duties related to its payroll function by doing the following:

- Salary placement is determined by salary schedules except for those individuals who have contracts Employment contracts are approved by the governing board.
- New City School's administrative coordinator maintains employee data in individual personnel files in a locked file cabinet.
- CharterWorks handles the payroll function for New City School via Paychex, a third-party payroll processing company.
- Paychex sends paychecks directly to New City School for distribution.

Recommendations

The charter school should:

1. Correct the at-will employment agreement of its assistant director of educational programs to indicate that this employee serves as the assistant director of educational programs.
2. Ensure employees are not paid before board approval of their salary placement.
3. Institute distribution procedures that require individuals to pick up their paychecks and sign a document acknowledging receipt as an internal control measure to prevent fictitious or "ghost" employees.
4. Continue to file payroll and retirement reports in a timely manner providing the county office with the necessary information regarding STRS and PERS data.

5. Continue making its payroll processing firm responsible for accumulating information for New City School's W-2 forms and for generating these documents.
6. Continue to maintain adequate segregation of duties related to employee data, salary placement and payroll functions.

Financial Condition

According to paragraph II.D.1.g. of the June 15, 2010 MOU on charter school oversight between New City School and the Long Beach Unified School District, “New City School shall maintain a minimum reserve for economic uncertainties (designated fund balance) in an amount to be determined appropriate by the District but in no case less than 3% of year end expenditures of New City School.” New City School’s 2012-13 first interim report shows a projected ending fund balance of \$434,214 and projected total year-end expenditures of \$3,604,355. Dividing the projected ending fund balance by the projected total year end expenditures produces a reserve of 1.21%, which is less than what was agreed to in the MOU.

Whether this reserve level could be considered “prudent” can be subject to various interpretations. The following risk factors can help determine whether this reserve level appropriate:

- Declining enrollment
- Delays in cash receipts (for example, apportionment deferrals)
- Other restricted funds that may require unrestricted general fund contributions
- Unstable labor relations
- Debt service risks
- A relatively small charter size
- The history of deficit spending and/or projected future deficit spending
- Reliance on one-time revenue sources
- Exposure to significant one-time expenditures

Having one or more of these risk factors would indicate that additional reserves are necessary, and New City School has several; declining enrollment, delays in cash receipts, debt service risk and a relatively small sized charter. Additionally, New City School’s reserves equate to only approximately 2.84 months of payroll, and FCMAT believes a 1.21% reserve is insufficient given the current financial situation and the other factors listed above.

Concerns about New City’s financial viability are not new. The June 30, 2011 and June 30, 2012 audited financial statements, which were prepared by two different audit firms, contained a going-concern note disclosure. Additionally, the Ford report reviewed New City’s financial operations and found that “overall financial status was precarious and appears to be trending in an increasingly negative direction. Without some combination of debt forgiveness, debt reduction, debt renegotiation and/or extensions, planning for and achieving steady and sizeable annual surpluses beginning FY 2012, and significant fundraising, NCPS may have a difficult time staying financially afloat or operable. In the event CSC ‘turns off the spigot,’ NCPS could collapse financially in a relatively short time.”

The Ford report also applied its fiscal performance framework, which consists of nine balance sheet, income statement, cash flow, budget and debt financial indicators, to New City’s financial information over the prior four years. This effort determined that “NCPS does not fare well as of the end of FY 2011 on the Framework’s financial viability or trend indicators. LBUSD has ample grounds to initiate immediate financial-specific monitoring and corrective action, for NCPS as a whole, and for both NCS and Colegio as separately chartered schools, and/or to non-renew or revoke one or both NCPS charters for financial reasons. NCPS’ deteriorating financial situation

will become clearer to the authorizer upon submission to LBUSD of the independent auditor's consolidated financial audit report for FY 2011."

New City School and CharterWorks provided FCMAT with two documents for their first interim multiyear financial projections. The first was the CY first interim, which was discussed above. This document included columns for total board-approved operating budget, total actual to date and total year-end projection. The second was a multiyear projection including columns for the 2012-13 board approved September 25, 2012, the 2013-14 fiscal year and the 2014-15 fiscal year dated September 21, 2012 (CY multiyear financial projection). Assumptions were provided with the projection; however, this was before passage of Prop 30. A comparison of those assumptions with information that should have been used in an MYFP at first interim show the following:

- General purpose block grant funding included a \$457 per ADA reduction, which had been eliminated with the passage of Prop 30.
- General purpose block grant funding included a reduction for in lieu property taxes in each category of funding except grades 9-12. While the district did not have grades 9-12 in its schools, formulas should remain consistent.
- New City School used \$500/ADA multiplied by the deficit factor for the categorical block grant, and the correct deficit amount was \$400.
- A deficit factor of 76.926234% was used instead of the 77.728% in the state's adopted budget.
- New City School used \$1,070 per pupil for its class size reduction program instead of the \$1,071 in the CDE's September 25, 2012 notice of the advance apportionment.
- A deficit factor of 96.4364684% was used for EIA instead of the 96.13187485% pursuant to School Services of California's post-election Dartboard.
- No assumptions were provided for expenditures.

For the 2013-14 and 2014-15 fiscal years, the same problems with assumptions were as noted above with the following additions:

- School Services' post-Proposition 30 Dartboard included a planning cost-of-living adjustment (COLA) for 2013-14 of 0%. New City School used 1.5%.
- School Services' post-Proposition 30 Dartboard included a planning COLA for 2014-15 of 2.3%. New City School used 1.5%.
- In both years, non-Proposition 20 lottery funding was budgeted at \$125 per ADA when the correct amount according to SSC's post-Proposition 30 Dartboard had \$124.25 per ADA.

After adjusting for the assumptions noted above, revenues increased by \$192,277, \$170,862 and \$190,799 for the 2012-13, 2013-14 and 2014-15 fiscal years, respectively. However, while the CY first interim budget included a column for the 2012-13 fiscal year board-approved budget that matched the CY MYFP total board-approved budget column, FCMAT was provided with five assumptions related to the calculation of the total year-end projection for the CY first interim. Those assumptions were eliminating the \$457 reduction per ADA and adjusting the budget to actuals for prior year general apportionment, child nutrition, other state revenue and interest, other local and prior year adjustment. No other assumptions were provided, and further analysis could not be performed.

During fieldwork, FCMAT determined that the severity of New City's level of debt and the June 30, 2013 maturity date warranted the immediate issuance of a management letter. This document was issued on January 11, 2013 and is attached as Appendix B to this report. The letter discusses the charter's long-term debt obligations as well as whether it can sustain financial solvency for the current and two subsequent years.

Recommendations

The charter school should:

1. Maintain reserve levels of more than 3% of year-end expenditures to remain in compliance with its MOU with the Long Beach Unified School District.
2. Continually update its MYFP as new information is known to provide as complete a financial picture as is possible.

Cash Receipts

Some of the more liquid assets handled by local educational agency employees are cash and check receipts. Sound internal control procedures are essential to help prevent misappropriation of these assets. Best practices in the cash receipts process include proper segregation of duties between employees receipting and record keeping, distributing prenumbered receipts to payers, maintaining a log of cash and checks received, performing monthly bank statement reconciliations, providing asset security, and cross-training employees.

New City's processes and procedures manual states that the cash receipts and deposits process begins with the administrative coordinator or designated staff member receiving and opening incoming mail. Checks to be deposited are delivered to the executive director. New City's NCPS office coordinator manual states that the office coordinator issues a receipt for each payment made, payments are logged into PowerSchool (for student lunches), funds are counted weekly and included in a New City cash receipts form, checks are photocopied, and a deposit slip is completed and submitted to the administrative coordinator by noon every Friday. Interviews of New City School staff provided a third version of the cash receipt process in which the administrative coordinator or designated staff member collects and opens the mail. Cash and unendorsed checks are placed in the office safe for security until preparation of the deposit, and the safe requires a key that only the office coordinator maintains.

The office coordinator removes the items from the safe and receipts funds either once a week or once every two weeks depending on the amount of monies received. Following receipting, the deposit information is forwarded to the administrative coordinator to prepare the deposit. The administrative coordinator reviews the work of office coordinator, verifies that each transaction has proper account coding, and deposits checks to Wells Fargo Bank electronically through a desktop deposit machine. The cash portion of the weekly deposit is delivered to the bank by the administrative coordinator. After the deposit is made, the cash receipts form is completed and forwarded to the executive director for review and signature. All deposit documents are delivered to CharterWorks each Tuesday via e-mail or fax, including the cash receipts form reviewed and approved by the executive director, bank deposit receipt, and spreadsheet summary with copies of checks deposited, and check register. CharterWorks is then responsible for recording the deposit in New City School's accounting records as well as reconciling the bank statement.

Segregation of duties is one of the most important internal controls to help prevent misappropriation of funds. Even with three versions of how cash receipts are initially handled, New City School maintains proper segregation of duties related to its cash receipts process except for placing unendorsed checks into the office safe.

FCMAT randomly selected two dates for deposit testing (October 16, 2012 and December 7, 2012) to verify that receipts were issued for all monies received. Of the 34 payer payments, the team was able to verify that all 34 payers received a prenumbered, handwritten receipt from New City School's office staff.

Recommendations

The charter school should:

1. Establish a policy to endorse all checks before placing them in the office safe to increase internal controls over cash and prevent the unauthorized negotiation of a check.

2. Ensure that deposits are processed at least weekly and no later than the last workday of the week.
3. Revise the accounting policies and procedures manual, NCPS office coordinator manual and actual practice to parallel one another.
4. Continue to maintain acceptable segregation of duties in the receipt, receipting, deposit and bank reconciliation processes.

Disbursements

Purchasing Process

Each individual department is responsible for requesting purchases via purchase requisition, and the administrative coordinator then prepares a purchase order. All purchases are authorized either by the administrative coordinator or the executive director on behalf of New City School and are forwarded to the vendor for purchase. Once the goods are received by New City School's main office, the receiving employee compares the items received to the receiving slip/packing slip and what was actually ordered. Following confirmation, the receiving slip is marked "OK to pay" and forwarded to the administrative coordinator for payment.

New City School's Cash Disbursement Process

The administrative coordinator and the executive director are responsible for preparing and reviewing cash disbursements for New City School. According to the processes and procedures manual, check disbursements require one of the following:

- A purchase order with proper authorization
- A check request/employee reimbursement request
- A travel reimbursement form
- An "OK to pay" stamp. Goods are received by the office coordinators who act as the receptionists at New City School's office.

The administrative coordinator obtains the mail daily and all invoices or bills are stamped and properly coded to the appropriate budget line. The administrative coordinator prepares an accounts payable batch by matching invoices to receiving documentation. Invoices to be paid are discussed with the executive director each Tuesday morning. Once finalized, the accounts payable batch is forwarded to CharterWorks for the processing and mailing of checks to vendors.

CharterWorks' Cash Disbursement Process

CharterWorks provides business office assistance to 23 California charter schools. CharterWorks utilizes the Sage 100 Fund Accounting software (Sage) for its charter school accounting. The cash disbursement process used by CharterWorks for New City School is as follows:

- CharterWorks receives invoices weekly from New City School for payment.
- All invoices are stamped "received" and reviewed for accuracy by the administrative assistant.
- The accounts payable batch is forwarded to the accounts payable clerk to verify the budget coding, then the information is entered into Sage. Each invoice is stamped "Entered" once completed.
- An unposted accounts payable transaction report, the invoices, and the accounts payable batch header is generated and forwarded to the accounting manager for review.
- The accounting manager either approves and signs the entire packet or returns it to the accounts payable clerk for revisions.

- Once the accounting manager confirms the accounts payable batch as accurate and signs it, a cash report and accounts payable aging is generated. This is to determine the number and amount of outstanding invoices versus those that can be paid then based on current and projected cash flow needs.
- New City School's executive director determines which items should be paid and marks the aging report accordingly. The aging report is then returned to the CharterWorks accounts payable clerk for processing.
- Checks are generated by the accounts payable clerk, matched to invoices, and the completed payment packets are forwarded to the CEO of CharterWorks for final review, approval, and manual signature. Each check is required to have only one signature, that of the CharterWorks CEO, and a signature stamp is utilized if the CEO is absent.

Bank statements are available online and are reconciled weekly and monthly by CharterWorks.

New City School staff indicated that the Sage accounting system cannot encumber purchase orders. This makes it difficult for New City School to determine the percentage of the budget that has been consumed by outstanding purchase orders and prevent overspending. Without an encumbrance system, New City School is required to wait for receipt of invoices from vendors at the end of the fiscal year to accurately assess its financial position. CharterWorks informed FCMAT that the Sage accounting system includes an encumbrance module, but it is not used because of increased contract cost.

Segregation of duties between purchase, receiving, and accounts payable are adequate based on interviews with New City School staff, CharterWorks staff and New City's processes and procedure manual except the signature process on checks and New City School's review of bank reconciliations. New City School's administrative coordinator and the executive director authorize purchases. They are approved by New City School's executive director, and those greater than \$25,000 require additional board approval. Some recurring transactions, such as payments for utilities, do not require direct, continuous approval if the executive directors gives prior approval. Receipt of goods is handled by New City School personnel separate from the accounts payable process. Finally, the accounts payable process involves a joint effort between New City School and CharterWorks administrators and staff.

Recommendations

The charter should:

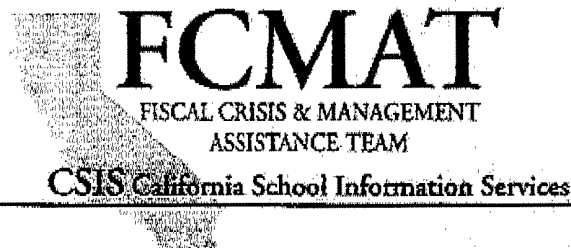
1. Contract with CharterWorks to purchase the encumbrance module in the Sage accounting system to help prevent overspending and enable New City School to more closely track accounts payable.
2. Consider adding the signature of New City School's executive director to the checks generated in cash disbursement to increase internal controls and prevent the issuance of a check without New City School's knowledge.
3. Review the monthly bank reconciliations performed by CharterWorks.
4. Continue to maintain acceptable segregation of duties in purchasing, receiving, and cash disbursement.

Appendices

A. Study Agreement

B. January 11, 2013 Management Letter

Appendix A - Study Agreement



FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM STUDY AGREEMENT October 30, 2012

The FISCAL CRISIS AND MANAGEMENT ASSISTANCE TEAM (FCMAT), hereinafter referred to as the Team, and the New City Charter School, hereinafter referred to as the Charter, mutually agree as follows:

1. BASIS OF AGREEMENT

The Team provides a variety of services to school Districts, county offices, community colleges and charter schools upon request. The Charter has requested that the Team provide for the assignment of professionals to study specific aspects of the New City Charter School operations. FCMAT's legislative authority to provide services to charter schools was made available through the passage of SB 430 (Runner, 2005). These professionals may include staff of the Team, County Offices of Education, the California State Department of Education, school districts, charter schools or private contractors. All work shall be performed in accordance with the terms and conditions of this Agreement.

In keeping with the provisions of AB1200, the County Superintendent will be notified of this agreement between the Charter and FCMAT and will receive a copy of the final report. The final report will be published on the FCMAT website.

2. SCOPE OF THE WORK

A. Scope and Objectives of the Study

The scope and objectives of this study are to:

The New City Charter School is an approved charter school authorized by the Long Beach Unified School District (LBUSD) in accordance with the Charter Schools Act of 1992 and Ed Code 47600. The New City is operated by New City Public Schools (NCPS), a California non-profit public benefit corporation that is responsible for the charter school's compliance with the terms and conditions regarding the Memorandum of Understanding (MOU) between the charter school and LBUSD.

On May 2, 2012, the LBUSD issued a Notice of Violations pursuant to Education Code section 47607(d) which stated that the New City Charter School had violated the conditions and standards set forth in the charter. As a result of this notice, on August 30, 2012 a subsequent MOU was agreed to that required the New City Charter School to contract with the Fiscal Crisis and Management Assistance Team (FCMAT) to conduct a review of the charter school's financial operations and submit the findings and recommendations to LBUSD by December 31, 2012. The following scope of work shall be included:

1. Financial Reporting, Budget and Accounting:
 - a. Review policies addressing budget, accounting, financial reporting and board approval
 - b. Evaluate the process to review and revise the budget for changes to student enrollment and operations
 - c. Review budget revisions to determine the level of board approval/ratification
 - d. Determine if all financial obligations are included in the budget and interim financial reports
 - e. Review the Charter's financial software to determine if separate accounts are maintained for restricted revenues or expenditures either by resource or class.
 - f. Evaluate the timeliness of the financial reporting and validate that all financial reporting requirements are being met and provided to the authorizing District
 - g. Review the cash flow projections to ensure sufficient funds are available to meet the charter school's financial obligations.
 - h. Evaluate the charter schools accounting practices and financial reporting to ensure that they meet generally accepted accounting principles (GAAP)
2. Audit:
 - a. Identify the independent auditor's time line and schedule to meet the annual deadline of December 15, 2012
 - b. Determine if a copy of the prior year audit has been accepted by the county office
 - c. Review the auditor selected to determine if the firm meets the state approved list and criteria
 - d. Identify the charter school's corrective action plan regarding prior year audit findings and recommendations

3. Payroll:

- a. Evaluate the salary placements or schedule, if any and determine if sample test data reconciles with payroll
- b. Review federal and state tax deposits to determine if they are made on time and no penalties are being assessed
- c. Identify earnings recorded for retirement reporting to Social Security, PERS and STRS
- d. Validate that systems are in place to provide STRS data is available to the county office
- e. Review processes that systems are in place for earnings records for preparation of W-2 information
- f. Evaluate the segregation of duties between employee data, salary placements and payroll.

4. Financial Condition:

- a. Determine if the charter school maintains prudent level of reserves for economic uncertainties
- b. Review the preparation of multi-year financial projections and assumptions
- c. Identify all long term debt obligations
- e. Provide summary findings regarding the charter school's ability to sustain their financial solvency for the current and two subsequent fiscal years

5. Cash Receipts:

- a. Review the policies and procedures for cash receipts, deposits and disbursements
- b. Evaluate the segregation of duties for the receipt of funds, deposit of monies and reconciliation of bank statements.
- c. Review test sample of transactions to determine if receipts are issued for all monies received.

6. Disbursements:

- a. Review the policies and procedures for disbursements
- b. Review the signature authorization process
- c. Evaluate the segregation of duties between purchasing, receiving and accounts payable, if any

B. Services and Products to be Provided

1. Orientation Meeting - The Team will conduct an orientation session at the Charter to brief management and supervisory personnel on the procedures of the Team and on the purpose and schedule of the study.
2. On-site Review - The Team will conduct an on-site review at the Charter office, and at school sites if necessary. The Team will also conduct interviews and discussions at Long Beach Unified School District.
3. Exit Meeting: - The Team will hold an exit meeting at the conclusion of the on-site review to inform the Charter of significant findings and recommendations to that point.
4. Exit Letter - The Team will issue an exit letter approximately 10 days after the exit meeting detailing significant findings and recommendations to date and memorializing the topics discussed in the exit meeting.
5. Draft Reports - Electronic copies of a preliminary draft report will be delivered to the Charter administration for review and comment.
6. Final Report - Electronic copies of the final study report will be delivered to the Charter administration following completion of the review. Written copies are available by contacting the FCMAT office.
7. Follow-Up Support – Six months after the completion of the study, FCMAT will return to the Charter, if requested, to confirm the Charter's progress in implementing the recommendations included in the report, at no cost. Status of the recommendations will be documented to the Charter in a FCMAT Management Letter.

3. PROJECT PERSONNEL

The study team will be supervised by Anthony L. Bridges, CFE, Deputy Executive Officer, Fiscal Crisis and Management Assistance Team, Kern County Superintendent of Schools Office. The study team may also include:

- | | | |
|----|------------------|--|
| A. | Julie Auvil, CPA | FCMAT Fiscal Intervention Specialist, Job Leader |
| B. | To Be Determined | FCMAT Consultant |
| C. | To Be Determined | FCMAT Consultant |

Other equally qualified consultants will be substituted in the event one of the above noted individuals is unable to participate in the study.

4. PROJECT COSTS

The cost for studies requested pursuant to E.C. 42127.8(d)(1) shall be:

- A. \$500.00 per day for each Team Member while on site, conducting fieldwork at other locations, preparing and presenting reports, or participating in meetings. The cost of independent consultants will be billed at the actual daily rate based on the provisions of Education Code section 84041.
- B. All out-of-pocket expenses, including travel, meals, lodging, etc. The Charter will be invoiced at actual costs, with 50% of the estimated cost due following the completion of the on-site review and the remaining amount due upon acceptance of the final report by the Charter.

Based on the elements noted in section 2 A, the total cost of the study is estimated at \$11,000.

- C. Any change to the scope will affect the estimate of total cost.

Payments for FCMAT services are payable to Kern County Superintendent of Schools - Administrative Agent.

5. RESPONSIBILITIES OF THE CHARTER

- A. The Charter will provide office and conference room space while on-site reviews are in progress.
- B. The Charter will provide the following (if requested):
 - 1. A map of the local area
 - 2. Existing policies, regulations and prior reports addressing the study request
 - 3. Current or proposed organizational charts
 - 4. Current and two (2) prior years' audit reports
 - 5. Any documents requested on a supplemental listing. Documents requested on the supplemental listing should be provided to FCMAT in electronic format.
 - 6. Documents that are only available in hard copy should be scanned by the Charter and sent to FCMAT in electronic format.
 - 7. All documents should be provided in advance of field work and any delay in the receipt of the requested documentation may affect the start date of the project. Upon approval of the signed study agreement, access will be provided to FCMAT's SharePoint document repository and all requested documents shall be uploaded by the Charter.

- C. The Charter Administration will review a preliminary draft copy of the study. Any comments regarding the accuracy of the data presented in the report or the practicability of the recommendations will be reviewed with the Team prior to completion of the final report.

Pursuant to EC 45125.1(c), representatives of FCMAT will have limited contact with pupils. The Charter shall take appropriate steps to comply with EC 45125.1(c).

6. PROJECT SCHEDULE

The following schedule outlines the planned completion dates for key study milestones:

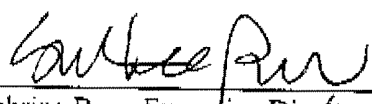
<i>Orientation:</i>	<i>to be determined</i>
<i>Staff Interviews:</i>	<i>to be determined</i>
<i>Exit Meeting:</i>	<i>to be determined</i>
<i>Preliminary Report Submitted:</i>	<i>to be determined</i>
<i>Final Report Submitted:</i>	<i>to be determined</i>
<i>Board Presentation:</i>	<i>to be determined, if requested</i>
<i>Follow-Up Support:</i>	<i>if requested</i>

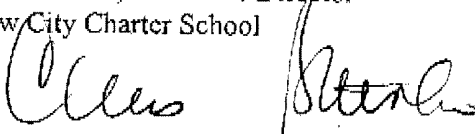
7. CONTACT PERSON

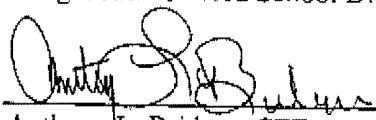
Name of contact person: Sabrina Bow, Executive Director

Telephone: (562) 599-6404 FAX: ~~562-599-6404~~
218-5620

E-Mail: sabrina@newcitytps.org

 Oct 31, 2012
Sabrina Bow, Executive Director Date
New City Charter School

 11/5/12
Christopher J. Steinhauser, Superintendent Date
Long Beach Unified School District

 October 30, 2012
Anthony L. Bridges, CFE Date
Deputy Executive Officer
Fiscal Crisis and Management Assistance Team

Appendix B - January 15, 2013 Management Letter



CSIS California School Information Services

January 15, 2013

Sabrina Bow, Executive Director
New City Public Schools
1637 Long Beach Boulevard
Long Beach, CA 90813

Dear Executive Director Bow:

The purpose of this management letter is to provide the findings and recommendations of the Fiscal Crisis and Management Assistance Team (FCMAT) concerning a review of the financial operations at New City Public Schools. New City Public Schools is a California nonprofit public benefit corporation that includes New City School, Colegio New City, New City Public Schools 1, LLC and New City Public Schools.

As agreed between FCMAT and New City Public Schools, FCMAT will not issue a final report since this management letter presents the findings and recommendations resulting from the on-site work conducted December 10-11, 2012 and subsequent analyses. Members of the study team were as follows:

Study Team

Julie Auvil, CPA, CGMA
FCMAT Fiscal Intervention Specialist
Bakersfield, CA

Kim Sloan, CPA, CIA*
Financial Operations Officer
Kern County Superintendent of Schools
Bakersfield, CA

*As a member of this study team, this consultant was not representing his respective employer but was working solely as an independent contractor for FCMAT.

The study agreement dated November 5, 2012, indicates FCMAT is to perform the following:

1. Financial Reporting, Budget and Accounting:
 - a. Review policies addressing budget, accounting, financial reporting and board approval
 - b. Evaluate the process to review and revise the budget for changes to student enrollment and operations
 - c. Review budget revisions to determine the level of board approval/ratification
 - d. Determine if all financial obligations are included in the budget and interim financial reports
 - e. Review the charter's financial software to determine if separate accounts are maintained for restricted revenues or expenditures either by resource or class

FCMAT

Joel D. Montero, Chief Executive Officer

1300 17th Street - CITY CENTRE, Bakersfield, CA 93301-4533 • Telephone 661-636-4611 • Fax 661-636-4647
422 Petaluma Blvd North, Suite. C, Petaluma, CA 94952 • Telephone: 707-775-2850 • Fax: 707-775-2854 • www.fcmat.org
Administrative Agent: Christine L. Frazier - Office of Kern County Superintendent of Schools

- f. Evaluate the timeliness of the financial reporting and validate that all financial reporting requirements are being met and provided to the authorizing district
 - g. Review the cash flow projections to ensure sufficient funds are available to meet the charter school's financial obligations
 - h. Evaluate the charter school's accounting practices and financial reporting to ensure that they meet generally accepted accounting principles (GAAP)
- 2. Audit:
 - a. Identify the independent auditor's time line and schedule to meet the annual deadline of December 15, 2012
 - b. Determine if a copy of the prior year audit has been accepted by the county office
 - c. Review the auditor selected to determine if the firm meets the state approved list and criteria
 - d. Identify the charter school's corrective action plan regarding prior year audit findings and recommendations
- 3. Payroll:
 - a. Evaluate the salary placements or schedule, if any and determine if sample test data reconciles with payroll
 - b. Review federal and state tax deposits to determine if they are made on time and no penalties are being assessed
 - c. Identify earnings recorded for retirement reporting to Social Security, PERS and STRS
 - d. Validate that systems are in place to provide STRS data is available to the county office
 - e. Review processes that systems are in place for earnings records for preparation of W-2 information
 - f. Evaluate the segregation of duties between employee data, salary placements and payroll
- 4. Financial Condition:
 - a. Determine if the charter school maintains prudent level of reserves for economic uncertainties
 - b. Review the preparation of multi-year financial projections and assumptions
 - c. Identify all long term debt obligations
 - d. Provide summary findings regarding the charter school's ability to sustain their financial solvency for the current and two subsequent fiscal years
- 5. Cash Receipts:
 - a. Review the policies and procedures for cash receipts, deposits and disbursements
 - b. Evaluate the segregation of duties for the receipt of funds, deposit of monies and reconciliation of bank statements
 - c. Review test sample of transactions to determine if receipts are issued for all monies received

6. Disbursements:
 - a. Review the policies and procedures for disbursements
 - b. Review the signature authorization process
 - c. Evaluate the segregation of duties between purchasing, receiving and accounts payable, if any

By far, the issue of paramount concern is the amount of debt owed by the charter/corporation in long-term obligations and under operating leases. This debt threatens the charter school's ability to sustain financial solvency for the current and two subsequent fiscal years.

Nonvoter-Approved Debt

Issuing long-term debt allows charter schools to obtain funds to acquire or construct buildings and purchase equipment and to spread the repayment over a period of years. It also provides funds to obtain buildings or equipment that might be impossible to purchase with existing resources. Unlike school districts, charter schools do not have access to a dedicated revenue source such as tax levies to service that debt; therefore, annual debt service payments must be made from the charter's unrestricted revenues at the expense of current operations. Additional complications arise when debt is used to fund current operations or to capitalize expenses.

Debt that the charter must repay from unrestricted revenues is considered unfunded because it requires the use of resources typically dedicated to the current costs of education, such as employees' salaries and benefits, administration and general operating supplies. Although most charter schools can fund some long-term debt (e.g. small operating leases for copy machines and equipment) from their unrestricted funds, they should exercise extreme caution in dedicating unrestricted revenues for debt service payments because this depletes funds available for current operations. Moreover, debt service payments are expenditures that cannot easily be reduced or eliminated from the budget and therefore place an additional burden on unrestricted funds during times of fiscal austerity.

New City Public Schools provided FCMAT with its audited financial statements from 2007-08 through 2011-12. Debt has been disclosed in the charter's audited financial statements for this entire period, and renegotiation of debt was not unusual for the corporation. Debt at June 30, 2007 consisted of a total of \$995,940 owed to six entities, a bank loan, and two lines of credit as follows:

Lender	Type of Loan	Amount at June 30, 2007
Private Party - Westbrook Foundation	Short Term Loan - Four Months	\$450,000
School Employee	Short Term Loan - Five Months	\$46,000
Board Member	Short Term Loan - Six Months	\$18,000
Other Related Party	Short Term Loan - Four Months	\$30,000
Charter School Growth Fund	Loan Payable - No Term Set	\$165,000
CDE Charter School Revolving Loan	Revolving Loan Payable - Five Years	\$150,000
Bank Loan		\$39,292
Bank Line of Credit		\$1,524
Bank Line of Credit		\$96,124
TOTAL		\$995,940

Disclosures in the audited financial statement reflect the following chronology of debt issuance and renegotiation from July 1, 2007 forward:

Date	Lender	Description	Amount
During 2007-08	Private Party - Westbrook Foundation	More capital borrowed	\$50,000
During 2007-08	Other Related Party	Loan increased and converted to a long-term liability	\$70,000
During 2007-08	Consultant/Vendor	New debt – 14-month term	\$15,000
8/30/2007	School Employee	Debt renegotiated from five months to a 15-month term	
10/1/2007	Private Party - Westbrook Foundation	Debt renegotiated from four months to a five-year term	
10/9/2007	W.J. Reid Foundation	New Loan – two-year term	\$297,500
1/18/2008	Other Related Party	New Loan – 12-month term	\$100,000
2/1/2008	School Employee	New Loan – 16-month term	\$4,000
4/16/2008	Raza Development	New Loan – 10-year term	\$748,426
During 2008-09	Other Related Party	Debt renegotiated -- repayment at 9-30-09	
During 2008-09	W.J. Reid Foundation	Drew down additional debt	\$2,500
August 2008	California Charter Schools Association	Short-Term Growth Loan – one-year term	\$465,000
March 2009	Charter School Growth Fund	Debt renegotiated from an undefined term to a five-year term	
10/1/2009	W.J. Reid Foundation	Debt renegotiated from two-year to five-year term	
11/25/2009	Other Related Party	Debt renegotiated from long term liability to five-year term	
5/24/2010	Low Income Investment Fund	New debt – 24-month term	\$5,428,000
July 2010	Green Opportunity Fund	New debt – 10-year term	\$250,000
During 2010-11	Charter School Capital, Inc.	Sale of future receivables – one-year term	\$2,349,610
5/20/2012	Low Income Investment Fund (LIIF)	New debt agreement -- Loan Agreement	
9/20/12	Other Related Party	Standstill Agreement	
9/20/12	Raza Development	Standstill Agreement	
9/25/12	Low Income Investment Fund (LIIF)	Forbearance and Modification Agreement	
9/27/12	W.J. Reid Foundation	Standstill Agreement	
9/27/12	Private Party - Westbrook Foundation	Standstill Agreement	
September 2012	Green Opportunity Fund	Forbearance Agreement	
12/3/2012	Green Opportunity Fund	Modification of Loan Terms	

The standstill, forbearance and modification of loan-term agreements were all entered into because of the corporation's failure to make loan payments to the Low Income Investment Fund for approximately six months beginning with its December 2011 payment. The Low Income Investment Fund issued a notice of default to commence proceedings for a trustee's sale; however, before the issuance of a notice of sale, the parties were able to enter into these agreements. However, these agreements provide limited

debt service payments to lenders other than the Low Income Investment Fund and unless the corporation obtains alternative debt arrangements, the entire \$5.8 million (principal and accrued interest as of October 30, 2012) will be due to the Low Income Investment Fund on June 30, 2013. As of FCMAT's fieldwork, New City Public Schools and the Low Income Investment Fund had not reached a written agreement to provide an alternate term for the loan. Consequently, these calculations rely on the June 30, 2013 date for repayment of the entire sum.

The Low Income Investment Fund's forbearance and modification agreement contains other conditions including the following:

- New City Public Schools is to deposit \$50,000 into a cash collateral account held jointly in the name of the Low Income Investment Fund and the corporation;
- Establishment of a lock box account to deposit all corporation revenues, and withdrawals are subject to the Low Income Investment Fund's written approval;
- Confirmation of corporation's 2012-13 enrollment of not less than 430 students;
- The corporation is to negotiate relief or termination of the lease for the 1230 Pine Avenue facility;
- Reimbursement of the Low Income Investment Fund's attorney's fees and costs for negotiating the forbearance and modification agreement;
- All operating income received by the corporation for the 2012-13 fiscal year in excess of its' budget be applied to the payment of the loan;
- Change of back-office provider services to CharterWorks.

After application of payments, deletions indicated in the audited financial statements and the retirement of the sale of receivables, the balance of debt at June 30, 2012 totals \$6,737,066. The addition of accrued interest for the period July 1 through October 30, 2012 brings the total to \$7,286,393. Of this amount, \$521,480 represents the remaining balances of three loans from the W.J. Reid Foundation, other related party and Westbrook used for operations. Their original amounts totaled \$850,000. The remaining debt is for tenant improvements, facility expansion, green improvements to facilities, and the purchase of facilities.

Lender	Amount at June 30, 2012	Current Portion Due During 2012-13
Raza Development	\$529,986	\$43,900
Charter School Growth Fund	\$110,000	\$ -
W.J. Reid Foundation	\$29,261	\$10,000
Other Related Parties	\$42,219	\$10,000
Westbrook Loan	\$450,000	\$50,000
Green Opportunity Fund	\$225,026	\$ -
Low Income Investment Fund	\$5,350,574	\$5,350,574
Subtotal	\$6,737,066	\$5,464,474
Accrued Interest	\$549,327	\$549,327
TOTAL	\$7,286,393	\$6,013,801

Operating/property and capital leases add to the charter's debt, and New City Public Schools has five of these outstanding. Two relate to leases of property for operations and three relate to leases of equipment (copier, Apple computers and iPads). These leases have the following future minimum lease payments as reported in the charter's 2011-12 audited financial statements and leasing documents:

Lease for	Payments Through	Total Lease Payment	2012-13 Lease Payment
1701 Long Beach Boulevard (play-ground and park)	June 30, 2015	\$118,560	\$54,720
1204 and 1228 Pine Avenue and III E. 12th Street	June 30, 2015	\$328,677	\$106,337
Canon Copier	June 30, 2017	\$45,988	\$11,262
Apple Computers and iPads	June 30, 2014	\$62,781	\$31,391
iPads	June 30, 2013	\$9,288	\$9,288
TOTAL		\$565,294	\$212,998

The sum of \$508,359 for operating/property and capital lease payments (representing \$439,595 for rents and leases - buildings, \$2,500 for other space rental and \$66,264 for equipment rents/leases) was included in the 2012-13 budget, approved by the charter's board on Nov. 25, 2012.

New City Public Schools' executive director reported that the charter had not provided copies of the capital leases to their auditors. The debt had not been disclosed in New City Public Schools' 2010-11 audited financial statements and was omitted in the corporation's debt disclosures in its draft 2011-12 audited financial statements. FCMAT advised the corporation's administrators to provide their auditors with copies of the leases as soon as possible because the 2011-12 financial statements were still in draft at the time of FCMAT's fieldwork; however, the final 2011-12 financial statements did not contain information regarding capital leases.

Debt Management Policy

It is standard practice in many state and local governments for the governing board to adopt a comprehensive debt management policy that provides guidelines for issuing and managing debt. The Government Finance Officers Association also recommends that all forms of government adopt a comprehensive debt policy. This helps ensure that underwriters and financial advisers provide the charter with adequate information to analyze future debt, enabling the charter to make sound business decisions.

The charter does not have a debt management policy, which would provide guidelines for all forms of indebtedness including leasing and nonvoter approved debt. Although the issuance of debt may be an appropriate method for financing capital projects and improvements, careful evaluation is required prior to issuance to preserve the charter's credit strength, financial flexibility and fiscal solvency. FCMAT has developed a list of conditions most commonly experienced by local educational agencies needing intervention, and one of the predictors is "Substantial Long-Term Debt Commitments." A sample debt management policy is attached as Appendix A to this letter. While these items have been developed for use in county offices and school districts, they are applicable and can be adapted to the finances of charter schools as well.

There is no officially established level for nonvoter approved debt for a charter school. Best practice is to provide guidelines for debt burden ratios and factors combined with debt affordability criteria in the debt management policy. FCMAT believes that a debt burden factor of 1% - 2% of a charter's annual unrestricted revenues is reasonable.

Debt Burden Ratio

Applying this methodology to the current debt obligation for New City Public Schools, the annual debt service payments are equivalent to 215.95% of the charter's current unrestricted revenues, an amount that cannot be feasibly sustained by the charter's unrestricted revenues.

Debt Affordability

Long-term debt obligations supported from the charter's unrestricted revenues require a balance between the debt issued against unrestricted resources and the ability to support the debt over a long period of time. Anytime debt that is supported by unrestricted revenues is issued, the charter runs a risk of encountering unknown variables that can affect the ability to support the debt obligation(s) and sustain budget flexibility and financial solvency, especially in a climate of fiscal uncertainty.

FCMAT analyzed the charter's total long-term indebtedness to determine how much debt is serviced using the unrestricted revenues and how much has a dedicated funding source other than the unrestricted revenues. A debt burden ratio indicates the charter's ability to support annual debt payments, including principal and interest, from current unrestricted revenue sources. This ratio is calculated as follows:

$$\frac{\text{Total Annual Government Revenue of Fund(s) Servicing Debt to}}{\text{Total Annual Governmental Debt Obligations}}$$

Based on the audited financial statements as of June 30, 2012, the charter's calculation of interest accrued and review of capital leases, the district had a total of \$7,851,687 in long-term unfunded debt, as shown in the following table:

Debt Funded from the Unrestricted Revenues (Unfunded)

Type of Debt	Debt Amount
Operating/Property Lease Obligations	\$447,237
Capital Lease Obligations	\$118,057
Long Term Debt Obligations	6,737,066
Accrued Interest Payable on Long-Term Debt	549,327
Total Unrestricted Revenue Debt	\$7,851,687

To determine whether a charter school has too much unfunded long-term debt, the amount of the annual long-term unfunded debt payments is compared to the charter's total unrestricted revenues. The following table shows the unfunded long-term debt payments according to schedules prepared by the charter's auditors, operating lease and capital lease payments as shown in leasing documentation compared with the unrestricted revenues included in the 2012-13 budget, approved by the charter's board on November 25, 2012.

Annual Debt Service Payments Funded from the Unrestricted Revenues (Unfunded)

**Debt Burden Ratio
Unrestricted Revenues to Budget Debt Obligation
For the Fiscal Year 2012-13**

Unrestricted Revenue Sources	
Revenue Limit Sources	\$2,164,508
Other State Revenue	\$ 693,421
Other Local Revenue	\$ 30,154
Total	\$2,888,083
Type of Debt	
Long-Term Debt Obligations	\$6,013,801
Operating/Property Lease Obligations	\$161,057
Capital Lease Obligations	\$51,941
Total	\$6,236,799
Debt Burden Ratio	215.95%

The unrestricted revenues for the district for fiscal year 2012-13 are projected to be \$2,888,083. Therefore, the total annual debt payments above are equal to 215.95% of unrestricted revenues, far exceeding the recommended level of 1% – 2%. This is unsustainable and will leave the charter fiscally insolvent as of June 30, 2013.

Because this issue must be resolved immediately for the charter school to remain fiscally solvent, it eclipses the remaining scope points included in the study agreement. Therefore, the New City Public Schools and FCMAT have agreed that the remaining scope points will be addressed at a later time.

FCMAT thanks all staff and administrators of New City Public Schools, Long Beach Unified School District and CharterWorks (the charter school's office services provider), for their cooperation during fieldwork and for allowing FCMAT to provide assistance. FCMAT appreciates the opportunity to provide service to the charter and hopes that this letter is beneficial to all concerned.

Sincerely,



Julie Auvin, CPA, CGMA
Fiscal Intervention Specialist

SAN LUIS OBISPO COUNTY OFFICE OF EDUCATION
P.O. Box 8105, San Luis Obispo, CA 93403-8105

(P) #3266 SAMPLE DEBT MANAGEMENT POLICY

Purpose

The County Office of Education recognizes that the foundation of a well-managed debt program is a comprehensive debt policy.

This debt policy sets forth a set of comprehensive guidelines for the financing of capital expenditures. It is the objective of this policy that: 1) the County Office of Education obtain financing only when necessary, 2) the County Office of Education will use a process for identifying the timing and amount of debt or other financing that is efficient, and 3) the County Office of Education will obtain the most favorable interest and other costs in issuing the debt.

This policy will be reviewed by the County Board of Education at least annually and updated as necessary.

Responsibilities

County Superintendent & Deputy Superintendent

Under the general direction of the Superintendent, the Deputy Superintendent will have the primary responsibility for developing financing recommendations and ensuring the implementation of the debt policy. In developing the recommendations, the Deputy Superintendent will be assisted by the Director of Internal Fiscal Services and the County Superintendent. These individuals will comprise the Debt Management Committee. The responsibilities of the committee will be to:

- Meet at least quarterly to review the County Office's capital improvement program and consider the need for financing to maintain the progress on the capital improvement program.
- Develop a Request for Proposal (RFP) that will be used in the selection of bond counsel, financial advisor and/or underwriter beginning in the Spring of 2002 if necessary.
- Select the financing participants for each debt issue, ensure the debt issue is integrated with the County Office's overall financing program, approve the structure of each debt issue, and review and approve all documentation for each issue.
- Oversee the preparation of the information for the official statement for debt issues.
- Meet as necessary in preparation for a financing or to review changes in state or federal laws or regulations.
- Prepare all information for the bond rating agencies and make presentations as necessary.

- Meet annually to review the County Office of Education's compliance with the existing debt agreements.
- Meet annually to review the services provided by the financial advisor, bond counsel, paying agents and other service providers to evaluate the extent and the effectiveness of the services provided.
- Administer the investment and expenditure of the debt proceeds and ensure that the debt payments are made on time.
- Ensure that the arbitrage requirements are monitored and that the appropriate reports are filed with the federal government.

Bond Counsel

The bond counsel will issue an opinion as to the legality and tax exempt status of any obligations. The County Office will also seek the advice of the bond counsel on questions involving the state or federal law or arbitrage. The bond counsel is also responsible for the preparation of the bond documents (including the authorizing resolutions that the County Board of Education will adopt) and most of the closing documents. The bond counsel will ensure that all legal requirements for the debt issue are met. The bond counsel will perform other services as defined by the contract approved by the County Superintendent of Schools.

Financial Advisor/Underwriter

The County Office staff will seek the advice of the financial advisor and/or underwriter when necessary. The financial advisor will advise on the structuring of the debt obligations that will be issued, inform the County Office of the options available for each issue, advise the County Office of Education as to how choices will impact the marketability of the County Office of Education's obligations, and will provide other services as defined by the contract approved by the County Superintendent of Schools.

County Office Auditors

The County Office of Education will include a review of any official statements issued in connection with a debt issue in its contract for services with the County Office of Education's independent auditors.

Short-Term Operating Debt Policy

The expenditures associated with the day-to-day operations of the County Office of Education will be covered by current revenues. However, because the County Office of Education does not receive its revenues in equal installments each month and the largest expenditures occur in equal amounts, the County Office of Education may experience temporary cash shortfalls. To finance these temporary cash shortfalls, the County Office of Education may incur short-term operating debt, typically, tax and revenue anticipation notes (TRANS). The County Office of Education will base the amount of the short-term operating debt on cash flow projections for the fiscal year and will comply with applicable federal and state regulations. The County Office of Education will pledge operating revenues to repay the debt, which will be repaid in one year or less. The County Office of

Education will minimize the cost of the short-term borrowings to the greatest extent possible and may participate in pooled TRANS to meet this goal.

Long-term Capital Debt Policy

The following will apply to the issuance of long-term debt:

- The County Office of Education will not use long-term obligations for operating purposes.
- The life of the long-term obligations will not exceed the useful life of the projects financed.
- The County Office of Education will strive to maintain level debt service payments.
- The County Office of Education will not issue unfunded long-term debt in excess of 3% of annual general fund revenues, unless there is a dedicated tax levy, surplus property sale, fixed lease payments from another public agency or redevelopment revenue stream committed to service the debt.

Bonds

The County Office of Education, upon approval of the County Board of Education, may issue general obligation bonds to finance significant capital improvements for the purposes set forth by the voters in the bond election. The County Office of Education may also issue revenue bonds to finance significant capital improvements without voter authorization, through Certificates of Participation (COP=s) or through Qualified Zone Academy Bonds (QZAB=s).

The County Office of Education staff will prepare a resolution authorizing the issuance of Certificates of Participation, Qualified Zone Academy Bonds, and General Obligation Bonds for presentation to the County Board of Education at least 45 days prior to the issuance.

Negotiated Versus Competitive Sale Versus Private Placement

When feasible and economical, the County Office may issue bonds either by competitive or negotiated sale. The County Office of Education will issue by negotiated sale when the issue is predominantly a refunding issue or in other non-routine situations that require more flexibility than a competitive sale allows. Whenever the option exists to offer an issue either for competition or negotiation, the Debt Management Committee will undertake an analysis of the options to aid in the decision making process.

Refunding

The County Office of Education will consider refunding debt whenever an analysis indicates the potential for present value savings of approximately 5% of the principal being refunded or at least \$200,000. The financial advisor will compute the economic gain or loss on the refunding and the members of the Debt Management Committee will verify the computation. The County Office of Education will not refund less than 5% of its outstanding debt at one time except in unusual circumstances such as when it intends to change bond covenants.

Capital Leases

Capital leasing is an option for the acquisition of equipment or other assets with a cost of less than \$500,000. The County Office of Education will not consider leasing when there are available funds on hand for the acquisition unless the interest expense associated with the lease is less than the interest that can be earned by

investing the funds on hand or when other factors such as budget constraints override the economic consideration.

When a lease is arranged with a private sector entity, the County Office of Education will seek a tax-exempt rate. When a lease is arranged with a government or other tax-exempt entity, the County Office of Education will try to obtain an explicitly defined taxable rate so that the lease will not be counted in the County Office of Education=s total annual borrowings subject to arbitrage rebate.

The lease agreement will permit the County Office of Education to refinance the lease at no more than reasonable cost. A lease that can be called at will is preferable to one that can merely be accelerated.

The County Office of Education staff may obtain at least three competitive proposals for any major lease financing. In evaluating the proposals, the net present value of the competitive bids will be compared, taking into account how and when the payments are made. If required by statute, the purchase price of equipment will be competitively bid.

Bond Rating

The County Office of Education=s goal is to maintain or improve its bond ratings. The County Office of Education=s staff will make a full disclosure to the bond rating agencies when necessary.

Arbitrage Liability Management

The County Office of Education will make every effort to minimize the cost of the arbitrage rebate and yield restriction while strictly complying with the law. The federal arbitrage law is intended to discourage entities from issuing tax exempt obligations unnecessarily. In complying with the spirit of the law, the County Office of Education will not issue obligations except for identifiable projects with very good prospects of timely initiation. Obligations will be issued as closely in time as feasible to the time contracts are awarded so as to minimize the time the debt proceeds are unspent.

The County Office of Education=s bond counsel and financial advisor will review, in advance, all arbitrage rebate payments and forms sent to the IRS.

Internal Interim Financing

In order to defer the issuance of debt obligations, when sufficient non-restricted funds are on hand, consideration will be given to appropriating them to provide interim financing for large construction projects. When the debt obligation is subsequently issued, the non-restricted funds will be repaid.

REVIEWED BY SCHOOLS LEGAL SERVICE DC 7/19/01

APPROVED BY COUNTY BOARD OF EDUCATION 10/4/01