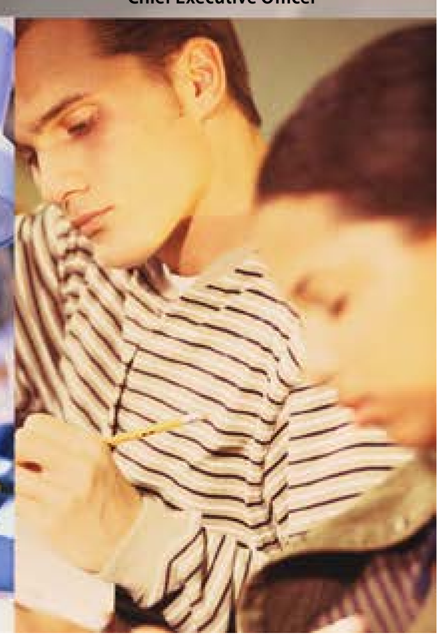
FCMAT
FISCAL CRISIS & MANAGEMENT
ASSISTANCE TEAM
CSIS California School Information Services

Monterey County Office of Education

Fiscal Review

January 6, 2015

Joel D. Montero
Chief Executive Officer



FCMAT
FISCAL CRISIS & MANAGEMENT
ASSISTANCE TEAM
CSIS California School Information Services

January 6, 2015

Nancy Kotowski, Ph.D., Superintendent
Monterey County Office of Education
901 Blanco Circle
Salinas, CA 93901

Dear Superintendent Kotowski:

In July 2014, the Monterey County Office of Education (COE) and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement for management assistance. Specifically, the agreement states that FCMAT will perform the following:

1. At the request of the COE, review and validate the San Ardo Union Elementary School District's 2014-15 adoption budget for the current and two subsequent fiscal years, and develop a financial recovery plan for the district.

2. The team will provide an overview of procedures performed during the collection of rents or payments for real property owned by the district. This will include interviews of department management and key personnel; a review of available financial reports; evaluation of policies and procedures associated with business processes; federal, state or local compliance requirements. The overview will seek to obtain a detailed understanding of the following:

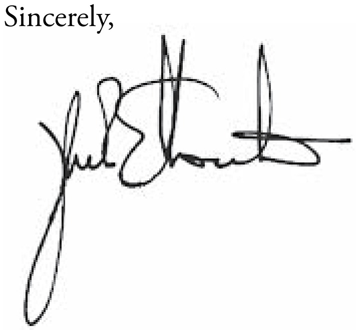
    - Rental fees or payments for the current and two prior fiscal years
    - Receivable balances
    - Fee collection history
    - Write-offs
    - Resolution of prior audit observations
    - Results of recent internal or external reviews

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

FCMAT
Joel D. Montero, Chief Executive Officer
1300 17th Street - City Centre, Bakersfield, CA 93301-4533 • Telephone 661-636-4611 • Fax 661-636-4647
755 Baywood Drive, 2nd Floor, Petaluma, CA 94954 • Telephone: 707-775-2850 • Fax: 707-636-4647 • www.fcmat.org
Administrative Agent: Christine L. Frazier - Office of Kern County Superintendent of Schools

FCMAT appreciates the opportunity to serve the Monterey County Office of Education and extends thanks to its staff and the San Ardo Union Elementary School District's staff for their cooperation and assistance during this review.

Sincerely,



Joel D. Montero
Chief Executive Officer

Table of Contents

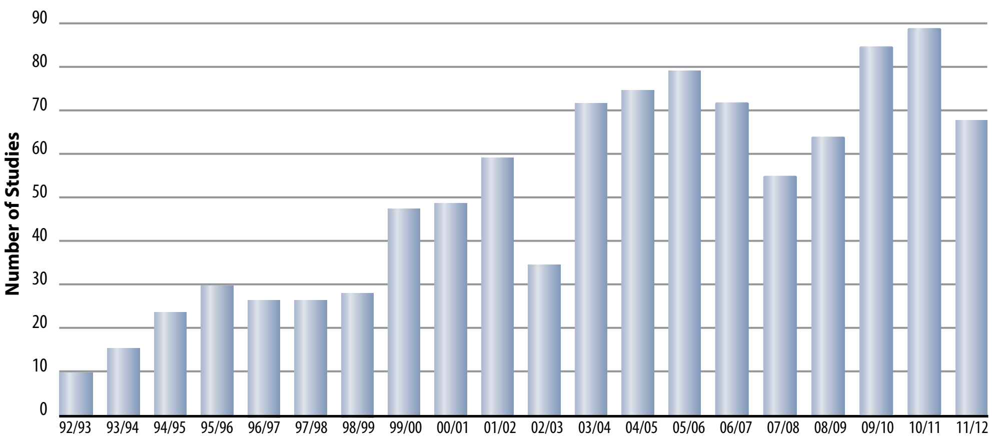
About FCMAT

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 offices 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 more than 1,000 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

Located in Monterey County, the San Ardo Union Elementary School District has a 5-member governing board and serves approximately 113 students at one kindergarten through eighth grade school. According to data from the California Department of Education, student enrollment has fluctuated from a high of 125 in 2004-05 to a low of 101 in 2012-13. The district serves a high-needs population; approximately 80% of its students are English learners and 99% are eligible for free or reduced-price meals.

The Monterey County Office of Education reviewed the district's 2013-14 second interim report and subsequently issued a negative budget certification. In its August 5, 2014 letter to the district, the county office indicated that the district's 2013-14 third interim financial projection and the 2014-15 adopted budget contained reductions recommended by the budget advisory committee. However, the reductions were not sufficient for the district to meet the state's minimum recommended reserve standard of 5% for 2014-15 and the two subsequent fiscal years.

In July 2014, the Monterey County Office of Education and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement for management assistance to review the district's 2014-15 adoption budget and multiyear financial projections, and various issues regarding rental property.

Study and Report Guidelines

FCMAT visited the county office and district on August 13 and 14, 2014 to conduct interviews, visit district facilities, collect data, and begin reviewing documents. County office and district staff continued to provide requested documents following FCMAT's fieldwork. This report is the result of those activities and is divided into the following sections:

- Executive Summary
- Budget Review
- Financial Recovery Plan
- Rental Property
- Appendix

In writing its reports, FCMAT uses the Associated Press Stylebook, a comprehensive guide to usage and accepted style that emphasizes conciseness and clarity. In addition, this guide emphasizes plain language, discourages the use of jargon and capitalizes relatively few terms.

Study Team

The study team was composed of the following members:

Diane Branham
FCMAT Chief Management Analyst
Bakersfield, CA

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

Eric D. Smith
FCMAT Fiscal Intervention Specialist
Bakersfield, CA

Leonel Martínez
FCMAT Technical Writer
Bakersfield, CA

Each team member reviewed the draft report to confirm its accuracy and to achieve consensus on the final recommendations.

Executive Summary

The 2013-14 State Budget Act included the Local Control Funding Formula (LCFF), which significantly changed the way local educational agencies (LEAs) are funded. The LCFF replaced revenue limits and most state categorical program funding with grade span adjusted base grants and supplemental and concentration grants determined by the number of students who are English learners, foster youth, and those eligible for free or reduced-price meals. The state anticipates it will take eight years to fully implement the LCFF.

Because of ongoing state budget reductions from prior years and apportionment deferrals, LEAs throughout the state continue to struggle to eliminate deficit spending, maintain a balanced budget in the current and subsequent fiscal years, sustain the state's prescribed level of reserves for economic uncertainties and the cash balances necessary to maintain financial solvency.

At the 2013-14 second interim reporting period, the county office issued a negative budget certification to the San Ardo Union Elementary School District. With the assistance of a budget advisory committee, the district identified and implemented several cost-saving measures. These measures include reducing certificated and classified employee positions, reducing the compensation package for the new superintendent and the chief business official, decreasing the number of outside services contracts, eliminating the preschool program, and sharing services for a speech and language pathologist position. The county office also appointed a fiscal expert to work with the district.

However, the district's 2014-15 adopted budget and multiyear financial projections, and FCMAT's review and analysis of those documents, indicate that the unrestricted general fund will not meet the minimum recommended 5% reserve for economic uncertainties in the current and two subsequent fiscal years and will have a negative ending balance in 2015-16 and 2016-17. FCMAT's analysis shows the following unrestricted general fund ending balances:

2014-15	2015-16	2016-17
$13,846	-$142,044	-$268,584

Based on these projections, the governing board and district administration will need to continue to make and implement difficult budget decisions. Unless revenue is significantly increased, the district will need to implement additional expenditure reductions to balance its general fund budget and remain fiscally solvent.

The district owns nine rental properties that are located in San Ardo, California. As of August 1, 2013, the district has used E & E Property Management Group, Inc. to manage its rental properties. This was part of the superintendent's duties prior to that time. To provide for proper oversight and effective internal controls, the district should establish board policies and administrative regulations memorializing the board's authority to lease the rental properties, authority to contract with an external agency to manage the properties, and the basis for the rental rates (e.g. fair market value). The district should also amend the management and operating agreement with E & E Property Management to include expanded financial reporting requirements, and fully implement the corrective action recommended by its external auditors and the recommended procedures provided by the county office.

Findings and Recommendations

Budget Review

Assembly Bill (AB) 1200 Oversight

If at any time during the fiscal year a district may be unable to meet its financial obligations for the current or two subsequent fiscal years or has a qualified or negative budget certification, the county superintendent of schools is required to notify the district's governing board and the state superintendent of public instruction (SPI). The county office is required to follow Education Code Section 42127.6 when assisting a school district in this situation and take all actions necessary to ensure that the district meets its financial obligations. Assistance may include steps such as assigning a fiscal expert or fiscal advisor to advise the district on financial issues, conducting a study of the district's financial and budget conditions and requiring the district to submit a proposal for addressing its fiscal condition. In the case of a district that does not meet the state's prescribed reserve levels, the intent of the multiyear financial projection (MYFP) is to help the county office and the district formulate a plan to regain fiscal solvency and restore the reserve.

At the 2013-14 second interim reporting period, the county office issued a negative budget certification to the district. The August 5, 2014 letter from the county office regarding the district's 2013-14 third financial projection states that, "The statutory requirements of the County Superintendent of Schools related to a negative certified school district remain in effect." According to Education Code Section 42131, a negative certification indicates that based on current projections, the district will be unable to meet its financial obligations for the current or subsequent fiscal year.

Regular and frequent budget monitoring becomes critical in times of fiscal uncertainty. The district will need to ensure that multiyear financial projections and cash flow projections are kept up to date and that the information they contain is accurate and based on the most current budget assumptions available. Based on the district's current financial situation, the governing board and district administration will need to continue to make and implement difficult budget decisions.

Multiyear Financial Projections

Multiyear financial projections are required by AB 1200 and AB 2756 and are a part of the adoption budget and interim reporting process. AB 2756 was signed into law in June 2004 and made substantive changes to the financial accountability and oversight used to monitor the fiscal position of school districts. Among other things, AB 2756 strengthened the roles of the SPI and county offices of education and their ability to intervene during fiscal crises, including requesting assistance from FCMAT.

MYFPs help local educational agencies make more informed decisions and project the future effects of current decisions. Projections are a required part of annual budget development and must be evaluated and updated during each interim financial reporting period. They should also be updated before any significant decisions are made that affect the budget, such as salary and benefit increases. When developing and implementing its multiyear financial projections, a district's main objectives are to achieve and sustain a balanced budget, improve academic achievement and maintain local governance. The MYFP helps identify specific planning milestones that will help the district make decisions.

Financial planning is crucial for every LEA, regardless of its size or structure. Long-term financial planning helps a district strategically align its budget with its instructional goals and programs. In addition, recognizing financial trends is essential to maintaining a district's fiscal health. Monitoring and analyzing year-to-year trends in key budget areas helps a district evaluate its budget direction and highlight possible areas of concern.

Any projection of financial data has inherent limitations because calculations are based on certain economic assumptions and criteria, including changes in enrollment trends; cost-of-living adjustments; estimates for utilities, supplies and equipment; and changing economic conditions at the state, federal and local levels. Therefore, the budget projection model should be evaluated as a trend based on certain criteria and assumptions rather than a prediction of exact numbers.

LEAs throughout the state have had to update their multiyear assumptions and projections several times each fiscal year since 2008-09 as the state experienced severe revenue declines. Multiyear projections can become somewhat less reliable in a time of fiscal instability, especially for the subsequent fiscal years, because projected revenue information from the state may change frequently. However, the MYFP still provides guidance for decisions that affect multiple fiscal years, and the district must continue to update and reassess the ramifications of state-imposed budget adjustments.

Enrollment and Average Daily Attendance

Accurate enrollment tracking and analysis of average daily attendance (ADA) are essential to providing a solid foundation for budget planning. Because much of a district's funding is based on the total number of student attendance days, monitoring and projecting student enrollment and attendance is a crucial function. When enrollment and related ADA decline, the district must consider the budgetary effects of the decline on teacher-to-student ratios and plan accordingly. The district must also exercise extreme caution regarding issues such as negotiations, staffing and deficit spending to ensure fiscal solvency. Accurate tracking and analysis of enrollment and ADA can help the district better project future revenues and control staffing expenditures to help maintain fiscal solvency.

Enrollment Projection

To project the district's future kindergarten enrollment, FCMAT used county birthrate statistics. Although other factors such as housing construction influence local population growth, in a stable and developed locale a strong correlation can be made between birthrates and kindergarten enrollment five years later. Birthrate data is available by county at the California Department of Public Health (CDPH) website:

http://www.cdph.ca.gov/data/statistics/Pages/default.aspx.

The CDPH data shows a decrease in birthrates for Monterey County for the past several years. By comparing actual kindergarten enrollment at San Ardo Union Elementary to birthrates five years prior, a relationship can be developed between birthrates and future kindergarten populations. For example, the data indicate that in 2008 there were 7,434 births in Monterey County. Five years later the district's kindergarten enrollment was 13 students, or .17% of births. Performing this calculation for multiple years shows that the district's kindergarten enrollment varies between .17% and .27% of births.

To project the district's future first through eighth grade enrollment, FCMAT used the cohort survival method, which groups students by grade level upon entry and tracks them through each year that they stay in school. This method evaluates the longitudinal relationship of the number of students who pass from one grade to the next in a subsequent year. This method closely accounts for retention, dropouts and students transferring to and from the district grade by grade. Although other projecting techniques are available, the cohort survival method usually is the best choice for school districts because of its sensitivity to incremental changes in several key variables.

Percentages are calculated from historical enrollment data to determine a reliable weighted average percentage of increase or decrease in enrollment between any two grades over the projection period. Ratios are calculated between grade levels from year to year, usually using data from the last five years. Enrollment variables include the following:

- Historical ratio of enrollment progression between grade levels
- Changes in educational programs
- Interdistrict and intradistrict transfers
- Migration patterns
- Changes in local and regional demographics
- Industry changes such as a new industry coming to the area or an industry leaving
- Residential housing starts and the generation factor per household

Average Daily Attendance

Average daily attendance is used to calculate the district's LCFF and many other federal and state revenue sources. District LCFF apportionments are based on the greater of current or prior year second period principal apportionment (P-2) ADA.

FCMAT reviewed the district's enrollment and ADA trends for 2009-10 through 2013-14. The review compared California Longitudinal Pupil Achievement Data System (CALPADS) student enrollment counts to the P-2 ADA to determine the average ADA-to-enrollment ratios. FCMAT's projections indicate that enrollment will decrease slightly in 2014-15 then increase minimally in the two subsequent years. However, the district needs to carefully monitor and project enrollment and ADA at each reporting period to ensure the most recent data is included in its budget assumptions. This becomes increasingly important as the district transitions from basic aid to state aid status, as discussed later in this report. The district's 2014-15 adopted budget includes enrollment of 104 and ADA of 101 in the current and two subsequent fiscal years. The following table shows the district's historical and projected enrollment using the cohort survival method.

Enrollment and ADA

Historical Years	Enrollment	ADA
2009-10	108	106.12
2010-11	116	107.44
2011-12	102	99.72
2012-13	101	99.71
2013-14	113	104.04
Projection Years		
2014-15	110	105.92
2015-16	111	106.76
2016-17	112	107.63

Budget and Multiyear Projection Assumptions

FCMAT conducted interviews with staff, reviewed the district's 2014-15 adopted general fund budget and multiyear financial projections and numerous other financial system reports and documents to analyze the adopted budget. FCMAT's analysis used budget assumptions based on the 2014-15 State Budget Act, School Services of California's (SSC's) Financial Projection Dartboard, and Department of Finance (DOF) estimates for LCFF funding factors. The following table includes the economic factors used by FCMAT in completing its review.

Projection Rules

Rule	Base Year 2014-15	Year 1 2015-16	Year 2 2016-17
Certificated COLA	*	3.00%	0.00%
Classified COLA	*	0.00%	0.00%
Certificated Step/Column	*	2.50%	2.50%
Classified Step	*	2.00%	2.00%
Health and Welfare Benefits	**	5.00%	5.00%
STRS Employer Rates - SSC	8.88%	10.73%	12.58%
PERS Employer Rates - SSC	11.77%	12.60%	15.00%
California CPI - SSC	2.40%	2.60%	2.70%
California Lottery Restricted - SSC	$34.00	$34.00	$34.00
California Lottery Unrestricted - SSC	$128.00	$128.00	$128.00
State Categorical and Special Education COLA - SSC	0.85%	2.10%	2.30%
Statutory COLA - SSC	0.85%	2.10%	2.30%
LCFF COLA - DOF	0.85%	2.19%	2.14%
LCFF Gap Closure - DOF	29.56%	20.68%	25.48%
Federal COLA	0.00%	0.00%	0.00%

**Based on information from district's position control spreadsheets.*
***Current year costs have not yet reached negotiated caps.*

FCMAT's review indicated some differences between the assumptions shown above and those used by the district. These differences are discussed in the following pages.

Adjustment Analysis

The following table and narrative show the differences between the district's 2014-15 adopted budget and FCMAT's analysis. The narrative also includes additional details regarding the assumptions used in the projection years.

General Fund Comparison Summary

	District 2014-15 Adopted Budget			FCMAT Analysis			Difference		
Description	Unrestricted	Restricted	Total	Unrestricted	Restricted	Total	Unrestricted	Restricted	Total
REVENUES									
LCFF/State Aid Sources	891,333.00	0.00	891,333.00	913,836.00	0.00	913,836.00	22,503.00	0.00	22,503.00
Federal Revenue	0.00	243,586.00	243,586.00	0.00	225,548.00	225,548.00	0.00	(18,038.00)	(18,038.00)
Other State Revenue	15,562.00	32,452.00	48,014.00	23,475.00	33,002.00	56,477.00	7,913.00	550.00	8,463.00
Other Local Revenue	3,590.00	47,950.00	51,540.00	11,625.00	39,886.00	51,511.00	8,035.00	(8,064.00)	(29.00)
TOTAL REVENUES	910,485.00	323,988.00	1,234,473.00	948,936.00	298,436.00	1,247,372.00	38,451.00	(25,552.00)	12,899.00
EXPENDITURES									
Certificated Salaries	270,401.00	184,838.00	455,239.00	365,039.00	74,399.00	439,438.00	94,638.00	(110,439.00)	(15,801.00)
Classified Salaries	166,252.00	15,173.00	181,425.00	159,082.00	15,135.00	174,217.00	(7,170.00)	(38.00)	(7,208.00)
Employee Benefits	173,374.00	51,284.00	224,658.00	172,524.00	19,208.00	191,732.00	(850.00)	(32,076.00)	(32,926.00)
Books and Supplies	41,299.00	17,501.00	58,800.00	41,299.00	17,501.00	58,800.00	0.00	0.00	0.00
Services and Other Operating	203,000.00	34,586.00	237,586.00	232,000.00	34,586.00	266,586.00	29,000.00	0.00	29,000.00
Capital Outlay	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other Outgo	0.00	95,000.00	95,000.00	0.00	95,000.00	95,000.00	0.00	0.00	0.00
Direct Support/Indirect Costs	(42,885.00)	42,885.00	0.00	(48,423.00)	48,423.00	0.00	(5,538.00)	5,538.00	0.00
Debt Service	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL EXPENDITURES	811,441.00	441,267.00	1,252,708.00	921,521.00	304,252.00	1,225,773.00	110,080.00	(137,015.00)	(26,935.00)
OTHER FINANCING SOURCES/USES									
Interfund Transfers In	19,650.00	0.00	19,650.00	19,650.00	0.00	19,650.00	0.00	0.00	0.00
Interfund Transfers Out	54,400.00	0.00	54,400.00	54,400.00	0.00	54,400.00	0.00	0.00	0.00
Contributions	(117,279.00)	117,279.00	0.00	(133,347.00)	133,347.00	0.00	(16,068.00)	16,068.00	0.00
TOTAL OTHER FINANCING SOURCES/USES	(152,029.00)	117,279.00	(34,750.00)	(168,097.00)	133,347.00	(34,750.00)	(16,068.00)	16,068.00	0.00
NET INCREASE (DECREASE) IN FUND BALANCE	(52,985.00)	0.00	(52,985.00)	(140,682.00)	127,531.00	(13,151.00)	(87,697.00)	127,531.00	39,834.00
FUND BALANCE									
Beginning Fund Balance	154,528.30	23,205.61	177,733.91	154,528.30	23,205.61	177,733.91	0.00	0.00	0.00
TOTAL ENDING FUND BALANCE	101,543.30	23,205.61	124,748.91	13,846.30	150,736.61	164,582.91	(87,697.00)	127,531.00	39,834.00

District 2014-15 Adopted Budget - Beginning fund balances adjusted to reflect 2013-14 unaudited actuals ending fund balances

Revenue

Local Control Funding Formula/State Aid – On July 1, 2013, Governor Brown signed into law Assembly Bill 97, which became effective immediately. AB 97 enacted the Local Control Funding Formula, which was the most significant change to California's school finance model in almost 40 years, replacing both the prior revenue limit funding formula and 32 types of categorical funding. Like revenue limit funding, the LCFF is based on ADA; however, the methods of calculation have changed significantly. The LCFF provides a base grant by grade level and additional funding based on the district's student population of English language learners, those who are eligible for the free and reduced-price meal program, and foster youth. In its simplest form, the LCFF has four main components:

1. LCFF sets four uniform base grant grade span rates: K-3, 4-6, 7-8 and 9-12. These constitute the majority of general purpose funding.

2. Base rate adjustments for grades K-3 and 9-12 are calculated based on a percentage of the grade span rates: 10.4% for grades K-3 for class size reduction, and 2.6% for grades 9-12 for career technical education.

3. Supplemental grant funding totaling 20% of the adjusted base rate is provided for certain student subgroups including English learners, foster youth, and students who qualify for free and/or reduced-price meals.

4. Concentration grant funding equal to 50% of the adjusted base rate is provided when these student subgroups exceed 55% of total enrollment.

Consequently, all students generate funds from base grants and all K-3 and 9-12 students generate funds from base rate adjustments; however, supplemental and concentration grant funds are generated from specific pupil counts. Supplemental and concentration funds are to be spent to increase or improve services to the groups that generate them. California Code of Regulations, Title 5, Section 15496 defines the requirements necessary for districts to demonstrate these increased or improved services for unduplicated pupils in proportion to the increase in funds appropriated for supplemental and concentration grants.

Following the calculation of the four main components, there are add-ons for the Targeted Instructional Improvement Block Grant and home-to-school transportation funding. The add-ons do not receive cost-of-living adjustments over the 8-year target implementation period.

During the transition from fiscal year 2012-13 to 2013-14, a base funding level and a target, representing full funding at the end of eight years, was determined for each school district and charter school. The difference between the base and the target is referred to as the gap. Beginning in 2013-14, districts and charter schools receive a percentage of the remaining gap amount each year until full funding is achieved. Base rates are adjusted each year for cost-of-living increases and for grade span adjustments if applicable. Because both supplemental and concentration grants are a percentage of the adjusted base grants, they too benefit from cost-of-living increases.

The state obligation for LCFF funding is offset by local property taxes and the economic protection account (EPA); therefore, the total revenue under LCFF received by each school district is a combination of state apportionments, local property taxes, and EPA. The EPA, also known as Proposition 30, was approved in the November 2012 election in an attempt to stabilize K-14 funding following massive budget cuts to education over the four previous fiscal years. The EPA generated revenues through a temporary state sales tax rate increase of 0.25% beginning January 1, 2013 and continuing through December 31, 2016 and through an increase to the California state personal income tax rates for upper-income taxpayers for seven years beginning January 1, 2012. These payments are separate from the principal apportionment and are paid quarterly.

During the transition year, approximately 130 school districts received an economic recovery target (ERT) add-on. The calculation for this add-on occurred only in the 2013-14 fiscal year for districts that qualified. The ERT was designed to adjust the new funding system for districts that would have received more funding under the old system had the revenue limit deficits been eliminated and previous categorical funding cuts of 19.84% restored. San Ardo Union Elementary School District did not qualify to receive ERT add-on funding.

Under both the previous revenue limit funding formula and the LCFF, school districts are either state aid districts that receive most of their funding from the LCFF or basic aid districts whose property tax revenues exceed the state aid calculations. San Ardo Union Elementary is a basic aid school district and therefore relies heavily on the estimates of local property taxes provided by Monterey County. However, the LCFF is in its second year of the projected 8-year implementation period. As funding is increased during the 8-year implementation, many basic aid districts may change to state aid because their calculated state aid funding will exceed property tax revenues.

San Ardo Union Elementary is one of the districts that is projected to change its status during the MYFP projection period. FCMAT's LCFF estimate indicates that the district will remain in basic aid status in 2014-15 and 2015-16 and become a state aid district in 2016-17, with projected funding of $913,836, $914,004 and $979,828 in each respective year. The primary differences between the district's calculation of the LCFF and FCMAT's are because of the recognition of property taxes at the level collected in the 2013-14 fiscal year for the budget and two subsequent fiscal years. Property values have stabilized and/or increased over the last couple of years; therefore, FCMAT's analysis includes the conservative 2013-14 property tax revenues in each year.

Additionally, the district assumed a reduction of its revenues based on an in-lieu transfer of property taxes to district authorized charter schools in accordance with Education Code Sections 47632 and 47635. However, the district has not authorized any charter schools nor previously denied any that were subsequently approved at the county level. Consequently, the reduction was eliminated. Following FCMAT's fieldwork and budget analysis, county office staff indicated that one district student attends the Monterey County Home Charter School.

<u>Lottery</u> – The California State Lottery was established by the California State Lottery Act of 1984. The purpose of the act, which was approved by California voters, was to increase revenue to schools without raising taxes. In 2000, voters approved Proposition 20, which mandated that a percentage of growth in revenues from the lottery must be allocated for instructional materials. As a result, revenues from the lottery are divided into two classifications: non-Proposition 20 funds, which are recorded as unrestricted general fund revenue; and Proposition 20 funds, which are recorded as restricted general fund revenue and are to be used for instructional materials.

For the 2014-15 fiscal year, FCMAT estimates non-Proposition 20 funds at $128 per ADA and Proposition 20 funds at $34 per ADA for a total projection of $13,703 and $3,640, respectively. In San Ardo Union Elementary, the unrestricted lottery revenues have been used to purchase books and supplies as well as provide for payment of rentals/leases and some professional/consulting services. Proposition 20 funds are used for instructional materials.

<u>Mandated Costs</u> – According to Government Code Section 17581.6, as amended by Senate Bill 858 (Chapter 32, Statutes of 2014), districts must make an annual choice to receive funds for mandated activities either through the Mandated Block Grant (MBG) or through the claim reimbursement process pursuant to Government Code Section 17560. If the district elects to receive the MBG, an application must be submitted to the California Department of Education (CDE), and a school district that receives MBG funding is not eligible to submit claims to the state controller for reimbursement for mandates included in the MBG.

Funds for the 2014-15 MBG are allocated at $28 per ADA for students in kindergarten through grade eight. The district has chosen to utilize the MBG to fund its 2014-15 mandated cost activities and FCMAT estimates $2,911 for this source. Because the district has utilized this funding mechanism for recapturing its mandated costs since the inception of the MBG, it is assumed that it will continue this practice for the 2015-16 and 2016-17 fiscal years.

The state's 2014-15 budget contained $400.5 million in onetime money for payment of prior-year mandate claims. The funds are to be allocated based on 2013-14 P-2 ADA and are estimated to be approximately $66 per ADA with payment to be received by districts during the fall. FCMAT's estimate for this onetime funding source is $6,861. Because it is unknown when the state intends to further reduce its debt to districts for prior-year unfunded mandates, revenue is not included in subsequent fiscal years.

<u>Federal Revenues</u> – Funding from federal grants and entitlements is restricted in accordance with the provisions of the grant and/or entitlement. The district receives funding for Title I, No Child Left Behind (NCLB); NCLB Title II – Teacher Quality; and Special Education Basic Grant.

Based on information provided by the CDE and the special education local plan area (SELPA), the district is projected to receive a total of $225,548 in federal funding for its three federal programs in 2014-15. Increased funding for subsequent fiscal years is not anticipated because each federal program is tied to factors that cannot be predicted, such as the number of low-income students, special education students or those receiving free and reduced-price meals.

<u>AB 602 Special Education</u> – The district is one of 28 participating in the Monterey County Office of Education SELPA, through which it receives an allocation of state funding to offset the cost of special education services and out-of-home care.

The SELPA funding is split between the participating districts in the SELPA. Documents provided by the SELPA show that the district is projected to receive $39,872 for the 2014-15 fiscal year. This amount was based on the district's 2013-14 P-2 ADA. FCMAT's analysis includes the cost-of-living increases (COLAs) as shown in the SSC dartboard and projected changes in ADA for the two subsequent fiscal years.

<u>After School Education and Safety</u> – Funding for this program was generated as a result of the 2002 Proposition 49 and is intended to create a partnership between schools and their local communities to provide literacy, academic enrichment and safe, constructive alternatives to students in kindergarten through ninth grades. Funds are allocated to districts based on the number of students to be served per day. The 2014-15 fiscal year is the third year that the district has participated in the program; however, funding has decreased in each of these years. The district's 2014-15 grant entitlement letter reflects an award of $29,362, a reduction from $101,250 in 2012-13 and $33,619 in 2013-14. FCMAT's analysis includes the COLA for categorical programs as shown in the SSC dartboard and projected changes in ADA for the two subsequent fiscal years.

<u>California Clean Energy Jobs Act</u> – This program was established by Proposition 39, an initiative passed by the state's voters in November 2012. The program provides for annual funding to districts for the 5-year period from 2013-14 through 2017-18. The allocation formula includes an amount based on the districts' prior year ADA with additional funding based on the prior year's number of students eligible for free and reduced-price meals (FRMP). The program establishes four tiers and provides for a minimum funding allocation as reflected in the following CDE table:

Tier Levels	Average Daily Attendance Prior Year	Minimum Funding Awards
Tier 1	100 or fewer	$15,000 plus FRPM
Tier 2	101 to 1,000	Based on prior year ADA or $50,000 (whichever amount is larger) plus FRPM
Tier 3	1,001 to 1,999	Based on prior year ADA or $100,000 (whichever amount is larger) plus FRPM
Tier 4	2,000 or more	Based on prior year ADA plus FRPM

Districts in the Tier 1 or Tier 2 categories may request both the current year and the following year's funding in the current year. However, if the district requests the 2-year combined award option and the district's ADA moves from Tier 1 to Tier 2 in the subsequent year, the district agrees to forfeit the additional $35,000 plus any added FRPM revenue.

San Ardo Union Elementary chose the 2-year combined award option in 2013-14 and its ADA rose from Tier 1 for the first year of the program to Tier 2 in the second year. Consequently, the district has forfeited its right to the additional $35,000 plus FRPM revenue for the 2014-15 fiscal year. Based on FCMAT's enrollment and ADA projections, the district will remain in Tier 2 status for the two subsequent years, and it is anticipated that it will receive the minimum funding award of $50,000 in each year.

Local Revenues – The district collects local revenues for fees charged for the use of its pool during the 40-day summer community pool program, use of facilities fees, restitution payments and various donations during the school year. Additionally, the district has received a donation of $7,500 from Chevron for educational/academic programs for 2014-15. As a result, FCMAT estimates $10,800 in revenues for the 2014-15 fiscal year. Elimination of the onetime Chevron donation reduces local revenues to $3,300 for the 2015-16 and 2016-17 fiscal years.

Expenditures

Certificated Salaries – Staff interviews indicated that the district has reduced certificated employee positions for the 2014-15 fiscal year. The certificated staffing spreadsheet includes 4.5 full-time equivalent (FTE) teaching positions. However, in the prior fiscal year, some teaching positions were partially charged to restricted federal resources. The staffing spreadsheet reflects that these positions will no longer be charged to federal resources, but the changes were not included in the adopted budget. These adjustments and any additional changes made before completion of FCMAT's fieldwork are reflected in the analysis; also included is the onetime cost for the interim superintendent and the salary of the superintendent that was hired in August 2014.

The district's budget assumptions narrative, dated June 25, 2014, shows 1.50% for the annual cost of step-and-column increases for certificated employees. However, FCMAT's review of the current and projected salary schedule placement of teachers yields an annual cost of 2.50%. The budget assumptions narrative also lists a 3% contractual certificated salary increase for 2015-16. However, the district's multiyear financial projections do not include this increased cost.

Classified Salaries – Staff interviews indicated that the district has reduced classified employee positions for the 2014-15 fiscal year. The district's classified staffing spreadsheet includes the following positions:

1.00 FTE Chief business official (CBO)

1.00 FTE School secretary

2.00 FTE Custodian

1.75 FTE Aide

.25 FTE Van driver

1.00 FTE Food service worker

FCMAT's analysis includes adjustments based on the staffing spreadsheet, any additional changes made before completion of FCMAT's fieldwork, and the CBO's revised contract, dated August 25, 2014.

The district's budget assumptions narrative, dated June 25, 2014, shows 1% for the annual cost of step increases for classified employees. However, FCMAT's review of the current and projected salary schedule placement of classified employees yields an annual cost of 2%.

Employee Benefits – FCMAT's analysis includes adjustments based on the certificated and classified staffing spreadsheets, any additional changes made before completion of fieldwork, the new superintendent's contract, and the CBO's revised contract.

The district has negotiated annual health and welfare benefit caps of $11,050 for certificated and $12,223.56 for classified employees, for employee only coverage. However, the current cost of employee only coverage has not yet reached the annual caps. The district's budget assumptions narrative does not include an increased cost for benefits in the projection years; however, historically the average cost of health and welfare benefits has increased approximately 5% each fiscal year. Therefore, FCMAT's analysis includes an increase of 5% in each fiscal year.

On March 10, 2014 the California Public Employees' Retirement System (PERS) issued Circular Letter No. 200-012-14 to school districts statewide that provided the projected future employer contribution rates through 2020-21. The letter indicates that the projected rate is 12.6% for 2015-16 and 15.0% for 2016-17. These increased rates are not included in the district's budget assumptions but are included in FCMAT's analysis.

Assembly Bill 1469 was signed into law on June 24, 2014 and increased employer, employee and state contribution rates to the California State Teachers' Retirement System (STRS) beginning in 2014-15. The rates increase annually until full implementation in 2020-21. The bill indicates an employer contribution rate of 10.73% in 2015-16 and 12.58% in 2016-17. The legislation was signed one day before adoption of the district's budget; therefore, the district's budget assumptions do not show these increases. The increases are included in FCMAT's analysis.

Books/Supplies, Services and Other Operating – Staff interviews and the 2014-15 adopted budget indicate that the district has reduced outside services contracts in several areas including grounds maintenance, speech services, and grant writing. Based on staff interviews and district documents, FCMAT's analysis includes increases for attorney fees, the Monterey County Teacher Induction Program, the annual independent audit, and onetime technology costs.

The district included inflationary increases in its budget assumptions narrative, and FCMAT's analysis includes increases based on the Consumer Price Index (CPI) and projected enrollment, as applicable, in each of the two subsequent fiscal years.

Indirect Costs – FCMAT's analysis adjusted indirect costs based on the district's 2014-15 state-approved indirect cost rate of 13.37%, and the maximum allowable indirect cost rate was applied to restricted programs in the current and projection years.

Other Funds

FCMAT completed a basic review of the district's 2013-14 estimated actuals and its 2014-15 adopted budget for other funds and found that the cafeteria fund is expected to require contributions from the unrestricted general fund in the current and two subsequent fiscal years. This issue will be discussed further in the Fiscal Recovery Plan section of this report.

Multiyear Financial Projection Analysis

FCMAT has analyzed all general fund sources and expenditure categories by resource. The analysis indicates that, without additional expenditure reductions and/or revenue increases, the district *will not* meet the 5% reserve for economic uncertainties in the current and two subsequent fiscal years. After adjusting the 2014-15 unrestricted general fund beginning balance to $154,528, as reflected in the district's 2013-14 unaudited actuals report, the unrestricted general fund is projected to have the following ending balances:

2014-15	2015-16	2016-17
$13,846	-$142,044	-$268,584

To protect its financial solvency, the district will need to make difficult choices about which expenditures and programs will continue to be funded and which will be scaled back, reconfigured or eliminated, unless revenue is significantly increased.

Recommendations

The district should:

1. Adopt a budget and MYFPs that eliminate deficit spending and meet the minimum recommended reserve requirements in the budget and projection years.
2. Maintain a reserve level sufficient to ensure that cash is available to meet payroll and other expenditure obligations and to avoid any adverse effects related to the requirements of AB 1200.
3. Ensure that MYFPs and cash flow projections are kept up to date and that the information they contain is accurate and based on the most current budget assumptions available.
4. Monitor and project student enrollment and ADA at each reporting period to ensure that the most recent data is included in budget assumptions.
5. Work with the county office to verify that one of its students is attending the Monterey County Home Charter School.

6. Review the actual historical costs and current salary schedule placements for certificated and classified employees to determine if the percentages used for step-and-column increases in the multiyear projections need to be changed.

7. Ensure that all employee contractual obligations are included in its budget and multiyear projections.

8. Review the actual and projected costs for employee benefits and revise the budget and multiyear projections as needed.

9. Ensure that the projected employer contribution rate increases for PERS and STRS are included in its budget and multiyear projections.

10. Review contributions to restricted programs and other funds and ensure that they are self-sustaining, except for special education since this program is underfunded.

Financial Recovery Plan

With the assistance of a budget advisory committee, the district identified and implemented several cost-saving measures for 2014-15. These measures include reducing the number of certificated and classified employee positions, reducing the compensation package for the new superintendent and the CBO, decreasing the number of outside services contracts, eliminating the preschool program, and sharing speech and language pathologist services with neighboring school districts.

The county office also appointed a fiscal expert to work with the district because of its negative budget certification status. However, as discussed earlier in this report, the district's 2014-15 adopted budget and MYFPs and FCMAT's analysis indicate that the unrestricted general fund will not meet the 5% reserve for economic uncertainties in the current and two subsequent fiscal years and will have a negative ending balance in 2015-16 and 2016-17. Therefore, unless revenue is significantly increased, the district will need to implement additional expenditure reductions to balance its general fund budget and remain fiscally solvent. The following pages include some options for the district to consider.

Revenue Increases and Expenditure Reductions

Tax Revenue – The district receives most of its funds from local property taxes and is located in an area that includes a large oil field with numerous drilling sites. Staff indicated that in years past, the district received a significant amount of tax revenue based on the area's oil production. The county office is working on the district's behalf with the CDE and the local tax assessor to determine if the district receives all the tax revenues to which it is entitled.

Average Daily Attendance – The district has less incentive to maximize ADA because it is in basic aid funding status; however, it is projected to move to state aid status in 2016-17. Because a significant portion of LCFF revenue is generated based on ADA, the need to maximize ADA and therefore state funding will be significant as this transition occurs. An article published by School Services of California, Inc. on September 19, 2014 states that the 2013-14 statewide average ratio of ADA-to-enrollment for elementary districts was 96.34%. However, the district's 2013-14 P-2 attendance rate was 91.25%, which is significantly less than the statewide average and less than the district's ratio in previous years, which ranged from 92.6% to 98.7%.

The district will need to explore options for increasing ADA such as offering monthly and annual incentives to students for perfect attendance; awarding a class trophy monthly on a rotating basis; reviewing the school calendar structure to determine dates when student attendance is low such as the day before or after holidays, and restructuring the calendar to maximize ADA. The district should also consider implementing Saturday school to recapture ADA for student absences.

Facility Use Fees – Education Code Section 38134 allows a school district to charge fees to individuals and groups that use the district's facilities. This code section also regulates the amount that may be charged for facility use. When implementing a facility use fee schedule or increasing fees for facility use, affected parties may not initially understand that while construction funds, such as general obligation bonds, may have been used to build district facilities, ongoing operational costs, such as utilities and maintenance, are paid by the district's general fund. As a result, fewer funds remain to provide for students' educational needs when outside organizations are not charged for the use of district facilities. When implementing a fee schedule for use of facilities, the district needs to develop policies, procedures and standardized forms to ensure that the fees comply with the Education Code requirements, that there is a system to process requests in a consistent manner, and that the district's insurance carrier approves the language on liability the district assumes when allowing outside organizations to use its facilities.

Swimming Pool – A swimming pool that was donated by a community member several years ago is located on district property. The district maintains and operates the pool for community use during the summer. Staff indicated that the pool is no longer used for educational purposes such as physical education classes, and that the annual cost of operation is approximately $25,000. The district charges a small fee to individuals for daily use, and total annual collections are approximately $800. Most of the remaining costs are paid by a transfer from the enterprise fund to the general fund. Because this reduces the funds available for students' educational needs, outside revenue sources should be explored for funding pool operations.

Indirect Cost – FCMAT's review of district reports indicated that it does not charge the maximum allowable indirect cost rate to all programs, including those that require a contribution from the unrestricted general fund such as special education. For example, the 2013-14 unaudited actuals report shows that Title I was charged 3.57% although the maximum allowed was 15%. The district should calculate and charge the full indirect cost rate to all allowable restricted programs to show the true cost of each program and maximize unrestricted resources.

Surplus Equipment – Best business practices include an ongoing evaluation of surplus equipment to determine if items stored in empty classrooms or a warehouse can be used at another school site or if they should be disposed of. Several private companies provide auction services for the sale of surplus goods, and many districts have found that they can generate revenue by using these services rather than paying to dispose of surplus items. This process may also help minimize storage costs and the potential for theft.

Cafeteria Fund – Education Code Section 49550 requires districts to provide at least one nutritionally adequate meal each school day, free of charge or at a reduced price, for students whose families meet federal eligibility criteria. CALPADS data indicate that 99.12% of the district's students were eligible for free or reduced-price meals in 2013-14. The 2013-14 unaudited actuals report shows that cafeteria fund expenditures exceeded revenues by $28,339. The district also projects that a contribution of approximately $54,400 from the unrestricted general fund will be required in the current and two subsequent fiscal years. In an effort to increase revenues, reduce costs and eliminate the unrestricted general fund contribution, the district should conduct a thorough review and analysis of the food service program.

Education Code Section 38101 allows the district's general fund to charge the cafeteria fund direct costs, including those for items such as telephone charges, water, electricity, gas and waste. The charges must be applied using the procedures defined in the California School Accounting Manual (CSAM), Procedures 905 and 910. Charging direct costs helps a district accurately show the total cafeteria program costs and capture allowable dollars in the unrestricted general fund. A review of the district's 2013-14 unaudited actuals report found that the cafeteria fund may not have been charged its share of all allowable direct costs.

The district CBO's salary and benefits are split funded; 90% is charged to the general fund and 10% to the cafeteria fund. Personnel activity reports (PARs) for this position are completed semiannually. PARs are detailed documents that support the salary and benefit distribution of employees who work on multiple activities or cost objectives by identifying the employee's daily activity by hours or percentage of time spent in each program. The Code of Federal Regulations, Title 2, Part 225, Appendix B state the documentation requirements.

The United States Department of Education has approved two substitute systems for time accounting that may take the place of monthly PARs for eligible employees. These substitute systems are designed to simplify recordkeeping. The Substitute System Based on Sampling Method was approved for California school districts in 1998. This method still requires PARs; however, they are required less frequently. If a district choses to use the sampling method, all multifunded employees who would be required to complete PARs must participate in the system. The newer method, Substitute System Based on Employee's Predetermined Schedule, was approved in September 2012. This method requires approval from the CDE and allows districts to use alternative documentation, such as a course schedule, instead of PARs to document an employee's time if he or she works on a predetermined or fixed schedule. This method permits an employee to complete a semiannual certification. More details about these alternate methods may be found in the CSAM, and in April 2013, the CDE provided a letter describing the predetermined schedule method, which may be found at http://www.cde.ca.gov/fg/ac/co/index.asp.

<u>Parcel Tax</u> - As state resources for school districts decreased and operating costs increased over previous fiscal years, many districts sought approval from local voters for a parcel tax to increase funding. Parcel taxes are normally levied at a flat rate per parcel and must be uniformly applied to all real property owners, with few allowable exceptions, such as exemptions for senior citizens and federal supplemental security income disability benefit recipients. Ballot language prepared by the district's governing board specifies the allowable purposes for the money. Parcel taxes can be difficult to pass because they require a two-thirds vote, and the advice of experienced financial advisors and legal counsel should be obtained before determining whether to place a local parcel tax measure on the ballot.

<u>General Obligation Bonds</u> – Education Code Section 15100 authorizes the governing board to seek approval from local voters for general obligation bonds to raise funds for facility needs, including the construction and modernization of school buildings. Staff indicated that district facilities were in disrepair, and some issues had to be resolved before the 2014-15 school year could commence. As a result, the opening of school was delayed from August to September. Following FCMAT's fieldwork, Chevron pledged a donation of $100,000 to help resolve some of the immediate facility needs. However, staff indicated that additional funds will be required to modernize facilities. The $100,000 donation nor the repairs mentioned here are included in FCMAT's budget and multiyear financial projection analysis because staff indicated the repairs would be paid from the donation and/or the enterprise fund rather than the general fund.

<u>Categorical Funds</u> – FCMAT's analysis of the district's 2014-15 adopted budgeted shows an ending balance in Title I of approximately $126,000. While these federal funds must be used to supplement rather than supplant the district's core instructional programs, the district should work with the county office and the CDE to determine how to maximize its use of these funds.

<u>Staffing and Employee Compensation</u> – As discussed previously, the district has reduced certificated and classified employee positions and is working with neighboring districts to share the services of a speech and language pathologist. However, given the district's current financial situation, additional consideration must be given to further reductions in staff and shared services. For example, the district may be able to share accounting and financial reporting services with neighboring school districts or contract with the county office for some of these services. Negotiations with the certificated and classified employee bargaining units may also need to be initiated to discuss reductions in employee compensation.

Article XI, Class Size, of the agreement, dated 2010-13, between the district and the certificated employee bargaining unit states the following:

> The District shall not exceed a ratio of more than 25 students to one unit member for grades kindergarten through fourth. The District shall not exceed a ratio of more than 28 students to one unit member for grades fifth through eighth. Combination classes shall not exceed two grade levels per unit member.

In addition, to receive the K-3 grade span adjustment included in the LCFF, the district must meet the class size requirements described in the California Code of Regulations Title 5 Sections 15498-15498.3 unless it has a collectively bargained agreement for an alternative class size. These items must be considered before reducing certificated positions.

Recommendations

The district should:

1. Continue to work with the county office, CDE and tax assessor's office to determine if it receives all the tax revenue to which it is entitled.
2. Explore options to increase student attendance.
3. Develop and implement a facility use fee schedule.
4. Explore outside revenue sources to fund the cost of pool operations.
5. Ensure that all programs are charged the maximum allowable indirect cost rate.
6. Evaluate stored surplus equipment to determine whether items can be used or sold in an auction.
7. Conduct a thorough review and analysis of the food service program.
8. Consider charging the cafeteria fund its share of all allowable direct costs.
9. Ensure that multi-funded positions are documented by PARs as required by the CDE and federal regulations.
10. Evaluate the feasibility of putting a parcel tax measure on the ballot.
11. Evaluate the feasibility of putting a general obligation bond measure before the voters.
12. Work with the county office and CDE to determine how to maximize use of its Title I funds.
13. Determine if further reductions in staff positions and/or additional sharing of services are necessary.
14. Determine if it needs to initiate negotiations with its employee bargaining units to reduce total compensation.

Rental Property

Rental Fees or Payments for Fiscal Years 2012-13, 2013-14 and 2014-15

The district owns nine rental properties located at 62440 College Street and 59915 through 59845 Jolon Street, in San Ardo, California. The district has rented some of the properties to its employees in the past, but FCMAT could not find board policies or administrative regulations that specify whether a tenant must be a district employee to rent the properties. Moreover, FCMAT could not locate board policies or administrative regulations that specify the current rental rates.

As of August 1, 2013, the district has used E & E Property Management Group, Inc. located in King City to manage its rental properties. E & E Property Management receives eight percent of the gross revenues collected, including security deposits, as compensation for providing these services. Before using E & E Property Management, the district included the management of the rental properties as part of the superintendent's duties paying that administrator 10 percent of the rental income received. FCMAT's review of the district's check stubs for the 2012 calendar year indicates that the superintendent was paid $6,310 for property management duties related to 2012 rental income and $580 for December 2011 property management duties. FCMAT could not determine the amount paid to the superintendent in the 2013 calendar year because several of the check stubs provided for this time period were blank. Staff indicated that the superintendent was also allowed to occupy one of the units free of charge.

E & E Property Management staff indicated that the current rate for the nine rental units is based on square footage and comparable market value as follows:

- Three units @ $1,000 per month
- Two units @ $700 per month
- One unit @ $550 per month
- One unit @ $750 per month

E & E Property Management staff indicated that two of the units are vacant and that they are actively marketing them to prospective tenants. They also indicated that none of the current tenants owe back rent.

E & E Property Management provides the district with a statement of activities each month. The best practice would be for the district to also receive and review the following information monthly:

1. The tenant receivables report
2. The accounts payable report
3. The monthly bank statement (if the property manager has a checking account for the properties)
4. The bank statement reconciliation

Moreover, when capital improvements are needed, and this work has been authorized by the district, E & E Property Management should provide and the district should review reports including the following:

1. A work-in-progress schedule
2. A monthly bank statement for the capital improvements account
3. A bank statement reconciliation for the capital improvements transactions
4. A cash-flow projection for the remaining improvements

Fee Collection History

Before the 2013-14 fiscal year, the district used a Chase bank account for financial transactions related to its rental properties. Staff indicated that the former superintendent oversaw the account and was the only authorized signatory. At the time of FCMAT's fieldwork, staff indicated that the accounting records for the rental properties were incomplete or missing, and that a request had been submitted to the bank for prior years' monthly bank statements. These statements were obtained and provided to FCMAT following completion of fieldwork.

The Chase bank statement for the district's rental account, dated January 29, 2009, had an ending balance of $81,045.55. In February 2009, $8,090.25 in checks was paid from the account, $15,334.75 was paid in March 2009, $14,275.02 in April 2009, FCMAT did not receive the May 2009 statement, $15,834.98 in June 2009, and $15,066.07 in July 2009. No deposits were made during these months, reducing the balance to $1,169.49. Some staff members indicated that extensive remodeling of the rental units occurred during this time, but others indicated that no improvements had been made in several years. FCMAT did not have access to copies of checks and supporting documents to determine whether funds were expended for this purpose. However, it is clear that the district's sizable fund balance in the account was virtually exhausted in a period of six months.

On July 27 and August 18, 2009 two deposits were made for $8,525.37 and $3,860.00, respectively, and $5,319.29 in checks was paid. In addition, a $10 verification of deposit fee was incurred.

In September 2009, deposits of $2,395 and $900 were made and $4,687.17 in checks was paid. In October 2009, $2,849.53 in checks was paid, but no deposits were made. In November 2009, a deposit of $5,140 was made, and $192 in checks was paid. In December a deposit of $2,550 was made and $2,391.15 in checks was paid, and the December 24, 2009 bank statement shows an ending balance of $9,090.72.

In calendar year 2010 and most of 2011, the balance in the rental account remained relatively static with revenue running slightly ahead of expense. However, no deposits were shown on the bank statements for several months in this time. Because of sizable deposits in the latter part of 2011, the fund balance was increased to $24,060.79 in December 2011.

During 2012, one $14,428, deposit was made to the account in November, and the fund balance was $18,268.95 in December 2012. As discussed previously, check stubs for the Chase bank account indicate that the superintendent was paid $6,310 for property management duties related to 2012 rental income. The amount paid was to be based on 10 percent of the rental income received; therefore, it would be expected that 2012 rental income was $63,100. However, deposits to this account totaled $14,428.

Deposits totaling $27,050 were shown on the July 25, 2013 bank statement, bringing the fund balance to $29,989.77 in December 2013.

The July 2014 Chase bank statement shows an ending balance of $2,846.65. A summary of the monthly bank statement transactions are shown on the following table.

Bank Statement Summary

Year	Month	Deposits	Checks Paid, Fees & Withdrawals	Balance
2009				
	January	$0.00	$0.00	$81,045.55
	February	$0.00	$8,090.25	$72,955.30
	March	$0.00	$15,334.75	$57,620.55
	April	$0.00	$14,275.02	$43,345.53
	May	No statement provided		$32,070.54
	June	$0.00	$15,834.98	$16,235.56
	July	$0.00	$15,066.07	$1,169.49
	August	$12,385.37	$5,329.29	$8,225.57
	September	$3,295.00	$4,687.17	$6,833.40
	October	$0.00	$2,849.53	$3,983.87
	November	$5,140.00	$192.00	$8,931.87
	December	$2,550.00	$2,391.15	$9,090.72
		$23,370.37	$84,050.21	
2010				
	January	$6,700.00	$11,144.54	$4,646.18
	February	$0.00	$1,601.14	$3,045.04
	March	$4,605.00	$130.00	$7,520.04
	April	$0.00	$1,508.91	$6,011.13
	May	$0.00	$2,132.00	$3,879.13
	June	$0.00	$830.00	$3,049.13
	July	$0.00	$1,628.96	$1,420.17
	August	$9,520.00	$834.97	$10,105.20
	September	$0.00	$2,352.75	$7,752.45
	October	$0.00	$6,526.61	$1,225.84
	November	$0.00	$142.50	$1,083.34
	December	$15,100.00	$3,441.23	$12,742.11
		$35,925.00	$32,273.61	
2011				
	January	$0.00	$3,352.74	$9,389.37
	February	$5,700.00	$11,995.07	$3,094.30
	March	$2,350.00	$4,871.24	$573.06
	April	$6,400.00	$4,321.68	$2,651.38
	May	$1,700.00	$2,427.29	$1,924.09
	June	$0.00	$21.00	$1,903.09
	July	$8,000.00	$2,906.00	$6,997.09
	August	$6,880.00	$0.00	$13,877.09
	September	$5,250.00	$756.82	$18,370.27
	October	$0.00	$2,060.00	$16,310.27
	November	$9,510.00	$1,192.00	$24,628.27
	December	$0.00	$567.48	$24,060.79
		$45,790.00	$34,471.32	

2012				
	January	$0.00	$0.00	$24,060.79
	February	$0.00	$1,635.00	$22,425.79
	March	$0.00	$901.47	$21,524.32
	April	$0.00	$0.00	$21,524.32
	May	$0.00	$258.95	$21,265.37
	June	$0.00	$741.94	$20,523.43
	July	$0.00	$0.00	$20,523.43
	August	$0.00	$3,590.00	$16,933.43
	September	$0.00	$1,818.75	$15,114.68
	October	$0.00	$2,974.70	$12,139.98
	November	$14,428.00	$1,506.14	$25,061.84
	December	$0.00	$6,792.89	$18,268.95
		$14,428.00	$20,219.84	
2013				
	January	$0.00	$1,865.65	$16,403.30
	February	$0.00	$1,944.39	$14,458.91
	March	$0.00	$299.27	$14,159.64
	April	$0.00	$0.00	$14,159.64
	May	$0.00	$2,123.53	$12,036.11
	June	$0.00	$0.00	$12,036.11
	July	$27,050.00	$2,814.00	$36,272.11
	August	$0.00	$6,282.34	$29,989.77
	September	$0.00	$0.00	$29,989.77
	October	$0.00	$0.00	$29,989.77
	November	$0.00	$0.00	$29,989.77
	December	$0.00	$0.00	$29,989.77
		$27,050.00	$15,329.18	
2014				
	January	$0.00	$0.00	$29,989.77
	February	$0.00	$27,038.12	$2,951.65
	March	$0.00	$21.00	$2,930.65
	April	$0.00	$21.00	$2,909.65
	May	$0.00	$21.00	$2,888.65
	June	$0.00	$21.00	$2,867.65
	July	$0.00	$21.00	$2,846.65
		$0.00	$27,143.12	

Based on findings included in the annual audit report, as discussed in the following pages, staff indicated that most account funds were transferred from the Chase bank account to the district's enterprise fund in 2014. The 2013-14 account transaction detail report from the district's financial system shows that transactions were reported in the enterprise fund beginning in November 2013.

Because of the lack of records supporting the bank account activity and the inability to interview key personnel with signatory authority on the Chase bank account, FCMAT is unable to provide further details regarding the financial transactions for the rental property. Consideration should be given to referring this matter to the district attorney for further review.

Resolution of Prior Year Audit Findings

The district's June 30, 2011 and June 30, 2012 independent audit reports include finding 2011-1 and 2012-1, respectively, stating that the rental cash account and rental income activity was not recorded in the general ledger.

The June 30, 2013 independent audit noted that the prior year corrective action had not been implemented and included finding 2013-1, which again indicated that the district's rental cash account and rental income activity was not recorded in the general ledger. The independent auditors also noted a lack of segregation of duties and internal controls, incomplete accounting records, and 1099 forms that were not prepared. As a result, rental fund activity, assets, liabilities, and net position were omitted from the general ledger and financial reports during the year, which could lead to a misappropriation of assets. The auditors issued a qualified report, which included the following statement, "We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2013-1 to be a material weakness."

As previously discussed, the district has transferred property management duties to E & E Property Management, who is now responsible for all aspects of managing the district's rental properties, including the collection of rents and property repairs and maintenance. The agreement with E & E Property Management states that a monthly check is to be issued to the district, net of its eight percent commission and any cost related to rental unit maintenance and repairs. The check is sent to the county office and deposited in the enterprise fund the district established in July 2013.

The county office has developed and provided the district with recommended procedures for the deposit of rental income in the district's enterprise fund (fund 63). These procedures include the following:

- E & E Property Management issues the San Ardo Union Elementary School District a check for rents, which does not include deductions for property management fees or reimbursements for contracted maintenance or repairs on the rental properties.
- E & E Property Management is set up as a vendor in the county office's Escape financial system with the 1099 field set to yes and box seven selected.
- Accounts payable checks are issued to E & E Property Management for their property management fee and reimbursement for contracted services, such as building maintenance and repair.
- At the end of the calendar year, a form 1099 is automatically generated and is issued to E & E Property Management.
- No journal entries are required to move expenditures for property management fees and reimbursement of expenses for contracted building repair and maintenance out of income object 8650 and into expenditure objects 5600/5800.

Staff indicated that the district has implemented recommendations from its independent auditor and the county office. However, the management and operating agreement with E & E Property Management indicates that it is "authorized to pay the Management Fees and any reimbursement due and owing Operator from the funds of Owner in the Depository Account…" This provision does not follow the county office's recommended procedures. Implementation and consistent application of these corrective actions and procedures should resolve the 2013-14 audit finding in this area.

Statutory Authority to Lease Property

The statutes governing the sale and lease of surplus school district property are considerable and complex. However, most of the statutes pertain to surplus property that was acquired to be used as a school site. The statutes that deal with other types of surplus are more limited in scope. Education Code Section 17481 is most closely aligned with the district's circumstance and states the following:

> In addition to any other authority to lease real property, the governing board of a school district, by a two-thirds vote of its members, may lease, for a term not exceeding three months, school district property having a residence thereon, which cannot be developed for district purposes because of the unavailability of funds. The lease shall be upon any terms and conditions that the parties thereto may agree and may be entered into without complying with any provisions in this code except as provided in this section. (Added by Stats. 1996, Ch. 277, Sec. 3. Effective January 1, 1997. Operative January 1, 1998.)

FCMAT could not identify the authority the district exercises to lease the rental properties at the locations previously mentioned. The district's governing board should place a consent item on the board meeting agenda every three months that expressly authorizes the district to lease the rental properties under Education Code Section 17481. The board should also cite Education Section 17481 when board policies and administrative regulations are developed regarding the lease of the district's rental properties.

Recommendations

The district should:

1. Establish board policies and administrative regulations memorializing the board's authority to lease the rental properties, the board's authority to contract with an external agency to manage the properties, the basis for the rental rates (e.g. fair market value), and any other information the board and district legal counsel deems necessary.

2. Work with the county office to determine if the amount paid to the former superintendent for property management duties and the value of the rental unit provided free of charge were included on his Form W-2 for each applicable year, and issue corrected W-2 forms if necessary.

3. Amend the management and operating agreement with E & E Property Management Group, Inc. to include expanded financial reporting requirements, as described above.

4. Sustain the corrective action recommended by the district's external auditors relating to rental account activities and internal controls.

5. Fully implement the procedures established by the county office relating to fund 63 and the issuance of 1099s for external property management services.

6. Work with E & E Property Management to amend the management and operating agreement as needed to coincide with the county office's recommended procedures.
7. Place a consent item on the board meeting agenda every three months that expressly authorizes the district to lease its rental properties under Education Code Section 17481.
8. Cite Education Code Section 17481 in board policies and administrative regulations regarding the lease of its rental properties.
9. Determine if the rental property matter should be referred to the district attorney for further review.

Appendix

A: Study Agreement

Appendix A – Study Agreement

FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
CSIS California School Information Services

FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
STUDY AGREEMENT
July 18, 2014

The Fiscal Crisis and Management Assistance Team (FCMAT), hereinafter referred to as the team, and the Monterey County Office of Education, hereinafter referred to as the COE, mutually agree as follows:

1. **BASIS OF AGREEMENT**

The team provides a variety of services to school districts and county offices of education upon request. The COE has requested that the team assign professionals to study specific aspects of the COE's operations. These professionals may include staff of the team, county offices of education, the California State Department of Education, school districts, or private contractors. All work shall be performed in accordance with the terms and conditions of this agreement.

Background
In accordance with Education Code section 42131, the COE reviewed the San Ardo Union Elementary School District's 2013-14 financial statements and cash flow projections (Third Interim) for the period of April 1 through June 30, 2014 and subsequently issued a negative budget certification.

The district's 2014-15 adoption budget contained budget reductions recommended by the budget advisory committee but were not sufficient to meet the recommended 5% reserve level for the current and two subsequent fiscal years. The district's negative budget certification remains unchanged.

2. **SCOPE OF THE WORK**

A. Scope and Objectives of the Study

1. At the request of the COE, review and validate the San Ardo Union Elementary School District's 2014-15 adoption budget for the current and two subsequent fiscal years, and develop a financial recovery plan for the district.

2. The team will provide an overview of procedures performed during the collection of rents or payments for real property owned by the district. This will include interviews of department management and key personnel; a review of available financial reports; evaluation of policies and procedures associated with business processes; federal, state or local compliance requirements. The overview will seek to obtain a detailed understanding of the following:

   - Rental fees or payments for the current and two prior fiscal years
   - Receivable balances
   - Fee collection history
   - Write-offs
   - Resolution of prior audit observations
   - Results of recent internal or external reviews

B. Services and Products to be Provided

1. Orientation Meeting - The team will conduct an orientation session at the COE to brief COE management and supervisory personnel on the team's procedures and the purpose and schedule of the study.

2. On-site Review - The team will conduct an on-site review at the COE office and at school sites if necessary.

3. Progress Reports - The team will hold an exit meeting at the conclusion of the on-site review to inform the COE of significant findings and recommendations to that point.

4. Exit Letter – Approximately 10 days after the exit meeting, the team will issue an exit letter briefly summarizing 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 COE's administration for review and comment.

6. Final Report - Electronic copies of the final report will be delivered to the COE's administration following completion of the review. The final report will be published on the FCMAT website. Printed copies are available from FCMAT upon request.

7. Follow-Up Support – If requested, FCMAT will return to the COE at no cost six months after completion of the study to assess the progress in implementing the recommendations included in the report. Progress in implementing the recommendations will be documented to the COE in a FCMAT management letter.

3. **PROJECT PERSONNEL**

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

A.	Diane Branham	Chief Management Analyst, Project Lead
B.	Eric D. Smith	FCMAT Fiscal Intervention Specialist
C.	To be determined	FCMAT Consultant

Other equally qualified staff or consultants will be substituted in the event one of the above 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 as follows:

A. $500.00 per day for each staff team member while on site, conducting fieldwork at other locations, preparing and presenting reports, or participating in meetings. The cost of independent FCMAT consultants will be billed at their actual daily rate.

B. All out-of-pocket expenses, including travel, meals, and lodging.

C. The COE 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 COE's acceptance of the final report.

Based on the elements identified in section 2 A, the total estimated cost of the study will be $10,000.

D. 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 COE**

A. The COE will provide office and conference room space during on-site reviews.

B. The COE will provide the following if requested:

1. Policies, regulations and prior reports that address the study scope.
2. Current or proposed organizational charts.
3. Current and two prior years' audit reports.

4. Any documents requested on a supplemental list. Documents requested on the supplemental list should be provided to FCMAT only in electronic format; if only hard copies are available, they should be scanned by the COE and sent to FCMAT in electronic format.
5. Documents should be provided in advance of field work; any delay in the receipt of the requested documents may affect the start date of the project. Upon approval of the signed study agreement, access will be provided to FCMAT's online SharePoint document repository, where the COE shall upload all requested documents.

C. The COE's administration will review a preliminary draft copy of the report resulting from 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 COE shall take appropriate steps to comply with EC 45125.1(c).

6. **PROJECT SCHEDULE**

The following tentative schedule outlines the planned completion dates for different phases of the study:

Orientation:	*July, 2014*
Staff Interviews:	*to be determined*
Exit Interviews:	*to be determined*
Preliminary Report Submitted:	*to be determined*
Final Report Submitted:	*to be determined*
Board Presentation:	*to be determined, if requested*
Follow-Up Support:	*if requested*

7. **CONTACT PERSON**

Contact person: Gary Bousum Associate Superintendent
Telephone: (831) 755-0312
E-mail: gbousum@monterey.k12.ca.us

7/22/14

Dr. Nancy Kotowski, Superintendent Date
Monterey County Office of Education

July 18, 2014

Anthony Bridges, CICA, CFE Date
Deputy Executive Officer
Fiscal Crisis and Management Assistance Team

REVIEWED FOR FISCAL IMPACT AND ADHERANCE TO MCOE REGULATIONS, POLICIES AND PROCEDURES.

7-22-14

AUTHORIZED SIGNATURE