



C SIS California School Information Services

Lake County Office of Education regarding the **Middletown Unified School District**

**AB 139 Extraordinary Audit
Food Services**

REVISED FINAL REPORT

April 1, 2019

Michael H. Fine
Chief Executive Officer





April 1, 2019

Brock Falkenberg, Superintendent
Lake County Office of Education
1152 S. Main Street
Lakeport, CA 95453

Dear Superintendent Falkenberg:

On June 5, 2018, the Lake County Office of Education and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement to conduct an AB 139 Extraordinary Audit to determine if fraud, misappropriation of funds or other illegal activities may have occurred at the Middletown Unified School District. Specifically, the agreement stated that FCMAT would perform the following:

1. Review the cash collections for child nutrition sales.
2. Determine, based on the sample testing performed and the auditor's judgment, whether adequate management and internal controls are in place regarding the district's reporting and monitoring of child nutrition sales financial transactions; and, based on that assessment, whether fraud, misappropriation of funds or other illegal fiscal practices may have occurred.
3. Review and test recorded transactions for fiscal years 2015-16 through 2017-18 to determine if fraud, misappropriation of funds or other illegal activities have occurred.

This revised final report contains the study team's findings and recommendations in the above areas of review. FCMAT appreciates the opportunity to serve the Lake County Office of Education and Middletown Unified School District, and extends thanks to all the staff for their assistance during fieldwork.

Sincerely,

Michael H. Fine
Chief Executive Officer

FCMAT

Michael H. Fine, Chief Executive Officer

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About FCMAT

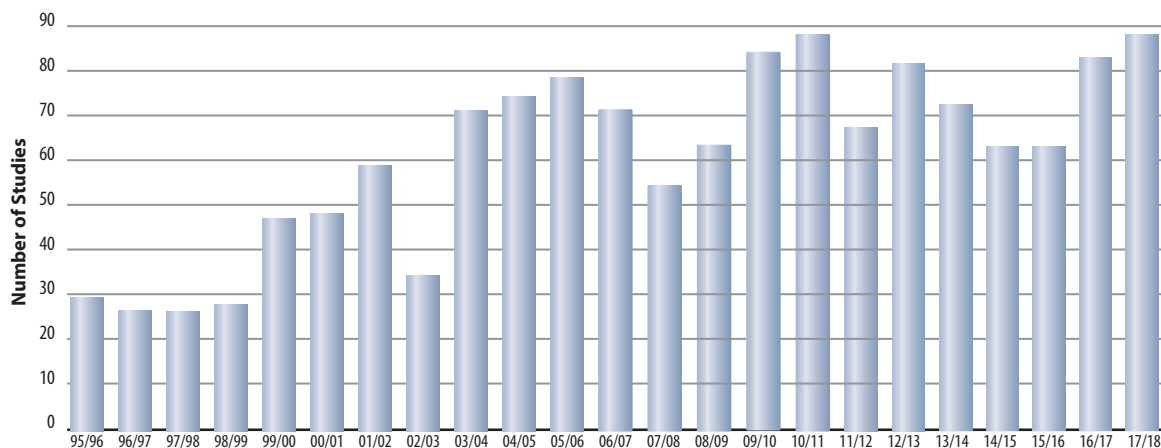
FCMAT's primary mission is to assist California's local K-14 educational agencies to identify, prevent, and resolve financial, human resources and data management challenges. FCMAT provides fiscal and data management assistance, professional development training, product development and other related 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, support the training and development of chief business officials and help to create efficient organizational operations. FCMAT's data management services are used to help local educational agencies (LEAs) meet state reporting responsibilities, improve data quality, and inform instructional program decisions.

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 LEA 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.

FCMAT has continued to make adjustments in the types of support provided based on the changing dynamics of K-14 LEAs and the implementation of major educational reforms.

Studies by Fiscal Year



FCMAT also develops and provides numerous publications, software tools, workshops and professional development opportunities to help LEAs operate more effectively and fulfill their fiscal oversight and data management responsibilities. The California School Information Services (CSIS) division of FCMAT assists the California Department of Education with the implementation of the California Longitudinal Pupil Achievement Data System (CALPADS). CSIS also hosts and maintains the Ed-Data website (www.ed-data.org) and provides technical expertise to the Ed-Data partnership: the California Department of Education, EdSource and FCMAT.

FCMAT was created by Assembly Bill (AB) 1200 in 1992 to assist LEAs to meet and sustain their financial obligations. AB 107 in 1997 charged FCMAT with responsibility for CSIS and its state-wide data management work. AB 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. AB 2756 (2004) provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans.

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

On September 17, 2018 AB 1840 was signed into law. This legislation changed the how fiscally insolvent districts are administered once an emergency appropriation has been made, shifting the former state-centric system to be more consistent with the principles of local control, and providing new responsibilities to FCMAT associated with the process.

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 Michael H. Fine, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

Introduction

Background

The Middletown Unified School District is located in rural southern Lake County and serves the communities of Middletown, Hidden Valley Lake, and Cobb Mountain. The district serves approximately 1,455 students in grades K-12 in three elementary schools, one middle school, one high school, and one continuation high school. The district is also the authorizer of two charter schools, the California Connections Academy and Lake County International, with a combined enrollment of 257.

The former director of food services had been employed by the district for nearly five years prior to separating from her position in May 2018. The former director performed her assigned duties in an office located on the high school campus. During her employment, three different employees served as chief business official (CBO). The first former long-standing CBO left the district in July 2015. The CBO that followed served approximately 18 months, from July 2015 through December 2016. The most recent former CBO started with the district in December 2016 and vacated the position in June 2018. As of FCMAT's fieldwork, the district was actively seeking a replacement candidate for the CBO position and had engaged with an interim CBO while candidates were being considered.

Shortly after the most recent former CBO assumed her position, she noticed that recorded revenues from food service sales had been declining and that the contribution from the general fund to the cafeteria fund had increased substantially over the last couple of years. The CBO reported that she met with the director to discuss the decline in the program and that the director was unable to provide an explanation.

In May 2017, the district migrated to a new food service point of sale (POS) system, Meals Plus. Significant issues occurred in the fiscal year subsequent to the initial implementation that resulted in questionable student eligibility data for free and reduced priced meals, inaccurate student account balances, questionable recognition of food service sales and potentially erroneous meal reimbursement claim submissions.

The culmination of challenges with the nutrition system migration and a noticeable decline in the job performance of the former director over the last couple of years, including excessive absences, improper management over food inventories, operating a summer meal program at a site that was not state approved, not fully utilizing the county cooperative food commodity program, and not reviewing and updating the school wellness policy as required all elevated the administration's concern relative to the former director's performance.

In May 2018, the former director was asked for a copy of her current food safety training certificate. The certificate produced by the former director showed an expiration date of 07/31/18. The superintendent suspected that the expiration date had been altered and compared it to a copy of the certificate that was on file and received from the former director when she was originally hired. The expiration date on the certificate from her personnel file was 01/31/18. The former director was placed on paid administrative leave on May 16, 2018, and submitted her letter of resignation later that same day.

After her resignation, the district became aware that certain food service program cash receipts may not have been properly accounted for and deposited into the district's bank accounts. This

led the former CBO and the superintendent to believe that the cash collected from the a la carte sales at the snack window had not been deposited into the district's bank account and had likely been misappropriated. The district superintendent contacted the Lake County Office of Education with this information.

In June 2018, the Fiscal Crisis and Management Assistance Team (FCMAT) received a request from the county office for an Assembly Bill (AB) 139 extraordinary audit of the Middletown Unified School District. Under the provisions of Education Code Section 1241.5, on June 5, 2018, FCMAT entered into an agreement with the county office to conduct an AB 139 extraordinary audit to determine if fraud, misappropriation of funds or other illegal activities may have occurred at the district.

Study and Report Guidelines (AB 139 Audit Authority)

Education Code Section 1241.5(b) permits a county superintendent of schools to review or audit the expenditures and internal controls of any school district in that county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. This review is known as an AB 139 extraordinary audit. Because the purpose of an AB 139 extraordinary audit is to determine if fraud, misappropriation of funds or other illegal fiscal practices may have occurred, it is considered a fraud audit. On completion of a fraud audit, if evidence exists that fraud or misappropriation of funds may have occurred, Education Code Section 42638(b) states “... the county superintendent shall notify the governing board of the school district, the State Controller, the Superintendent of Public Instruction, and the local district attorney.”

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.

Fraud Audit Fieldwork

Fraud investigations fieldwork consists of gathering information and documentation pertaining to specific allegations; establishing an audit plan; interviewing potential witnesses and assembling evidence from internal and external sources; gaining an understanding of internal controls applicable to the scope of the fieldwork; performing various audit test procedures; evaluating the loss associated with the alleged fraud; and, if possible, determining who was involved and how it may have occurred. The team's fieldwork occurred from August 28 through November 5, 2018.

The fieldwork focused on determining whether there is sufficient evidence to indicate that fraud, misappropriation of district funds or other illegal fiscal practices may have transpired relative to the district's nutrition services snack sales (a la carte) program.

Scope and Procedures

Allegations of asset misappropriation have been asserted by the Middletown USD and are directed toward the former food services director. The specific assertions made are that the former director may have skimmed cash from snack sales collected at the middle school/high school site. FCMAT concentrated on the allegations that cash sales of snack window (a la carte) sales at the Middletown High School campus were collected at the point of sale but not recorded in

the district's POS system and were not deposited into the district's accounts during the 2015-16, 2016-17 and 2017-18 fiscal years. Therefore, FCMAT focused on the allegations of misappropriation of assets, cash handling practices, food sales records, deposits to the district's bank account and transfer of those funds to the Lake County Treasurer's Office, and recorded transactions in the district's general ledger during the same time frame.

FCMAT visited the Lake County Office of Education and Middletown Unified School District on August 28-30, 2018 to conduct interviews, collect data and review documents. FCMAT interviewed county office staff, current and former district administrative personnel, district office staff, and food services department staff to obtain an understanding of the district's general business practices and events that transpired during the period under review, including any alleged financial mismanagement, fraud or abuse.

During interviews, FCMAT team members asked questions pertaining to policies and procedures; job responsibilities; cash handling practices; cash deposit practices; purchasing practices; free and reduced-price meal (FRPM) eligibility determination; and the internal control structure, including control activities, lines of authority and oversight of food services financial activities. Open-ended questions were designed to elicit information about other possible irregularities related to the scope of work. FCMAT also communicated with the Meals Plus software vendor to gain an understanding of their experience in the system setup and employee training and to gain a general understanding of the system's functionality.

To investigate the allegations, several testing and analytical procedures were developed to provide an analysis and understanding of the allegations and potential outcomes. FCMAT reviewed, analyzed and tested business records including cash receipts, deposits, cash disbursements, bank statements and reconciliations, check registers, food service POS system reports, snack bar menu price lists, inventory lists, general ledger activity, vendor payment history, financial reports, board policy and administrative regulations, board meeting minutes, and other relevant internal documents secured from various departments and from independent sources.

Transaction Sampling

The district's detailed general ledger, warrant register, check register, and other reports containing detailed transaction data for the 2015-16, 2016-17, and 2017-18 fiscal years were exported from the district's financial system and obtained from the county office. The district was only able to provide copies of bank deposit slips for August 2015, February 2016, and March 2016 and 2017; no deposit slips could be provided for 2017-18. FCMAT also obtained detailed student activity and balance reports from the Meals Plus POS system for 2017-18; point of sale records for prior periods were not available. Bank statements for all three years were provided and analyzed by the team.

The team evaluated policies, procedures and other internal control activities and tested transactions recorded by the district to verify the compliance and effectiveness of those controls.

To accomplish the objectives, FCMAT developed and conducted a number of audit test procedures to analyze and evaluate the allegations and potential outcomes. Fraud audit scope, objectives, and substantive transaction testing was based on the audit team's experience and professional judgment and did not include the testing of all available transactions and records. Transactions were analyzed to determine compliance with board policy, operational procedures and industry standard or best practice procedures.

Testing procedures and noted exceptions are detailed in the substantive testing section of this report. Sample testing and examination results are intended to provide reasonable but not absolute assurance of the accuracy of the transactions and financial activity and/or to identify if fraud, misappropriation of funds or other illegal fiscal practices may have taken place during the period under review. FCMAT's findings were developed from the above audit procedures and from interviews with former and current district administration, district office and food services staff, and county office staff.

FCMAT examined cash receipt and deposit transactions of the food services department for fiscal years 2015-16, 2016-17, and 2017-18. Selected deposit transactions were compared to available reports from the POS system, bank statements, and food service revenues recorded in the district's general ledger to ascertain whether revenue received for food services sales transactions was recorded in the POS system, that revenue was deposited in the district's bank account and properly recorded in the district's financial system, and that appropriate cash handling procedures were followed.

FCMAT reviewed, analyzed and tested numerous reports from the POS system, including the monthly receipts and collections report, charges and prepayment report, transaction history reports, account balance report, and detailed daily transaction registers. Additionally, the team reviewed bank statements, cash receipts, and deposit receipts. FCMAT reviewed food service receipt transactions, comparing bank deposits with reports from the food service POS system.

Several weaknesses related to cash-handling procedures were identified during FCMAT's review and are described in greater detail in the following pages.

Study Team

The study team was composed of the following members:

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Overview of Fraud

Fraud can include an array of irregularities and illegal acts characterized by intentional deception and misrepresentations of material facts. A material weakness is a deficiency in the internal control process whereby errors or fraud may occur or can be a violation of specific law or regulation. Because of the weakness, employees in the normal course of business may not detect errors in time to correct them. Although all employees have some degree of responsibility for internal controls, the governing board, district superintendent and senior management ultimately are responsible for the controls that employees under their supervision are expected to follow.

Occupational Fraud

Occupational fraud occurs when an organization's owners, executives, managers or employees use their occupation to deliberately misuse or misapply the employer's resources or assets for personal benefit. Occupational fraud includes asset misappropriation, corruption, and fraudulent financial statements. Asset misappropriation is the largest group of occupational schemes that include 21 separate fraudulent disbursement schemes.

Asset misappropriation includes the theft or misuse of district assets and may take place in the form of taking of cash, inventory or other assets, and/or fraudulent disbursements. Skimming and cash larceny are the two primary methods of stealing cash that comes into the district; the difference between the two is *when* the money is stolen. Cash skimming, also referred to as "off-book fraud," includes the taking of money *before* it is recorded in financial records of the LEA. Cash larceny occurs after the money has already been recorded in the LEA's financial records. For example, cash larceny occurs where sales are recorded in the LEA's POS system and then cash is taken from the register before the deposit is completed.

Corruption schemes involve an employee using his or her influence in business transactions to obtain a personal benefit that violates that employee's duty to the employer or the organization. Financial statement fraud includes the intentional misstatement or omission of material information in financial reports.

Occupational fraud is one of the most difficult types of fraud and abuse to detect; the most common method of detection comes from tips, which help prevent occupational fraud three times as often as any other detection method. According to the 2018 Report to the Nations conducted and published by the Association of Certified Fraud Examiners, asset misappropriation causes the smallest median loss of \$114,000 but is the most common form of occupational fraud, occurring in 89% of 2,690 reported cases. Corruption schemes accounted for 38% of the cases reported, with a median loss of \$250,000.

Based on responses to a survey included in the ACFE 2018 report, 30% of all cases cite that "a simple lack of controls was the main factor that enabled the fraud to occur, while another 19% of cases occurred because the perpetrator was able to override the controls that had been put in place."

Based on this study, there is a direct correlation between the perpetrator's position and authority in an organization and the losses incurred. The report notes that losses from fraud by owners and executives are six times higher than those from fraud by managers and 17 times higher than losses incurred as a result of fraud by employees. Proper monitoring and effective oversight are also

highly effective at preventing fraud. To commit fraud, the perpetrator usually has the following characteristics:

- Incentive/Pressure/Motivation: Needs to get something accomplished, self-promoting, has financial pressures or personal reputation to protect.
- Opportunity: In a position of authority or provides an essential function in the organization.
- Rationalization/Attitude: Confident that fraudulent behavior will go undetected.
- Capability: Able to understand the systems (financial/accounting) and can override internal controls.

This report focuses on whether the former director of food services and/or others misappropriated funds by skimming cash received for food service a la carte sales..

Internal Control

The accounting industry defines the term “internal control” as it applies to organizations, including school agencies. Internal control is “a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance.” [The Committee of Sponsoring Organizations of the Treadway Commission – May 2013] The reference to achievement of objectives fundamentally refers to an organization’s work of planning, organizing, directing, and performing routine tasks relative to operations, and monitoring performance.

An organization establishes control over its operations by setting goals, objectives, budgets and performance expectations. Several factors influence the effectiveness of internal control, including the social environment and how it affects employees’ behavior, the availability and quality of information used to monitor the organization’s operations, and the policies and procedures that guide the organization. Internal control helps an organization obtain timely feedback on its progress in meeting operational goals and guiding principles, producing reliable financial reports, and ensuring compliance with applicable laws and regulations.

Internal control is the principal mechanism for preventing and/or deterring fraud or illegal acts. Illegal acts, misappropriation of assets or other fraudulent activities can include an assortment of irregularities characterized by intentional deception and misrepresentation of material facts. Effective internal control provides reasonable assurance that operations are effective and efficient, that the financial information produced is reliable, and that the organization complies with all applicable laws and regulations.

Internal control provides the framework for an effective fraud prevention program. An effective internal control structure includes the board policy and administrative regulations established by the board and operational procedures used by staff, adequate accounting and information systems, the work environment, and the professionalism of employees. The five integrated components of internal control and their summarized characteristics are included in the table on the next page.

Internal Control Component	Characteristics
Control Environment	The set of standards, processes and structures providing the basis for carrying out internal control across an organization. Comprises the integrity and ethical values of the organization. Commonly referred to as the moral tone of the organization, the control environment includes a code of ethical conduct; policies for ethics, hiring and promotion guidelines; proper assignment of authority and responsibility; oversight by management, the board or an audit committee; investigation of reported concerns; and effective disciplinary action for violations.
Risk Assessment	Identification and assessment of potential events that adversely affect the achievement of the organization's objectives and the development of strategies to react in a timely manner.
Control Activities	Actions established by policies and procedures to enforce the governing board's directives. These include actions by management to prevent and identify misuse of the district's assets, including preventing employees from overriding controls in the system.
Information and Communication	Ensures that employees receive information regarding policies and procedures and understand their responsibility for internal control. Provides opportunity to discuss ethical dilemmas. Establishes clear means of communication within an organization to report suspected violations.
Monitoring Activities	Ongoing monitoring to ascertain that all components of internal control are present and functioning; ensures deficiencies are evaluated and corrective actions are implemented.

The five components of internal control are supported by 17 underlying principles that help ensure an entity achieves effective internal control. Each of the five components listed above and their relative principles must be present and functioning in an integrated manner to be effective. An effective system of internal control can provide reasonable but not absolute assurance that the organization will achieve its objectives.

While the board and all employees in the district have some responsibility for internal control, the superintendent, board and other key management personnel have a higher ethical standard, fiduciary duty and responsibility to safeguard the assets of the district.

Control Environment

The internal control environment establishes the moral tone of the organization. Though intangible, it begins with the leadership and consists of employees' perception of the ethical conduct displayed by the governing board and executive management.

The control environment is a prerequisite that enables other components of internal control to be effective in achieving the goals and objectives to prevent and/or deter fraud or illegal acts. It sets the tone for the organization, provides discipline and control, and includes factors such as integrity, ethical values and competence of employees.

The control environment can be weakened significantly by a lack of experience in financial management and internal control.

Control Activities

Control activities are a fundamental component of internal control and are a direct result of policies and procedures designed to prevent and detect misuse of a district's assets, including preventing any employee from overriding system controls. Examples of control and transaction activities include the following:

1. Performance reviews, which compare actual data with expectations. In accounting and business offices, this most often occurs when budgeted amounts are compared with actual expenditures to identify variances, and followed up with budget transfers to prevent overspending.

2. Information processing, which includes the approvals, authorizations, verifications and reconciliations necessary to ensure that transactions are valid, complete and accurate.
3. Physical controls, which are the processes and procedures designed to safeguard and secure assets and records.
4. Supervisory controls, which assess whether the transaction control activities performed are accurate and in accordance with established policies and procedures.
5. Segregation of duties, which consists of processes and procedures that ensure that no employee or group is placed in a position to be able to commit and conceal errors or fraud in the normal course of duties. In general, segregation of duties includes separating the custody of assets, the authorization or approval of transactions affecting those assets, the recording or reporting of related transactions, and the execution of the transactions. Adequate segregation of duties reduces the likelihood that errors will remain undetected by providing for separate processing by different individuals at various stages of a transaction, and for independent review of the work.

Employees should be regularly trained in what constitutes fraud and how it damages the organization. Employees should have several avenues for reporting improprieties and should be encouraged not to ignore warning signs. Risk awareness training about suspicious situations that merit reporting will help create a districtwide culture that supports appropriate reporting.

The district should also implement common fraud detection methods such as a third-party anonymous tip hotline, surprise audits or fraud risk assessments. Knowing that someone is checking or could anonymously report suspicious behavior can deter fraudulent activity.

Fiduciary Responsibilities

A fiduciary duty is the highest standard of care. The person who has a fiduciary duty is called the fiduciary, and the person to whom he owes the duty is typically referred to as the principal or the beneficiary. (Source: https://www.law.cornell.edu/wex/fiduciary_duty)

A fiduciary also may be a person who holds a legal or ethical relationship of trust with one or more other parties (person or group of persons). In other words, a fiduciary takes care of money or other assets for another. District board members, administrators and management are examples of those who have fiduciary responsibilities or a fiduciary duty. The Cornell law source further describes several components of fiduciary duties, which FCMAT summarizes and applies to districts as follows:

Duty of Care: Before making a decision, collect all evidence and information available. Do your due diligence and review all the information and evidence available – don't just accept the information as it is presented. Assess information with a critical eye and ask the questions: who, what, when and where. A fiduciary's responsibility is to protect the assets of the district.

Duty of Loyalty: You cannot use your position in the organization to further your private interests. Avoid anything that might injure the district.

Duty of Good Faith: Advance the interests of the district. Do not violate the law. Fulfill your duties and responsibilities.

Duty of Confidentiality: Keep confidential matters confidential and never disclose confidential information to avoid personal liability.

Duty of Prudence: Be trustworthy to a degree of care and skill that a prudent board member, member of management, or fiduciary would exercise. Prudent means acting with wisdom and care, including exercising good judgment.

Duty of Disclosure: Act with complete candor. Be open, sincere, honest and transparent. Disclose all financial interests on Form 700, Statement of Economic Interests.

Findings

Point of Sale System

Administrative Regulation 3551, Food Service Operations/Cafeteria Fund states that the district shall maintain an accounting indicating payments received from each student for the purchase of school meals. In addition, the regulation states that the superintendent or designee shall maintain records of the number of meals served each day by school site and by category of free, reduced-price, and full-price meals.

The district implemented the Meals Plus POS system in May 2017, one month prior to the close of the 2016-17 fiscal year. Prior to migrating to Meals Plus, the district used a module within its Infinite Campus student information system for managing student nutrition and sales data. The Meals Plus system is designed to verify student eligibility for free or reduced-price meals and account for payments on student accounts and meals charged against those student accounts. The POS tracks the number of and type of meals served each day, aggregates those numbers and generates a variety of reports.

The cashier's computers are networked so that the head cook, the director of food services, and the CBO can run reports for each POS terminal from their own computers. Student identification is made with unique identification numbers given to each individual student. The Meals Plus system can generate letters to notify parents when their student's account balance is past due. Parents also have online access to view their student's account balance(s) or to add money to their student's account using the K-12 Payment Center. Payments made using this online option post directly to the student's account in the Meals Plus system.

Interviews with district staff and Meals Plus representatives indicate that the former director of food services and the technology supervisor were both involved with the system migration efforts with the software vendor: the technology supervisor for hardware and software installation and the former food services director for system setup and data transition. Interviews and system migration notes provided by Meals Plus representatives identified that they were notified that all student status information was correct as of November 15, 2017.

Interviews and review of system records indicate that the district experienced several complications managing student data in the POS system after the initial migration that are described in the sections that follow.

Eligibility for Free and Reduced-Price Meals

The district participates in the National School Lunch and School Breakfast programs, which are regulated by USDA and the CDE. Breakfast and lunch are offered at all district schools, after-school snacks are offered at one elementary school, and the Seamless Summer Option was offered at one school site.

The free and reduced application process is a critical component of the USDA Food and Nutrition Services program. The provision of nutrition to students fall into three very narrowly defined categories: paid, reduced and free. Students who are not in paid status must be approved through a process mandated by the USDA for reimbursement of meals.

Individual school districts are responsible for conducting verification activities and making eligibility determinations. This is a “same as cash” transaction, due to the monetary value of the status. Eligibility status for free or reduced-price meals is determined annually on the basis of an income application, categorical eligibility, or direct certification. Students may be classified as eligible for free or reduced-price meals based on household income reported on the Free and Reduced Price Meal (FRPM) application. A student may be determined to be categorically eligible for free or reduced-price meals if the student is classified as foster, migrant, or homeless. A student may be determined to be eligible for free meals based on information obtained directly from a state or local agency certifying that the child’s household receives assistance under the Supplemental Nutrition Assistance Program, Temporary Assistance for Needy Families program or Food Distribution Program on Indian Reservations; this is referred to as “direct certification” and is not determined by the district.

Notices of changes in status must be mailed to the child’s parent or guardian. The USDA mandates that a physical form, or listing on a direct certification database, be available for review to support each child who is in a free or reduced status, and these documents must be maintained by the district for a three-year period.

Board Policy 3551, Food Service Operations/Cafeteria Fund, states that “students who are enrolled in the free or reduced-price meal programs shall receive meals free of charge or at a reduced price in accordance with law, Board policy, and administrative regulation.” According to 7 CFR 245.6(c)(2), a student’s eligibility status determined in the prior school year carries over to the subsequent school year for up to 30 operating days or until a new eligibility determination has been made. Additionally, 7 CFR 245.6(c)(6)(i) requires districts to review applications, make eligibility determination and notify the household of its eligibility status within 10 days of receiving the application.

During the 2016-17 school year, the district’s data manager processed FRPM applications and input the information from the applications into the Infinite Campus student information system (SIS) for eligibility determination. The data manager accepted another position in the district, and in 2017-18 the responsibility for processing the applications was assigned to the director of food services.

As part of the transition process from Infinite Campus to Meals Plus, beginning student account balances and FRPM eligibility status for each student were provided to the software vendor for import into the Meals Plus system. While student data including eligibility status may have initially been successfully uploaded into the new system, district staff reported to FCMAT that on November 30, 2017, after the initial setup and transition, the FRPM eligibility status for all students reverted to full pay. Students whose eligibility status had previously been free or reduced-price started accruing charges on their accounts for their meals. Interviews with staff indicate that parents were calling the district to complain about amounts owed on their students’ meal accounts.

The district should have reviewed FRPM applications, made eligibility determination, and input FRPM status into the Meals Plus POS system within the first 30 days of school, or by approximately September 25, 2017. Because the meal benefit expiration date in the Meals Plus system was set to November 30, 2017, approximately 71 school days into the 2017-18 school year, student eligibility that was not entered or verified reverted to “paid” status.

Both the technology supervisor and former food services director reportedly worked together to attempt to resolve the matter. Attempts were made to import FRPM status from the Infinite Campus student information system back into the Meals Plus POS system; however, the POS system would not allow the change of eligibility without the data from student meal applications. Subsequently, the former director reportedly instructed the technology supervisor to import the meal benefit status as directly certified; this forces student eligibility into free meal status. It was

unclear as to whether all students with paid eligibility had their status modified to direct certification or if specific students were modified. Interviews indicate this caused all of the student status markers for free and reduced status to be manually re-input into the new Meals Plus system. The head cook for the high school was then reportedly assigned to re-enter student FRPM application data into the system to correct all student eligibility status.

There is no indication that the district implemented proper or adequate controls over the migration to the new food services system. Interviews indicate that while each party may have played some role in the transition, there was no indication a collaborative process was established to include the former chief business official, former director of food services and the technology supervisor. Neither Meals Plus representatives nor the district could provide a copy of the final database file used to transition student data from the former Infinite Campus system to the new Meals Plus system.

Student Accounts

District staff reported that the district started receiving an increased volume of calls from parents regarding incorrect student account balances. Food services staff reported that the former director instructed the cashiers to continue to allow students to take a meal regardless of their account status or if they had payment. As a result, charges began to accrue on student accounts.

Interviews indicate that the former director of food services instructed a head cook from one of the sites to clear student account balances in the POS system with a manual adjustment. FCMAT's review of the Transaction History Report from the Meals Plus system from May 1, 2017 through July 1, 2018 revealed that that student accounts with both positive and negative balances were cleared manually from the POS system on multiple dates throughout the year. Records confirm that on January 10, 2018 the head cook cleared 928 account balances totaling \$42,540.91.

FCMAT also noted multiple types of adjustments made by multiple users on multiple dates as noted in the table below.

User		HHIGH		BHUGGINS		TPIKE		TMICHEL		Total	
Date	Adjustment Type	Count of Price	Sum of Price	Count of Price	Sum of Price	Count of Price	Sum of Price	Count of Price	Sum of Price	Count of Price	Sum of Price
6/1/17	PPAY	539	16,515.45							539	\$ 16,515.45
7/3/17	PUTL	431	(5,813.57)							431	\$ (5,813.57)
8/3/17	PUTL	5	950.00							5	\$ 950.00
8/14/17	PUTL	2	24.79							2	\$ 24.79
8/15/17	PUTL	15	350.25							15	\$ 350.25
8/16/17	PUTL	3	161.30							3	\$ 161.30
8/28/17	PUTL	3	92.50							3	\$ 92.50
9/7/17	PUTL	2	148.50							2	\$ 148.50
9/15/17	PUTL	1	44.95							1	\$ 44.95
9/22/17	PUTL	2	163.00							2	\$ 163.00
10/4/17	PUTL	144	4,990.39							144	\$ 4,990.39
11/6/17	PUTL	2	342.25							2	\$ 342.25
11/7/17	PUTL	2	303.70							2	\$ 303.70
11/14/17	PUTL	1	200.00							1	\$ 200.00
11/27/17	PUTL	103	9,575.00							103	\$ 9,575.00
1/10/18	PPAY					928.00	42,540.91			928	\$ 42,540.91
1/11/18	PUTL	1	180.50							1	\$ 180.50
1/22/18	PUTL	3	(0.50)							3	\$ (0.50)
3/19/18	PUTL	468	43,513.55							468	\$ 43,513.55
3/22/18	PUTL	112	7,022.25							112	\$ 7,022.25
3/29/18	PUTL	2	180.50							2	\$ 180.50
4/10/18	PUTL	75	5,664.20							75	\$ 5,664.20
4/27/18	PUTL	4	454.50							4	\$ 454.50
5/1/18	PUTL	22	2,078.85							22	\$ 2,078.85
5/4/18	PUTL	2	(15.00)							2	\$ (15.00)
5/7/18	PUTL	1	223.90							1	\$ 223.90
5/14/18	PUTL	1	255.99							1	\$ 255.99
5/15/18	PUTL	5	602.50							5	\$ 602.50
5/16/18	PUTL	33	2,653.35							33	\$ 2,653.35
5/17/18	PUTL							1	115.50	1	\$ 115.50
5/23/18	PUTL			2	(0.75)					2	\$ (0.75)
6/1/18	PUTL			1	231.50					1	\$ 231.50
Total		1984	\$ 90,863.10	3	\$ 230.75	928	\$ 42,540.91	1	\$ 115.50	2916	133,750.26

During interviews concerns were raised, and FCMAT identified irregularities in accounting for specific student accounts and individual transactions. Student transaction histories are a subsidiary ledger to the cafeteria fund containing a detailed subset of all transactions. These student histories combine to form a master roster or database. The sum of the student account database, when combined, equals the deferred revenue: revenue collected but not yet earned.

FCMAT noticed that the meal eligibility status code was changed on many student accounts multiple times to free, reduced-price or full-pay. Review of selected student accounts revealed that the former director made several manual adjustments to each of her own three children's accounts, manually increasing the balances of each account.

The tables below depict the manual adjustments to each of her three children's accounts.

Student 6774

Date	Status *	Description	Amount	User
05/23/17	2	Balance Adj. from Import	\$175.00	FOOD
08/3/17	4	Balance Adj. from CPSB Utility	\$200.00	HHIGH
04/10/18	2	Balance Adj. from CPSB Utility	\$2.60	HHIGH
08/20/18	3	Net Balance Transfer	\$100.00	SERVICE
08/20/18	3	Net Balance Transfer	-\$100.00	SERVICE
		TOTAL	\$377.60	

Student 6775

Date	Status *	Description	Amount	User
05/23/17	2	Balance Adj. From Import	\$147.00	FOOD
07/03/17	0	Balance Adj. Deleted Student	-\$147.00	HHIGH
08/03/17	4	Balance Adj. From CPSB Utility	\$175.00	HHIGH
08/03/17	4	Balance Adj. From CPSB Utility	\$200.00	HHIGH
04/10/18	2	Balance Adj. From CPSB Utility	\$53.70	HHIGH
08/20/18	3	Net Balance Transfer	100.00	SERVICE
08/20/18	3	Net Balance Transfer	-\$100.00	SERVICE
		TOTAL	\$428.70	

Student 6709

Date	Status *	Description	Amount	User
05/23/17	2	Balance Adj. From Import	\$175.00	FOOD
07/03/17	0	Balance Adj. Deleted Student	-\$175.00	HHIGH
08/03/17	4	Balance Adj. From CPSB Utility	\$175.00	HHIGH
08/03/17	4	Balance Adj. From CPSB Utility	\$200.00	HHIGH
04/10/18	2	Balance Adj. From CPSB Utility	\$71.20	HHIGH
08/20/18	3	Net Balance Transfer	-\$100.00	SERVICE
08/20/18	3	Net Balance Transfer	-\$100.00	SERVICE
08/20/18	3	Net Balance Transfer	\$100.00	SERVICE
08/20/18	3	Net Balance Transfer	\$100.00	SERVICE
		TOTAL	\$446.20	

* Status: 0= Deleted Student, 2 = Free, 3= Reduced, 4= Paid

During interviews the district superintendent shared that the former director had requested that the balances on her children's student accounts be refunded to her when she separated from employment; the request was denied. FCMAT was unable to trace the exceptionally high balances on student accounts to any payment made by the former food services director. As each student is served a meal charged against these unconfirmed balances, a direct financial benefit is provided to the former director.

Although AR 3551 mandates that "Any charges to, or transfers from, a food service program shall be dated and accompanied by a written explanation of the expenditure's purpose and basis," many entries were made to student accounts with no supporting documentation. The adjustments to student account balances represent an opportunity for fraud. No supporting documentation for student beginning balances or adjustments could be located to validate payments from parents and/or circumstances to support the entries.

Student account balances should not be adjusted without justification supported by documentation. All account adjustments should be reviewed and approved in advance by the district business office. The business office staff should review POS system data and ensure financial data is reconciled against that recorded in the cafeteria fund.

Food Sales, Cash Handling Procedures and Deposits

The district serves breakfast and lunch at all school campuses, and after-school snacks are offered at one elementary school. At the middle school/high school campus, a cash only a la carte snack window is accessible to students. The district has also operated a seamless summer meal program at one elementary school site. However, the program had been discontinued for the current summer as it was reportedly not being operated at an approved site, and when moved to an appropriate campus there was not enough participation to support the program. The district also prepares and transports lunches for one district-authorized charter school.

Meal Service

Interviews with school site staff revealed that as students move through the meal service line, they enter their 4-digit PIN code on a PIN pad. If the student does not remit cash during the transaction the cashier applies the meal purchase to the account. If the student tenders cash, to pay for the purchase or to deposit into their account, the cashier applies the payment to the account first then charges the purchase transaction. When the student's ID number is entered, the Meals Plus system will identify to the cashier if the student's account balance is positive or overdrawn. Cashiers are directed to allow students to eat even if accounts are negative, so no student is denied a meal.

Cash Count and Deposits

At the end of the meal service period, the cashier counts their till, prepares a cash count sheet and enters the amount collected (less any beginning cash balance) into the system. Food services staff reported that the cash and checks collected each day from students at the food service line is accounted for using a cash count sheet at the end of each service day. The totals from the cash count sheet are entered into the POS system by the cashier. The system reconciles the cash and check totals recorded at the POS against the drawer count entered and identifies if the cash drawer is over or short.

Each cashier counts and verifies daily cash receipts alone. No secondary confirmation is performed, even when discrepancies occur between the system records and drawer counts. During interviews, some staff indicated that if there are any discrepancies, they will go back through the transactions and try to identify possible errors. To conform to sound internal control and fraud prevention practices, cash should always be counted and verified by two individuals.

Interviews indicate there have been changes over the past few years in how deposits are handled. In most cases, the head cook at each site prepares a deposit slip, noting any over/under amount on the cash count sheet if the totals do not match the systems report. The deposit slip, cash count sheet and the cash and checks are placed in a deposit bag. For school sites that operate more than one POS terminal during meal service, each cashier provides their accounting documentation and money to the head cook, who consolidates everything into one deposit for the site. At the middle school/high school site, cashiers reported that they gave the deposit bags to the former food services director. Interviews indicate that the former director was frequently absent, and in her absence, the deposit bags were placed in the former director's desk drawer. Cash should always be stored in a locked, secured location and keys should be accessible only to a few authorized people.

The district utilizes a clearing account at a local bank to make daily deposits and transfers funds from the clearing account to the cafeteria fund in the county treasury. The head cook at some sites reported that they took the deposit to the bank night drop each day while at other remote sites the deposits were taken to the bank less frequently, once or twice a week.

School sites do not retain copies of the cash count sheet, deposit slips and system reports. Each school site should maintain copies of these records. Cash should be forwarded to the district office where a secondary count is performed and both parties sign off on the cash count. Copies of all supporting documentation should be retained with the deposit receipt. Reconciliations of daily sales recorded in the Meals Plus system for each school and daily bank deposits by site should be performed.

FCMAT reviewed bank statements dated July 1, 2015 through June 30, 2018. The district was only able to provide copies of bank deposit slips for the following periods:

- August 2015
- February 2016
- March 2016
- March 2017

No daily sales reports, cash count sheets or other supporting documentation accompanied these deposit receipts. A comparison of bank statements to the POS reports obtained from the Meals Plus software vendor revealed that none of the sites consistently made daily deposits. Because the district was unable to provide detailed supporting documentation for the deposits, FCMAT was unable to determine if all cash collections from all sites were deposited into the bank.

Analysis of the available deposit slips indicated that most sites made deposits that were comprised solely from collections at their sites; however, Middletown High School and Middle School deposits were consolidated. In January 2018 deposits shown on bank statements confirm that cash collections for all sites were consolidated into a single district deposit.

Snack Sales (a la carte)

In addition to the food service line, the middle school/high school site operates a snack window accessed by students outside of the cafeteria. While student access is in an area away from the general meal service, it is operated within the same kitchen contiguous to the general meal service preparation and serving area.

Types of food items described as sold at the snack bar include Gatorade, water, juice, doughnuts, chips, cookies, hot pockets, pizza, and fruit snacks. Snack items are not available in the regular food service line and meals are not available from the snack bar window, although components of the meal, such as burritos, were reportedly sold.

When the former director of food services vacated her position, the head cook at the high school was appointed to serve as interim director of food services. On her first day in that capacity, she asked the district's CBO what she should do with the cash collected from the snack bar sales. She informed the CBO that the cash and checks collected from daily breakfast and lunch meal sales were deposited in the bank each day by the head cook at each school site, but that the cash collected from the a la carte sales at the high school's snack window was always put in an envelope and placed in a drawer in the former director's desk. It was understood by staff that the former director prepared and made the deposit for snack sale collections.

Review of documentation supporting the actual receipts collected from the snack window sales over the course of an 11-day period following the head cook's inquiry indicate an average cash collection for that window of \$243 per day. When extrapolated over a 180-day school year it is reasonable to expect annual cash collections from snack sales to be approximately \$43,886. Because the a la carte snack window sales were not accounted for in the district's POS system and there is no documentation, including cash count sheets for daily sales, FCMAT is unable to confirm a total potential estimated loss of cash proceeds that may have been skimmed from the district's daily sales. Furthermore, the district does not prepare and retain detailed inventory records for snack inventories purchased and sold, so no attempt to reconcile inventory shrinkage was performed.

While the administration reported having no knowledge of the a la carte sales at the snack window or how long the snack window had been in operation, interviews with food service staff indicate an overall general common knowledge among site staff of ongoing active sales. Interviews reveal that sales from this snack window have been handled by a single long-standing food service employee who reports it being operational at least as far back as 1999.

Sales transactions at the snack window are cash only. Sales are not entered into the POS system and no cash register or other type of tracking system is used to track daily sales and items sold. The cashier estimated that the snack window typically generates \$250 to \$500 per day; minimum days or game days generate lower sales volume.

Interviews with the cashier who operated the a la carte snack window indicate that at the end of the sale period each day, the cashier counted the cash in the drawer, tallied the cash and coin by denomination and wrote the information on a piece of paper that she initialed and dated. The cash was counted by the cashier alone, without another person present, and no secondary confirmation was performed. The cashier put the cash and the tally sheet in an envelope and placed the envelope in the former director's desk drawer or in the safe. The keys to the safe were stored in a small orange recipe style box that reportedly sat on top of the former director's desk. Staff reported that the cash envelopes would sometimes accumulate in the drawer when the former director was out for extended periods.

Interviews with department staff revealed an understanding that the director took the snack sales cash to Lakeport for deposit rather than to the local bank where all other collections were deposited. Reportedly, the former director told the head cook that the snack sales cash went to a separate account and was not a part of the food fund, which led to the understanding that there was a separate account.

Charter School Food Sales

The food service staff at the Minnie Cannon School prepare and transport lunches daily to the Lake County International Charter School, a district-sponsored charter school. The school transports 45 meals each day unless the charter school calls and requests a different number of meals. The school receives a list of students for each class indicating whether the student is taking lunch that day, and any amount paid. The cash collected by the charter school is placed into an envelope and stapled to the front of the student lists.

FCMAT's review of the POS system reports by site indicates that the charter school was assigned a separate school code and its students were assigned unique student identification numbers and accounts. The cashier for the site that prepared the meals reported that the director collected the charter school money from the school site each day.

Review of system reports for the charter school site indicate that meals prepared for the charter school were recorded in the POS system during the 2017-18 fiscal year. FCMAT compared the daily meal count and cash remittance information available on the meal count sheets for the same time frame. Data contained in the POS system reports were inconsistent with the data available from the daily meal counts provided from the charter school. The daily sales reports provided by the charter school indicate that 5,943 meals were requested during the 2017-18 fiscal year and that \$2,430.80 in cash collections was remitted to the food services department with their request for meal delivery. The Meals Plus system recorded \$119.30 in meal sales and no cash receipts. Additionally, FCMAT found no documentation supporting deposits of the cash collected from the charter school.

Vending Machine Sales

The district has one vending machine located on the high school/middle school campus in the cafeteria. FCMAT received varying reports relative to its operating; some staff reported that the machine has been broken or otherwise not operational for over a year. Food services staff reported to FCMAT that vending money was at one time collected by the director and often given to one head cook to be rolled and then returned to the director for deposit. While staff reported that cash collected from the machine was approximately \$150-\$200 twice a week, FCMAT found no documentation relative to vending proceeds and received conflicting reports regarding its operations.

Cash Handling Deficiencies

Administrative Regulation 3551, Food Service Operations/Cafeteria Fund, states in part that "all proceeds from food service sales and other services offered by the cafeteria shall be deposited in the cafeteria fund." The CBO draws a check, on an inconsistent basis, from the Westamerica bank account to transfer balances to the cafeteria fund at the county treasury. The amounts transferred from the clearing account to the cafeteria fund lacked transparency because the check

is coded to local revenue when deposited into the cafeteria fund and is net of bank charges and fees, which are not recognized.

Transfers were not made timely, were not complete, did not identify the source of funds being transferred and were net of bank charges and other fees associated with associated student body funds. Revenue and expenditures for the food services department were both likely understated in the district's cafeteria fund during the period under review because bank charges and electronic collection system charges were netted against amounts deposited into the cafeteria fund for food sales.

In January 2018, the district instituted new procedures whereby the head cook at each site brings the daily deposit to the district office. The cash is re-counted by the receptionist in the district office in the presence of the head cook. The clerk and the head cook both initial the cash count form confirming collections. The cash collections from all sites are consolidated into one deposit, and the deposit is taken to the bank by a district office representative. Review of bank statements indicate that deposits are made approximately once a week. While these are remarkable improvements to the cash handling procedures, the district does not require funds to be counted jointly by two employees on site before the funds are transported to the district office for deposit. Dual cash counting is the industry standard and is important in preventing fraud.

Deficiencies in cash controls create an environment conducive to skimming. This type of fraud involves the removal of cash before it can be recorded in the accounting records, leaving no direct audit trail to the theft. Strong internal controls for cash collection are necessary to prevent mishandling of district funds and are designed to safeguard and protect employees from potential accusations of mishandling funds by defining their responsibilities in the cash handling process.

Each time a sale is made, the cashier should ring up the sale in the POS system or cash register, and this includes snack bar sales. At the end of the day, the point of sale report should equal the total of the cash collected. The cash should be counted in the presence of two employees and recorded on a cash count form. The cashier and/or supervisor should immediately investigate any cash shortage/overages.

Accounting and Reconciliations

The food service program should be self-sustaining. Revenues generated by the program should be sufficient to fund all expenses of the department. Board Policy 3551, Food Service Operations/Cafeteria Fund, states the "school food services program shall be a self-supporting, nonprofit program." The CBO should monitor the financial activity of the cafeteria fund routinely and at least monthly, investigate significant revenue or expenditure variances from expected values. The district should closely monitor revenue and expenditure activity and identify opportunities for revenue enhancements and/or expenditure reductions sufficient to eliminate deficit spending and contributions from the general fund.

FCMAT compared the enrollment and eligibility trends with financial activity reported in the district's cafeteria fund for fiscal years 2012-13 through 2017-18. The following table presents historical enrollment and student FRPM eligibility for fiscal years 2012-13 through 2017-18.

Analysis of Historical Enrollment and Free and Reduced Price Meal Eligibility

Enrollment	2012-13*	2013-14*	2014-15*	2015-16*	2016-17*	2017-18 #
MUSD (non-charter)	1583	1532	1526	1470	1450	1455
Lake County International Charter	58	73	71	75	79	85
Enrollment for Child Nutrition Program (CNP)	1641	1605	1597	1545	1529	1540
California Connections Academy @ North Bay	0	0	70	109	151	172
Total Enrollment	1641	1605	1667	1654	1680	1712
CNP Enrollment Increase/(Decrease) over prior year	-	-36	-8	-52	-16	11
Increase/(Decrease) as a %		-2.2%	-0.5%	-3.3%	-1.0%	0.7%
Free and Reduced Priced Meal (FRPM) Eligibility						
MUSD (non-charter)	719	701	786	995	888	928
Lake County International Charter	47	47	49	63	56	67
FRPM Eligibility CNP	766	748	835	1058	944	995
California Connections Academy @ North Bay	0	0	19	46	54	66
Total FRPM Eligibility	766	748	854	1104	998	1061
CNP FRPM Eligibility Increase/(Decrease) over prior year	-	-18	87	223	-114	51
% CNP FRPM to Enrollment	46.7%	46.6%	52.3%	68.5%	61.7%	64.6%
Increase/(Decrease) as a %		-0.1%	5.7%	16.2%	-6.7%	2.9%

Source: * EdData, # CDE state certified data exhibits 2017-18 P-2

The table below summarizes financial activity recorded in the district's cafeteria fund for fiscal years 2012-13 through 2017-18.

Analysis of Historical Revenue, Expenditures and Contributions - Cafeteria Fund

Object Code	Revenue Source / Fiscal Year	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18 Actuals
Revenue							
8220	Federal Child Nutrition	\$ 366,655.16	\$ 422,407.63	\$ 424,836.86	\$ 469,772.74	\$ 720,565.73	\$ 623,685.67
8221	Commodities	-	-	-	-	25,995.19	17,406.04
8290	All Other Federal Revenue	-	-	6,575.00	-	-	-
8520	State Child Nutrition	31,680.22	34,677.42	36,927.90	36,299.70	63,134.87	44,418.86
8634	Food Service Sales *	157,355.52	125,695.92	141,433.45	106,890.67	103,437.69	81,294.08
% Increase/(Decrease) in Food Sales			-20.1%	12.5%	-24.4%	-3.2%	-21.4%
8660	Interest	347.82	229.40	186.68	145.78	602.79	459.20
8699	All Other Local Revenue	10,074.39	3,240.20	4,395.09	237.29	467.50	1,105.10
Total Revenue		\$ 566,113.11	\$ 586,250.57	\$ 614,354.98	\$ 613,346.18	\$ 914,203.77	\$ 768,368.95
Expenditures							
2XXX	Classified Salaries	\$ 226,383.12	\$ 211,873.07	\$ 217,326.94	\$ 271,777.81	\$ 269,396.41	\$ 287,543.20
3XXX	Benefits - Certificated	79,266.48	97,493.82	100,726.09	124,414.64	147,886.86	150,977.33
4XXX	Supplies	272,478.62	295,831.44	264,221.82	237,286.48	356,870.75	400,733.28
5XXX	Services	12,090.58	18,519.03	20,814.83	23,288.13	45,873.19	36,643.36
6XXX	Capital Outlay	(3.00)	-	6,575.00	-	-	-
7XXX	Other Uses and Transfers Out	26,185.37	12,750.00	14,750.00	14,750.00	39,812.71	45,900.00
Total Expenditures		616,401.17	636,467.36	624,414.68	671,517.06	859,839.92	921,797.17
Excess / (Deficiency) Before Interfund Transfers		\$ (50,288.06)	\$ (50,216.79)	\$ (10,059.70)	\$ (58,170.88)	\$ 54,363.85	\$ (153,428.22)
8916	Interfund Trf To Café from Gen		24,316.00	11,000.00	103,000.00	74,720.00	75,000.00
Excess / (Deficiency)		(50,288.06)	(25,900.79)	940.30	44,829.12	129,083.85	(78,428.22)
Beginning Fund Balance		\$ 102,823.79	\$ 52,535.73	\$ 26,634.94	\$ 27,575.24	\$ 72,404.36	\$ 201,488.21
Restatements							\$ (70,580.00)
Ending Fund Balance		\$ 52,535.73	\$ 26,634.94	\$ 27,575.24	\$ 72,404.36	\$ 201,488.21	\$ 52,479.99

Source: # General ledger exports

Note: * Food Service Sales includes payments received for reduced price and paid meals and ala-carte sales

FCMAT identified noteworthy changes in both revenue and expenditure activity as well as enrollment and FRPM eligibility. Changes in revenue recorded for federal and state nutrition program funding and food sales over the past three fiscal years appear inconsistent with changes in enrollment and free and reduced price meal eligibility trends. FCMAT also found that expenditures for supplies and services increased considerably during this same time frame. FCMAT did not test the claims submitted for federal and state nutrition program submissions or analyze

meals served data, but did review the deposits recorded in the general ledger to verify that the amounts recorded were related to meal claim submissions and that snack sale revenue had not been inadvertently commingled.

While there were identifiable variances in a la carte sales reported as food service sales from one year to the next, similar fluctuations in student enrollment also occurred. Snack window sales were not recorded in the POS system and the daily cash count sheets could not be provided. Due to the lack of supporting documentation, FCMAT found insufficient evidence to make a determination as to whether snack bar revenue was deposited into the district's bank account.

To minimize the opportunity for misappropriation or loss of cash, all sales should be entered into the POS system and included in the daily deposit. Cash should always be stored in a secure location, preferably a safe or a locking cabinet. Access to the keys to the safe should be limited and properly safeguarded.

Analysis of Bank Records

Revenue and expenditure activity of the food services department is recorded in a special revenue fund held at the county treasurer's office. Cash collections and online payments are deposited into an established clearing account with Westamerica Bank. When a clearing bank account is established at a financial institution for the convenience of making timely deposits and/or accepting electronic payments for student accounts, the funds should be routinely transferred to the county treasury, at least monthly.

While the district was able to provide FCMAT with monthly statements for the account held at Westamerica Bank where the food services department deposits are made, it was unable to locate and provide supporting documentation for transactions recorded in that account other than copies of deposit receipts. The district was unable to locate documentation supporting the amounts recorded on each deposit receipt.

FCMAT reviewed monthly bank statements dated July 1, 2015 through June 30, 2018 for the food service account. An analysis of the bank statements shows similar, although not exact totals when compared against postings to the general ledger. The sum of branch deposits plus electronic deposits from the district's online payment system are presented for the period under review in the table below.

Revenue Source / Fiscal Year	2015-16	2016-17	2017-18
Food Service Sales-Cafeteria Fund	\$ 106,890.67	\$ 103,437.69	\$ 81,294.08
Bank Deposits	\$ 103,422.97	\$ 108,430.19	\$ 83,113.89

The differences between the bank deposits and the sales revenue likely result from timing of transfers from the bank account to the district's cafeteria fund.

The team identified various types of transactions on the bank statements including online payments, branch deposits, interest, payments, and bank fees. Deposit slips provided to FCMAT by the district for the months of August 2015, February 2016, March 2016, and March 2017 were compared to deposits reported on the bank statements. Each deposit slip was matched to a deposit on the bank statement. However, not all deposits listed on the bank statement had a corresponding matching deposit slip. FCMAT's testing sample is summarized in the table below:

Description / Month-Year	August 2015	February 2016	March 2016	March 2017
Total number of deposits	50	85	107	62
Total value of deposits	\$ 6,114.85	\$ 6,338.47	\$ 9,447.81	\$ 7,771.21
Number of deposits without matching deposit slips	1	1	1	1
Value of deposits without matching deposit slips	\$ 105.00	\$ 75.00	\$ (100.00)	\$ 286.50

Note: the \$(100.00) deposit is the result of a bounced check.

The entries to record each deposit into the cafeteria fund should clearly separate the sales revenue from the bank fees. For greatest transparency, each deposit should be entered as a separate line recording the deposit into the cafeteria fund so it can be easily traced back to the original deposit in the bank account. Any fees charged to the bank account should be accounted for as an expense in the deposit entry; the net result will balance to the amount of the check drawn on the bank account. All documentation supporting each original bank deposit should be retained and available to support the transactions recorded in the cafeteria fund.

Analysis of Recorded Sales in Meals Plus

FCMAT reviewed the Transaction History report from the Meals Plus POS system for all dates from May 1, 2017 through July 1, 2018. The report lists all activity by student number, date, time, student name, item description, serving site, FRPM status, voided transactions, quantity, price, and user. Transaction descriptions include the type of meal served such as breakfast, lunch, a la carte, or other; payments made such as breakfast payment, lunch payment, other payment, or internet payment; and adjustments made such as balance transfers and other adjustments.

The Receipts and Collections report details all activity for all sites and includes all prepayments made, prepayments used, charges made, charges paid, total accruals, total receipts, actual deposits, and over/under amounts. The report received included transactions from May 1, 2017 through June 30, 2018. The report is summarized by date and site, but not by individual student. For the 2017-18 fiscal year, total receipts from the report were \$42,814.41 and total deposits for the same period were \$42,234.80, for a difference of \$579.61.

FCMAT attempted to match deposits for the 2017-18 fiscal year as shown on the Receipts and Collections report to deposits shown on the bank statement. The team was able to match many deposits from meal sales, but not all of the deposits. Because the district was unable to provide FCMAT with POS system reports from its former system, comparisons for fiscal years 2015-16 or 2016-17 could not be made. Due to the lack of supporting documentation and accounting records FCMAT was unable to determine that all cash proceeds collected from food service sales were deposited and recorded in the district's general ledger.

Online Payment Systems

The district utilizes an online payment system so that parents/guardians may make prepayments on their student's accounts. Prior to 2017-18, the district used a system called Vanco Payment Solutions. The system worked in conjunction with the POS system to automatically apply payments to the student's account and deposit the proceeds into the district bank account electronically. With the transition from Infinite Campus to Meals Plus POS system, the district now accepts online payments through a system called K-12 Payment Center, which also credits the student's account automatically and deposits revenues into the district bank account electronically.

The Vanco system was shared by the district food services department and the high school associated student body (ASB). Although the food service program no longer uses Vanco for payments on student accounts, Vanco continues to credit the district's cafeteria bank clearing account for convenience fees collected from parents and debit the account for service charges, all unrelated to the food services department.

The clearing account earns interest income each month in amounts usually less than \$1.00. The district does not properly account for income and expenses in its general ledger. The district combines bank deposits, interest income, Vanco convenience fees collected, Vanco service charges, and bank service charges, and records the net sum as food service sales in the general ledger. This results in a misclassification of revenues and an understatement of both income and expense in the general ledger. The district should account for income and expense items separately, as described in the Standardized Account Code Structure (SACS). Furthermore, the district should discontinue sharing this account with the ASB and ensure that the full value of all sales, convenience fees and bank charges is accounted for in the entry that records the deposit into the county treasury for the food services department.

Bank Reconciliations

The district does not prepare bank reconciliations accurately or in a timely manner. The district provided FCMAT with reconciliations for November 2017 and March 2018 that appeared to match bank deposits with deposits listed on the bank statement. There was no evidence to support that the district reconciled receipts from the POS system to bank deposits.

Bank statements and online payment system statements are received in the district office. The district fiscal specialist is responsible for reconciling the statements. When bank statements are received, the CBO records the deposits made during the month as food service sales revenue in the district's general ledger and transfers money from the district's local account to the cafeteria fund in the county treasury.

FCMAT reviewed 36 bank statements for the food service clearing account for July 1, 2015 through June 30, 2018. March 2017 sales were transferred in May 2017; June 2017 sales were transferred in Aug 2017; Aug 2017, September 2017, October 2017 and November 2017 sales were transferred in January 2018. The bank balance shown on the December 2017 statement rose to \$46,304.54 before funds were transferred. FCMAT's review of bank statements identified several months where the cash was not transferred to the county treasury in a timely manner.

The CBO or designee should reconcile deposits slips, bank statement deposits and point of sale reports monthly. Funds deposited for food sales should be transferred to the cafeteria fund in the county treasury and recorded at the original deposit value for food sales at least monthly. The transfer of revenue should not be recorded in the district's general ledger at net value; rather, cash collections should be distinguished separately from any fees and/or bank charges.

Preparing bank reconciliations is a routine business office process. The purpose of a bank reconciliation is to balance what the bank shows for the account with what appears in the district's books, including the general ledger or check register. When preparation, review and approval duties are properly implemented, reconciliation serves as a strong internal control activity over cash management. Although a number of different formats are commonly used for preparing bank reconciliations, the methods and results are the same: the differences between the bank balance and the book balance are identified, and any unrecorded transactions or errors are investigated and resolved.

The district should reconcile the account within 30 days of receipt of the statement. The clearing bank account should be reconciled to its board-authorized balance of \$400 each month. The district's deposit records should be supported by reports from the POS system and cash count sheets for each site to ensure that all revenues received are recorded in the POS system, included in the weekly bank deposits and accounted for in the district's general ledger.

Snack Sale Inventory

Physical assets, including inventory, should be stored in a secure location with access restricted to certain employees. Inventory balances should be tracked and adjusted for daily sales. Interviews indicate that the former food services director ordered all snack bar inventory and it was stored in the director's office and not in a secure location. Food services staff reported to FCMAT that they sometimes noticed items missing from the snack inventories.

Because no system is established to track the food items purchased for sale at the snack window and no system is in place to track what is sold each day, it is not possible for the district to ensure inventory is safeguarded and accounted for.

Audit Findings

The 2016-17 and 2017-18 independent audit reports contained findings related to the food services department. The 2016-17 audit report contained a finding related to internal control over cash receipts. The audit report noted that the food services department did not maintain proper supporting documentation to verify each individual transaction. The 2017-18 audit report stated that internal controls over cash receipts had been implemented. However, the district was unable to provide FCMAT with supporting documentation for all of the receipts collected in the food service program for 2017-18.

The 2016-17 and 2017-18 audit reports both contained findings related to the classification of students as FRPM eligible. The audit report for 2016-17 noted a lack of documentation supporting eligibility designations for one out of 60 students tested that were listed as FRPM. The 2017-18 audit report identified a lack of documentation supporting eligibility designations for 37 out of 60 students classified as FRPM eligible. In addition, the audit reports notes that three out of 60 students tested had been classified as "paid" but had either free or reduced eligibility designations in the student information system. The auditor's findings extrapolated across the affected population estimated the total number of improperly classified students to be 276.

The district business office should routinely monitor all activity in the food services department and should collaborate in CALPADS reporting. Funds should be transferred monthly from the clearing account to the cafeteria fund at the county treasurer's office. Revenue and expenditure trends should be routinely monitored and any unanticipated changes should be investigated.

Internal Control Deficiencies

Internal controls are the cornerstone of a properly functioning accounting, financial, and operational system. Internal controls, best practices, and board policies and administrative regulations provide the foundation for the food services operations. Management is responsible for developing, implementing, monitoring, and improving the internal control system to ensure that

mistakes and errors are corrected. FCMAT identified weaknesses in internal control including (but not limited to) the following:

- Lack of administrative oversight over food service operations.
- Lack of collaborative participation in the CALPADS student data reporting process between food services, technology, and district administration.
- Failure to develop and execute a collaborative implementation plan for migrating to a new food services POS system that included:
 - Retention of records and documentation relative to data transition
 - Collaboration and documentation of system errors and corrective action
 - Administrative oversight
- Failure to design, implement and monitor proper cash handling procedures from the point of collection through bank reconciliation.
- Failure to prepare documented procedures or internal controls over cash handling activities.
- Failure to accurately classify payments received for the food services department.
- Failure to accurately classify expenditures of the food services department.
- Failure to process timely student SNAP applications and record proper determinations for student eligibility.
- Inaccurate student eligibility designations entered into, maintained and/or adjusted in the POS system.

Conclusion and Recommendation

Prevention and Detection

Ethical Values and Fiduciary Duty

A system of strong internal control is among the most important aspects of any fraud prevention program. Superintendents, chief business officials and other managers are in a position of authority and therefore have a higher standard of care to establish the ethical tone and serve as examples to other employees. Employees with administrative responsibility have a fiduciary duty to the district to ensure that those activities are conducted in compliance with all applicable board policies, laws, and regulations.

Management personnel are entrusted to safeguard the district's assets and ensure that internal controls function as intended. The internal control environment includes ethical values and integrity displayed by the governing board and management, as well as the underlying tone established by the organization's site administrators. While the governing board and all district employees have some responsibility for internal controls, the superintendent, former CBO and former director of food services had a fiduciary duty and responsibility to ensure that the governing board fiscal policies and procedures were applied and conducted responsibly and ethically.

The control environment is an essential element and provides the foundation for other internal controls to be effective in achieving the goals and objectives to prevent and/or deter fraud or illegal fiscal acts. The tone of the organization set by management through its words and actions demonstrates to others that dishonest or unethical behavior will not be tolerated. An atmosphere in which employees feel safe to communicate concerns is a fundamental component of a strong and effective internal control environment.

FCMAT found that the former director of food services and/or others may have misappropriated funds by skimming cash received for food service sales. Additionally, there is evidence that indicates the former director may have used her position to gain access to the food services accounting system to adjust the balances of her children's student accounts in ways that provided a personal financial benefit. The district's internal control environment has significant material weaknesses that increase the probability of fraud and/or abuse.

AB 139 Extraordinary Audit Report Summary: Potential Fraud

Based on the findings in this report, there is sufficient evidence to demonstrate that fraud, mismanagement and misappropriation of the district's food services resources and assets may have occurred. Significant material weaknesses in the district's internal control environment in the food services department increase the probability of fraud and/or abuse. These findings should be of great concern to the district's governing board and the Lake County Office of Education and require immediate intervention to limit the risk of fraud and/or misappropriation of assets in the future.

The county office and the district's superintendent and governing board should carefully review the findings and recommendations included in this report and implement effective internal controls over the food sales and cash handling in the food services department.

Judgments Regarding Guilt or Innocence

The existence of fraud is solely the purview of the courts and juries, and FCMAT will not make statements that could be construed as a conclusion that fraud has occurred. In accordance with Education Code Section 42638(b), action by the county superintendent shall include the following:

If the county superintendent determines that there is evidence that fraud or misappropriation of funds has occurred, the county superintendent shall notify the governing board of the school district, the State Controller, the Superintendent of Public Instruction and the local district attorney.

In accordance with Education Code Section 1241.5(b), the county superintendent shall report the findings and recommendations to the governing board of the district at a regularly scheduled board meeting within 45 days of completing the audit. The governing board of the school district shall notify the county superintendent within 15 days after receipt of the report of its proposed actions regarding the county superintendent's recommendations.

Recommendation

The county superintendent should:

1. Notify the governing board of the Middletown Unified School District, the state controller, the superintendent of public instruction, and the local district attorney that fraud or misappropriation of district funds and/or assets may have occurred.

Appendix A

Study Agreement



CSIS California School Information Services

**FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
AB139 STUDY AGREEMENT
June 5, 2018**

The Fiscal Crisis and Management Assistance Team (FCMAT), hereinafter referred to as the team, and the Lake 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 local educational agencies (LEAs). Pursuant to the provisions of Education Code (EC) Section 1241.5 (b), county superintendents may review or audit the expenditures and internal controls of any school in their county if they have reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. The extraordinary audits conducted by the county superintendent shall be focused on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and shall be conducted in a timely and efficient manner.

All work shall be performed in accordance with the terms and conditions of this agreement.

2. SCOPE OF THE WORK

A. Scope and Objectives of the Study

The COE has requested that FCMAT assign professionals to conduct an AB 139 Extraordinary Audit. This audit will be conducted pursuant to Education Code Section 1241.5 (b). The COE has received information regarding possible fraud, misappropriation of funds or other illegal practices at the Middletown Unified School District and is requesting that FCMAT review the cash collections for child nutrition sales.

The primary focus of this review is to determine, based on the sample testing performed and the auditor's judgment, whether (1) adequate management and internal controls are in place regarding the district's reporting and monitoring of child nutrition sales financial transactions, and (2) based on that assessment, whether fraud, misappropriation of funds or other illegal fiscal practices may have occurred.

The team will review and test recorded transactions for fiscal years 2015-16 through 2017-18 to determine if fraud, misappropriation of funds or other illegal activities may have occurred. Testing for this review will be based on the auditor's judgment and a sample of transactions and records for this period. Testing and review results are intended to provide reasonable but not absolute certainty about whether the district's financial transactions and activity were sufficiently accurate.

B. Services and Products to be Provided

1. Orientation Meeting - The team will conduct an orientation session at the district to brief 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 district office and at school sites if necessary; and will continue to review pertinent documents off-site.
3. Progress Reports - The team will inform the COE of material issues as the review is performed.
4. Exit Meeting – The team will hold an exit meeting at the conclusion of the on-site review to inform the COE of any significant findings to that point.
5. Draft Report – When appropriate, electronic copies of a preliminary draft report will be delivered to the COE's administration for review and comment on a schedule determined by the team.
6. Final Report - Electronic copies of the final report will be delivered to the COE following completion of the review. Printed copies are available from the FCMAT office upon request.
7. Follow-Up Support – If requested, the team will meet with the COE and/or district to discuss the findings and recommendations of the report.

PROJECT PERSONNEL

The FCMAT study team may also include:

- | | | |
|-----------|--------------------------------|--------------------------------|
| A. | <i>To Be Determined</i> | <i>FCMAT Staff</i> |
| B. | <i>To Be Determined</i> | <i>FCMAT Consultant</i> |

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 EC 42127.8 (d) (1) shall be:

- A. \$1,100 per day for each staff team member while on site, conducting fieldwork at other locations, presenting reports, or participating in meetings. The cost of independent FCMAT consultants will be billed at their actual daily rate for all work performed.
- B. All out-of-pocket expenses, including travel, meals and lodging.

Based on the elements noted in Section 2A, the total estimated cost of the study will be \$34,200.

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

Payments for FCMAT services may be reimbursed from funds pursuant to EC 1241.5 set aside for this purpose. Other payments, when deemed necessary, are payable to Kern County Superintendent of Schools - Administrative Agent located at 1300 17th Street, City Centre, Bakersfield, CA 93301.

5. RESPONSIBILITIES OF THE COE AND/OR DISTRICT

- A. The district will provide office and conference room space during on-site reviews.
- B. The district will provide the following if requested:
 - 1. Policies, regulations and prior reports addressing the study request
 - 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 district and sent to FCMAT in an electronic format
 - 5. Documents should be provided in advance of fieldwork; any delay in the receipt of the requested documents may affect the start date and/or completion date of the project. Upon approval of the signed study agreement, access will be provided to FCMAT's online SharePoint document repository where the district shall upload all requested documents.
- C. The COE's administration will review a preliminary draft copy of the report. 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 district shall take appropriate steps to comply with EC 45125.1(c).

6. PROJECT SCHEDULE

The following schedule outlines the planned completion dates for different phases of the study and will be established upon the receipt of a signed study agreement:

<i>Orientation:</i>	<i>To be determined</i>
<i>Staff Interviews:</i>	<i>To be determined</i>
<i>Exit Meeting:</i>	<i>To be determined</i>
<i>Preliminary Report Submitted:</i>	<i>To be determined</i>
<i>Final Report Submitted:</i>	<i>To be determined</i>

7. COMMENCEMENT, TERMINATION AND COMPLETION OF WORK

FCMAT will begin work as soon as it has assembled an available and appropriate study team consisting of FCMAT staff and independent consultants, taking into consideration other jobs FCMAT has previously undertaken and assignments from the state. The team will work expeditiously to complete its work and deliver its report, subject to the cooperation of the district and any other parties from which, in the team's judgment, it must obtain information. Once the team has completed its fieldwork, it will proceed to prepare a preliminary draft report and a final report. Prior to completion of fieldwork, the COE may terminate its request for service and will be responsible for all costs incurred by FCMAT to the date of termination under Section 4 (Project Costs). If the COE does not provide written notice of termination prior to completion of fieldwork, the team will complete its work and deliver its report and the COE will be responsible for the full costs. The COE understands and agrees that FCMAT is a state agency and all FCMAT reports are published on the FCMAT website and made available to interested parties in state government. In the absence of extraordinary circumstances, FCMAT will not withhold preparation, publication and distribution of a report once fieldwork has been completed, and the COE shall not request that it do so.

8. INDEPENDENT CONTRACTOR

FCMAT is an independent contractor and is not an employee or engaged in any manner with the COE. The manner in which FCMAT's services are rendered shall be within its sole control and discretion. FCMAT representatives are not authorized to speak for, represent, or obligate the COE in any manner without prior express written authorization from an officer of the COE.

9. INSURANCE


During the term of this agreement, FCMAT shall maintain liability insurance of not less than \$1 million unless otherwise agreed upon in writing by the COE, automobile liability insurance in the amount required under California state law, and workers compensation as required under California state law. FCMAT shall provide certificates of insurance, with Lake County Office of Education named as additional insured, indicating applicable insurance coverages upon request.


10. HOLD HARMLESS

FCMAT shall hold the COE, its board, officers, agents and employees harmless from all suits, claims and liabilities resulting from negligent acts or omissions of its board, officers, agents and employees undertaken under this agreement. Conversely, the district shall hold FCMAT, its board, officers, agents and employees harmless from all suits, claims and liabilities resulting from negligent acts or omissions of its board, officers, agents and employees undertaken under this agreement.

11. CONTACT PERSON

Contact: Michelle Buell
 Telephone: (707) 262-4114
 E-mail Address: michelleb@lakecoe.org

 5/JUN/2018
 Brock Falkenberg, Superintendent Date
 Lake County Office of Education

 June 5, 2018
 Michael H. Fine Date
 Chief Executive Officer
 Fiscal Crisis & Management Assistance Team