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MODOC COUNTY SUPERINTENDENT OF SCHOOLS REVIEW OF 2008 AND 2009 SINGLE AUDIT REPORTS FOR THE COUNTY OF MODOC

PURPOSE

To evaluate and draw attention to the detrimental effect the qualified audits and "lack of going concern" comments within the audits, for the County of Modoc, may cause the schools of the county.

AUDIENCE

Primary: MCOE's external auditing firm (Hawes, Theobald & Auman), District Superintendents, MCOE Chief Business Official, District Business Managers, and School Board Members of the county.

Secondary: School Business Office Staff, School Administrators, School Personnel, and the Public.

BACKGROUND

The County of Modoc mismanaged and misappropriated government funds over a period of several years. During the month of May 2009, the county's officials allowed school funds deposited in the County Treasury to be used by the county government as an asset to support their general operations. Apart from the 2008 and 2009 audits, it is reasonable to conclude that school funds were used as assets in years prior to 2008, without the knowledge of schools officials.

METHODOLOGY

All findings were read in both audits. A comparison of the 2008 to 2009 audits determined that no significant differences exist between the two in relation to school concerns. Findings that could be of concern to the schools or were addressed as concerns prior to the release of the audits were selected for review. Quotes from within each finding are presented; a corresponding response follows the quotes.

REVIEW

FINDING #1 OVERSIGHT BY THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

“Those charged with oversight of the County’s financial health, funds, assets, financial systems and internal control systems have not exercised an adequate level of oversight for several years.”

Once the financial crisis became public, school officials met with several county officials within the first week. It was immediately obvious to school officials that the County Board of Supervisors, County Auditor, and County Treasurer had failed to provide proper oversight. Additionally, the county officials were overwhelmed and not able to quickly develop and implement a corrective action plan. Their working plan was to continue to use school, special district, and restricted funds for ongoing county government operations.

While there are over 60 findings in each audit report, the findings are neither surprising nor unexpected. The system of oversight and accounting was operated without regard for the law and Generally Accepted Accounting Principles (GAAP), as was evident from the report made to the Board of Supervisors on June 16, 2009.

The absence of a coherent, multi-year financial recovery plan is detrimental to the county and schools. Families will not move to a county with inadequate services and some families will move from the county for the same reason. Consequently, the schools should anticipate declining student enrollment leading to less revenue.

FINDING #2 UNDERSTANDING GAAP/FINANCIAL TRAINING

“Government managers are responsible for providing reliable, useful, and timely information for accountability of government programs and their operations.”

Individuals and Boards in positions of authority and oversight cannot perform their responsibilities if they do not have the basic understanding of Governmental Accounting Standards Board (GASB) pronouncements, Generally Accepted Accounting Principles (GAAP), OMB Circular A-133, Government Auditing Standards, laws, and regulations pertaining to their offices.

Proper education and experience on the part of county officials will take time to acquire. This lack of knowledge and ability to properly manage, plan, and oversee county operations is detrimental to the county and schools. Improper management of funds increases the possibility of state and federal audits of schools and other government agencies that have financial associations with the county government.

FINDING #3 FINANCIAL CONDITION OF THE COUNTY – GOING CONCERN

“As of June 30, 2009 the County owed the Investment Pool \$(1,626,462) net or \$(15,031,780) gross. To finance its ongoing operations, the County has utilized cash balances from other unrestricted and restricted funds, and external pool participants.”

A school district is determined to be “not a going concern” when they are insolvent or facing insolvency within the year. Swift action to control poor governance occurs on the part of the county superintendent, FCMAT, and the state when school districts spend all of their cash. Now that the audit reports are finished, what will be the response on the part of the state? State control is long-term and extremely difficult for school districts. Any type of outside control over the county will create unpredictable outcomes for the county and the schools.

The county continues to use restricted monies for general fund cash flow purposes on the legal basis of AUERBACH v. BOARD OF SUPERVISORS of the County of Los Angeles. AUERBACH states in footnote 2, “The [Los Angeles County] auditor testified that there are approximately 1800 funds that the auditor holds on

behalf of various agencies and districts. The auditor does not use many of these for cash management purposes because they are legally restricted County funds or specifically belong to an agency or district.”

Hence, the county auditor did not use legally restricted funds or any that belonged to an agency or district. Nor does it appear that the county auditor used federal funds for cash flow purposes.

County officials state that they have curtailed their use of restricted funds. Whether their continued use of restricted funds is legal or not, using restricted funds to spend in excess of income is problematic for the county. Continued financial problems in the county will cause enrollment, service, and audits concerns for the schools.

The county's response to this finding contains this statement, “Short-term financing, such as Tax Revenue Anticipation Notes [TRANS] will be sought to assist the County in meeting its debt obligations during periods of the fiscal year that are historically low in receipts (i.e. the summer months).”

A school district with a Qualified Audit (such as the audits for the County of Modoc) cannot qualify for a TRANS. A school district with Negative Audit or that is “not a going concern” (which is the state of the County of Modoc) cannot qualify for a TRANS. Indeed, there is no indication that any entity will provide a TRANS to the County of Modoc. The TRANS statement within the county’s response is inconsistent with prior public statements and difficult to justify.

The auditor and treasurer have made verbal commitments to protect school cash. It is important to the schools that statements made by county officials are consistent and justifiable.

FINDING #4 UNAUTHORIZED BORROWING OF FUNDS FROM THE INVESTMENT POOL

“Government Code Section 27100.1 states; ‘Notwithstanding any other provision of law, when any public entity or any public official acting in fiduciary capacity, who is required or authorized by law to deposit funds in the county treasury, makes a deposit, those funds shall be deemed to be held in trust by the county treasurer on behalf of the depositing entity or public official. The funds shall not be deemed funds or assets of the county and the relationship of the depositing entity or public official and the county shall not be one of creditor-debtor.’”

Within one week of the financial crisis becoming public, the county superintendent informed the Board and County Counsel, at a public meeting, of the county’s violation of this section of the government code.

County Counsel continually referred to the lack of oversight, mismanagement, and misappropriation as a fiscal not a legal concern. The Board of Supervisors acted more than a year later to establish a restricted fund “borrowing scheme” based on its interpretation of AUERBACH v. BOARD OF SUPERVISORS of the County of Los Angeles.

The auditor and treasurer have made verbal commitments to act in their fiduciary capacity to protect school assets, as required by Government Code Section 27100.1.

FINDING #5 FINANCIAL REPORTING FUND STRUCTURE

“GASB Statement No. 34 identified the following with respect to fiduciary funds: ‘Separate fiduciary fund statements (including component units that are fiduciary in nature) also should be presented as part of the fund financial statements. Fiduciary funds should be used to report assets that are held in a trustee or agency capacity for others and that cannot be used to support the government's own programs.’”

The auditor and treasurer have made verbal commitments to act in their fiduciary capacity to protect school assets, as required by GASB Statement No. 34.

FINDING #17 INTEREST APPORTIONMENT

“We noted that the County has been incorrectly allocating interest earnings from other governmental agencies (school districts and special districts), as well as from County departments (mental health and public health) to the County’s General Fund.”

During periods of time, the schools had large deposits, while at the same time the county government had little or no cash on deposit. (Finding #3, “...the County owed the Investment Pool...”) The schools may be due interest apportionments from prior years of an undetermined amount.

FINDING #20 REPORTING OF FEDERAL EXPENDITURES

“The County was unaware of the requirements relating to OMB Circular A-133. The County did not have procedures to identify the federal funds received, to capture federal expenditure [sic] and to prepare the Schedule of Expenditures of Federal Awards.”

The county’s noncompliance to federal reporting requirements could trigger an audit of federal programs. Since schools were sub-recipients of federal program dollars administered by the county, they could face the burden of federal audits or additional reporting requirements.

FINDING #21 TAX APPORTIONMENT PROCESS

“Certain errors were discovered relating to the amounts input into the [tax apportionment] spreadsheets.”

The schools anticipate errors will continue to be identified by the County Auditor that may negatively affect tax receipts.

FINDING #23 INFORMATION AND COMMUNICATION

“In order to make timely financial decisions it is necessary to have accurate and timely information for the financial condition of the County.”

“The County’s information and communication system needs to be improved.”

The topic of accurate and timely communication has been addressed by school officials at meetings with county officials since the financial crisis was made public. The schools have seen an improvement in the communication of information.

FINDING #24 CASH FLOW MONITORING

“The County has used restricted resources to finance ongoing operations.”

The County Treasurer and County Auditor are providing accurate and timely information on cash flow to school officials.

FINDING #31 DISTRIBUTION OF FUNDS TO OTHER GOVERNMENTAL AGENCIES

“We noted that the County distributed one hundred percent of the secured and unsecured property taxes to the various governmental agencies in the County in November. As noted in the criteria section the taxes are typically collected in two installments in December and April (the last day taxes are due without becoming delinquent). As a result the County is distributing taxes before the taxes are collected.”

The county has corrected this practice. Schools no longer receive property taxes prior to collection. This affects the historical pattern of cash receipts for the schools and creates a cash flow management issue that had not existed in the past. However, this change is appropriate.

The issue that remains a concern to schools is that an equitable distribution of property taxes must occur. The county government cannot take property taxes that are due to schools, special districts, and other entities and treat them as if they are assets of the county government. An equitable and timely distribution is required and will be monitored by the schools.

FINDINGS #50-#52 FEDERAL AWARD FINDINGS AND QUESTIONED COSTS: SECURE RURAL SCHOOLS AND COUNTIES

“The County is not in compliance with allowable cost compliance requirements.”

“The County’s procedures did not ensure that program expenditures are consistently supported and tracked.”

The county’s noncompliance of program expenditure requirement may trigger a federal audit of the Secure Rural Schools and Counties monies, of which the schools have received in excess of \$1.3 million annually. Federal auditors may not make the distinction between the county government (which acts as a pass-through agency) and the schools of the county. Consequently, the schools may face the burden of federal audits or additional reporting requirements on their portion of the Secure Rural Schools and Counties monies.

CONCLUDING REMARKS

COMMUNICATION

Timely and accurate communication between the county and school officials has improved. The auditor and treasurer are accessible to school officials. Past accounting mistakes will continue to generate questions and concerns which are best answered and addressed through open lines of communication.

INTEREST ALLOCATION

Past and future interest earned on pooled assets and the proper and legal distribution of interest to the schools will be monitored. Questions remain about interest earned in the investment pool and its distribution to school funds after the county government liquidated all of their cash assets to pay ongoing costs and debts. This subject will be formerly addressed with the external auditing firm contracted to serve the County of Modoc.

PROPERTY TAX ALLOCATION

The complicated process of allocating property taxes correctly to multiple agencies has been inaccurate. Adjustments and potential liabilities to the schools of the county are expected.

PROPERTY TAX DISTRIBUTION

The equitable and timely distribution of property taxes to the schools will be monitored. Concerns remain that last year's distribution schedule favored the county government over other governmental agencies. Property taxes, upon collection and deposit by the County Treasurer, are assets of specific agencies, based on various tax formulas, and cannot be deemed assets of the county government. This subject will be formerly addressed with the external auditing firm contracted to serve the County of Modoc.

FEDERAL PROGRAMS

If federal auditors decide to audit the County of Modoc, the schools should anticipate that Secure Rural Schools and Counties and other federal programs in which schools are sub-recipients will be audited.