



Berkeley Unified School District

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Javetta Cleveland, Deputy Superintendent

January 19, 2017

Mr. Victor Diaz
REALM Charter Middle School
1442 A Walnut Street #172
Berkeley, CA 94709

**FISCAL EVALUATION OF REALM CHARTER MIDDLE SCHOOL FIRST INTERIM
FY 2016-17 AND AUDITED ACTUALS FOR FY 2015-16**

Dear Mr. Diaz,

In accordance with Education Code Section 47604.33, we have reviewed the First Interim for FY 2016-17 and the Audited Financial Statements for FY 2015-16 for **REALM Middle School:**

Our oversight responsibility includes monitoring the fiscal condition of the Charter school through review of State required financial reports that include REALM's adopted budget, interim budget reports and the unaudited and audited financial statements.

AUDITED ACTUALS FOR FY 2015-16

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 \$(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 ending fund balance as identified in REALM's recent audited financial statements.

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.

Note 10 Management Plans

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. The 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. 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 FY 2016-17.

FIRST INTERIM FY 2016-17

Deficit Spending

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

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 attached conditions for renewal). 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. Any additional information regarding this issue as of Second Interim should be also be provided to the District.**

Revenues and Expenditure

Overall revenues are projected to be \$417,563 less than revenues at Adoption, 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 increase by the same amount.

Expenditures at First Interim are \$143,796 less than amount at projected at Budget Adoption, 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.

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 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 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 the end of the 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 attached conditions for approval).

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.**

Long Term Debt and Line of Credit

Notes Payable

In September 2011, the 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 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 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.

Insufficient Minimum Reserves

The Unaudited Actual report indicates that REALM Middle Charter School will not meet the recommended minimum reserve of 3%. This demonstrate 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 obligation

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 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.

Overall

Based on our review of the Audited Actuals for FY 2015-16 and the First Interim Budget for FY 2016-17, we have noted a deterioration in financial condition, and we continue to have very serious concerns about the fiscal health of REALM Middle and the 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 month budget and cash flow reports.

As noted in the petition renewal review, the ability of REALM Middle and High School to continue as a going concern is dependent on the success of the actions listed in the review and additional cuts that need to be made to get REALM's budgets in balance.

Please provide requested information to Pauline Follansbee, Director of Fiscal Services **within 5 working days of receipt of this letter.** Please contact her at (510) 644-8915 if you have any questions.

Sincerely,

Javetta Cleveland
Deputy Superintendent

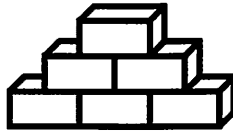
Cc: Donald Evans, E.d.D, BUSD Superintendent,

BUSD Board of Directors

Beatriz Leyva-Cutler, Karen Hemphill, Judy Appel, Ty Alper, Josh Daniels

Board of Directors, REALM Middle School

Jabari Mahiri, Tracey Schear, Thea Oliphant, Rebecca Prager



December 16, 2015

Dear Javetta Cleveland;

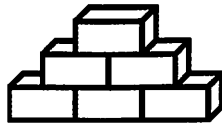
As the Executive Director of REALM Charter Schools, I write to certify, in writing, that all of the conditions below we be met in accordance with the timeline/s and expectations specified by the District:

- REALM will resubmit multi-year projections for both schools to reflect first interim adjustments and other corrections identified during the review by December 18, 2015.
- REALM will make additional reductions in excess of the \$673,000 already identified over two years to fully address the Middle School's deficit spending and \$800,000 negative ending fund balance by the end of fiscal year 2016-17; and they must also submit a revised detailed list of reductions by January 31, 2016.
- REALM will provide monthly budget to actual updates and 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 must respond in writing to specific District concerns and request for information included in the prior fiscal oversight letters by December 18, 2015 and subsequent oversight letters within 5 working days of the date of the letter.
- REALM understands the District will not advance REALM's share of in-lieu property taxes after charter renewal. REALM received two advances of in lieu property taxes for more than one month in fiscal year 2015-16.

We also want to thank you, the BUSD School Board, Superintendent Dr. Evans, and the District's leadership team for assisting REALM throughout this process. We believe strongly that these recommendations will strengthen our organization as well as our academic program.

Sincerely,

Victor Diaz
Executive Director



November 28, 2016

Re: Fiscal Evaluation of REALM Charter High School Unaudited Actuals (Closed Books).

Dear Javetta Cleveland,

Thank you for allowing REALM to respond to the issues BUSD has raised regarding our unaudited actuals. Below are the specific responses we were asked to address:

Revenues and Expenditures

BUSD notes that REALM is moving to the EDCOE SELPA in 2016-17. Please note that REALM has been a member of the EDCOE SELPA since the start of the 2015-16 school year. In fact, the rising cost of special education services, previously not identified while under BUSD SELPA, continues to impact our overall budget. We continue to have a rising number of overall students with IEP's, special education students that need Non-Public School placements, and an increasing number of 'specialists' in order to meet the actual needs of our special education students.

LCFF/LCAP

The district is requesting LCFF calculations for the unaudited actuals. Please see email attached is the CDE apportionment summary, titled "REALM YE Accrual", for the CDE's accounting of REALM's LCFF funding.

Assets and Liabilities

BUSD requested detailed A/R listing. Please see "REALM HS AR Receipts" documents attached. BUSD Requested LLT liabilities. Please see the document titled "REALM FYE16 LT Liabilities" and note that the bulk of these liabilities are **not** long term (rather, short-term cash flow/receivables financing), but the applicable object code led to listing these as LT liabilities. This will be appropriately reflected in the forthcoming audit. Therefore, the amount listed, \$1.2 million, is mostly reflected in receivables sold and paid back within the fiscal year—and not long-term debt.

Sincerely

Victor Diaz
Executive Director