FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
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

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 (playground and park)	June 30, 2015	$118,560	$54,720
1204 and 1228 Pine Avenue and 111 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:

Total Annual Government Revenue of Fund(s) Servicing Debt to

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

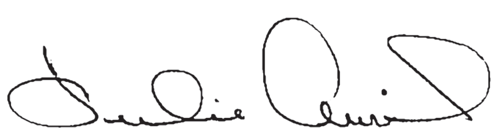
Unrestricted Revenue Sources	
Revenue Limit Sources	$2,164,508
Other State Revenue	$ 693,421
Other Local Revenue	$ 30,154
Total	**$2,888,083**
Type of Debt	
Long-Term Debt Obligations	$6,013,801
Operating/Property Lease Obligations	$161,057
Capital Lease Obligations	$51,941
Total	**$6,236,799**
Debt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

<u>Short-Term Operating Debt Policy</u>

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