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

Glenn County Office of Education

Extraordinary Audit

August 12, 2014

Joel D. Montero
Chief Executive Officer

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FISCAL CRISIS & MANAGEMENT
ASSISTANCE TEAM
CSIS California School Information Services

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Tracey Quarne, Superintendent
Glenn County Office of Education
311 South Villa Avenue
Willows, CA 95988

Dear Superintendent Quarne:

In January of 2014, the Glenn County Office of Education (GCOE) 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 Orland Joint Unified School District. Specifically, the agreement states that FCMAT will peråform the following:

1. The GCOE has requested the team provide an assignment of professionals to conduct an AB 139 Extraordinary Audit. Pursuant to Education Code section 1241.5 (b),(c), the superintendent of Glenn County has reason to believe that fraud, misappropriation of funds or other illegal practices may have occurred and shall conduct a review of the OJUSD. In addition to the authority granted under Education Code 1241.5 (c) and 47604.3, the county superintendent may conduct an investigation of the district and charter schools based upon written complaints by parents or other information that justifies the review.

   The primary focus of this review is to provide the COE and the OJUSD with reasonable assurances based on the testing performed that adequate management controls are in place regarding the district's reporting and monitoring of financial transactions, and that fraud, misappropriation of funds or other illegal activities have not occurred. Management controls include the processes for planning, organizing, directing, and controlling program operations, including systems for measuring, reporting, and monitoring performance. The expenditure of funds for salary and benefit compensation including stipends, vacation, sick leave; conflicts of interest related to construction projects; and the use of credit cards can be areas of high risk in which potential fraud issues such as fictitious employees or vendors, or misappropriation of assets including cash, may be detected during an audit. Specific audit objectives will include evaluating the policies, procedures, and internal controls and transactions performed by the district.

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The team sampled test data from the current and two prior fiscal years and included a review of the expenditures authorized by administrative personnel to determine if fraud, misappropriation of funds or other illegal activities may have occurred. Testing associated with the review was based on the sample selection; it did not include testing of the complete list of all transactions and records for this period. Sample testing and review results are intended to provide reasonable, but not absolute, assurance as to the accuracy of the district's transactions and financial activity.

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

FCMAT appreciates the opportunity to serve you and extends our thanks to all the staff of the Glenn County Office of Education and Orland Joint Unified School District for their cooperation and assistance during fieldwork.

Sincerely,

Joel D. Montero
Chief Executive Officer

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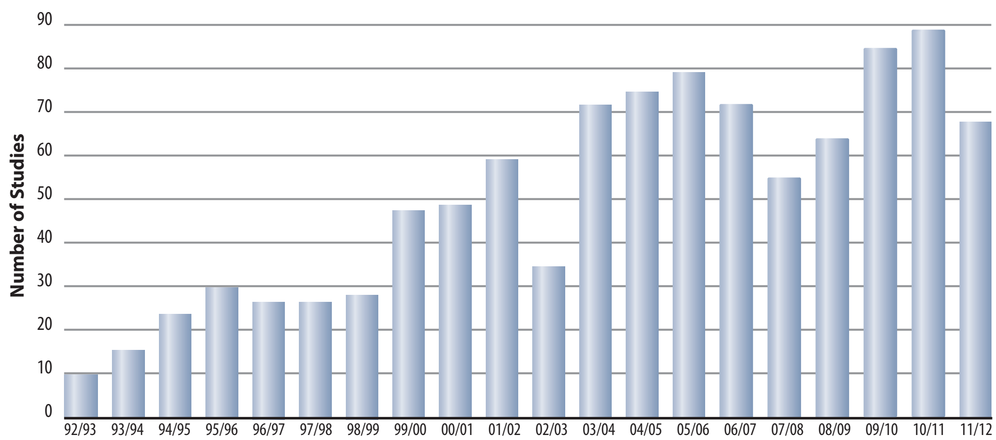
About FCMAT

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

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

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

Studies by Fiscal Year



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

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

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

Since 1992, FCMAT has been engaged to perform more than 1,000 reviews for LEAs, including school districts, county offices of education, charter schools and community colleges. The Kern County Superintendent of Schools is the administrative agent for FCMAT. The team is led by Joel D. Montero, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

Introduction

Background

The Glenn County Office of Education had received allegations of fiscal irregularities and questionable expenditures at Orland Joint Unified School District. Concerned that these allegations may have violated government and education codes related to fraud and/or misappropriation of assets, the county superintendent initiated an investigation to determine whether fraud, misappropriation of funds or other illegal activities may have occurred in order to report the matter to the local district attorney's office for further investigation. Under the provisions of Education Code Section 1241.5 (b), FCMAT entered into a contract with the Glenn County Office of Education to conduct an AB 139 extraordinary audit in January of 2014.

Glenn County has several small to medium sized rural school districts. Orland Unified School District is the largest school district in Glenn County with approximately 2,215students. In March 2006, the district hired a new superintendent whose agenda included strategies to pass a local bond to modernize existing schools and provide new construction. The superintendent was provided broad latitude to oversee the district's construction projects, and authorization to represent the district with minimal intervention by the governing board.

The district was successful in its efforts to pass general obligation bonds totaling $21.9 million dollars in an election held February 5, 2008 to finance construction, provide furnishings and new equipment for district facilities. Following the election, the district made application to the Office of Public School Construction (OPSC) to maximize funding to which the district is approved but unfunded as of this date.

One method schools are authorized to utilize for construction is through a lease, lease-back arrangement. The lease, lease-back arrangement provides for the district to "lease" the facility during the construction period and upon completion of the project, the district purchases the facility. This particular option is attractive as the district is guaranteed a maximum price without the responsibility of bidding the project including subcontractors. Under this arrangement, OJUSD requested and received several proposals. A local firm from Chico, California was awarded the contracts for all the construction projects.

In December 2013 shortly before the superintendent retired from the district, he entered into a lease/purchase agreement for a new district office building. Without real estate appraisals, legal review or any other documentation to support the purchase agreement, the superintendent authorized a $50,000 down payment using general obligation bond funds and directed the monthly lease/rent payments to be paid from the Developer Fee funds. The entire transaction consisting of two pages was signed by the superintendent representing the district and the owner of the construction company who was also under contract to complete all the bond construction and modernization projects. Further, the owner of the construction company is also the owner of the holding company that owned the unfinished building and land.

The building was a shell with a dirt floor, requiring plans to complete the interior, including heating, air conditioning, plumbing, etc. Before the lease/purchase agreement was executed, plans to fix the building had been completed, having been designed to the district superintendent's specifications. During FCMAT's review, the entire transaction was openly questioned in the local media and throughout the district. Issues have ranged from a lack of transparency to questionable bond-fund use.

FCMAT Fieldwork

Investigating allegations of fraud requires a number of steps including interviews with potential witnesses and gathering evidence from internal and external sources. FCMAT reviewed, analyzed and tested business records including time sheets, cash disbursements, general ledger activity, financial reports, board policy and administrative regulations, board meeting minutes, and internal documents secured from the county office, district and from independent sources.

FCMAT also conducted interviews with former management personnel, business office and other district staff to obtain information related to general business practices and events that transpired during the current and two preceding fiscal years, including any alleged mismanagement, fraud or abuse.

Fraud can be defined by three elements that must be present for fraud to occur: Opportunity, incentive and finally rationalization. Financial fraud is a form of white collar crime "characterized by deceit, concealment, or violation of trust" according to the Federal Bureau of Investigation. Although there are many different types of fraud that meets this definition, occupational fraud is the most common type of fraud occurring when employees are in a position of trust and have access to assets. Embezzlement occurs when someone who is lawfully entrusted with property takes it for his or her personal use. Common elements in all fraud include the following:

- Intent or knowingly committing a wrongful act;
- Misrepresentation to accomplish the act;
- Reliance on weaknesses in the internal control structure; and
- Concealment to hide the act.

Scope and Procedures

The primary focus of this review is to determine and report to the Glenn County Office of Education and the district whether there are reasonable assurances, based on testing, that adequate management controls are in place for the district's reporting and monitoring of financial transactions, and whether fraud, misappropriation of funds or other illegal activities may have occurred.

Fraud investigations consist of gathering adequate information about specific allegations and performing audit test procedures to determine whether fraud has occurred; evaluating the loss associated with the fraud; and determining who was involved and how it may have occurred.

During interviews, FCMAT team members asked questions pertaining to authorization procedures; board policies and administrative regulations; job duties and areas of responsibility; cash handling, purchasing and expenditure authorization; the receipt of cash, equipment and other assets from outside parties; and open-ended questions designed to elicit information about other possible irregularities related to the scope of this investigation.

FCMAT's findings and recommendations are the result of the above audit procedures.

Study Guidelines

FCMAT provides a variety of services to school districts and county offices of education upon request. Education Code Section 1241.5(b)(c) 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. According to the Education Code, the review or audit conducted by the county superintendent will focus on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and is to be conducted in a timely and efficient manner. This is in accordance with Education Code Section 42638(b), which states as follows:

> 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.

Therefore, FCMAT focused on the allegations of misappropriation of assets, and specific expenditures related to the lease, lease-back of the district office to determine whether the Orland Unified School District and/or its personnel were involved in or may have committed fraudulent activities.

FCMAT visited the district in February and March to conduct interviews, collect data and review documents. This report is the result of those activities.

Study Team

The study team was composed of the following members:

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Findings and Recommendations

Fraud Definition and Internal Controls

Fraud can include an array of irregularities and illegal acts characterized by intentional deception and misrepresentations of material facts. A significant issue in the investigation of the Orland Joint Unified School District was the lease, lease-back of the district office facilities and whether fraud may have occurred.

A material weakness is a deficiency in the internal control process whereby errors or fraud may occur. Because of this weakness, employees in the normal course of business may not detect errors in time to correct them. A material weakness also can be a violation of law or regulations.

Although all employees have some degree of responsibility for internal controls, the governing board, superintendent and senior management are ultimately responsible.

Internal Control

The term "internal control" is clearly defined by the accounting industry as it applies to organizations, including school agencies. An organization establishes control over its operations by setting goals, objectives, budgets and performance expectations. Several factors influence the effectiveness of internal controls, 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 controls provide the means to direct, monitor, and measure an organization's assets and resources and play an important role in protecting it from fraud, abuse or misappropriation.

All educational agencies should establish internal control procedures to accomplish the following:

1. Prevent management from overriding internal controls.
2. Ensure ongoing state and federal compliance.
3. Assure the governing board that the internal control system is sound.
4. Help identify and correct inefficient processes.
5. Ensure that employees are aware of the expectation that proper internal controls will be utilized.

Internal control has five components:

- **Control Environment** is the tone of the organization and influences employee behavior. It is the foundation for all other components of internal control.
- **Risk Assessment** identifies and analyzes the risks that may prevent an organization from achieving its objectives. This component forms the basis for how these risks should be managed.
- **Information and Communication** require systems that identify, gather and exchange information in a format and a time frame that enable the people in the organization to successfully perform their duties.

- **Control Activities** help ensure that management directives are carried out. Control activities are also designed to avoid errors or irregularities or find them after they have occurred.
- **Monitoring** is used to assess the quality of internal control performance over time.

Each person in an organization is responsible for internal control in some capacity as nearly everyone either produces information used by the internal control system or takes action to implement organizational control. Further, each individual should take responsibility for appropriately communicating problems in operations, noncompliance with policies, or illegal actions. *Ultimately, internal control should pervade every level of the organization; however, the governing board members and superintendent have specific roles to play.*

As the organization's leader and chief executive, the superintendent sets the overall tone for the organizational. Factors that contribute to a positive control environment include integrity, ethical values, management philosophy and operating style, organizational structure or configuration, assignment of authority and responsibility, and employee expertise and proficiency.

The governing board works as a group to provide governance, guidance and oversight. Individual board members particularly enhance the control environment when they are informed, free of bias, inquisitive, conduct themselves in a principled and ethical manner, and expect the same standard of conduct from all employees within the organization.

Independent auditors assess whether the controls are properly designed and implemented, and monitor whether the controls are working effectively. They also make recommendations for improving internal controls.

FCMAT found that the district's control environment has been compromised by the decision of the superintendent and the governing board to grant the superintendent great latitude to enter into contracts and make financial decisions on behalf of the district.

Fraud and the misuse of physical or cash assets occur when three factors converge: pressure or motive, opportunity, and rationalization or lack of integrity. This is known as the "fraud triangle." When two of the three factors are present, the probability fraud will occur increases. When all three factors are present, it is almost certain fraud will occur.

The opportunity for fraud varies throughout the district depending on the duties assigned to an employee. Rationalization and lack of integrity are more likely to be present in organizations that do not implement and/or promote anti-fraud policies. In reviewing the practices of the Orland Joint Unified School District, the FCMAT study team identified unacceptable practices that have been occurring for years due to the districts lack of internal policies and procedures.

As is common in smaller school districts, the risk assessment component of internal control at the district is assigned to its independent auditors as part of their annual audit. However, the scope of the auditors' review is limited to consideration of internal control as a basis for designing audit procedures. Consequently, independent auditors do not express an opinion on the effectiveness of the district's internal control but rather if proper internal controls are in place.

The following basic concepts and procedures help ensure a strong internal control structure:

- **System of checks and balances –** Formal procedures should be implemented to initiate, approve, execute, record and reconcile transactions. The procedures should identify the employees responsible for each step and the time period for completion. Key areas requiring checks and balances include payroll, purchasing, accounts payable and cash receipts.

- **Segregation of duties –** Adequate internal accounting procedures must be implemented and necessary changes made to segregate job duties and protect the district's assets. No single employee should handle a transaction from initiation to reconciliation, and no single employee should have custody of an asset, such as cash, and maintain the records of its transactions.

With the changes due to the departure of the superintendent and business manager, the district has determined the need to review processes and procedures on governance, proper oversight and implementing an effective internal control system.

Internal Control Environment

The internal control environment is a prerequisite that enables other components of internal control to effectively prevent and/or deter fraud or illegal acts. The environment sets the overall tone for the organization, provides discipline and control, and includes factors such as integrity, ethical values and employee competence.

The internal control environment can be weakened significantly in a small to medium sized school district where a lack of experience in financial management and a weak internal control structure exists because a limited number of staff are charged with multiple responsibilities and duties.

Policies, procedures and actions should reflect the philosophy of the governing board and management and the overall moral tone of the district. Management's actions should reflect board policy and administrative procedures. Actions by those in a position of trust such as the management staff and the governing board ultimately create the employees' perception of the ethical conduct within the organization.

The Orland JUSD exhibited an overall lack of internal controls, particularly with the management and oversight of the bond and construction projects and grant administration. Employees that were interviewed expressed that the superintendent and senior staff members took advantage of their positions to give themselves stipends and other perks not afforded to the majority of other district personnel. In particular, the superintendent used perks such as gasoline credit cards to a select number of managers but was quick to take the perks away when a manager fell out of grace.

The district has board policies and administrative regulations, but the governing board circumvented many of the procedures by allowing the superintendent great discretion over the financial affairs, most specifically with construction projects and authority to enter into binding contracts without proper supporting documentation including independent third-party evidence to substantiate the expenditure of bond dollars and other district funds.

The superintendent had a general lack of experience with bond and construction accounting rules and regulations yet single-handedly made major financial decisions on behalf of the district and governing board. Once such decision was the authorization to spend $50,000 of general bond funds as a down payment for a five year lease/purchase agreement for a new district office building shortly before the superintendent retired.

The lease/purchase agreement for the new district office was signed by the owner of the construction company contracted to do all the new construction and modernization who is also the owner of the holding company that owned the building and land of the new district office. The superintendent directed the monthly lease/rent payments to be made from Developer Fee funds. The entire transaction was comprised of two pages and lacked any documentation or appraisal from a real estate professional or legal review. This transaction is fully described later in this report.

A properly controlled environment includes appropriate oversight supported by management sign-off, governing board approval and supporting documentation that aligns with all the laws and regulations. The district should initiate and enforce proper controls that include at a minimum:

- Proper supporting documentation for all transactions which includes appraisals for property acquisition, lease/purchase agreements or rent.
- Authorization by the governing board for each transaction that involves real property acquisition, lease/purchase agreements or rent.
- Specific authorization to enter into contracts for real property acquisition, lease/purchase agreements or rent.
- Review by legal counsel for all contracts including lease, lease-purchase or rent agreements.
- Final approval evidenced by minutes of the governing board in open session.

The internal control environment is critical because it 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.

FCMAT found the district's internal control environment lacks essential checks and balances in the oversight of fiscal operations that include sufficient supporting documentation for contracts including the approval process. Having proper procedures and safeguards in place that are enforced will reduce the risk of fraud and/or unintentional errors.

The down payment of $50,000 for the lease purchase of the district office was forwarded to the county office without any supporting documentation. The payment request indicated that it was for a new building and not a lease purchase for the district office facility. Since the district had been involved in numerous construction projects, the payment request did not raise any concerns for GCOE staff and the request was processed. In the future, the county office should require the district to submit a comprehensive listing of specific projects and associated tracking numbers with all payment requests. This will assist the county office in reconciling all requested payments for construction or related projects and alleviate any doubt as to the district's intent.

Control Activities

Control activities are a fundamental element of internal controls, and are a direct result of policies and procedures designed to prevent and identify misuse of a district's assets, including preventing any employee from overriding controls in the system. According to Cendrowski, Martin, and Petro in "The Handbook of Fraud Deterrence," if control procedures are not adequately defined and consistently enforced within the organization, the opportunity for fraud is introduced." Control activities include the following:

1. Record keeping: includes adequate documentation and storage of records.
2. Information processing: includes approvals, authorizations, verifications and reconciliations necessary to ensure that transactions are valid, complete and accurate.

3. Physical controls: the processes and procedures designed to safeguard and secure assets and records.

4. Segregation of duties: includes 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.

5. Monitoring and performance reviews: testing controls to ensure that existing controls are functioning and meet 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.

Although the district has board policies and administrative regulations in place, they were not adequately defined or consistently enforced within the organization.

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. The three main types of occupational fraud are asset misappropriation, corruption, and financial statement fraud.

Asset misappropriation includes cash skimming, falsifying expense reports and/or forging checks. Corruption involves one or more 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; however, the most common method of detection is receiving tips from current and/or former employees. This occurs three times more frequently than any other prevention method for this type of fraud, and accounts for 42.2% of detections overall. According to the 2014 Report to the Nations on Occupational Fraud and Abuse conducted by the Association of Certified Fraud Examiners, corruption schemes accounted for 36.8% of all occupational fraud cases reported, with a median loss of $200,000.

This same study also indicates there is a direct correlation between the perpetrator's position and authority in an organization and the losses incurred. Approximately 42% of fraud perpetrators were employees; 36.2% were managers; 3.2% were "others," and 18.6% were owner/executives. Although owner/executives are the second lowest percentage of fraud perpetrators, this group generated the largest median loss of any group: $500,000 for the 646 cases reported in the United States.

Conflict of Interest

A conflict of interest exists when an individual has a private financial interest in the outcome of a contract or a public decision and does either of the following:

1. Participates in the decision-making process
2. Influences, or attempts to influence, others making a contract or decision

Statues that govern conflicts of interest include the Political Reform Act, Government Code 1090, Government Code 87100, and Corporations Code Section 5233 for nonprofit organizations. Governing board members and administrators should abstain from all discussions, negotiations and votes that are related to a contract in which they have a personal financial interest by removing themselves from the meeting and ensuring that abstention and departure are recorded in the board minutes. A conflict of interest can still exist with subsequent action on the contract, such as authorizing payment under a contract, negotiating disputes or contract terms; therefore, the governing board member, administrator and/or a designated employee should abstain from all discussions, negotiations and/or votes related to the contract in which he or she has a personal interest.

This report will demonstrate that conflict of interest existed that allowed the superintendent and business manager to gain financially.

Political Reform Act – Disclosure, Conflicts of Interest and Enforcement

The Political Reform Act (PRA), Government Code Sections 81000 - 91015, was enacted by Proposition 9 in June 1974. The stated intent of the act was to establish a process for most state and local officials as well as certain designated employees to publicly disclose their personal income and assets as follows:

> [a]ssets and income of public officials which may be materially affected by their official actions…[are] disclosed and in appropriate circumstances the officials…[are]disqualified from acting in order that conflicts of interest may be avoided.

The PRA provisions are enforced by the Fair Political Practices Commission (FPPC) and require every state and local governmental agency to adopt a conflict-of-interest code. The commission is the state agency responsible for interpreting the provisions of the law and issuing California Form 700 – Statement of Economic Interests. Because school governing board members are considered "public officials" and governing boards are considered "legislative bodies," board members and certain designated individuals must file a Form 700 annually, or upon taking office/position. Additionally, a consultant to the organization "who makes, participates in making, or acts in a staff capacity for making governmental decisions" may be required to complete Form 700.

PRA provides an eight-step process to determine whether a conflict of interest exists as follows:

1. Is the individual a public official?
2. Is the public official making, participating in making, or influencing a governmental decision?
3. Does the public official have one of the six qualifying types of economic interests? (An economic interest will be discussed more fully in the next section of this report.)

4. Is the economic interest directly or indirectly involved in the governmental decision?

5. Will the governmental decision have a material financial effect on the public official's economic interests?

6. Is it reasonably foreseeable that the economic interest will be materially affected?

7. Is the potential effect of the governmental decision on the public official's economic interests distinguishable from its effect on the general public?

8. Despite a disqualifying conflict of interest, is the public official's participation legally required?

The designated employees have filed Form 700. Forms examined showed that the former superintendent did not declare any financial interest in the schools' affairs or disclosed any conflict of interest that would result in *personal financial gain*.

The former superintendent and business manager exercised significant influence over financial decisions that provided a direct personal financial benefit that included authorizing a grant with California State University, Chico and participating in the grant proceeds by collecting stipends. In addition, the superintendent had an obligation to disclose the purchase of a personal residence at less than 50% of the estimated market price; this is fully described later in this report.

The business manager also participated in grant proceeds by receiving a stipend. According to the business manager, the superintendent explained that the stipend was to compensate her for all the extra accounting work for the construction projects. During her interview, the business manager admitted she did very little work on the grant documents and anticipated that following the FCMAT investigation, these funds would possibly need to be paid back to the school district.

Although other employees also received stipends, they were not considered "designated employees" for purposes of the Form 700 requirements.

Government Code 1090 – Financial Interest of Public Officials, Officers and Employees

Simply stated, the intent of Government Code 1090 is to prohibit a public official, officer or employee from engaging in a contract in which he or she has a financial interest in both a governmental and personal capacity.

Section 1090 has broad implications, applies to school districts, and provides as follows:

> Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by anybody or board of which they are members. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity.

> As used in this article, "district" means any agency of the state formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries.

This report will establish that a business relationship may have existed between the contractor and superintendent as evidenced by contracts and lease agreements. There is supportive documentation to demonstrate that the superintendent and the business manager may have had significant personal involvement, financial interest, and personal gain so as to have violated the conflict of interest statutes.

Residential Purchase

The superintendent's wife, a real estate professional, worked under a broker who is a widower of a former local developer. Approximately 15 months following voter approval for general obligation bonds, the superintendent and his wife purchased a personal residence located in Chico, California.

FCMAT's analysis demonstrates that the purchase of the superintendent's personal residence was more than 50% below the estimated market value and was not disclosed in accordance with laws and regulations set forth by the FPPC.

Zillow provides an online real estate marketplace designed to help real estate professionals, sellers, homebuyers, homeowners and others. The Zillow website lists properties for sale, rent, current offerings and prior sales. According to Zillow "more than 110 million U.S. homes" are included in its database. The database is updated three times each week using information collected from public records and user submitted data. Zillow uses advanced algorithms within a geographic area to analyze related data and comparisons to actual sales prices. The algorithm includes physical attributes, tax assessments, current and prior transactions to estimate market values at any given point in time. Although this is not an official appraisal, it offers a range of values, which is highly dependent on local information gathered on similar homes.

The table below is based on information listed from the Zillow website. Each property is adjusted for market indicators at the time of sale. All three properties selected are on the same street and built by the same developer.

Comparison of Property Sales
Zillow Estimates and Actual Purchase Prices

Property Numerical Address	Superintendent 112	Same Street 124	Same Street 116
Date of Sale	February 2008	December 2009	May 2010
Purchase Price	$187,000	$277,000	$300,000
Zillow Estimate	$441,000	$244,000	$287,000
Above/Below Zillow Estimate	($254,000)	$33,000	$13,000
Square Foot	2,458	1,401	1,663
Lot Size	0.20	0.21	0.20
Lot/Sq. Ft	8,712	9,147	8,712
Price Per Sq. Ft.	$76.08	$197.72	$180.40

Although this information is based on estimates, clearly the superintendent's purchase price is well below the Zillow estimates.

The other two properties were purchased during the depths of California's recession that officially began in December 2007 yet the price per square foot is more than double that of the superintendent's home, which was purchased shortly after the recession started.

Two foreclosures listed on the Chico, CA Real Estate Blog and MLS Search for single-family homes built between 2004 to 2006 with square footage between 2,060 and 2,460 are listed in the following table. The superintendent's purchase price is lower than any foreclosure and $100.75 ($176.83-76.08) per square feet lower than the most comparable foreclosure listed.

Comparison of Foreclosures
Single Family Homes Built Between 2004 - 2006
April 11, 2008

Property Numerical Address	352 Mesa Verde Court *	2718 Ceanothus Avenue
Price	$435,000	$279,900
Rooms/Baths	4 Bedrooms, 3 Baths	3 Bedrooms, 3 Baths
Square Footage	2,460	2,060
Year Built	2005	2006
Per Square Foot	$176.83	$135.87

**Property represents the most comparable in bedrooms, baths and square footage.*

This transaction represents a financial gain and was not properly reported on Form 700 in accordance with FPPC regulations.

General Obligation Bonds

The district was successful in its efforts to pass general obligation bonds totaling $21.9 million dollars in an election held February 5, 2008 to finance construction, provide furnishings and new equipment for district facilities. Following the election, the district made application to the Office of Public School Construction (OPSC) to maximize funding to which the district is approved but unfunded as of this date.

One method schools are authorized to utilize for construction is through a lease, lease-back arrangement. Under this arrangement, the district requested and received proposals. A local firm from Chico, California was awarded the contracts for all the construction activity.

The lease, lease-back arrangement provides that the district "leases" the facility during the construction period and upon completion of the project, the district purchases the facility. This particular option is attractive because the district is guaranteed a maximum price without the responsibility of bidding the project including subcontractors. The district issued three series of general obligation bonds:

Series A,	June 4, 2008	$ 8,000,000
Series B,	March 27, 2012	$ 8,034,047
Series C,	March 7, 2013	$ 1,020,024
Total		$17,054,071

Over the course of approximately seven years, various projects were completed successfully but in order to complete the final projects, the district was unable to draw the final $4,845,929 of voter authorization because the assessed valuation of properties to support the bond payments had decreased during the recession.

Anxious to complete construction, the district's governing board was advised by the superintendent to enter into a Certificate of Participation (COPs) for $6.1 million on December 7, 2010 with no payments until 2016-17 with the expectation that the economy would recover sufficiently to support selling the remaining bonds to pay off the COPs before the regular semi-annual payments became due. The following amortization schedule shows the principal and interest obligations:

Year Ended June 30,	Principal	Interest	Total Payment Due
2014	$0	$0	$0
2015	$0	$0	$0
2016	$0	$0	$0
2017	$120,000	$321,588	$441,588
2018	$125,000	$317,066	$442,066
2019-2023	$705,000	$1,498,384	$2,203,384
2024-2028	$895,000	$1,295,319	$2,190,319
2029-2033	$1,175,000	$1,002,806	$2,177,806
2034-2038	$1,565,000	$599,250	$2,164,250
2039-2041	$1,180,000	$108,900	$1,288,900
Total	$5,765,000	$5,143,313	$10,908,313

In addition to the bonds and COPs to support improvements of various education facilities, the district issued $780,000 of lease revenue notes on April 1, 2010, which along with interest of $25,350 is due for the 2013-14 fiscal year.

At the time of this review, the economy has improved but not to the point where the assessed valuation of properties is sufficient to support the sale of the remaining bonds. According to the notes included in the audited financial statements as of June 30, 2013, the district has received Deferred Maintenance Hardship funding and intends on using these funds to repay the principal portion of these lease revenue bonds.

The decision to issue COPs and revenue bonds to complete construction places a heavy burden on the district's general fund. In the middle of California's worst recession with unprecedented deficits on state apportionments, budget cuts and deferrals on cash, the district, like most other school districts in California, struggled to balance the operating budget. At the same time, from the 2006-07 through the 2009-10 fiscal years, the district's enrollment declined by 95 students. Many employees experienced pay cuts in the form of furlough days, reduction in work days and benefits, and some lost jobs, yet the superintendent continued to place pressure on the district's general fund by issuing more debt to complete construction and modernization projects.

Years of budget cuts, deficit funding, declining enrollment and debt burden depleted the district's general fund reserves to the point where the Glenn County Office of Education declared a fiscal emergency for OJUSD. Unable to support its current obligations including payroll cash-flow issues forced the district to borrow funds through a County of Glenn approved TRAN (tax and revenue anticipation note).

Lease, Lease-Back

FCMAT's review found that the district's control environment is lacking in many areas. For the district to perform and emulate best business practices, it is crucial for the district to develop a code of ethics and communicate its expectations on standards of conduct to the administration and staff.

The lease, lease-back project delivery method was authorized by the state legislature in accordance with California Education Code Section 17406 with the following conditions:

- A district may lease any real property that belongs to the district to a "person, firm, or corporation," (the builder) for $1.00 per year;
- The agreement between the district and the builder must provide for the construction on of a building or improvement on the district's property; and
- The district may do this without advertising for bids.

This method allows districts to enter into agreements with partners based on qualification and price to deliver facility improvements. Districts may consider "best value" proposals, similar to procedures associated with procuring other professional services contracts under Government Code Chapter 2254, and avoid the disadvantages associated with the accepting the "low bid" method used in the formal bidding process.

The lease, lease-back contracting method was developed specifically to provide districts with the same negotiating tools as the private sector. This method allows the contractor to be selected on the basis of criteria developed by the district including references or past performance.

The lease, lease-back process has been used by many school districts for the completion of construction projects because it offers distinct advantages over the traditional design-bid-build process that involves the development of construction plan documents which are publicly bid upon by contractors, and must be awarded to the lowest bidder. Under the lease, lease-back process the contractor is selected by the district under a qualifications-based process - although not required by law. The district did solicit proposals from qualified contractors but did not outline specific criteria for the award.

After a contractor is selected by the district, they work together with their architect to review the construction plans and determine a guaranteed maximum price (GMP) for the project. The district then signs two different lease agreements with the contractor in order to complete the project; a site lease, and a facilities lease. The site lease facilitates the leasing of the district property to the contractor for a nominal amount, typically $1 per year. The facilities lease agreement is more comprehensive and must specifically stipulate the value of the project in accordance with the guaranteed maximum price and the construction documents, and grant title of the improved property to the district upon the completion of the construction project. The site lease and the facilities lease usually terminate upon the final payment of the facilities lease. There are other detailed elements to these leases involving structured lease payments, subleasing, and provisions regarding public indebtedness if a third-party financial intermediary is involved, but the site lease and facilities lease are essentially the two fundamental documents necessary to facilitate the lease, lease-back process.

School districts find this method of construction attractive because there is an incentive for the contractor and architect to identify all the potential construction issues with the project before the project commences. Under the concept of a GMP if there are any issues with the project related to design error or errors in the identification of material or labor costs after the project begins, then these costs must be borne by the contractor.

This approach is the opposite of the process under the design-bid-build concept whereby all errors identified after the job has been awarded to the lowest bidder are borne by the school district, often at inflated prices by the contractor since the school district has no negotiating leverage, and often there is no other choice in who may complete the job, after the project has begun.

The GMP concept allows the school district to relieve themselves of the unknown costs associated with the change order process and provides a level of certainty in the cost of the project that they do not have when completing a project under the traditional design-bid-build process. As a result the contractor and architect often work more diligently to identify all potential project costs before the GMP is agreed upon. This concept of cost-certainty has been the perhaps the most attractive element for school districts in the utilization of the lease, lease-back method for construction project delivery.

The lease, lease-back process has also been an acceptable method for construction project delivery by the State Allocation Board (SAB) and the Office of Public School Construction (OPSC) for the completion of school facility projects that are completed with funding granted through the State School Building Program. The construction projects must be completed with plans and specifications approved by the Department of the State Architect (DSA) and the California Department of Education (CDE), and are subject to legal requirements regarding public works projects such the requirement of performance and payment bonds, payment of prevailing wages, and other labor code and insurance requirements. Projects utilizing State funding for their completion must demonstrate compliance with Education Code section 17070.5 regarding the certification of a competitive process used to select a design professional for the lease, lease-back project.

With regard to the projects completed utilizing the lease, lease-back process at the Orland Joint Unified School District, FCMAT was unable to determine if there was a competitive process regarding the selection of a design professional since all of the district records pertaining to the selection process, and the project records themselves, were unable to be located. There were some facilities records available at the time of the visit by FCMAT, but they provided no relevant information.

Because of the lack of adequate documentation, it was difficult to determine the adequacy or sufficiency of all the transactions involved in the development of new district facilities by the Orland Unified School District.

Of most concern was the lease purchase transaction to acquire the building for a new district office facility from the same local contractor that was awarded all of the construction project contracts.

Of most concern was the lease purchase transaction to acquire the building for a new district office facility from the same local contractor that was awarded all of the construction project contracts.

The building was acquired through a lease-purchase agreement by the district under the authority granted to the superintendent by the governing board during the closed session of a special board meeting on December 10, 2012.

On December 13, 2012 the superintendent signed a lease-purchase agreement in the amount of $520,000 for a new district office facility located at 903 South Avenue in Orland, Ca from Diamond Holdings LLC. Diamond Holdings LLC is owned and operated by R&R Horn Construction Company.

The building construction infrastructure was incomplete and was currently under its final construction improvements at the time of district purchase. FCMAT's review has determined that the building improvements were under construction at that time by R&R Horn Construction of Chico, California, the same contractor the district used to complete each of its lease, lease-back projects using proceeds from its local school bond, and that R&R Horn Construction was completing improvements to the new district office building based on plans developed by the district well in advance of board approval of the building's lease-purchase agreement.

Furthermore, FCMAT identified information that the unimproved office building was purchased from a local medical corporation by Diamond Holdings LLC, which is owned by the same ownership as R&R Horn Construction, just days before the purchase of the building by the Orland Unified School District at an amount substantially lower than the amount paid by the district.

The lease-purchase agreement signed by the district for the building was a lease-purchase contract, which included a non-refundable deposit of $50,000 to be applied towards the purchase price of $520,000. Monthly lease payments of $3,250 for a five-year period stipulated that $500 of each monthly payment for up to 36 months would also be applied towards the purchase price if the purchase occurred within a three year period. The district could purchase the building outright for $520,000 following the first year up to the 60th month at which time the price could be increased based on an appraisal but would be no less than $520,000.

The table below demonstrates that if completed through to the five year term, the district will have paid a total amount of $629,000 for the building.

Lease Purchase Option Agreement
Orland JUSD and Black Diamond Holding

Option If Exercised Within 60 Months:		
Rent	$3,250 X 60 months	$195,000
Portion of rent applied to purchase price	$500 X 36	($18,000)
Net Amount of Rent		$177,000
Purchase Price		$520,000
Less: Deposit		(50,000)
Less: Rent Offset		(18,000)
Rent with offset over 60 months		177,000
Total		$629,000
Option If Not Exercised:		
Rent	$3,250 X 60 months	$195,000
Non-Refundable Deposit		50,000
Total		$245,000
Monthly Rent Equivalent		$4,083

Best business practices were not followed in the course of this transaction since there was no appraisal of the property or indications of a title search conducted prior to its purchase. Real estate professionals such as a broker or a real estate sales person were not consulted nor was there an attorney present to review the transaction as to form and content. The transaction clearly lacks due diligence by the district, transparency for the public and questions the use of bonds funds and developer fee funds to complete the lease-purchase of the building. The transaction also occurred at a time when the district was struggling to meet monthly payroll demands and could not demonstrate that sufficient cash existed to meet all of its financial obligations.

A normal real estate transaction following best practices with the intent to lease or purchase would involve the buyer, seller, mortgage broker, real estate company, escrow company, title company and legal representation. At the conclusion of a normal transaction, all documents would normally be recorded as a public document. There was no evidence to support that the transaction was ever recorded as a public document.

This transaction raises the perception whether the buyer (district) and seller (contractor) of the lease-purchase of the district office acted independently and have no relationship to each other. The concept of an “arm’s length transaction” is to ensure that both parties are not acting in their own self-interest and are not subject to any pressure or duress from the other party.

Because of the lack of formal policies and proper management oversight by the board, the district’s culture or business environment regarding the lease-purchase of the district office and other financial matters, including independently negotiating binding contracts, often became a routine and acceptable practice that was afforded to the superintendent and passively approved the governing board.

Project Co-STARS

Project Co-STARS (Collaboration for Student and Teacher Achievement in Rural Schools) is a program administered by the School of Education at California State University, Chico (CSU, Chico). The program involves a partnership between the CSU, Chico School of Education and four high-need rural school districts in northern California, focusing on the recruitment and training of highly qualified teachers who can meet the needs of rural schools in the hiring and development of teaching professionals. Project Co-STARS was developed by CSU, Chico through a $7.3 million *Teaching Quality Partnership Grant* they received from the U.S. Department of Education, Office of Innovation and Improvement.

According to their website, the Co-STARS project has three developmental pathway options for its student candidates: Integrated Teacher Education Core, Transfer Teacher Education Core, and Rural Teacher Residency programs. One element of the program pathways involves the placement of CSU, Chico students who are enrolled in the teaching credential program, known as residents, with the Orland Unified School District in order to provide the residents with training, mentoring, and classroom teaching opportunities.

The district originally entered into an agreement with the CSU, Chico Research Foundation to become a partner in the Co-STARS program over a five-year period beginning in 2009. The agreement specified an annual payment to the district, ranging from $39,100 in Year 1 to $29,300 in Year 5, to reimburse the district for their incurred costs associated with administering the Co-STARS program. The agreements also specified certain district personnel identified as Project Personnel who were to be directly involved in the oversight of the Co-STARS project, along with their individual roles and responsibilities. The Project Personnel would perform their duties under the agreement and then the district would directly invoice CSU, Chico for reimbursement of their costs on a quarterly basis.

For example, on page 9 of the Year 4 agreement provided to FCMAT, four specific district employees were named as the Project Personnel. According to the agreement the district was to be reimbursed for the labor costs of each of the individuals specified in the budget document contained in the agreement, which were estimated labor costs based upon their annual salary and the percentage of time each of the four Project Personnel spent working with the Co-STARS program. The district invoiced CSU, Chico quarterly according to the agreement and, after receiving the revenue, would then issue individual stipends to each of the employees named in the agreement as Project Personnel.

The business manager was named on page 10 of the agreement as having responsibility for the submission of quarterly invoices to CSU, Chico and “in-kind” documentation reports of designated district personnel who provided service to the Co-STARS program at the district. According to inter-office memoranda provided to FCMAT however, the business manager directed the payroll clerk to prepare stipends for individuals other than those Project Personnel named in the agreement. Specifically the business manager directed the payroll clerk to prepare stipends for herself, as evidenced in three of the inter-office memos provided to FCMAT despite not having been named in the agreement as one of the Project Personnel.

When FCMAT interviewed the business manager about these memos directing the payroll clerk to prepare stipends for herself, the business manager stated they were directed to do so by the superintendent, however there is no written evidence substantiating this claim, and there was no written signature or initials by the superintendent on the inter-office memos directing the payroll clerk to prepare the stipends that would indicate knowledge or approval by the superintendent.

The business manager did receive the stipends, and also indicated the superintendent had directed her to pay stipends to other individuals who were not specifically named in the Co-STARS agreement as Project Personnel. However, no other individuals who were not identified as Project Personnel in the grant documents were identified by FCMAT as having received stipends from the Co-STARS revenue.

The business manager, despite receiving a stipend under the Co-STARS agreement, is not specifically named in the agreement as one of the Project Personnel, while the inter-office memos directing the payment of stipends specifically state "for the participants who performed duties for the Chico State Co-Stars Program."

During interviews, the business manager stated the superintendent had indicated he specifically included the business manager's role in the Co-STARS agreement as having responsibility for the invoicing to CSU, Chico and the business manager was therefore entitled to receive a stipend as compensation. However, FCMAT found no written evidence in the agreement that the time spent on the invoicing was a cost specifically reimbursable under the terms of the agreement. The business manager also stated that the superintendent felt that he had the express authority to award stipends to any individuals he chose using the revenue received under the Co-STARS agreement because the governing board had given him that authority, and that the revenues were a "pass-through" to the district for the work being performed by specific employees of the Orland Unified School District under his direction.

The business manager stated she was "not comfortable" receiving the stipend since she was not certain about whether or not her labor cost was an allowable reimbursement under the Co-STARS agreement, but was only following the specific direction of her direct supervisor (the superintendent) in issuing memos to the payroll clerk to prepare stipends to individuals not specified in the agreement. She also stated she was told her stipend was to reimburse her for the additional work she did for construction and modernization projects, and she was prepared to reimburse the district following FCMAT's review.

Since the superintendent was not available for interview by FCMAT during fieldwork, it cannot be determined if the superintendent did in fact direct the business manager to issue a stipend to herself. Two board members of the district who were interviewed by FCMAT indicated they were not aware that the payment of stipends was being directed by the superintendent to be paid to specific employees in the district.

The invoices the district submitted to CSU, Chico for reimbursement of eligible costs under the agreement were also not provided to FCMAT, so it cannot be determined if the business manager's labor cost was a cost specified for reimbursement by CSU, Chico. Potential fraud may exist if the district was invoicing CSU, Chico for specific costs incurred by individuals named under the agreement, and subsequently issuing district stipends to individuals not specified on the invoices or named as Project Personnel under the agreement.

Further investigation is necessary to determine if the individuals named on the invoices submitted to CSU, Chico were also the same individuals who were named in the Co-STARS agreement as Project Personnel, and who also received stipends from the Co-STARS revenue.

Additionally the district should undertake a comprehensive review of its payroll and warrant processing procedures to ensure there are appropriate levels of review and approval for all financial disbursements since the existing practice of allowing the business manager to direct the payroll clerk, an employee they supervise, to prepare a payment directly to herself without a secondary review or approval represents the most serious violation of internal control in the processing of cash disbursements.

Additionally, this request for payment was initially presented to GCOE without supporting documentation. GCOE required such documentation prior to processing the stipends, which was then provided as a memorandum from the OJUSD chief business official.

Governance

Board policies and administrative regulations are based on laws and regulations in numerous documents, including the California Constitution, Education Code, Code of Regulations, Government Code, federal regulations, case law, and industry practice. Board policies and regulations provide guidelines and directives for the operation of the district and its personnel and are a key component of internal controls. It is important to ensure that board policies are updated to reflect changes in legislation.

In designing board policies and administrative regulations, management is responsible for designing and implementing a system of internal controls over financial reporting. This system should provide reasonable assurance that misstatements and/or noncompliance affecting the financial statements are prevented or detected and corrected through normal operating procedures. When adopting board policy, the district should carefully consider the specific guidelines that promote behavior that secures the assets from misuse or fraud.

Recommendations

The district should:

1. Hold regular staff meetings of the entire district office to discuss the workload and duties of all staff members during peak workload periods. Immediately address the conflicts and issues that exist among business office staff and define job duties so responsibilities and professional standards are clear.

2. Develop specific performance objectives to maintain a high level of accountability for all district office positions.

3. Communicate expectations on the standards for working together and the consequences of not following board policies and administrative regulations.

4. Communicate changes made in responsibilities and processes throughout the organization.

5. Assign each district office staff member to complete a step-by-step procedures manual for each of their job duties and include these procedures in a desk manual.

6. Ensure that employees are cross-trained in all key areas of responsibility.

7. Adopt and implement board policies that identify measures for the prevention of fraud.

8. Adopt and implement board policies that identify the proper internal controls and segregation of duties for the business office.

Prevention and Detection

As previously mentioned, the internal control environment includes ethical values and integrity displayed by the governing board and management as well as the underlying tone set by the organization's site administrators. 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.

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 organization in the course of their employment to ensure that those activities are conducted in compliance with all applicable board policies, laws, regulations, and standards of conduct. Management personnel are entrusted to safeguard the district's assets and ensure that internal controls function as intended.

The role of the governing board is to ensure that the district maintain fiscal solvency. The governing board should refrain from delegating blanket authorization to any individual to enter into binding contracts for the district, enter into property negotiations without board participation or allow long-term debt arrangements that affect the district's general fund without financial and legal review to support fiscal solvency with the inclusion of multiyear commitments.

While the governing board and all employees in the organization have some responsibility for internal controls, the superintendent and business manager positions had a fiduciary duty and responsibility to make certain that the assurances that the governing board fiscal policies and procedures were conducted responsibly, ethical and updated in a timely manner.

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.

Conclusion

Internal controls clearly are among the most important aspects of any fraud prevention program. Management is a position of authority and therefore has a higher standard of care to establish the ethical tone and serve as examples to other employees. Employees with supervisory responsibility have a duty to monitor all the activities of their subordinates in the course of their employment to ensure that those activities are conducted in compliance with all applicable board policies, laws, regulations, and standards of conduct. Management personnel are entrusted to safeguard the district's assets and ensure that internal controls function as intended.

Based on the documentation presented to FCMAT, there are questionable transactions and business practices that may demonstrate mismanagement and misappropriation of district funds and assets and significant material weaknesses in the district's internal control environment, which increases the probability of fraud and/or abuse. These findings should be of great concern to the district and require immediate intervention to limit the risk of fraud and/or misappropriation of assets.

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.

Recommendation

The county superintendent should:

1. Notify the governing board of the 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

Appendix A - Study Agreement

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

FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
AB139 STUDY AGREEMENT
January 22, 2014

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

1. BASIS OF AGREEMENT

The team provides a variety of services to school districts and county offices of education upon request. Pursuant to the provisions of Education Code Section 1241.5 (b), a county superintendent of schools may review or audit the expenditures and internal controls of any school in his or her county if he or she has 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 Glenn County Office of Education has requested that the team provide for the assignment of professionals to conduct an AB 139 Extraordinary Audit. Pursuant to Education Code section 1241.5 (b),(c), the superintendent of Glenn County has reason to believe that fraud, misappropriation of funds or other illegal practices may have occurred and shall conduct a review of the Orland Unified School District. In addition to the authority granted under Education Code 1241.5 (c) and 47604.3, the county superintendent may conduct an investigation of the district and charter schools based upon written complaints by parents or other information that justifies the review.

The primary focus of this review is to provide the COE and the Orland Unified School District with reasonable assurances based on the testing performed that adequate management controls are in place regarding the district's reporting and monitoring of financial transactions, and that fraud, misappropriation of funds or other illegal activities have not occurred. Management controls include the processes for planning, organizing, directing, and controlling program operations, including systems for measuring, reporting, and monitoring performance. The expenditure of funds for salary and benefit compensation including stipends, vacation, sick leave; conflicts of interest related to construction projects; and the use of credit cards can be areas of high risk in which potential fraud issues such as fictitious employees or vendors, or misappropriation of assets including cash, may be detected during an audit. Specific audit objectives will include evaluating the policies, procedures, and internal controls and transactions performed by the district.

The team will sample test data from the current and two prior fiscal years and include a review of the expenditures made for administrative positions to determine if fraud, misappropriation of funds or other illegal activities have occurred. Testing associated with this review will be based on the sample selection; it will not include testing of the complete list of all transactions and records for this period. Sample testing and review results are intended to provide reasonable, but not absolute, assurance as to the accuracy of the district's transactions and financial activity.

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. Draft Reports – 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.

5. Final Report - Electronic copies of the final report will be delivered to the COE and/or district following completion of the review. Printed copies are available from the FCMAT office upon request.

6. Follow-Up Support – If requested, the team will meet with the COE and/or district to discuss the findings and recommendations of the report.

3. PROJECT PERSONNEL

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

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

4. PROJECT COSTS

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

A. $800 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.

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 $18,000.

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.

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. Existing policies, regulations and prior reports addressing the study request
2. Current or proposed organizational charts
3. Current and two (2) 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 field work; any delay in the receipt of the requested documents may affect the start date of the project. Upon approval of the signed study agreement, access will be provided to FCMAT's online SharePoint document repository, to which the district shall upload all requested documents.

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

Pursuant to EC 45125.1(c), representatives of FCMAT will have limited contact with pupils. The 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:

Orientation:	***To be determined***
Staff Interviews:	***To be determined***
Exit Interviews:	***To be determined***
Preliminary Report Submitted	***To be determined***
Final Report Submitted	***To be determined***
Board Presentation	***To be determined***

7. CONTACT PERSON

Contact:	Tracey Quarne, Superintendent
Telephone:	(530) 934-6575 x 3060
FAX:	(530) 934-6576
E-mail Address:	traceyquarne@glenncoe.org

Tracey Quarne 1/24/14

Tracey Quarne, Superintendent — Date
Glenn County Office of Education

Anthony L. Bridges — January 22, 2014

Anthony L. Bridges, CFE, CICA — Date
Deputy Executive Officer
Fiscal Crisis & Management Assistance Team