



Berkeley Unified School District

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Javetta Cleveland, Deputy Superintendent

January 26, 2017

VIA ELECTRONIC MAIL -- victor@realmcharterschool.org
Victor Diaz, Executive Director
REALM Charter School
1222 University Ave, Berkeley, CA 94702

Dear Mr. Diaz:

This document constitutes a Notice of Violation ("NOV") issued by the Berkeley Unified School District (the "District") to REALM Middle School and REALM High School (collectively "Charter Schools") under Education Code § 47607(d).

I. LEGAL BASIS FOR ACTION

A. Purpose of Notice of Violation

As is noted in more detail below, the purpose of the NOV is to commence a process under which the District sets forth findings in support of the NOV, as well as a remedy period. At the end of the remedy period, Charter School shall respond in writing to the findings in the NOV, and identify measures taken to remedy the violations set forth therein. At that time, the District will assess Charter School's response and remedies and will determine whether to pursue revocation of the Charter School charter through issuance of a Notice of Intent to Revoke.

B. Education Code Provisions

The revocation of a charter is governed by Education Code § 47607. Education Code § 47607(c) sets forth the grounds for revocation:

A charter may be revoked by the authority that granted the charter under this chapter if the authority finds, through a showing of substantial evidence, that the charter school did any of the following:

- (1) Committed a material violation of any of the conditions, standards, or procedures set forth in the charter;
- (2) Failed to meet or pursue any of the pupil outcomes identified in the charter;

- (3) Failed to meet generally-accepted accounting principles, or engaged in fiscal mismanagement; or
- (4) Violated any provision of law.

The charter-authorizing agency precedes revocation with a Notice of Violation and a reasonable opportunity to remedy the violation under Education Code § 47607(d):

Prior to revocation, the authority that granted the charter shall notify the charter public school of any violation of this section and give the school a reasonable opportunity to remedy the violation, unless the authority determines, in writing, that the violation constitutes a severe and imminent threat to the health or safety of the pupils.

Prior to revocation, the charter-authorizing agency provides the charter school with a Notice of Intent to Revoke, and conducts a public hearing on the potential revocation (Education Code § 47607(e)):

Prior to revoking a charter for failure to remedy a violation pursuant to subdivision (d), and after expiration of the school's reasonable opportunity to remedy, without successfully remedying the violation, the chartering authority shall provide a written notice of intent to revoke and notice of facts in support of revocation to the charter school. No later than 30 days after providing the notice of intent to revoke a charter, the chartering authority shall hold a public hearing, in the normal course of business, on the issue of whether evidence exists to revoke the charter. No later than 30 days after the public hearing, the chartering authority shall issue a final decision to revoke or decline to revoke the charter, unless the chartering authority and the charter school agree to extend the issuance of the decision by an additional 30 days. The chartering authority shall not revoke a charter, unless it makes written factual findings supported by substantial evidence, specific to the charter school, that support its findings.

The charter school may appeal the revocation to the County Board. (Education Code § 47607(f)(1).)

C. California Code of Regulations

Cal. Admin. Code tit. 5, § 11968.5.2, sets forth additional procedures for a school district's revocation of a charter. Subsection (a) of the regulation provides the charter school 72 hours' notice before the board considers issuing a Notice of Violation:

At least 72 hours prior to any board meeting in which a chartering authority will consider issuing a Notice of Violation, the chartering authority shall provide the charter school with notice and all relevant documents related to the proposed action.

Subsection (c) describes the charter school's obligations once a Notice of Violation is served:

Upon receipt of a Notice of Violation, the charter school's governing body as described in the school's charter, if it chooses to respond, shall take the following actions:

- (1) Submit to the chartering authority a detailed, written response addressing each identified violation which shall include the refutation, remedial action taken, or proposed remedial action by the charter school specific to each alleged violation. The written response shall be due by the end of the Remedy Period identified in the Notice of Violation.
- (2) Attach to its written response supporting evidence of the refutation, remedial action, or proposed remedial action, if any, including written reports, statements, and other appropriate documentation.

Once the charter school responds to the Notice of Violation, the District will determine whether to proceed with the revocation process. As set forth in Cal. Admin. Code tit. 5, § 11968.5.2, sections (d) and (e):

- (d) After conclusion of the reasonable opportunity to remedy, the chartering authority shall evaluate the response of the charter school's governing body as described in the school's charter response to the Notice of Violation and any supporting evidence, if submitted, and shall take one of the following actions:
 - (1) If the chartering authority has substantial evidence that the charter school has failed to refute, to the chartering authority's satisfaction, or remedy a violation identified in the Notice of Violation, the district shall continue revocation of the school's charter by issuing a Notice of Intent to Revoke to the charter school's governing body as described in the school's charter; or
 - (2) Discontinue revocation of the school's charter and provide timely written notice of such action to the charter school's governing body as described in the school's charter.
- (e) If the chartering authority does not act, as specified in subdivision (d), within 60 calendar days of the conclusion of the Remedy Period specified in the Notice of Violation, the revocation process is terminated and the Notice of Violation is void.

If the District proceeds to issue a Notice of Intent to Revoke, the Board will hold a public hearing no later than 30 days thereafter, and take action on a Final Decision in open session within 30 days of the public hearing:

On the date and time specified in the Notice of Intent to Revoke, the chartering authority shall hold a public hearing concerning revocation. No more than 30 calendar days after the public hearing (or 60 calendar days by written mutual agreement with the charter school), the chartering authority shall issue a Final Decision.

The charter school must file any appeal to the County Board within 30 days of Board action. (Cal. Admin. Code tit. 5, § 11968.5.4(a).)

II. VIOLATIONS GIVING RISE TO THIS NOTICE

A. Failure to Follow Generally Accepted Accounting Principles and Fiscal Mismanagement (Education Code section 47607(c)(1)(C)) Violation of terms of the Charter (Education Code section 47607(c)(1)(A))

The District's oversight responsibility includes monitoring the fiscal condition of the Charter Schools through review of State required financial reports, including the Charter Schools' adopted budget, interim budget reports and unaudited and audited financial statements.

The Charter School is obligated under the law to avoid fiscal mismanagement and use Generally Accepted Accounting Principles. (Education Code section 47607(c)(1)(C).) Appendix I of the REALM Middle School Charter requires the Charter School to maintain fiscal solvency and a positive ending fund balance, as do conditions of the Board's December 9, 2015 renewal of the charter. (**Exhibit A**)

In accordance with Education Code Section 47604.33, the District has reviewed the Unaudited Actuals for Fiscal Year 2015-16 for REALM High School.

B. REALM HIGH SCHOOL

1. Fiscal Year 2015-2016 Analysis – Unaudited Actuals

A review of the Unaudited Actuals indicates the following:

- Revenues are \$3,404,224 for Unrestricted programs, and \$448,881 for Restricted programs, for total revenues of \$3,853,085;

- Expenditures are \$2,758,181 and \$875,537 for Unrestricted and Restricted programs respectively, with a contribution of \$200,172 from Unrestricted to Restricted programs;
- There is a resulting surplus of \$445,870 for Unrestricted programs and a deficit of \$26,503 for Restricted program;
- The ending fund balance of \$244,725 is comprised of \$219,501 for Unrestricted Programs and \$25,224 for Restricted Programs. (**Exhibit B**)

The charter school has met the conditions of the Board's December 9, 2015 renewal of the charter by making reductions that would balance the negative ending fund balance by the end of 2016-17. The ending fund balance for the combined general fund is \$244,725 as of 2015-16, and is higher than the ending fund balance of \$147,713 projected in the charter petition renewal.

2. Fiscal Year 2015-2016 Analysis – Audited Actuals

REALM'S audited financial statements for Fiscal Year 2015-2016 stated that REALM High School has net assets of \$243,646 at June 30, 2016. At Second Interim, REALM's projected ending fund balance was \$294,296. Therefore, REALM High School closed the books with an audited ending fund balance of \$50,650 less than projected. (**Exhibit C**)

REALM's audited actuals for Fiscal Year 2015-2016 also contained the following "Matter regarding Going Concern":

The accompanying financial statements have been prepared assuming the Schools will continue as a going concern. As noted in Note 9 to the financial statements, in the previous year, the School experienced an operating deficit, cash flow, difficulties, and did not have adequate cash reserves or accounts receivable to meet its current obligations without obtaining additional financing or funding. The Schools reduced the deficit for the year ended June 30, 2016, but still had an ending deficit net asset balance and required substantial financing to meet its current obligations. These factors cause substantial doubt about the Schools' ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 10. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Under Note 10 ("Management Plans"), the audited actuals note the following:

Management has taken steps to ensure that net assets are positive by the end of the next fiscal year. They following are steps and factors that Management has identified:

- Major staffing cuts over the next two years in order to balance the budget and establish a 3% reserve.
- To make major cuts without impacting the quality of the teaching and learning as promised under the charter.
- To submit monthly financial budgets to our Authorizer, Berkeley Unified School District (BUSD) in order to maintain a correct and accurate course of action.
- Apply for additional local, regional, and statewide multi-year grants.

The ability of the School to continue as a going concern is dependent on the success of these actions. The financial statements do not include any adjustments relating to the recoverability of recorded asset amounts or the amounts of liabilities that might be necessary should the Schools be unable to continue as a going concern.

The District concurs with the auditor's concerns. These steps were noted in the prior year audited financial statements and in the charter school renewal and conditions for renewal adopted by the Board on December 9, 2015. The charter school renewal petition contained a projected fund balance as of June 30, 2017 that was not met as noted below in the District's review of the First Interim for Fiscal Year 2016-17. REALM Charter High School therefore has not met the conditions of the Board's renewal.

3. Fiscal Year 2016-2017 – First Interim Report

A review of the First Interim Report for Fiscal Year 2016-2017 indicates that revenues are projected to be \$4,033,991 and expenditures are projected to be \$4,204,372, for a deficit of \$170,381. The audited beginning fund balance is \$243,646 and the audited ending fund balance at First Interim is \$73,265. (**Exhibit C**)

Based on the projections included in the charter petition renewal for the combined unrestricted and restricted general fund, REALM projected a surplus of \$357,324 when in fact ended up deficit spending by \$170,381. In effect, REALM High School missed the projection by \$527,705.

The charter school's projected ending fund balance per the renewal petition was \$949,580. The ending fund balance at First Interim of \$73,265 is \$876,315, less than the balance in the charter renewal petition. REALM's failure to meet the ending fund balance projected in its renewal petition does not demonstrate financial progress toward meeting the Board's renewal conditions.

REALM High School's response to its First Interim contains the reasons that the projected ending balance for 2016-17 did not meet the projected ending fund balance included in the petition renewal.

- The District asks REALM High School to provide any additional information regarding its failure to meet its ending fund balance to the District.

Revenues and Expenditures

Overall revenues at First Interim are projected to be \$284,291 less than revenues in the adopted budget, primarily due to a reduction in LCFF funding in the amount of \$472,797, which is partially offset by an increase in other state revenue in the amount of \$245,388.

Expenditures at First Interim are projected to be \$191,874 more than in the adopted budget, due primarily to an increase in professional/consulting services and operating expenditures in the amount of \$149,703. The First Interim Report contains no explanation for the significant increase in expenses for professional/consulting services.

- Please explain the basis for the significant increase in expenses for professional/consulting services.

LCFF and LCAP

LCFF funding total \$3.1 million and represent 78% of all funding. REALM High School is projected to receive \$1,438,671 as State Aid funding, \$499,995 as Education Protection Account (EPA) State Aid funding and \$1,204,590 as Transfers in Lieu of Property Taxes. Per the District's books, REALM High School is projected to receive \$1,395,978, which is \$191,388 more than REALM is reporting. It is important that the District review the calculation of LCFF funding to ascertain the validity of the amounts reported for State Aid and EPA funding. The District is requesting the LCFF calculations which should be submitted with each Interim. In the future the LCFF calculation should be submitted with the budget.

Cash Flows

The combined Cash Flow Statement provided with the First Interim Report shows a balance of \$275,766 at December 31, 2016. The Cash Flow Statement should have shown actual cash transactions as of the cut-off period, as well as cash flow projections through June 30, 2017. Given REALM has a significant cash flow troubles, the District cannot determine if REALM will have the cash available to meet its fiscal obligations through June 30, 2017 without accurate and complete information.

Since the charter renewal, REALM High School has not received any advances on its in-lieu property taxes, which meets the condition of the renewal. However, REALM continues to sell receivables of their future ADA revenue and property taxes to meet its expenditure obligations. On October 21, 2016, REALM sold its January 2017 State Apportionment, in-lieu of property taxes and special education revenue to receive those found now to help with current cash flow. On November 14, 2016, REALM sold the same revenue sources for February 2017 receipts. On December 13, 2016, REALM sold the

same revenue sources for March and April 2017. These indicators of poor cash flow indicate that REALM is short on cash to meet current obligations.

The conditions for renewal of the charter petition required that REALM provide monthly cash flows to the District for each school beginning with December 2015 until negative ending fund balance is resolved and 3% reserve is obtained. REALM has not met this conditional requirement. (See, **Exhibit A.**)

- Please provide cash flow projections through June 30, 2017.

Long Term Debt and Line of Credit

Notes Payable

In September 2011, the Charter Schools obtained a promissory note of \$309,968 from Kaufman Constructions, Inc. The note carries annual interest rate of 8.5% and requires monthly payments of \$3,843 by the Charter Schools. The note matures in September 2021. The note balance as of June 30, 2016 was \$192,300.

In October 2013, the School's obtained a loan of \$60,000 from Fred Huxman. The loan has a term of up to 10 years and carries no interest rate. The loan balance as of June 30, 2016 was \$60,000.

In February 2016, the Schools obtained a promissory note of \$1,387,363 from Charter Asset Management Fund, Inc. The note carries annual interest rate of 10% and requires monthly payments of \$200,000. The note matures in March 2017. The note balance as of June 30, 2016 was \$1,284,446.

Line of Credit

The Schools have a revolving line of credit with Wells Fargo for \$100,000 with an annual interest rate of 10.25%. There was a balance of \$71,367 for the year ended June 30, 2016.

Enrollment and ADA

The state no longer requires ADA for charter schools to be reported on an in-district vs out-of-district basis for apportionment purposes. Therefore, this breakdown is not currently in REALM's Student Information System. The District reported P-2 ADA for REALM High School for Fiscal Year 2015-16 of 341.15, and 328.37 at P-1 for Fiscal Year 2016-17. The snapshot provided by REALM as of December 15, 2016 is 327 ADA. The amount cannot be compartmented to ADA used to calculate LCFF funding since the LCFF calculator was not provided.

Insufficient Minimum Reserves

In its adopted budget for Fiscal Year 2016-2017, REALM High School indicated that it met the recommended minimum reserve of 3%. However, at First Interim, the reserve for economic uncertainty is 1% and does not meet the recommended minimum reserve of 3%. This demonstrates that REALM High will be unable to sustain any unforeseen expenditures and may not be able to meet its current and future financial obligations.

Overall

Based on the District's review of the Audited Actuals for Fiscal Year 2015-16, and the Budget for the First Interim Report for Fiscal Year 2016-17, we have noted a deterioration in financial condition based on the information provided. The District continues to have very serious concerns about the fiscal health of REALM High School and its ability to meet financial obligations and continue as a going concern. REALM High School not met it projected ending balance for Fiscal Year 2016-17 and the conditions of the charter petition renewal to provide monthly budget and cash flow reports.

C. REALM Middle School:

1. Fiscal Year 2015-2016: Unaudited Actuals

In accordance with Education Code Section 47604.33, the District has reviewed the Unaudited Actuals for FY 2015-16 for REALM Middle School. **(Exhibit D)**

a. Fiscal Year 2015-2016: Deficit Spending

A review of the Unaudited Actuals indicate that REALM middle school has engaged in a protracted pattern of deficit spending spanning over a number of fiscal years:

- Revenues are \$2,858,874 for unrestricted programs, expenditures are \$2,967,982 and contribution to restricted programs total \$161,745;
- REALM Middle School is deficit spending by \$270,853 for the unrestricted general fund. The beginning fund balance is \$929,653 and the ending fund balance is \$1,164,860;
- Based on the projections included in the charter petition renewal for the combined unrestricted and restricted general fund, REALM projected a surplus of \$69,817 when in fact ended up deficit spending by \$305,359.

The charter school has not met the conditions of the charter petition renewal by making reductions that would balance the negative ending fund balance by the end of 2016-17. The ending fund balance for the combined general fund grew to a negative \$1,146,910, Likewise, in 2015-2016, REALM Middle School projected a negative fund balance of \$771,735 in its renewal petition. This negative balance does not demonstrate financial progress toward meeting the conditions in which the charter was renewed.

- The District is requesting an explanation of why the ending balance for Fiscal Year 2015-16 did not meet the projected ending fund balance included in the petition renewal.

b. Fiscal Year 2015-2016: Revenues and Expenditure

Overall revenues are \$115,585 more than budgeted due to an increase in State and LCFF revenues and other local revenues. Expenditures are \$179,119 more than budgeted primarily due to Certificated Salaries and benefits exceeding budget.

- The District is requesting explanation of this budget to actual variance.

c. Fiscal Year 2015-2016: Local Control Funding Formula (LCFF) Funding

LCFF funding total \$2.3 million and represents 79.3% of all Unrestricted funding. REALM Middle School receives \$761,999 as State Aid funding (current and prior year), \$392,454 as Education Protection Account (EPA) State Aid funding and \$1,110,620 as Transfers in Lieu of Property Taxes. Transfers in Lieu of Property Taxes reported by REALM agree to the District's books. However, it is important that the District review the calculation of LCFF funding to ascertain the validity of the amounts reported for State Aid and EPA funding.

- The District is requesting that REALM Middle School demonstrate how it reached its LCFF calculations for the Unaudited Actuals, including actual ADA numbers.

d. Fiscal Year 2015-2016: Assets and Liabilities

A review of Assets shows a negative cash balance of \$202,905 and a receivable of \$408,621. Assets include \$408,621 in amounts due from Grantor Governments. We are unable to ascertain if this amount is valid since the detail to substantiate this amount was not provided.

- The District is requesting proof of subsequent receipts of this receivable, by providing the District with the dates, reference numbers and amounts of subsequent receipts.

Liabilities include accounts payable of \$273,560 and Long Term Liabilities in excess of \$1.9 million. The consolidated Accounts Payable detail schedule provided with the Unaudited Actuals does not include the amount owed to the District for the High School for maintenance services provided in the amount of \$89,828. This does not impact Unaudited Actuals for the Middle School, but it will reduce the ending fund balance for the High School.

- The District is requesting a schedule to support Long Term Liabilities totaling \$1.9 million, so the District can ascertain the validity of the amount reported.

e. Fiscal Year 2015-2016: Cash Flows

The combined Cash Flow Statement provided with the Unaudited Actual submittal indicates that REALM Middle School had negative cash balances for September of \$5,871, October of \$49,547 and November of \$214,555. REALM received two cash advances of its in-lieu of property taxes during 2015-16, which included an advance for January 2016. Since the charter renewal, REALM has not received any additional advances on their in-lieu property taxes, which meets the condition of the renewal.

However, REALM continues to sell receivables of their future ADA revenue and property taxes to meet its expenditure obligations. On October 21, 2016, REALM sold its January 2017 State Apportionment, in-lieu of property taxes and special education revenue to receive those funds now and help with current cash deficiency. On November 14, 2016, REALM sold receivables for these same revenue sources for February 2017. These indicators of poor cash flow indicate that REALM is short on cash to meet current obligations.

f. Fiscal Year 2015-2016: Insufficient Minimum Reserves

The Unaudited Actual report indicates that REALM Middle Charter School will not meet the recommended minimum reserve of 3%. This demonstrates that REALM Middle School has a budget deficit, will be unable to sustain any unforeseen expenditures and may not be able to meet its current and future financial obligations.

g. Fiscal Year 2015-2016: Overall

Based on our review of the Unaudited Actuals for FY 2015-16, the District has noted a deterioration in REALM Middle School's financial condition, and continues to have very serious concerns about its ability to meet its ongoing financial obligations. The charter school also has not met the conditions of the charter petition renewal make additional reductions that would balance the negative balance by the end of 2016-17.

2. Fiscal Year 2015-2016: Audited Actuals

The audited financial statements indicate that REALM Middle School has negative net assets (ending fund balance) of \$1,146,107 at June 30, 2016. At Second Interim for 2015-16, the projected ending fund balance was negative \$1,045,662. REALM Middle School closed the books with an audited ending fund balance of \$100,445 less than projected. This is a very large negative ending fund balance as identified in REALM's recent audited financial statements. (Exhibit E)

The audit contained the following emphasis of Matter regarding Going Concern or REALM Middle School's ability to continue operating.

The accompanying financial statements have been prepared assuming the School will continue as a going concern. As noted in Note 9 to the financial statements, in the previous year, the School experienced an operating deficit, cash flow, difficulties, and did not have adequate cash reserves or accounts receivable to meet its current obligations without obtaining additional financing or funding. The School reduced the deficit for the year ended June 30, 2016, but still had an ending deficit net asset balance and required substantial financing to meet its current obligations. These factors cause substantial doubt about the Schools' ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 10. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

The Management of the Schools have noted a negative change in unrestricted net assets on the Statement of Activities:

Management has taken steps to ensure that net assets are positive by the end of the next fiscal year. They following are steps and factors that Management has identified:

- Major staffing cuts over the next two years in order to balance the budget and establish a 3% reserve.
- To make major cuts without impacting the quality of the teaching and learning as promised under the charter.
- To submit monthly financial budgets to our Authorizer, Berkeley Unified School District (BUSD) in order to maintain a correct and accurate course of action.
- Apply for additional local, regional, and statewide multi-year grants.

The ability of the School to continue as a going concern is dependent on the success of these actions. The financial statements do not include any adjustments relating to the recoverability of recorded asset amounts or the amounts of liabilities that might be necessary should the Schools be unable to continue as a going concern.

The District concurs with the auditor's concerns. These steps were noted in the prior year audited financial statements and in the charter school conditions for renewal. The conditions for charter renewal required REALM Middle School to eliminate this negative ending fund balance by the end of FY 2016-17 as noted below in the District's review of the First Interim for Fiscal Year 2016-17.

3. Fiscal Year 2016-2017: First Interim Report

a. Deficit Spending

A review of the First Interim report indicates that revenues are projected to be \$2,698,432, and expenditures are projected to be \$2,810,053, with deficit spending of \$111,621. The audited beginning fund balance is negative \$1,146,107 and the audited ending fund balance is negative \$1,257,728. (**Exhibit E**)

Based on the projections included in the charter petition renewal for the combined unrestricted and restricted general fund, REALM projected a surplus of \$301,307 when in fact ended up deficit spending by \$111,621. In effect, REALM Middle missed the projection by \$412,928.

The charter school has not met the conditions of the charter petition renewal by making additional reductions that would balance the negative balance by the end of 2016-17 (**See, Exhibit A.**) The projected ending fund balance for the combined general fund grew to a negative \$1,257,728 as of 2016-17 when it was projected to be a negative \$470,428 in the petition renewal. REALM middle missed the projection for ending fund balance by \$787,300. This balance does not demonstrate financial progress toward meeting the conditions in which the charter was renewed.

The District has attached REALM Middle School's response to its First Interim review for why the projected ending balance for 2016-17 did not meet the projected ending fund balance included in the petition renewal.

- REALM should provide any additional information on why it engaged in deficit spending as shown in its First Interim Report for Fiscal Year 2016-2017.

b. Revenues and Expenditure

Overall revenues are projected to be \$417,563 less than revenues as reflected in the adopted budget, primarily due to reduction in LCFF sources. The amount reflected for In Lieu of Property taxes of \$891,820, does not agree with the funding per our records which is \$1,185,323. There is an unexplained reduction of \$293,503 in Lieu of Property Taxes. Therefore, the amount to be received from the State after in Lieu of Property Taxes will be increased by the same amount.

Expenditures at First Interim are \$143,796 less than amount at projected as reflected in the adopted budget, primarily due to a reduction in certificated salaries. REALM Middle School needs to ensure that reductions in expenditures do not impact the quality of the teaching and learning as promised under the charter.

c. LCFF and LCAP

LCFF funding total \$1.9 million and represents 72% of all funding. REALM Middle School is projected to receive \$736,085 as State Aid funding, \$315,297 as Education Protection Account (EPA) State Aid funding and \$891,820 as Transfers in Lieu of Property Taxes. As mentioned earlier, transfers in Lieu of Property Taxes reported by REALM do not agree to the District's books. It is important that the District review the calculation of LCFF funding to ascertain the validity of the amounts reported for State Aid and EPA funding.

- The District is requesting the LCFF calculations for the First Interim Report for Fiscal Year 2016-2017, and which should be submitted with each interim report. In the future the LCFF calculation should be submitted with the budget.

d. Cash Flows

The combined Cash Flow Statement provided with the First Interim shows a balance of \$275,766 at December 31, 2016. The Cash Flow Statement should have shown actual cash transactions as of the cut-off period and cash flow projections through June 30, 2017. Given REALM has a significant cash flow concern, staff cannot determine if REALM will have the cash available to meet its fiscal obligations through June 30, 2017 without accurate and complete information.

The conditions for renewal of the charter petition required that REALM provide monthly cash flows to the District for each school beginning with December 2015 until negative ending fund balance is resolved and 3% reserve is obtained. REALM has not met this conditional requirement (See, Exhibit A.)

Since the charter renewal, Realm has not received any advances on their in-lieu property taxes which meets the condition of the renewal. However, REALM continues to sell receivables of their future ADA revenue and property taxes to meet its expenditure obligations. On October 21, 2016, REALM sold its January 2017 State Apportionment, in-lieu of property taxes and special education revenue to receive those found now to help with current cash flow. On November 14, 2016, REALM sold the same revenue sources for February 2017 receipts. On December 13, 2016, REALM sold the same revenue sources for March and April 2017. These indicators of poor cash flow indicate that REALM is short on cash to meet current obligations. The District is requesting cash flow projections through June 30, 2017.

e. Long Term Debt and Line of Credit

i. Notes Payable

In September 2011, the Charter Schools obtained a promissory note of \$309,968 from Kaufman Constructions, Inc. The note carries annual interest rate of 8.5% and requires monthly payments of \$3,843. The note matures in September 2021. The note balance as of June 30, 2016 was \$192,300.

In October 2013, the Charter Schools obtained a loan of \$60,000 from Fred Huxman. The loan has a term of up to 10 years and carries no interest rate. The loan balance as of June 30, 2016 was \$60,000.

In February 2016, the Charter Schools obtained a promissory note of \$1,387,363 from Charter Asset Management Fund, Inc. The note carries annual interest rate of 10% and requires monthly payments of \$200,000. The note matures in March 2017. The note balance as of June 30, 2016 was \$1,284,446.

ii. Line of Credit

The Charter Schools have a revolving line of credit with Wells Fargo for \$100,000 with an annual interest rate of 10.25%. There was a balance of \$71,367 for the year ended June 30, 2016.

iii. Insufficient Minimum Reserves

The Unaudited Actual report indicates that REALM Middle Charter School will not meet the recommended minimum reserve of 3%. This demonstrates that REALM middle has a budget deficit, will be unable to sustain any unforeseen expenditures and may not be able to meet its current and future financial obligations.

iv. Enrollment and ADA

The state no longer requires ADA for charter schools to be reported on an in-district vs out-of-district basis for apportionment purposes; therefore, this information is not currently in REALM's Student Information System. The District reported P2 ADA for REALM Middle School for FY 2015-16 of 289.67, and 244.3 at P1 for FY 2016-17. The snapshot provided by REALM as of December 15, 2016 is 234 ADA. This is a significant drop in ADA, which will reduce future funding. This amount cannot be compared to ADA used to calculate LCFF funding since the LCFF calculator was not provided.

4. Overall

Based on the District's review of the Audited Actuals for Fiscal Year 2015-16 and the First Interim Budget for Fiscal Year 2016-17, the District has noted a deterioration in financial condition, and continues to have very serious concerns about the fiscal health of REALM Middle School and its ability to meet financial obligations and continue as a going concern. The charter school also has not met two of conditions of the charter petition renewal make additional reductions that would balance the negative ending balance by the end of 2016-17 and provide monthly budget and cash flow reports.

As noted in the petition renewal review, the ability of REALM Middle and High School to continue in a financially viable manner is an ongoing concern and is dependent on REALM taking the actions set forth herein, and making and additional cuts, to achieve a balanced budget.

III. CONCLUSION

The District provides Charter School with a remedy period ending July 1, 2017 in which to provide a written response to this Notice of Violation. In its written response, Charter School must address the violations addressed herein and identify remedial steps in all of the areas raised in the Notice of Violation, including but not limited to responses to the following requests for REALM Middle School, and including steps it will take to achieve a balanced budget:

REALM HIGH SCHOOL

- Any additional information regarding its failure to meet its ending fund balance in its First Interim Report for 2016-2017.
- The basis for the significant increase in expenses for professional/consulting services in the First Interim Report for 2016-2017.
- Cash flow projections through June 30, 2017.

REALM MIDDLE SCHOOL

- An explanation of why the ending balance for 2015-16 did not meet the projected ending fund balance included in the petition renewal.
- An explanation of the budget to actual variance for fiscal year 2015-2016.
- A demonstration of how the Charter School reached its LCFF calculations for the Unaudited Actuals, including actual ADA numbers.
- Proof of subsequent receipts of all receivables, by providing the District with the dates, reference numbers and amounts of subsequent receipts.
- A schedule to support Long Term Liabilities totaling \$1.9 million, so the District can ascertain the validity of the amount reported.
- Any additional information on why it engaged in deficit spending as shown in its First Interim Report for Fiscal Year 2016-2017.
- The District is requesting the LCFF calculations for the First Interim Report for Fiscal Year 2016-2017, and which should be submitted with each interim report.

Victor Diaz, Executive Director
January 26, 2017
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Please take notice that the District reserves the right to pursue revocation if Charter School fails to remedy any or all of the violations listed above. Therefore, the District intends to issue a Notice of Intent to Revoke in the event that Charter School fails to remedy any or all of the violations set forth in this notice.

Under Cal. Admin. Code tit. 5, §11968.5.2(c) and (d), the District will evaluate Charter School's written response to this Notice of Violation, and, in light of Charter School's identified remedial measures, will consider whether to proceed with the revocation of the Charter School charter.

Sincerely,



Javetta Cleveland
Deputy Superintendent