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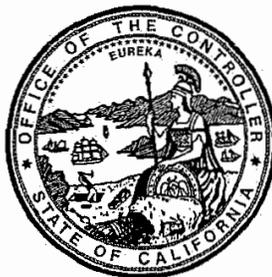
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GOLDEN DAY SCHOOLS, INC.

Audit Report

CHILD DEVELOPMENT AND NUTRITION SERVICES PROGRAMS

For Fiscal Years 2008-09, 2009-10, 2010-11, and 2011-12



BETTY T. YEE
California State Controller

February 2015



BETTY T. YEE
California State Controller

February 18, 2015

Superintendent Tom Torlakson
California Department of Education
1430 N Street
Sacramento, CA 95814

Dear Superintendent Torlakson:

The California Department of Education (CDE), following its Limited Scope Review (LSR), requested an audit of the Child Development Program (CDP) and the Nutrition Services Program (NSP) of Golden Day Schools, Inc. (GDSI). GDSI reported in its financial statements approximately \$17.1 million in charges for the CDP and NSP programs. GDSI is a not-for-profit child care entity for which Clark E. Parker, Ph.D. is the director. Approximately 540 children were enrolled in GDSI during the audit period. GDSI reports that its activities are overseen by a governing board, and that Dr. Parker and his wife, Jeanette Parker, Ph.D., are two of five members, or 40% of the board.

Our audit objectives were to determine whether:

- GDSI's internal controls over pupil enrollment (eligibility, enrollment, and attendance) and financial operations were adequate and whether any claims made against the State were proper and adequately supported.
- Program activities and claims for GDSI's CDP and NSP costs were in compliance with applicable requirements, laws, and regulations, specifically Title 5, *California Code of Regulations*, Division 1, Chapter 19 and Title 5, Chapter 15; and United States Department of Agriculture federal cost principles.

Our audit found the following:

- GDSI overstated a total of 47,492 attendance days for fiscal year (FY) 2008-09, FY 2009-10, and FY 2010-11. GDSI did not participate in the CDP for FY 2011-12. The ineligible days were due to GDSI improperly determining enrollment eligibility for the CDP. For the entire audit period, GDSI had 1,587 pupils enrolled in the CDP. In all, GDSI reported 689,490 days of attendance for the audit period, an average of almost 230,000 days annually. Approximately 7% of these reported attendances were deemed ineligible.

Superintendent Tom Torlakson

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- GDSI lacks adequate internal controls over financial operations. In addition, because of poor recordkeeping and questions surrounding related-party transactions, we were unable to determine whether the expenditures were in compliance with the requirements, laws, and regulations. During fieldwork, GDSI failed to provide auditors with documented accounting policies and procedures; in fact, these were only made available after the presentation of our findings at the exit conference. The outsourced accountant, Miller Accountancy, was unaware of and had no such documents available during our on-site visit.

We determined that \$16,166,739 of \$17,173,941, or approximately 94% of the reported costs, were questionable as they were unsupported, unallowable, or excessive as follows:

1. Salaries – The entire \$5,415,417 reported in the financial statements was unsubstantiated due to a lack of the related entities' accounting records and source documents.
2. Benefits – The entire \$2,885,672 in employee benefits was unsubstantiated due to unsupported labor costs. Furthermore, we could not determine whether the recorded \$1,770,220 in pension contributions was attributable to the salaries reported. GDSI lacked accounting records and source documents to substantiate pension charges.
3. Triple-net (rent, property tax, and maintenance) lease expenses – The entire \$3,747,459 in rent-related charges was unsupported due to a lack of source documents, specifically, an independent fair market rental estimate, to substantiate the annual rental charges. Furthermore, a triple-net lease agreement, in which GDSI agreed to pay rent, property taxes, and maintenance costs relating to buildings was in effect, but no related-party accounting records and source documents were available. Therefore, we could not substantiate whether the reported rent and triple-net lease charges were for GDSI only. Our audit also determined that the agreement represents an operating lease arrangement, when in fact, a capital lease arrangement exists. The entire rental charges also are unallowable as a result, as the only form of reimbursement would have been depreciation. However, depreciation expense would not be an allowable charge, as the facilities have been fully depreciated for more than a decade.
4. Insurance, utilities, and housekeeping – The entire \$859,219 in reported expenses was unsubstantiated due to lack of related entities' accounting records and source documents to substantiate GDSI-related costs.
5. Auto allowance – \$36,000 in auto expenses was unsubstantiated. GDSI's accounting records identified a \$1,000 monthly recurring auto allowance charge. However, no source documents were provided to substantiate these charges.
6. Instructional supplies – \$18,344 in expenses recorded for FY 2009-10 was for unknown previous fiscal years.
7. Legal fees – \$25,000 in legal fees was deemed unallowable. These reported legal fees were for unallowable legal defense activities. The legal fees were incurred to defend the position that the CDP fund advances were expended on allowable and reimbursable activities.

Superintendent Tom Torlakson

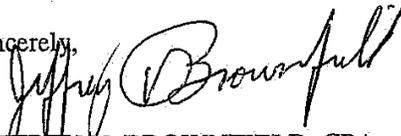
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8. Interest expenses – GDSI reported \$247,262 in interest expenses for interest on a long-term note. Our audit found that the entire recorded interest expenses are not reimbursable, and therefore, are unallowable program expenses. Furthermore, the interest expenses were with a related party, specifically, the director and president of GDSI's governing board. The outside auditor's Notes to the Financial Statements explain that the interest charges are the result of accumulation of debt, approximately \$905,000, to the director. The Notes further explain that the accumulated debt is due to the need for working capital for daily operations in prior periods. In addition, in 2011, \$37,178 in interest charges were recorded due to delayed state funding; however, no records were provided to substantiate that the CDE approved the delayed funding interest charges. We found that the interest expenses were due to significant internal control deficiencies. As mentioned in the findings, many of these questionable costs were excessive, unreasonable, or unallowable. It appears that the deficiency in working capital arose due to expenses that pertained to related entities.
9. Nutrition program – Due to a lack of related-entity records, \$1,789,326 claimed for the NSP was unsubstantiated. While the number of reported meals was supported by meal counts, the cost of reported meals was unsubstantiated, as GDSI failed to provide related-party records for Today's Fresh Start Charter School, Inc. We further determined that had the reported meal charges been substantiated, GDSI might have received approximately \$0.5 million in excess of incurred costs.
10. Administrative salaries and wages – Despite our requests during the audit, GDSI failed to provide duty statements for Dr. Parker's activities as the director for GDSI or its related entities. It was only after discussion of this finding with Dr. Parker at the exit conference that we were provided a written document delineating his GDSI activities. The document states that the director spent approximately 73 hours per week working on GDSI activities during the audit period. This requires a daily work schedule of approximately 10.5 hours for GDSI businesses, including non-business days (i.e., weekends). Though the director explained his roles and daily tasks for GDSI operations, we were unable to determine how the director conducted his many related business operations. Therefore, we could not determine whether the director's duties for GDSI and related entities were performed at the same time, and if so, whether his compensation was equitably charged against all related entities, or whether the costs of the executive salaries for related entities that were absorbed by GDSI were eventually charged against public funds. As such, all \$1,143,040 in reported director's administrative salaries was deemed unallowable.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,



JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/mh

Attachment

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Audit Report

Summary

The California Department of Education (CDE), following its Limited Scope Review (LSR) requested an audit of the Child Development Program (CDP) and the Nutrition Services Program (NSP) of Golden Day Schools, Inc. (GDSI). GDSI reported in its financial statements approximately \$17.1 million in charges for the CDP and NSP programs. GDSI is a not-for-profit child care entity administered by Clark E. Parker, Ph.D., Director. Mr. Parker is also the president of GDSI's governing board. Approximately 540 children were enrolled in GDSI during the audit period. GDSI reports that its activities are overseen by the board, and that Dr. Parker and his wife, Jeanette Parker, Ph.D., are two of five members, or 40% of the board.

The audit was performed by the State Controller's Office (SCO) on behalf of the CDE. The authority to conduct this audit is given by:

- Interagency agreement number CN 120338, dated January 14, 2013, between the SCO and CDE, which provides that the SCO will perform an audit of GDSI's CDP and NSP for fiscal year (FY) 2008-09 through FY 2011-12.
- Government Code Section 12410, which states, "The State Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."

Our audit objectives were to determine whether:

- GDSI's internal controls over pupil enrollment (eligibility, enrollment, and attendance) and financial operations were adequate and whether any claims made against the State were proper and adequately supported.
- Program activities and claims for GDSI's CDP and NSP costs were in compliance with applicable requirements, laws, and regulations, specifically Title 5, *California Code of Regulations*, Division 1, Chapter 19 and Chapter 15; and United States Department of Agriculture federal cost principles.

Our audit found the following:

- GDSI overstated a total of 47,492 attendance days for FY 2008-09, FY 2009-10, and FY 2010-11. GDSI did not participate in the CDP for FY 2011-12. The ineligible days were due to GDSI improperly determining enrollment eligibility for the CDP. For the entire audit period, GDSI had 1,587 pupils enrolled in the CDP. In all, GDSI reported 689,490 days of attendance for the audit period, an average of almost 230,000 days annually. Approximately 7% of these reported attendances were deemed ineligible.

- GDSI lacks adequate internal controls over financial operations. In addition, because of poor recordkeeping and questions surrounding related-party transactions, we were unable to determine whether the expenditures were in compliance with the requirements, laws, and regulations. During the audit, GDSI failed to provide auditors with documented accounting policies and procedures; in fact, these were only made available after the presentation of our findings at the exit conference. The outsourced accountant, Miller Accountancy, was unaware of and had no such documents available during our on-site visit. All business decisions primarily are made by the director.

We determined that \$16,166,739 of \$17,173,941, or approximately 94% of the reported costs, were questionable as they were unsupported, unallowable, or excessive as follows:

1. Salaries – The entire \$5,415,417 reported in the financial statements was unsubstantiated due to a lack of the related entities' accounting records and source documents.
2. Benefits – The entire \$2,885,672 in employee benefits was unsubstantiated due to unsupported labor costs. Furthermore, we could not determine whether the recorded \$1,770,220 in pension contributions was attributable to the salaries reported. GDSI lacked accounting records and source documents to substantiate pension charges.
3. Triple-net (rent, property tax, and maintenance) lease expenses – The entire \$3,747,459 in rent-related charges was unsupported due to a lack of source documents, specifically, an independent fair market rental estimate, to substantiate the annual rental charges. Furthermore, a triple-net lease agreement, in which GDSI agreed to pay rent, property taxes, and maintenance costs relating to buildings was in effect, but no related-party accounting records and source documents were available. Therefore, we could not substantiate whether the reported rent and triple-net lease charges were for GDSI only. Our audit also determined that the agreement represents an operating lease arrangement, when in fact, a capital lease arrangement exists. The entire rental charges are unallowable as a result, as the only form of reimbursement would have been for depreciation expenses. However, the facilities have already been fully depreciated for more than a decade.
4. Insurance, utilities, and housekeeping – The entire \$859,219 in reported expenses was unsubstantiated due to lack of related entities' accounting records and source documents to substantiate GDSI-related costs.
5. Auto allowance – \$36,000 in auto expenses was unsubstantiated. GDSI's accounting records revealed a \$1,000 monthly recurring auto allowance charge. However, no source documents were provided to substantiate these charges.
6. Instructional supplies – \$18,344 in expenses recorded for FY 2009-10 was for unknown previous fiscal years.

7. Legal fees – \$25,000 in legal fees was deemed unallowable. These reported legal fees were for unallowable legal defense activities. The legal fees were incurred to defend the position that the CDP fund advances were expended on allowable and reimbursable activities.
8. Interest expenses – GDSI reported \$247,262 in interest expenses for interest on a long-term note. Our audit found that the entire recorded interest expenses are not reimbursable, and therefore, are unallowable program expenses. The interest expenses were with a related party, specifically, the director and president of GDSI's governing board. The outside auditor's Notes to the Financial Statements explain that the interest charges are the result of accumulation of debt, approximately \$905,000, to the director. The Notes further explain that the accumulated debt is due to the need for working capital for daily operations in prior periods. In addition, in 2011, \$37,178 in interest charges were recorded due to delayed state funding; however, no records were provided to substantiate that the CDE approved the delayed funding interest charges. We found that the interest expenses were due to significant internal control deficiencies. As mentioned in the findings, many of these questionable costs were excessive, unreasonable, or unallowable. It appears that the deficiency in working capital arose due to expenses that pertained to related entities.
9. Nutrition program – While the number of reported meals was supported by meal counts, the cost of reported meals was unsubstantiated, as GDSI failed to provide related-party records for \$1,789,326. We further determined that had the meal charges been substantiated, GDSI might have received approximately \$0.5 million in excess of incurred costs.
10. Administrative salaries and wages – Despite our requests during the audit, GDSI failed to provide duty statements for the director's activities for GDSI or its related entities. It was only after discussion of this finding at the exit conference that the director provided a written document delineating his GDSI activities. The document states that the director spent approximately 73 hours per week working on GDSI activities during the audit period. This required a daily work schedule of approximately 10.5 hours for GDSI businesses, including non-business days (i.e., weekends). Though the director explained his roles and daily tasks for GDSI operations, we were unable to determine how the director conducted his many related business operations. Therefore, we could not determine whether his duties for GDSI and related entities were performed at the same time, and if so, whether his compensation was equitably charged against all related entities, or whether the costs of the executive salaries for related entities that were absorbed by GDSI were eventually charged against public funds. As such, all \$1,143,040 in reported director's administrative salaries was deemed unallowable.

Background

GDSI, established in 1968, provides child care and development services for needy families within the City of Los Angeles and vicinity. GDSI operates as a not-for-profit corporation. Clark Parker, Ph.D., functions as the following for GDSI:

- Founder/owner¹
- President of the governing board
- Director

GDSI's governing board exists to make decisions for GDSI. The director and his wife, Jeanette Parker, Ph.D., are two of five members, or 40% of the board. In addition, the director and his family members own several businesses that often engage in business activities with GDSI.

GDSI operates seven child development centers (schools) situated in four locations: 2255 West Adams Blvd., 6422 Crenshaw Blvd., 4470 Crenshaw Blvd., 4476, 4478, and 4480 Crenshaw Blvd., 4500 Crenshaw Blvd., 4508 Crenshaw Blvd., and 4514 Crenshaw Blvd., within Los Angeles and vicinity cities. These locations are jointly occupied by a related charter school program. The charter school, Today's Fresh Start Charter School, Inc. (TFSI), also was established as a not-for-profit corporation. Dr. Jeanette Parker is the president of TFSI and superintendent of TFSI Schools. During fiscal year (FY) 2008-09, FY 2009-10, and FY 2010-11, approximately 540 students attended GDSI schools annually, and approximately 1,100 students were enrolled in the charter school program. In addition, these addresses are common to many of the related Parker entities, such as Spectrum Surveillance Systems, Pacific Books & Supplies, and Natural Solutions.

The school sites are structured similar to traditional California elementary schools, with child development centers and classrooms for kindergarten through eighth-grade students. A building with multiple classrooms or several buildings with multiple classrooms are situated at each of the above-mentioned locations. The fixed assets, buildings, equipment, and furniture are owned by the Parkers, and the facilities are leased to GDSI. GDSI reports that it subleases the classrooms to TFSI. In addition, the businesses that share the same compounds engage in related business transactions, such as sales to GDSI for cleaning, instructional materials, and facility lease-back charges.

California Department of Education's Limited Scope Review

The CDE conducted an LSR for the CDP for FY 2006-07 and FY 2007-08. The CDE found that GDSI lacked procedures to ensure that eligibility and attendance were properly documented and accurately reported to the CDE. As a result, the LSR found that 23,674 days of attendance for 250 of the 1,232 children were not properly certified for program services. The LSR found that the family data files did not contain a parent's or GDSI representative's signature on the applications for service, and some family files did not contain supporting documentation that eligibility was properly recertified each year.

¹ *Golden Day Schools, Inc. v California Department of Education* (CCTR 6150 and CCTR 7150).

In addition, the CDE determined that GDSI lacked sufficient controls over its fiscal operations to ensure compliance with the CDP laws, regulations, and requirements. The CDE found that GDSI inappropriately charged approximately \$2.5 million for program expenses that primarily were due to unsupported payroll costs, unallowable related party costs, and excessive administrator compensation.

GDSI disagreed with the CDE and appealed the LSR results to the Office of Administrative Hearings. The matter was heard by Honorable Rebecca M. Westmore, Administrative Law Judge (ALJ). The ALJ agreed with the CDE that GDSI lacked sufficient internal controls over its fiscal operations. In addition, the ALJ agreed with the CDE's observations on unsupported and excessive payroll and related party expenses. The attached findings and recommendations, as applicable, include the CDE's observations and the ALJ's decisions.

Objectives, Scope, and Methodology

As a practice, when the CDE's LSR, which is essentially a program evaluation, reveals deficiencies, the CDE has the responsibility to conduct follow-up audits. Therefore, the CDE requested the SCO to conduct an audit of GDSI to include the CDP and NSP programs for FY 2008-09, FY 2009-10, FY 2010-11, and FY 2011-12.

GDSI received the following reimbursement for the CDP and NSP programs:

Fiscal Year	Programs			Total
	Child Development Program ¹	Child and Adult Care Food Program	School Nutrition Program	
2008-09	\$ 4,628,469	\$ 336,132	\$ 201,137	\$ 5,165,738
2009-10	4,525,259	304,930	213,816	5,044,005
2010-11	4,331,358	386,212	189,649	4,907,219
2011-12	—	370,215	288,981	659,196
Total	<u>\$ 13,485,086</u>	<u>\$ 1,397,489</u>	<u>\$ 893,583</u>	<u>\$ 15,776,158</u>

¹ The CDE suspended GDSI's CDP effective June 30, 2011.

The purpose of our audit was to determine whether:

- GDSI's internal controls over pupil enrollment (eligibility, enrollment, and attendance) and financial operations were adequate and whether any claims made against the State were proper and adequately supported.
- Program activities and claims for GDSI's CDP and NSP costs were in compliance with applicable requirements, laws, and regulations, specifically *California Code of Regulations* (CCR) Title 5, Division 1, Chapter 19; CCR Title 5, Division 1, Chapter 15; and USDA federal cost principles.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We limited our review of the GDSI's internal controls to gaining an understanding of the transaction flow and claim preparation process as necessary to develop appropriate auditing procedures.

Conclusion

GDSI recorded and claimed approximately \$17.1 million in costs for the CDP and NSP programs. The CDE reimbursed approximately \$15.8 million of these claimed costs. The purpose of our audit was to determine whether (1) GDSI's internal controls over pupil enrollment (eligibility, enrollment, and attendance) and financial operations were adequate and that any claims made against the State were proper and adequately supported; and (2) claimed costs were in compliance with applicable requirements, laws, and regulations, specifically Title 5, *California Code of Regulations*, Division 1, Chapter 19 and Chapter 15; and USDA federal cost principles.

Our audit determined the following:

- GDSI overstated a total of 47,492 attendance days for FY 2008-09, FY 2009-10, and FY 2010-11. GDSI did not participate in the CDP for FY 2011-12. The ineligible days were due to GDSI improperly determining enrollment eligibility for the CDP. For the entire audit period, GDSI had 1,587 pupils enrolled in the CDP. In all, GDSI reported 689,490 days of attendance for the audit period, an average of almost 230,000 days annually. Approximately 7% of these reported attendances were deemed ineligible.
- GDSI lacks important internal control safeguards over financial operations. The director and his wife are two of five governing board members of GDSI. Although GDSI hired an outside accounting service provider, the director had complete control of preparing GDSI's general ledger. The director limited the outside accountant's responsibilities to recording monthly transactions and printing electronic payroll and vendor checks. We also observed that many of the business decisions involve the related entity, TFSI. TFSI jointly operates its charter school program at the GDSI facilities. These facilities are owned by the director and his wife and, since inception, GDSI has been the lessee; however, many of the facilities are subleased to TFSI. Our audit determined that GDSI and TFSI have many common and shared personnel and operations costs, such as labor, services, supplies, and facilities. We requested, but GDSI failed to provide all accounting records including those of the related entities to validate GDSI's recorded and claimed costs. In fact, during our audit, for every document request, the director would not show us file rooms, nor would he make available all of the accounting records and source documents. Upon our request, the

director would review and edit information, stating, that an audit of “recorded information” may not provide a logical audit trail. We were not shown any of this “recorded information.”

As a result, we determined that \$16,166,739 of \$17,173,941, or approximately 94% of the reported costs, are unallowable as they were either unsupported, unallowable, or excessive.

Views of Responsible Official

We issued a draft report on June 20, 2014. The director responded via letter dated September 8, 2014, disagreeing with the audit results. The director contends that this was not a performance audit. Instead, the director argues that the SCO performed a financial and compliance audit and that such an audit is improper, as GDSI has previously submitted said audit to the CDE. Furthermore, GDSI contends that the audit results are flawed because the audit is biased and provides no evidence that recorded and charged operating expenses are unreasonable and unnecessary. GDSI requests that the CDE reject the SCO’s findings and recommendations.

SCO’s Comment

The findings and recommendations remain unchanged.

The SCO did not conduct a financial and compliance audit, the objective of which is to render an opinion on GDSI’s financial position. Instead, the SCO conducted a performance audit, the objective of which is to provide findings or conclusions based on an evaluation of sufficient, appropriate evidence weighed against criteria. Accordingly, the objective of our audit was to provide objective analysis to assist those charged with governance and oversight, specifically the CDE, in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibilities to oversee or initiate corrective action, and contribute to public accountability.

GDSI provided a detailed narrative, but no evidence, such as accounting records and supporting documents, to substantiate the actual operating expenses for the CDP and NSP. GDSI, a related charter school, and several other related businesses appear to have shared operating expenses, such as payroll, payroll-related benefits, and facility costs. GDSI refused to provide all accounting records and source documents, and thus, the SCO is unable to determine if the recorded and claimed CDP and NSP expenses are actual costs and whether these charges are reasonable and necessary.

Had GDSI submitted these records, our audit would have evaluated these documents against the applicable criteria to determine if recorded operating expenses are substantiated.

The Summary section of this report has been updated to include the SCO’s audit authority.

Golden Day Schools, Inc.

Child Development and Nutrition Services Programs

Restricted Use

This report is solely for the information and use of the California Department of Education, the Golden Day Schools, Inc., and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.



JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

February 18, 2015

Programs and Revenues For Fiscal Years 2008-09, 2009-10, 2010-11, and 2011-12

GDSI, since being established in 1968, has provided private and state-funded child development programs for disadvantaged children. The program prepares these disadvantaged children for kindergarten through eighth grade for the public school system.

GDSI operates seven child development centers situated in four locations within the Los Angeles and vicinity cities:

1. 2255 West Adams Blvd, 6422 Crenshaw Blvd
2. 4470 Crenshaw Blvd
3. 4476, 4478, and 4480 Crenshaw Blvd
4. 4500 Crenshaw Blvd, 4508 Crenshaw Blvd, and 4514 Crenshaw Blvd

For the audit period, GDSI reported the following enrollment:

School Year	Enrollment ¹
2008-09	949
2009-10	821
2010-11	952
2011-12	—
Average Enrollment	907

¹ Approximately 540 children attended the CDP on a daily basis.

All of the children are enrolled under the subsidized child care program. Children either attend full-day or partial school days. Approximately 92% of the program revenues were from state apportionments, and private/parent fees provided the remainder of the program revenues as follows:

Fiscal Year	Parent fees	State Apportionments	Others	Total	Percentage of state apportionment to total revenue
2008-09	\$ 114,160	\$ 4,528,980	\$ 369,724	\$ 5,012,864	90.35%
2009-10	90,893	4,521,211	237,311	4,849,415	93.23%
2010-11	93,689	4,674,410	299,096	5,067,195	92.25%
Total	\$ 298,742	\$ 13,724,601	\$ 906,131	\$ 14,929,474	91.94%

Claims Process

Child Development and Nutrition Services Program For Fiscal Years 2008-09, 2009-10, 2010-11, and 2011-12

Effective July 1, 2011, GDSI does not participate in the State's Child Development Program (CDP). Prior to July 1, 2011, on a quarterly basis, GDSI submitted claims for costs incurred for the CDP.

Quarterly reports included Form DCFS 8501, Attendance and Fiscal Report For California State Preschool Programs; and Form CDFS 9529, Fiscal Report For Child Development Support Contracts. The California Department of Education (CDE) processed the attendance and fiscal data and determined the reimbursements due to the provider. The reimbursement base, also referred to as "reimbursement limit" was the least of the following:

1. The maximum reimbursable amount as stated in the annual child development contract
2. The actual and allowable net costs
3. Contract service earnings – The adjusted child-days/hours of enrollment for certified children, times the contract rate per child-day/hour of enrollment, times the actual percentage of attendance plus five percent (5%), but in no case to exceed one hundred percent (100%) of enrollment

On an annual basis, GDSI submitted forms 8501 and 9529 to adjust for any overages or understated attendance and costs. The CDE determined the over- or underpayments and took action to resolve these differences.

Annual claimed expenses and reimbursement limits were as follows:

<u>Fiscal Year</u>	<u>Claimed CDP Costs</u>	<u>Reimbursement Limit</u>	<u>Reimbursement Bases</u>
2008-09	\$ 5,054,512	\$ 4,628,469	Maximum Reimbursable Amount
2009-10	4,885,101	4,525,259	Maximum Reimbursable Amount
2010-11	5,117,467	4,331,358	CDFS 9500 not finalized
Total	\$ 15,057,080	\$ 13,485,086	

For the Nutritional Services Program, each meal (breakfast, lunch, supplement, PM Snacks, and Other) was subsidized at preset and approved rates from the CDE. Each month, the provider electronically submitted meal counts to the CDE. Based on the preset rates, the CDE reimbursed the provider for the quantity of each meal type served.

Golden Day Schools, Inc. Audit Report, February 2015

Golden Day Schools, Inc.

Child Development and Nutrition Services Programs

**Schedule 1—
Summary of Recorded, Allowable, and Unallowable
Child Development and Nutrition Service Program Costs
July 1, 2008, through June 30, 2012**

Cost Description	FY 2008-09			FY 2009-10			FY 2010-11			FY 2011-12			Total			Reference	
	Recorded	Allowable	Unallowable	Recorded	Allowable	Unallowable	Recorded	Allowable	Unallowable	Recorded	Allowable	Unallowable	Recorded	Allowable	Unallowable		
Child Development Program (CDP):																	
Certificated and classified salaries	\$ 1,914,550	\$ —	\$ 1,914,550	\$ 1,640,241	\$ —	\$ 1,640,241	\$ 1,860,626	\$ —	\$ 1,860,626	\$ 5,415,417	\$ —	\$ 5,415,417				Finding 3	
Employee benefits	926,083	—	926,083	968,315	—	968,315	991,274	—	991,274	2,885,672	—	2,885,672				Finding 4	
Triple-net lease	1,137,036	—	1,137,036	1,466,944	—	1,466,944	1,143,479	—	1,143,479	3,747,459	—	3,747,459				Finding 6	
Insurance, utilities and housekeeping, other	234,412	—	234,412	323,966	—	323,966	300,841	—	300,841	859,219	—	859,219				Finding 7	
Instructional supplies	23,025	23,025	—	56,513	38,169	18,344	15,069	15,069	—	94,607	76,263	18,344				Finding 10	
Other supplies and expenses	54,152	54,152	—	34,992	34,992	—	38,528	38,528	—	127,672	127,672	—					
Transportation	—	—	—	—	—	—	1,597	1,597	—	1,597	1,597	—					
Student transportation	79,976	79,976	—	53,965	53,965	—	57,473	57,473	—	191,414	191,414	—					
Travel	7,177	7,177	—	1,720	1,720	—	2,500	2,500	—	11,397	11,397	—					
Subtotal	4,376,411	164,330	4,212,081	4,546,656	128,846	4,417,810	4,411,387	115,167	4,296,220	13,334,454	408,343	12,926,111					
Administrative support services costs																	
Administrative salaries	362,152	—	362,152	374,826	—	374,826	406,062	—	406,062	1,143,040	—	1,143,040				Finding 5	
Depreciation and use allowance	49,723	37,723	12,000	49,723	37,723	12,000	50,232	38,232	12,000	149,678	113,678	36,000				Finding 8	
Audit, accounting, and legal fees	85,934	85,934	—	110,335	110,335	—	169,912	144,912	25,000	366,181	341,181	25,000				Finding 9	
Interest	84,028	—	84,028	63,028	—	63,028	100,206	—	100,206	247,262	—	247,262				Finding 11	
Other	48,000	48,000	—	48,000	48,000	—	48,000	48,000	—	144,000	144,000	—					
Subtotal	629,837	171,657	458,180	645,912	196,058	449,854	774,412	231,144	543,268	2,050,161	598,859	1,451,302					
Total CDP Cost	5,006,248	335,987	4,670,261	5,192,568	324,904	4,867,664	5,185,799	346,311	4,839,488	15,384,615	1,007,202	14,377,413					
Nutrition Services Program (NSP)																	
Food service personnel	94,342	—	94,342	94,200	—	94,200	93,318	—	93,318	85,594	—	85,594	367,454	—	367,454		
Food and food services (materials)	380,946	—	380,946	386,809	—	386,809	367,473	—	367,473	286,644	—	286,644	1,421,872	—	1,421,872		
Total NSP Costs	475,288	—	475,288	481,009	—	481,009	460,791	—	460,791	372,238	—	372,238	1,789,326	—	1,789,326		Finding 12
Total CDP and NSP Costs	\$ 5,481,536	\$ 335,987	\$ 5,145,549	\$ 5,673,577	\$ 324,904	\$ 5,348,673	\$ 5,646,590	\$ 346,311	\$ 5,300,279	\$ 372,238	\$ —	\$ 372,238	\$ 17,173,941	\$ 1,007,202	\$ 16,166,739		

*Golden Day Schools, Inc.**Child Development and Nutrition Services Programs*

**Schedule 2—
Summary of Reported, Ineligible, and
Eligible Child Development Enrollment Days
July 1, 2008, through June 30, 2012**

<u>Fiscal Year</u>	<u>Reported Days</u>	<u>Ineligible Days¹</u>	<u>Eligible Days</u>
2008-09	236,237	31,670	204,567
2009-10	211,862	8,949	202,913
2010-11	241,391	6,872	234,519
Total	<u>689,490</u>	<u>47,492²</u>	<u>641,999</u>

¹ See Finding 2 of the Findings and Recommendation Section.

² Difference due to rounding.

Findings and Recommendations

FINDING 1— Lack of internal controls over related party transactions

GDSI engaged in various related-party transactions with the director, and his wife, as well as several other related entities: TFSI, Natural Solutions, Spectrum Surveillance Systems, and Pacific Books & Supplies. The GDSI's General Ledger Detail revealed related-party transactions such as salaries, fringe benefits, a triple-net lease, and others (Findings 3 through 12) amongst these entities. The director's wife is the administrator of TFSI. Spectrum Surveillance Systems is owned and operated by the director. Natural Solutions is owned and operated by the director's son; and Pacific Books & Supplies is a function of TFSI. Spectrum Surveillance Systems, TFSI, Pacific Books & Supplies, and Natural Solutions have addresses common to GDSI.

We observed that GDSI lacked internal controls over financial operations for the entire audit period. The director attests to the presence of a governing board, independent of daily operations, that helps create policies for GDSI. However, there is significant doubt as to whether a governing board actually existed. GDSI lacked written accounting policies and procedures for financial accounting bookkeeping purposes for the audit period. Furthermore, GDSI lacked an adequate recordkeeping system, maintaining accounting records and source documents to substantiate costs reported in the financial statements. GDSI lacked accounting records and source documents substantiating that costs were incurred solely for GDSI purposes. GDSI also lacked supporting documentation for related-party transactions, demonstrating that they were arms-length transactions at fair value. The director refused to provide related-party accounting records for TFSI, Pacific Books & Supplies, Natural Solutions, and Spectrum Surveillance Systems.

During fieldwork, we requested board minutes to establish the existence of a governing board making decisions on behalf of GDSI, independent of the director. However, GDSI failed to provide minutes until after the presentation of our findings at the exit conference. Due to the lateness of GDSI's response, we are uncertain as to whether these board minutes were maintained during the audit period. The board minutes provided to us by the director did not include a roll call of board members attending the meetings. The minutes were signed by Maria Iniquez, who was designated as the secretary of the board. However, Ms. Iniquez was not listed as a board secretary, nor was she declared a board member to the Internal Revenue Service (IRS). Nonetheless, we reviewed these board minutes and determined that all key financial duties and responsibilities were vested solely with the director.

Thus, we question the purpose and presence of the governing board, as all business decisions were made by the director. We also question the validity of the board members. During the audit, we had requested the director to provide a list of board members, to which the director responded that such a document was not readily available, and that he

did not recall the names of board members active during the audit period. Subsequently, the director did provide a list of board members. We noted that a few members were not consistent with the IRS declaration. We identified the following individuals as being listed/declared as board members:

Member	Fiscal Year			
	2008-09	2009-10	2010-11	2011-12
Clark E. Parker	x	x	x	x
Erbie Phillips ¹	x	x	x	x
Glen Sterling	x	x	x	x
George Rogers	x	x	x	x
Charles Stone		x	x	x
Jeanette Parker ²	x	x	x	x

¹ Not declared as a board member to the IRS (Form 990, Return of Organization Exempt From Income Tax)

² Not included as a board member by the director

Also, during the fieldwork, the director failed to provide written accounting policies and procedures. These were only made available after the presentation of our findings at the exit conference. We are uncertain if these documents were in existence during the audit period, as the outsourced accountant, Miller Accountancy, was unaware of and had no such documents available during our onsite visit.

The key financial responsibilities were:

- Accounting records and source documents for GDSI and related parties
- General ledger
- Audited financial statements
- Claims to the CDE

Consistent with our observation, the CDE, in their LSR, have also determined that GDSI “did not have adequate policies and procedures in place to ensure that expenditures claimed for reimbursement were properly supported, reasonable, and necessary to the operation of the child development program.” The CDE determined that GDSI’s oversight of their fiscal operations lacks checks and balances in place to ensure that the director’s management of fiscal operations is adequate or in compliance with program requirements. In fact, the ALJ asked GDSI to separate the key financial duties and responsibilities from the director in order to maintain effective internal controls and oversight over its fiscal operations.

GDSI’s external auditor, Steven A. Flores, Certified Public Accountant (CPA), had also observed that all business matters were decided by the director of GDSI.

This continued significant internal control weakness has become the primary cause for possible misuse of public funds charged for these several related party activities:

- GDSI lacked prudent procurement practices to ensure fair values of related party transactions. The GDSI facilities are owned by Dr. and Mrs. Parker¹. Annually, GDSI pays the Parkers approximately \$1 million in rent. The rent was a related party transaction, as Dr. and Mrs. Parker were related parties of GDSI. As such, GDSI was required to obtain fair market rental estimates from an independent licensed appraiser to substantiate rent. However, GDSI refused to provide such estimates. As a result, we could not determine the validity of rental expenses claimed and paid by the public funds.

The director draws an annual salary of approximately \$350,000 that he claims has been approved by the governing board. The director drew \$1,143,040 in total salaries for the audit period. While the director has many GDSI responsibilities, we found that he has many related-entity responsibilities as well. The director is the Chief Executive Officer of Spectrum Surveillance Systems, a 10-19 employee organization with at least \$2.5 million in annual revenue; and owner of View Park Development Corporation, a 50-employee organization with at least \$50 million in annual revenue. The director has developed hundreds of commercial and residential properties throughout Southern California. He is a Licensed General Contractor, Real Estate Developer, and California Licensed Real Estate Broker. In addition, the director is a TFSI board member. During our audit, the director did not provide any documents, such as a duty statement, to substantiate his daily GDSI activities until after the presentation of our findings at the exit conference. In fact, it was only after the discussion of the audit results that the director provided a written description of his daily GDSI tasks. The director asserts that he spent in excess of 73 hours weekly, more than 10 hours daily, for GDSI operations. Though the director explained his roles and daily tasks for GDSI operations, we were unable to determine how the director conducted his related business operations. As such, we could not determine whether his duties for GDSI and related entities were performed at the same time, and if so, whether his compensation was equitably charged against all related entities, or whether the costs of the executive salaries for related entities that were absorbed by GDSI were eventually charged against public funds.

- We also observed several transactions for instructional materials and cleaning supplies with Pacific Books & Supplies and Natural Solutions. However, as was also observed by the CDE during its LSR, there is a lack of procurement policies that would substantiate that these related-party transactions charged against public funds were indeed at fair values.

¹ *Golden Day Schools, Inc. v California Department of Education* (CCTR 6150 and CCTR 7150).

- GDSI reported \$247,262 in unallowable interest expenses. The CPA's notes to the financial statements explain the interest charges as an accumulation of debt, approximately \$905,000, owed to the director. The CPA explained that the debt is necessary to provide working capital (cash) for daily operations in prior periods. We found that the \$905,000 note accumulated \$0.5 million in finance charges that are due to the unsupported, excessive, unreasonable, and allowable costs questioned in the findings, including more than \$1.0 million in annual rent charges due the director and Jeanette Parker, board secretary. Had it not been for these costs, borrowed working capital would not have been necessary.

Although GDSI hired an outside accountant, the director had complete control of preparing GDSI's general ledger, according to our interview with the accountant. The director limited the outside accountant's responsibilities to recording monthly transactions and printing electronic payroll and vendor checks. The accountant did not have any fiscal authority to make financial accounting decisions. Furthermore, the outside accountant was not allowed by the director to have access to GDSI source documentation.

After the presentation of our findings to the director at the exit conference, we were provided an engagement letter explaining the accountant's duties and responsibilities. The letter provided no evidence that the accountant had any fiscal authority, as the accountant agreed only to process data for accounting purposes. In addition, the letter explained that the accountant was privy only to "information extracted from original source documents," not to the actual source documents themselves.

GDSI's CPA also did not have access to source documents for audit documentation. Our audit findings denote a similar lack of accounting records and source documents to substantiate a recorded transaction. In fact, during our audit, for every document request, the director would not show us file rooms, nor would he make available all of the accounting records and source documents. Upon our request, the director would review and edit information, stating that an audit of "recorded information" may not provide a logical audit trail. We were not shown any of this "recorded information."

The director had complete control of preparing and submitting cost claims to the CDE for the CDP and NSP. The director created these claims on behalf of GDSI, based on overall total costs reported in the audited financial statements and general ledger. Neither the CPA nor the outsourced accountant was involved with the preparation and submission of cost claims to CDE for CDP and NSP.

The director significantly limited the availability of accounting records and source documents to the CPA for the required annual financial statement audits for fiscal years 2008-09 through 2011-12. In our review of the CPA's audit file, we observed no copies of GDSI source

documents in the audit files. When inquired, Mr. Flores explained that the director would not allow copies to be made of source documentation. GDSI has maintained the same CPA for the past several years for its annual audit. Per the director, a separate accountant and CPA exist for TFSI. We found that the GDSI's CPA has limited his audit efforts for GDSI to only those specific assertions made by the director, and as such, no independent test procedures and conclusions have been rendered for exchange of assets with TFSI.

Our audit revealed shared facilities, operations, and personnel costs. The CPA relied on cost allocation plans and cost estimates generated by the director, but performed no test procedures to determine whether the related-party activities were indeed reasonable, allowable, and chargeable against the CDP and NSP programs.

Prudent business practices suggest that entities establish a system of internal controls to help meet its goals. As such, practical concerns for establishing internal controls include the ability to:

- have accurate information to carryout business operations;
- safeguard assets and records;
- promote operational efficiency by preventing unnecessary duplication of effort and waste in all aspects of business operations; and
- ensure compliance with prescribed policies.

California State Preschool Programs (CSPP) Funding Terms and Conditions (FT&C), Section II, Q. Conflicts of Interest, states in part,

For any transaction to which the contractor is a party and the other party is: (1) An officer or employee of the contractor or of an organization having financial interest in the contractor; or (2) A partner or controlling stockholder or an organization having a financial interest in the contractor; or (3) A family member of a person having a financial interest in the contractor, the transaction(s) shall be fair and reasonable and conducted at arm's length. Based on corporate law (*Corporations Code* sections 310, 5233-5234, 7233 and 9243 as applicable) the general rules that would be followed to ensure that transactions are conducted "at arm's length" include: (1) Prior to consummating the transaction, the governing body should authorize or approve the transaction in good faith and the board should require the interested party, or parties, to make full disclosure to the board both in writing and during the board meeting where the transaction is being discussed; and (2) All parties having a financial interest in the transaction should refrain from voting on the transaction and it should be so noted in the board minutes...

As the director has disregarded these best practices, GDSI's assets and records have lacked necessary safeguards, causing possible mismanagement of public funds.

Recommendation

Although GDSI no longer participates in the CDP, it continues to participate in the NSP program. Therefore, we recommend that the CDE require GDSI to establish policies, procedures, and internal control standards. Doing so would ensure that the NSP funds are claimed only for reasonable, allowable, and allocable costs.

GDSI's Response

GDSI provided a detailed explanation, disagreeing with the finding. For the complete text, see GDSI's response (attached). GDSI contends the following:

- The audit staff was biased
- Procurement practices were in place to ensure that related-party transactions were properly valued
- TFSI, Spectrum Surveillance Systems, Pacific Books & Supplies, and Natural Solutions were not related parties of GDSI
- GDSI provided accounting policies, procedures, records, and source documents during fieldwork
- GDSI provided actual source documents to the outside accountant
- GDSI has a governing board, independent of operations, that segregates key financial duties from the director

SCO's Comment

The finding remains unchanged.

For clarity, we have numbered GDSI's responses to correspond to our comments, as follows:

- 1.1 The audit did not state that GDSI's lease transactions with the director and his wife were improper. GDSI lacked and the director refused to provide the required fair market rental estimates from an independent licensed appraiser to substantiate the rent charges.
- 1.2 The audit disclosed that Spectrum Surveillance Systems (Spectrum), owned by the director, shared an address common to GDSI. Though we did not examine accounts and ownership records of Spectrum, various audit evidence, such as newspaper articles and social media identified the director as the owner.

We neither examined nor did we take exceptions to any transactions of Spectrum Electronics.

- 1.3 The director states that GDSI has not conducted business with Pacific Books for the past 6 years, i.e. since 2008; however, GDSI's General Ledger revealed approximately \$3,000 of transactions between GDSI and Pacific Books during the audit period. Our audit disclosed that Pacific Books was a function of related entity TFSI. The director's wife, Jeanette Parker, serves as: (1) secretary of GDSI governing board, (2) administrator of TFSI, and (3) landlord of buildings leased to GDSI that are also subleased to TFSI.
- 1.4 Natural Solutions is a related entity; it is owned by the director's son, Clark Parker, Jr., who is also listed as an employee of GDSI and related entity TFSI. Natural Solutions has a business address common to GDSI. GDSI lacked established procurement practices to substantiate that these related-party transactions were valued fairly. GDSI did not provide accounting records and source documents to substantiate that the related-party transactions with Natural Solutions were properly valued.
- 1.5 GDSI did not provide written accounting policies and procedures during the audit; these were only made available subsequent to the exit conference with the director, which included the discussion of the audit results. Distinct groups of audit staff were assigned this engagement, as the examination was conducted in phases: (1) student eligibility, (2) student attendance, and (3) expenditures. The test of expenditures required an evaluation of the related accounting policies and procedures.

In August 2013, as we commenced examination of recorded salaries, benefits, supplies, materials, and service transactions, we, once again, requested copies of the accounting policies and procedures. The director referred the audit team to its outsourced accountant, Miller Accountancy, for all accounting policies, records, and source documents. Miller Accountancy was unaware of the existence of such policies and procedures, and provided documents that were consistent with the contractual agreement with GDSI; "information extracted from original source documents," and not the actual source documents.
- 1.6 Steve Flores, CPA, informed us, during our review of his financial and compliance audit documentation, that the director did not make available copies of source documents for the CPA's audit work papers.
- 1.7 Please refer to comment 1.1. GDSI did not provide any policies, procedures, or practices to ensure that the related-party transactions were charged at arm's length and fair value.
- 1.8 Our audit revealed that all business matters were decided by the director. There is a lack of the necessary checks and balances to assure that the claimed program expenses were properly supported, reasonable, and necessary for the CDP operations.

Furthermore, the requirement for fair market rent assessment was discussed with the director during the course of the audit, at the conclusion of the fieldwork, and during the exit conference. The director was adamant and had advised that no such records will be made available. The director understood that related recorded expenses were questionable as a result.

- 1.9. GDSI provided no new information to support the purpose and presence of the GDSI Board. Board minutes were only made available after the exit conference. Furthermore, GDSI reported a list of board members on Form 990 to the IRS for fiscal years 2008-09 through 2011-12 that was different from what GDSI provided for the audit. Board minutes do not indicate that the board properly segregated key financial duties from the director. Furthermore, the minutes did not include a roll call of members. As such, we could not determine which members, if any, attended the board meetings.
- 1.10 The director is mistaken that the audit results are flawed due to bias. In addition to the CDE's request for an independent audit, it is the SCO's responsibility to be an independent protector of public funds. We accomplish this through independent examinations of a claimant's accounts and records. The audit staff assigned to this engagement performed a series of audit procedures pursuant to the aforementioned standards independently and methodically. Audit results were based on evaluation of sufficient evidence evaluated against the applicable criteria.
- 1.11 Please see the SCO's comments for Finding 5.

**FINDING 2—
Ineligible attendance**

Our audit determined that GDSI overstated a total of 47,492 attendance days for FY 2008-09, FY 2009-10, and FY 2010-11. GDSI did not participate in the CDP for FY 2011-12. The ineligible days were due to GDSI improperly determining enrollment eligibility for the CDP. For the entire audit period, GDSI had 1,587 pupils enrolled in the CDP. In all, GDSI reported 689,490 days of attendance for the audit period, an average of almost 230,000 days annually. Approximately 7% of these reported attendances were deemed ineligible.

The CDP prepares disadvantaged children for the kindergarten through eighth-grade public school system. This program is a federal- and state-subsidized service for which eligibility is based primarily on income and need. GDSI provides the necessary child development services on a fee-for-service basis. Needy families receive child care service for free or at reduced costs. For families eligible for free child development services, state apportionments allowed GDSI approximately \$33 per day to be charged against program-related costs. All of the GDSI pupils were enrolled under the subsidized child care program. Children either attended full-day or partial school days. Approximately 92% of the program revenues were from state apportionments, and private/parent fees (share of costs) provided the remainder of resources for the program.

To claim the subsidized service fee, GDSI submitted to the CDE quarterly reports (Form DCFS 8501, Attendance and Fiscal Report For

California State Preschool Programs; and Form CDFS 9529, Fiscal Report For Child Development Support Contracts). The CDE processed the attendance and fiscal data and determined the reimbursements due the provider. The reimbursement base, also referred to as "reimbursement limit" was the least of the following:

1. The maximum reimbursable amount as stated in the annual child development contract
2. The actual and allowable net costs
3. Contract service earnings – The adjusted child-days/hours of enrollment for certified children, times the contract rate per child-day/hour of enrollment, times the actual percentage of attendance plus five percent (5%), but in no case to exceed one hundred percent (100%) of enrollment

GDSI was required to establish and maintain family data files pursuant to *California Code of Regulations* (CCR), Title 5, section 18081. CCR requires that the family data files contain completed and signed application for services; documentation of income eligibility and need in accordance with Education Code Section 8263 (a)(1) and (a)(2). Each family's data file requires annual recertification for continued eligibility and reassessment of share of costs.

Due to a large number of family data files, we created a statistical sample plan with a sample size of 267 family data files. This sample size gave us an estimated 3.4% margin of error at a 94% confidence level. Doing so enabled us to conclude with high confidence that the sample estimate was within 3.4% of the percent ineligible that would be obtained if all 1,587 family data files were examined.

For the sample family data files selected, we conducted tests procedures to determine if:

- The family data file contained eligibility documentation in accordance with the applicable CCR section.
- The family income and employment was documented in accordance with CCR §18096, §18086, and §18084; specifically, that:
 - An income calculation worksheet was used to specify frequency and amount of pay and all other income.
 - The applicant provided pay stubs, tax returns, or contractor-attested self-certification of income/employment.
 - The applicant provided total income for all individuals counted in the family size.
 - The applicant had signed a release authorizing the contractor to contact the employer (§ 18084(a)(1)(B)).
- The family fee specified on the Notice of Action was correct.
- Both parents' addresses were documented and, if not, supporting documents explaining why.

Of the sampled 267 family data files reviewed, 85 data files lacked the required eligibility processes and documentation. These files contained many of these irregularities as follows:

- 7 instances of missing calculation worksheets or errors on the calculation worksheet.
- 3 instances of missing or incomplete income documentation.
- 65 instances of lack of all income in the household. Sixty of the exceptions taken in this area were due to being unable to verify whether one or both parents were present in the household.
- 4 instances of missing information release forms authorizing GDSI to contact the applicant's employer to verify income and employment status.
- 10 instances of incorrect assessment of parent fees. Incorrect parent fees resulted from calculation errors, changes in income, or incorrect information used in the calculation, such as family size or payment frequency.
- 65 instances of missing documentation verifying the absence or presence of a parent who was claimed to not be part of the household.
- 23 instances of children who were claimed for attendance outside of the certification period.

As a result, we identified a total of 10,928 ineligible attendance days for 85 of the 267 sampled students. We extrapolated these results for the entire pupil population for the audit period to determine that total number of days in question for FY 2008-09, FY 2009-10, and FY 2010-11 as follows:

Fiscal Year	Fiscal Year			Total
	2008-09	2009-10	2010-11	
A Population	949	821	952	
B Sample size	152	121	135	
C Ineligible sample size	64	34	20	
D Error Rate (C/B)	42.11%	28.10%	14.81%	
E Ineligible days (per CDE form 9500)	6,819	2,168	1,941	10,928
F Standard deviation	79	43	46	
G Average ineligible days (E/B)	44.86	17.92	14.38	
H Margin of error at 95% confidence level	10,904	5,761	6,815	23,480
I Total ineligible days (A X G)	42,572	14,712	13,690	70,974
J Total ineligible days, net of Margin of error (I-H)	31,670	8,949	6,872	47,492

Title 5, *California Code of Regulations*, section 18083 (5 CCR §18083) states that application for service must contain the parent's signature and the date of the signature and the signature of the contractor's representative certifying the eligibility.

5 CCR §18081 states,

- (a) Contractors shall establish and maintain a family data file for each family receiving child care and development services.
- (b) The family data file shall contain a completed and signed application for services and the following records as applicable to determine eligibility and need in accordance with Education Code section 8263(a)(1) and (a)(2):
 - (1) Documentation of income eligibility, including an income calculation worksheet;
 - (2) Documentation of employment;
 - (3) Documentation of seeking employment;
 - (4) Documentation of training;
 - (5) Documentation of parental incapacity;
 - (6) Documentation of child's exceptional needs;
 - (7) Documentation of homelessness;
 - (8) Documentation of seeking permanent housing for family stability;
 - (9) Written referral from a legally qualified professional from a legal, medical, or social services agency, or emergency shelter for children at risk of abuse, neglect, or exploitation.
 - (10) Written referral from a county welfare department, child welfare services worker, certifying that the child is receiving protective services and the family requires child care and development services as part of the case plan.
 - (11) If the parent of the child was on cash assistance, the date the parental cash aid was terminated.
- (c) A signed Child Care Data Collection Privacy Notice and Consent Form CD 9600A (Rev. 01/04) shall be included.
- (d) Notice of Action, Application for Services and/or Recipient of Services shall be included.

5 CCR §18084 states,

- (b) The contractor:
 - (1) Shall retain copies of the documentation of total countable income and adjusted monthly income in the family data file.
 - (2) When the parent is employed, shall, as applicable, verify the parent's salary/wage; rate(s) of pay; potential for overtime, tips or additional compensation; hours and days of work; variability of hours and days of work; pay periods and frequency of pay, start date for the employee. If the employer refuses or is non-responsive in providing requested information or a request for employer documentation would adversely affect the parent's employment, and if the information provided pursuant to subdivision (a)(3) is inconsistent with the contractor's knowledge or community practice, shall request clarification in the self-certification of income, additional income information or a reasonable basis for concluding that the employer exists.

- (3) When the parent is self-employed, shall obtain and make a record of independent verification regarding the cost for services provided by the parent that may be obtained by contacting clients, reviewing bank statements, or confirming the information in the parent's advertisements or website.

If the income cannot be independently verified, the contractor shall assess whether the reported income is reasonable or consistent with the community practice for this employment.

- (4) May request additional documentation to verify total countable income to the extent that the information provided by the parent or the employer is insufficient to make a reasonable assessment of income eligibility.
- (5) To establish eligibility, shall, by signing the application for services, certify to the contractor's reasonable belief that the income documentation obtained and, if applicable, the self-certification, support the reported income, are reliable and are consistent with all other family information and the contractor's knowledge, if applicable, of this type of employment or employer.

5 CCR §18086 states,

- (a) If the basis of need as stated on the application for services is employment of the parent, the documentation of the parent's employment shall include the days and hours of employment.
- (b) If the parent has an employer, the documentation of need based on employment shall consist of one of the following:
- (1) The pay stubs provided to determine income eligibility that indicates the days and hours of employment;
 - (2) When the provided pay stubs do not indicate the days and hours of employment, the contractor shall verify the days and hours of employment by doing one of the following:
 - (A) Secure an independent written statement from the employer;
 - (B) Telephone the employer and maintain a record;
 - (C) If the provided pay stubs indicate the total hours of employment per pay period and if the contractor is satisfied that the pay stubs have been issued by the employer, specify on the application for services the days and hours of employment to correlate with the total hours of employment and the parent's need;
 - (D) If the variability of the parent's employment is unpredictable and precludes the contractor from verifying specific days and hours of employment or work week cycles, specify on the application for services that the parent is authorized for a variable schedule for the actual hours worked, identifying the maximum number of hours of need based on the week with the greatest number of hours within the preceding four weeks and the verification pursuant to subdivisions (A), (B), or (C) above. Until such time as the employment pattern becomes predictable, need for services shall be updated at least every four months and shall be based on the requirements of subdivision (b) and the child care services utilized;

- (E) If the employer refuses or is non-responsive in providing the requested information, record the contractor's attempts to contact the employer, and specify and attest on the application for services to the reasonableness of the days and hours of employment based on the description of the employment and community practice; or
 - (F) If the parent asserts in a declaration signed under penalty of perjury that a request for employer documentation would adversely affect the parent's employment, on the application for services:
 - (i) Attest to the reasonableness of the parent's assertion; and
 - (ii) Specify and attest to the reasonableness of the days and hours of employment based on the description of the employment and community practice.
- (3) When the employed parent does not have pay stubs or other record of wages from the employer and has provided a self-certification of income, as defined in section 18078(o), the contractor shall assess the reasonableness of the days and hours of employment, based on the description of the employment and the documentation provided pursuant to section 18084(a)(3), and authorize only the time determined to be reasonable.

5 CCR §18096 states,

The contractor shall calculate total countable income based on income information reflecting the family's current and on-going income:

- (a) Using an income calculation worksheet that specifies the frequency and amount of the payroll check stubs provided by the parent and all other sources of income pursuant to section 18078(q).

Recommendation

Although GDSI no longer participates in the CDP, we recommend that the CDE calculate the reimbursement limit and determine overpayments resulting from these ineligible days. We also recommend that the CDE take action to promptly recover these overpaid funds.

GDSI's Response

We have presented herewith our response to the proposed eligibility and attendance findings for the 96 children and family files the SCO allege they found errors with. Each stack of names addresses a certain issue that the SCO raised in their draft audit report.

We disagree with all error findings set forth in your finding Number 2 except two income calculation errors that have no bearing on the family's eligibility for subsidized child care.

The sample error method the SCO propose to use to randomize the error rate across the total population of approximately 1600 family files is improper. The data is not homogeneous and as such a randomize error rate sample is not appropriate for a data base with these many variables. There are over 32 variable scenarios that must be taken into

consideration in order to use a stratum that will work in this scenario. For example the attendance is broken down into 5 different categories and can vary this much for one child over any time period. The categories for eligibility varies by 7 eligibility criteria (e.g., Limited English Deficiency, Handicapped, Special Needs, No Special needs, Infants/Toddlers, Preschool and School Age) and for different time periods within these categories, half-time, three-quarter time, full-time and full-time plus. A child can go from one category to the next within one week and multiple times within the same month. Any type of randomizing error sampling technique must be limited to a homogenous group for all categories because the standard deviation (r^2) will vary greater than $>.0.50$ for any group and this will render the sample error results void for a lack of homogeneity.

Further, CDE field supervisor, Mr. Greg Hudson, has stated to GDS in writing that any error rate less than 25% will not be considered an out of compliance issue, therefore, if there are only two errors, GDSI's error rate is less than 0.50%, simply put, we are in compliance with our performance audit based on CDE's standard of measurement.

SCO's Comment

The finding remains unchanged.

We did not create a statistical random sample plan for a non-homogenous population. GDSI had in excess of 1,580 family data files; each file represented a child. Each file contained the required family data, the content of which depended on applicable eligibility criteria for the respective family. The statistically selected sample was not for the individual criteria applicable for a family data file, but for the family data file. These family data files were defined as the population for our examination. Each file represented a sample item; each of these family data files had an equal chance of being statistically selected. Once selected, each sample family data file was then reviewed against the applicable criteria.

The CDE is unaware of the alleged error rate threshold for variances of less than 25% as out of compliance. This error rate does not pertain to this audit.

GDSI also provided six sets of confidential information as evidence. To the extent these documents contained personal confidential data, we have either excluded or redacted them from this final report. The non-confidential information is included in the attachment, and, for clarity, we have numbered GDSI's responses to correspond to our comments as follows:

- 2.1 Our audit identified 85, not 96, family data files that lacked the required eligibility processes and documentation. Of the additional 11 children that GDSI assumed the audit had deemed ineligible, only one child was deemed ineligible due to lack of documentation. For the remaining ten students, our audit procedures did not reveal them to be ineligible, and therefore, their attendance remained unquestioned.

- 2.2 The second set of documents refers to 12 children's eligibility questioned due to "gap in recerts between days." The additional documentation did not provide any new information to support that each of these respective children's family data file was recertified in a timely manner, i.e., as authorized, "at least once each contract period and at intervals not to exceed twelve (12) months," pursuant to 5 CCR §18103.

Furthermore, while GDSI asserts that the process of recertification began at least a month before the end of current contract period, no evidence exists in the respective child's family data file to support that the eligibility was recertified at the time a new contract period began. Our audit found that there was a lapse of time in which a child was deemed eligible; therefore, only the days ineligible were questioned.

- 2.3 The third set of documents refers to five children's ineligibility due to lack of information to support that parents sought employment pursuant to 5 CCR §18086.5 (b). The additional documentation does not provide any new information to suggest otherwise. Furthermore, GDSI asserts that 5 CCR §18086.5(b) was not effective until October 1, 2008. To the contrary, 5 CCR §18086.5 was renumbered, amended, and filed on May 28, 2008, and was operative effective June 27, 2008. The code section was in effect prior to the audit period.
- 2.4 The fourth set of documents refers to six children's eligibility questioned for lack of documentation for "family change in income" pursuant to 5 CCR §18102. We did not question eligibility for two of these children. For another child, our audit found that the additional family income, specifically, the mother's, was to increase after six weeks of employment. No additional documentation was included in the family data file. Furthermore, the family data file was not updated to determine eligibility. The additional two of these six children were already deemed ineligible due to lack of evidence to support that the parent sought employment pursuant to 5 CCR §18086.5 (b). For the last child, we examined all available documents including the CDE form 9600.
- 2.5 The fifth set of documents refers to 55 children's eligibility questioned due to lack of evidence to verify the presence or absence of parents. This additional documentation does not provide information to suggest otherwise. GDSI is incorrect that 5 CCR §1800 (a) and (b), which required such evidence for determining a child's eligibility, was ineffective for the audit period. To the contrary, the above referenced authority was amended on August 16, 2007, and became effective on September 15, 2007; this regulation was effective for the audit period.
- 2.6 GDSI identified seven children but provided no records to substantiate proper income calculation.

*Golden Day Schools, Inc.**Child Development and Nutrition Services Programs***FINDING 3—
Unsupported salaries**

GDSI reported, in total, \$5,415,417 in salaries but did not provide all accounting records and source documents to substantiate GDSI-related certificated and classified salaries for FY 2008-09, FY 2009-10, and FY 2010-11. As a result, the recorded salaries were deemed unallowable. The unallowable salaries are as follows:

	FY 2008-09		FY 2009-10		FY 2010-11		Total
	Average # of Employees	Salaries	Average # of Employees	Salaries	Average # of Employees	Salaries	
Teacher	60	\$ 1,068,071	56	\$ 875,153	51	\$ 889,437	\$ 2,832,661
Clerical and others	6	144,207	4	86,027	4	95,980	326,214
Instructional aides	26	399,243	23	337,167	31	504,525	1,240,935
Maintenance and operations	17	303,029	16	341,894	16	370,684	1,015,607
Total		\$ 1,914,550		\$ 1,640,241		\$ 1,860,626	\$ 5,415,417

GDSI operates child development centers in four locations for approximately 540 enrolled children. The related charter school, TFSI, as discussed below, serves approximately 1,100 kindergarten through eighth-grade students at these and two additional locations. In all, GDSI had eight classrooms at all four locations, which were primarily used for the child development program. Approximate student and age group enrollment for each of the locations were as follows:

Site	Location	Percentage by age group		No. of Students	
		Pre-school	Before & After		
1	2255	90%	10%	130	
2	6422	90%	10%	120	
3	4508	99%	1%	140	
4	4476	0%	100%	150	
Total students					540

Within each child development classroom, pupils were enrolled in multiple groups. Each group formed a class and each class was staffed with one teacher and a teacher's aide. GDSI's outsourced accounting processor explained that the GDSI-related staff costs for teachers, instructional aides, and maintenance staff hours were determined by the director. The accountant then recorded these hours to a specific code in GDSI's account code structure. The annual auditor's report validated these recorded costs. GDSI paid their employees bi-weekly.

GDSI and TFSI jointly function at the four locations. GDSI is operated by the director and TFSI is operated by the director's wife who is also GDSI's governing board secretary. The director asserts that the two entities are unrelated as each is operated individually as not-for-profit entities. For operations and record keeping, the director asserts that during the audit period, GDSI was open for business for approximately 12 hours daily, except weekends, beginning at 6:00 a.m.; whereas TFSI operated from 9:00 a.m. to 3:00 p.m.

Our review of GDSI's chart of accounts and account code structure revealed that separate entity records, or transactions, were identified and recorded as GDSI business. While the accounts and records give the appearance of separate entities, the two organizations are related, and as such, a review of related-party transactions is necessary to determine the existence, valuation, and proper recording of related activities. We compared the GDSI staff roster to the TFSI staff roster for FY 2008-09 and FY 2009-10 and identified 43 employee names, representing 29 teachers and 14 non-teacher staff, or approximately 40% of the GDSI employee roster, common to both entities.² Approximately 29 of 40 TFSI's teachers (72%) and 14 of 34 non-teacher TFSI staff (41%) represented personnel common to GDSI.

The CDE, for its LSR, requested but was refused TFSI records. The CDE had determined that GDSI charged payroll costs to the child development program for 48 employees who also worked for TFSI. The CDE requested supporting payroll documents from TFSI in an effort to resolve payroll inconsistencies identified during its review. However, the director and TFSI refused to provide any TFSI payroll documentation. The ALJ agreed with the CDE's conclusion and noted that it was "very troubling" that GDSI failed to provide payroll records from TFSI.

Similarly, in order to determine whether the recorded salaries were only for GDSI and that they were valued and recorded properly, we requested but the director refused to provide related-entity accounting records. The director argued that TFSI was unrelated to GDSI as his wife is one of the many officers of the charter school. TFSI's annual audit reports for FY 2008-09, FY 2009-10, FY 2010-11, and FY 2011-12 notes Mrs. Parker as TFSI's administrator, a position equivalent to the director of GDSI. We informed the director that while we understood GDSI's accounting processes and that the two entities maintained separate accounting records, a review of the TFSI account and records was necessary to validate the processes and recorded costs. Absent this validation, we would not be able to determine whether the transactions are properly charged and recorded to each respective entity. The director understood that these labor costs would be deemed unsubstantiated without TFSI accounting records and source documents.

Statements of Financial Accounting Standards 57 defines a related party as "an entity that can control or significantly influence the management or operating policies of another entity to the extent one of the entities may be prevented from pursuing its own interests. A related party may be any party the entity deals with that can exercise that control. Examples of related parties include members of management, the governing board, and their immediate families."

California State Preschool Programs Funding Terms and Conditions (FT&C) for FY 2008-09, FY 2009-10, and FY 2010-11, Section VI, Accounting and Reporting Requirements, Subsection E, General Record Keeping Requirements, states, in part, "If an employee is multi-funded on a time accounting basis, then the employee's timesheet must indicate the actual amount of time spent in each program per day."

² TFSI Staff List – Los Angeles County Office of Education.

FT&C, Section II, Q. Conflicts of Interest, states in part, "For any transaction to which the contractor is a party and the other party is: (1) An officer or employee of the contractor or of an organization having financial interest in the contractor; or (2) A partner or controlling stockholder or an organization having a financial interest in the contractor; or (3) A family member of a person having a financial interest in the contractor, the transaction(s) shall be fair and reasonable and conducted at arm's length..."

FT&C, Section V. Costs, Earnings, and Reimbursement A. Reasonable and Necessary Costs, states, "Contractors will be reimbursed for actual costs that are reasonable and necessary to the performance of the contract as defined in Section 1 above."

Recommendation

Although GDSI no longer participates in the CDP, we recommend that the CDE calculate the reimbursement limit and determine overpayments, as the net program costs have been significantly disallowed due to unsupported labor costs. We also recommend that the CDE take action to promptly recover these overpaid funds.

GDSI's Response

GDSI provided a detailed explanation, disagreeing with the finding. For the complete text, see GDSI's response (attached). In addition, GDSI's accountant and the CPA provided several declarations disputing the audit results.

GDSI contends the following:

- GDSI conducted and administered one program
- GDSI and TFSI are not prohibited from doing business with each other
- Time card source documentation, signed by the employee and supervisor, were maintained
- Employees did not work for TFSI or any other employer during the hours recorded on time cards for GDSI
- The SCO's reference to the ruling of the administrative law judge (ALJ) in the matter of Golden Day Schools' appeal before the Office of Administrative Hearings is improper
- GDSI is controlled by a separate and independent Board of Directors
- Dr. Jeanette Parker was not a member of the Board of Directors during the audit period
- GDSI staff possessed proper qualifications and maintained at least the required number of staff

Accountant's declarations:

See accountant's declaration numbers 3, 5, 6, 8, 9, and 11 (attached).

CPA's declarations:

See CPA's declaration numbers 5, 9, and 10 (attached).

SCO's Comment

The finding remains unchanged.

For clarity, we have numbered GDSI's responses to correspond to our comments as follows:

3.1 GDSI and related TFSI operations are funded by multiple sources of CDE-administered federal and state funds. The accounting records and audited financial statements identify that GDSI operations include federal- and state-funded CDP and NSP funds. The NSP provides GDSI two types of funds for the nutrition program. For the related charter school that conducts business in the same location and appears to share common certificated and classified staff, the outside auditors report identifies various forms of federal- and state-funded programs, such as Attendance Revenue, NSP, Block Grant, and Class Size-Reduction.

A review of TFSI records might have validated that GDSI's program costs were actual, reasonable, and necessary.

3.2 GDSI did not make available all time records. As such, we could not determine whether recorded employee hours and related costs were proper.

3.3 We requested TFSI financial records and source documents to substantiate that employees did not work for TFSI during recorded hours for GDSI. This complete set of records was necessary to validate that GDSI employees did not provide concurrent services to TFSI or any other related entity. Our results are consistent with the CDE's LSR. GDSI disagreed with the LSR, but was unsuccessful in its appeal to the Office of Administrative Hearings. The Court ruled that TFSI records were necessary to substantiate the CDP claims.

3.4 Our audit does not question GDSI staff qualification and staff ratio.

3.5 The ALJ decision is not the basis for our finding. Our audit results are based on the facts that were applied against the applicable criteria.

3.6 Please see Finding 1 for GDSI's concerns and our comments regarding the GDSI governing board. GDSI asserts that it is controlled by a separate and independent board of directors, however, our audit questioned the purpose and presence of the governing board as all business decisions were made by the director.

3.7 We discussed with the director, the related TFSI records during GDSI site visits on September 12, 2013. The director informed us that such records would not be made available.

Accountant

The accountant's declarations contradict our discussions during our visit to her office. The director advised that all accounting records and source documents were available at the accountant's office and referred us to the accountant's office. The accountant provided a walk-through of her GDSI-related roles and responsibilities.

In fact, the purpose of the entire audit team's visit to the accountant's office was to resume examination of the expenditure account records and source documents. Had these documents been available, as stated by the accountant, we would have requested and examined these records. The accountant had advised that no records were available at her office.

The audit staff resolved any miscommunication between the accountant and audit staff and no audit team member left the meeting.

CPA

During our visit to review GDSI's financial and compliance audit working papers, Steve Flores, CPA indicated that GDSI would not permit us to make photocopies of the documents.

The purpose of the CPA's onsite visit was to facilitate our ongoing performance audit; it was not to examine, evaluate, and provide a conclusion on the quality of the CPA's work.

FINDING 4— Unsupported employee benefits

In addition to the salary expenses discussed in Finding 3, GDSI reported approximately \$2.8 million in employee benefits. Of these, as shown below, approximately \$1.0 million was for payroll-related contributions for Old Age, Survivors and Disability Insurance (OASDI), unemployment insurance, worker compensation, etc.; and approximately \$1.8 million was for pension contributions.

	Fiscal Year			Total
	2008-09	2009-10	2010-11	
Other payroll-related contributions	\$ 347,304	\$ 351,874	\$ 416,274	\$ 1,115,452
Pension	578,779	616,441	575,000	1,770,220
Total	\$ 926,083	\$ 968,315	\$ 991,274	\$ 2,885,672

As the recorded salaries were unsubstantiated due to a lack of related-party accounting records and source documents, and therefore, unallowable, the fringe benefit costs were also deemed unsubstantiated, and therefore, unallowable.

Furthermore, we could not determine whether the recorded \$1.8 million for pension contributions was attributable to the entire salaries. The director explained that the pension contributions were determined under the GDSI governing board-approved terms that were approved more than 15 years ago. The external audit notes the pension benefits as a defined benefit plan. In a defined benefit plan, an employer/sponsor, such as GDSI, promises a specified monthly benefit upon retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age, rather than on individual investment returns. The director provided a "profit-sharing" Pension Plan agreement approved by himself on behalf of the Board and GDSI. The director explained that contributions to all eligible participants were based on longevity and annual time spent on the job. GDSI made contribution payments to Merrill Lynch, the pension administrator. Per the director, GDSI provides an annual census of employees, their longevity, and annual GDSI compensation. The pension administrator then assigns the contributions for each employee. The director asserts that except for an accounting entry to record the pension contribution, no GDSI or Merrill Lynch accounting records and source documents are available to identify contributions for each employee. Furthermore, no source documents were made available, such as an actuarial valuation study, to determine whether the pension contributions were fairly funded. No records exist to determine if the pension liability is being over- or under-paid. Thus, even if the salaries were to be deemed allowable, the pension costs would remain unallowable due to lack of accounting records and source documents to substantiate these expenses.

California State Preschool Programs Funding Terms and Conditions (FT&C) for FY 2008-09, FY 2009-10, and FY 2010-11, Section VI, Accounting and Reporting Requirements, Subsection E, General Record Keeping Requirements, states, in part, "If an employee is multi-funded on a time accounting basis, then the employee's timesheet must indicate the actual amount of time spent in each program per day."

FT&C, Section 1, Definitions (As Applicable To Each Specific Program Type), states, in part, "Actual and allowable net costs" means the cost which may be reimbursed under particular child development contract after disallowed costs and restricted income have been subtracted from total expenditures..."

FT&C, Section V. Costs, Earnings, and Reimbursement A. Reasonable and Necessary Costs, states, "Contractors will be reimbursed for actual costs that are reasonable and necessary to the performance of the contract as defined in Section 1 above."

Recommendation

Although GDSI no longer participates in the CDP, we recommend that the CDE calculate reimbursement limits and determine overpayments, as the net program costs have been significantly disallowed due to unsupported labor costs. We further recommend that the CDE take action to promptly recover these overpaid funds.

GDSI's Response

This FINDING 4 seeks to disallow the mandatory employee State and Federal tax benefits that all employers are required to pay for their employees. The employee benefits in question included but were not limited to payments made for Social Security Benefits, State Unemployment Taxes, Employee Medical Insurance and State Disability Taxes sufficient to cover the Golden Day Schools' employees as paid.

When the employee's salaries are determined to be allowed then the employee benefits totaling \$1.115 million must also be determining to be allowed.

Therefore, GDSI restates its argument put forth in FINDING 3 as support for this FINDING 4's allowability.

The SCO states the GDSI employee's Pension Program contributions, administered by a third party administrator, (Merrill Lynch), are also unallowable for this audit.

The GDSI Pension Program was authorized by the GDSI Board of Directors approximately 20 years ago. Prior to the initiation of the Pension Program it was approved by the Internal Revenue Service, the Federal Department of Labor and the Golden Day Schools' Board of Directors. Dr. Clark Parker abstained from voting for the Pension Program. The allowability of the Pension Program contributions for the audit period under review is based on the same argument put forth in Finding 4 and Finding 5 as they relate to the administrative salaries.

These employee benefits, taxes and Pension contributions were reasonable and necessary and they are allowable as per the definition set forth in Education Code Section 8208(n) and CCR Title 5 Section 18013(s)

GDSI disagrees with SCO's conclusion and recommendation. The employee benefits and pension contributions expended by GDSI and the corresponding salaries were reasonable and necessary and allowable for this audit period 08-11.

SCO's Comment

The finding remains unchanged.

GDSI did not provide accounting records and source documents to contend the audit results.

**FINDING 5—
Unsupported
administrative salaries**

The director draws an annual salary of approximately \$350,000 that he claims has been approved by the GDSI governing board. The director drew \$1,143,040 in total salaries for the audit period. While the director has many GDSI responsibilities, we found that he has many related entity responsibilities as well.³ The director is the Chief Executive Officer of Spectrum Surveillance Systems, a 10-19 employee organization with at least \$2.5 million in annual revenue; and owner of View Park Development Corporation, a 50-employee organization with at least \$50 million in annual revenue. The director has developed hundreds of commercial and residential properties throughout Southern California.

³ South Coast Air Quality Management District – Biography – Dr. Clark E. Parker, Senate Rules Committee Appointee

He is a Licensed General Contractor, Real Estate Developer, and California Licensed Real Estate Broker. In addition, the director is a TFSI board member and executive officer of Surveillance Security Systems.

During the audit, the director did not provide any documents, such as a duty statement, to substantiate his daily GDSI activities. It was only after discussion of this finding that the director provided a written document to delineate his GDSI activities. The document suggests that the director spends approximately 73 hours per week working on GDSI activities during the audit period. This requires a daily work schedule of approximately 10.5 hours for GDSI businesses, including the non-business days, i.e. weekends. Though the director explained his roles and daily tasks for GDSI operations, we were unable to determine how the director conducted his related business operations. As such, we could not determine whether his duties for GDSI and related entities were performed at the same time, and if so, whether his compensation was equitably charged against all related entities, or whether the costs of the executive salaries for related entities that were absorbed by GDSI were eventually charged against public funds.

California State Preschool Programs Funding Terms and Conditions (FT&C) for FY 2008-09, FY 2009-10, and FY 2010-11, Section VI, Accounting and Reporting Requirements, Subsection E, General Record Keeping Requirements, states, in part, "If an employee is multi-funded on a time accounting basis, then the employee's timesheet must indicate the actual amount of time spent in each program per day."

FT&C, Section 1, Definitions (As Applicable To Each Specific Program Type), states, in part, "Actual and allowable net costs" means the cost which may be reimbursed under particular child development contract after disallowed costs and restricted income have been subtracted from total expenditures..."

FT&C, Section V. Costs, Earnings, and Reimbursement A. Reasonable and Necessary Costs, states, "Contractors will be reimbursed for actual costs that are reasonable and necessary to the performance of the contract as defined in Section 1 above."

Recommendation

Although GDSI no longer participates in the CDP, we recommend that the CDE calculate reimbursement limits and determine overpayments, as the net program costs have been significantly disallowed due to unsupported labor costs. We further recommend that the CDE take action to promptly recover these overpaid funds.

GDSI's Response

GDSI provided a detailed explanation, disagreeing with the finding. For the complete text, see GDSI's response (attached).

SCO's Comment

The finding remains unchanged.

For clarity, we have numbered GDSI's responses to correspond to our comments, as follows:

- 5.1 GDSI comments that the audit report includes an incorrect administrator's salary charged to the CDP. GDSI states that the administrator salaries for the three years were approximately \$300,000, rather than \$350,000. The annual \$350,000 compensation was an approximate annual compensation, determined as an average of the administrator's total actual compensation per the General Ledger Detail and the Audited Financial Statements. GDSI did not provide any accounting records or source documents to determine whether the charged administrators' compensations were for services rendered only to GDSI.
- 5.2 The audit did not conclude that the administrator's compensation was excessive. Furthermore, we did not question if the compensation, cost of living adjustments, or pay raises, were reasonable and necessary; rather, we requested but GDSI failed to provide accounts and records of related affiliations. Such review is necessary to determine if the compensation charged to the CDE-funded programs was for costs incurred for these programs.
- 5.3 As discussed in Finding 4, pension charges remained unsubstantiated.

**FINDING 6—
Unallowable triple-net
lease: rent, property
taxes, and renovation
and repair**

GDSI reported \$3,747,459 in rent-related charges for the CDP. However, GDSI failed to provide an independent fair market rental estimate to substantiate the annual rental charges. Furthermore, a triple-net-lease agreement, in which GDSI agreed to pay rent, property taxes, and maintenance costs relating to buildings was in effect, but no related-party accounting records and source documents were available. Therefore, we could not substantiate whether the claimed rental and triple-net-lease charges were for GDSI only. The director asserts that TFSI, Pacific Books & Supplies, and Natural Solutions are unrelated and that recorded triple-net-lease costs are for GDSI only.

Annual rent and related triple-net-lease costs were as follows:

Fiscal Year	Rent	Property Taxes	Renovation and Repair	Total
2008-09	1,007,323	29,713	100,000	1,137,036
2009-10	1,049,777	36,718	380,449	1,466,944
2010-11	1,055,566	36,659	51,254	1,143,479
Total	3,112,666	103,090	531,703	3,747,459

The director and his wife⁴, are the owners of all GDSI building facilities. As a lessor, the Parkers entered into building lease agreements with GDSI, the sole lessee of the four locations. Per the director, GDSI board members approved the triple-net-lease agreement and annual rent charges. As mentioned earlier, the board's president and secretary represent 40% of the board members. GDSI paid the Parkers over \$1 million in rent each year. Rent was a related-party transaction, as the board's president and secretary were related parties of GDSI. As such, fair market estimates performed by an independent appraiser were required to substantiate rent-related charges. Because the current fair market rental estimates were unavailable, we could not determine whether the annual rental charge represents a fair charge for the limited use of GDSI operations. We observed that GDSI occupied two of the classrooms at each location. Equipment and other playground activities were located in areas assessable and available to GDSI and TFSI students.

The current lease agreement was not available; but an agreement executed in 1980 revealed a 20-year lease term. Per GDSI's external auditor's reports, an annual lease with a prevailing market rate is currently in effect. In addition, per the director, GDSI, as a sub-lessor, entered into an agreement with TFSI, the sub-lessee. TFSI paid GDSI each month for shared use of common buildings. According to the director, pursuant to the sublease agreements, TFSI paid GDSI only for the use of certain buildings from 9:00 a.m. through 3:00 p.m., Monday through Friday. While GDSI's related entities, Pacific Books & Supplies and Natural Solutions, have business addresses common to GDSI, no related accounting sublease or related-party accounting records and source documents for these entities were available to determine whether GDSI was absorbing rent, property tax, and maintenance expenses for these entities.

GDSI failed to provide current independent assessment of fair market rental estimates, and related-entities' accounting records and source documents relevant to the audit period. Thus, we could not determine whether claimed annual rent, property tax, and maintenance expenses were reasonable, allowable, and chargeable to the CDP program.

Furthermore, the alleged lease arrangement has been executed as an operating lease, or rental arrangement, rather than a capital lease. A capital lease arrangement is considered to have the economic characteristics of asset ownership. A capital lease would be considered a purchased asset for accounting purposes. An operating lease, on the other hand, would be handled as a true lease, or rental, for accounting purposes.

⁴ *Golden Day Schools, Inc. v California Department of Education* (CCTR 6150 and CCTR 7150).

Since inception more than 40 years ago, GDSI has been the sole lessee of the Parkers' buildings. In such arrangements, if the lease term is equal to or more than 75% of the economic useful life of the leased buildings, said arrangements are classified as capital leases. As such, the building-related assets and liabilities would be recorded as GDSI's transactions and, as a result, depreciation expense, not lease payments, would have been the reimbursable expense. With a depreciable life of 31.5 years, these buildings likely have been fully depreciated for more than a decade.⁵ Thus, GDSI has inappropriately claimed approximately \$1.0 million annually for over-depreciated facility costs in the form of annual lease expenses.

During its LSR, the CDE had also concluded that the lease payments were unsupported for FY 2006-07 and FY 2007-08. The CDE determined that the lease costs were a related-party transaction because GDSI's administrator and wife were owners of the properties. Therefore, GDSI was required to obtain a fair market rental estimate from an independent licensed appraiser to justify rent and all rent increases.

However, no updated fair market rental estimates were provided by GDSI. The ALJ upheld the finding, as GDSI did not obtain a fair market estimate from an independent licensed appraiser.

California State Preschool Programs Funding Terms and Conditions (FT&C) for FY 2008-09, FY 2009-10, and FY 2010-11, Section 1, Definitions (As Applicable To Each Specific Program Type), states, in part, "Actual and allowable net costs" means the cost which may be reimbursed under particular child development contract after disallowed costs and restricted income have been subtracted from total expenditures..."

FT&C, Section V. Costs, Earnings, and Reimbursement A. Reasonable and Necessary Costs, states, "Contractors will be reimbursed for actual costs that are reasonable and necessary to the performance of the contract as defined in Section 1 above."

FT&C, Section II, Q. Conflicts of Interest, states in part,

For any transaction to which the contractor is a party and the other party is: (1) An officer or employee of the contractor or of an organization having financial interest in the contractor; or (2) A partner or controlling stockholder or an organization having a financial interest in the contractor; or (3) A family member of a person having a financial interest in the contractor, the transaction(s) shall be fair and reasonable and conducted at arm's length. Based on corporate law (*Corporations Code* sections 310, 5233-5234, 7233 and 9243 as applicable) the general rules that would be followed to ensure that transactions are conducted "at arm's length" include: (1) Prior to consummating the transaction, the governing body should authorize or approve the

⁵ IRS Publication 946 – 31.5 years for property placed in service before May 13, 1993 (or before January 1, 1994, if the purchase or construction of the property is under a binding contract in effect before May 13, 1993, or if the construction began before May 13, 1993).

transaction in good faith and the board should require the interested party, or parties, to make full disclosure to the board both in writing and during the board meeting where the transaction is being discussed; and (2) All parties having a financial interest in the transaction should refrain from voting on the transaction and it should be so noted in the board minutes. If the transaction involves the renting of property, either land or buildings, owned by affiliated organizations, officers or other key personnel of the contractor or their families, the board of directors shall request the interested party to obtain a "fair market rental estimate" from an independent appraiser, licensed by the California Office of Real Estate Appraisers. If the contractor has no board or is a sole proprietor, the requirement for a "fair market rental estimate" shall also apply. The contractor has the burden of supporting the reasonableness of rental costs. If the property is owned by the contractor, rental costs are not reimbursable and costs may be claimed only as depreciation or use allowance....

Statements of Financial Accounting Standards 57 defines a related party as "an entity that can control or significantly influence the management or operating policies of another entity to the extent one of the entities may be prevented from pursuing its own interests. A related party may be any party the entity deals with that can exercise that control. Examples of related parties include members of management, the governing board, and their immediate families."

Financial Accounting Standard Board Statement No. 13 Lease Classification Criteria, states in part, "If, at the date of lease agreement, a lease meets any of the following criteria, it is classified and accounted as a capital lease... (3) The lease term is equal to 75% or more of the estimated economic life of the leased property..."

Recommendation

Although the provider no longer participates in the CDP, we recommend that the CDE calculate the reimbursement limit and determine overpayments, as net program costs discussed in this and the previous findings have been significantly disallowed. We further recommend that the CDE promptly recover these overpayments.

GDSI's Response

GDSI provided a detailed explanation, disagreeing with the finding. For the complete text, see GDSI's response (attached).

In addition, GDSI's accountant and the CPA provided the following comments:

Accountant

"...I personally prepare each monthly lease payment check. The lease payments are made by my firm at the directions from the Golden Day Schools Board of Directors..."

CPA

“...I further disagree with the statement made in the draft audit regarding the facilities’ leases for the properties leased to Golden Day Schools, Inc. by Clark and Jeanette Parker. My audit team and I were given copies of the current and prior leases and we have copies in our files of the leases and copies of the Fair Rental Estimate Appraisals, performed by an MAI appraisal I professionally disagree that these leases should be recorded as a capital lease, and are appropriately characterized as operating leases. The four criteria to classify a lease as a capital lease do not apply to these leases. I believe the lease expenses as set forth in the respective years’ audits reasonably reflect the lease expense as recorded in the general ledger and in the audit reports...”

SCO’s Comment

The finding remains unchanged.

For clarity, we have numbered GDSI’s responses to correspond to our comments.

6.1 GDSI did not provide the audit staff with a current lease agreement and an appraisal report. On the contrary, GDSI provided to audit staff the 1980 agreement for the 20-year lease arrangement. This same agreement was also included as an attachment to GDSI’s response to refute this audit finding. The appraisal report was provided effective April 21, 2011, and was for properties used as “charter school facilities.”

Reference to current lease arrangements, “annual lease with a prevailing market rate,” was disclosed in the audited financial statement. No such agreements were available for our audit.

6.2 As noted by the CPA, the generally accepted accounting principles (GAAP) are the basis of GDSI’s financial statement presentation. Accordingly, exception to these accounting principles has been previously discussed in the Findings and Recommendations.

6.3 GDSI is correct that the IRS provides a 40-year depreciable life for similar commercial properties. However this useful life was for properties placed in service after 1993. Prior to 1993, depreciable lives of such properties were 31.5 years.

6.4 We are not aware of why the LSR did not include an assessment of capital versus operating lease accounting.

6.5 GDSI states that this disallowance is improper, unreasonable, and unfair. Our audit results were based on a review of the source documents or lack thereof applied against the applicable criteria, the terms and conditions. These terms and conditions refer to CDE’s instructed accounting practices, GAAP. To the extent GDSI believes that the applicable criteria are improper, we recommend that GDSI address these issues with the CDE upon issuance of this final report.

6.6 GDSI failed to provide accounts and records of related entities. These entities shared facilities common to GDSI. We could not substantiate whether the claimed triple-net lease costs, property taxes, renovation, and repair, were for GDSI only.

**FINDING 7—
Unallowable expenses:
insurance, utilities,
housekeeping, and other
expenses**

GDSI reported \$859,219 but failed to provide all accounting records and source documents to substantiate GDSI-related insurance, utilities, housekeeping, and other maintenance expenses. As mentioned in Findings 1 and 6, because GDSI shares the premises with related entities (TFSI, Pacific Books & Supplies, Spectrum Surveillance Systems, and Natural Solutions), we requested related-entity, specifically TFSI, accounting records and source documents to determine whether the claimed charges were indeed for GDSI operations. The director refused to provide accounting records and source documents of the related entities. The director insisted that TFSI, Pacific Books & Supplies, and Natural Solutions were unrelated to GDSI, that each entity maintains its accounts and records, and that these claimed operating costs were only for GDSI. We explained to the director that without accounting records and source documents for TFSI, Pacific Books & Supplies, and Natural Solutions, we would not be able to ascertain whether these claimed costs were only for GDSI operations and that the recorded expenses were reasonable and necessary. As these expenses remain unsubstantiated, we deemed them to be unallowable.

<u>Fiscal Year</u>	<u>Liability Insurance</u>	<u>Utilities and Housekeeping</u>	<u>Contract (Other)</u>	<u>Total</u>
2008-09	58,236	125,311	50,865	234,412
2009-10	89,217	143,656	91,093	323,966
2010-11	30,657	142,038	128,146	300,841
Total	178,110	411,005	270,104	859,219

Per the LSR, the CDE identified similar liability insurance expenses, including an umbrella insurance policy, covering properties occupied by TFSI, other businesses, and the director's personal residence. The CDE could not determine what portion of the umbrella insurance policy was attributable to GDSI sites. As GDSI did not provide the CDE sufficient documentation to enable the CDE to make this determination, the CDE disallowed the charges. The Administrative Law Judge upheld this finding, deeming the evidence provided by GDSI as insufficient to support insurance charges.

California State Preschool Programs Funding Terms and Conditions (FT&C), Section II, Q. Conflicts of Interest, states in part,

For any transaction to which the contractor is a party and the other party is: (1) An officer or employee of the contractor or of an organization having financial interest in the contractor; or (2) A partner or controlling stockholder or an organization having a financial interest in the contractor; or (3) A family member of a person having a financial interest in the contractor, the transaction(s) shall be fair and reasonable and conducted at arm's length. Based on corporate law (*Corporations Code* sections 310, 5233-5234, 7233 and 9243 as applicable) the general rules that would be followed to ensure that transactions are conducted "at arm's length" include: (1) Prior to consummating the transaction, the governing body should authorize or approve the transaction in good faith and the board should require the interested party, or parties, to make full disclosure to the board both in writing and during the board meeting where the transaction is being discussed; and (2) All parties having a financial interest in the transaction should refrain from voting on the transaction and it should be so noted in the board minutes...

Statements of Financial Accounting Standards 57 defines a related party as “an entity that can control or significantly influence the management or operating policies of another entity to the extent one of the entities may be prevented from pursuing its own interests. A related party may be any party the entity deals with that can exercise that control. Examples of related parties include ...members of management, the governing board, and their immediate families.”

FT&C for FY 2008-09, FY 2009-10, and FY 2010-11, Section 1, Definitions (As Applicable To Each Specific Program Type), states, in part, “Actual and allowable net costs” means the cost which may be reimbursed under particular child development contract after disallowed costs and restricted income have been subtracted from total expenditures...”

FT&C, Section V. Costs, Earnings, and Reimbursement, A. Reasonable and Necessary Costs, states, “Contractors will be reimbursed for actual costs that are reasonable and necessary to the performance of the contract as defined in Section 1 above.”

Recommendation

Although GDSI no longer participates in the CDP, we recommend that the CDE calculate the reimbursement limit and determine overpayments, as net program costs have been significantly disallowed. We further recommend that the CDE promptly recover these overpayments.

GDSI’s Response

GDSI provided a detailed explanation, disagreeing with the finding. For the complete text, see GDSI’s response (attached).

SCO’s Comment

The finding remains unchanged.

For clarity, we have numbered GDSI’s responses to correspond to our comments, as follows:

- 7.1 The audit did not conclude that “each item charged was necessary and reasonable under the applicable law.” Instead, our audit concluded that GDSI failed to provide accounting records and source documents to substantiate insurance, utilities, housekeeping, and other maintenance expenses. As a result, we were unable to ascertain whether these claimed actual costs were for GDSI operations only, and that the recorded expenses were reasonable and necessary.

We agree that the reasonable and necessary costs, pursuant to the terms and conditions, in part, provide expenditures that in nature and amount do not exceed what an ordinary prudent person would incur in the conduct of a competitive business. However, these terms and conditions further define reasonable and necessary costs to be “...actual costs that are reasonable and necessary to the performance of the contract ...” GDSI did not provide accounts, records, and

source documents. Accordingly, we could not substantiate whether the recorded CDP costs were indeed actual costs that were reasonable and necessary for the program.

7.2 The SCO did not conduct a second financial and compliance audit of GDSI. The objective, scope, and methodology section of the report describes this performance audit. The objective of this audit was to provide conclusions based on sufficient, appropriate evidence against applicable criteria, the terms and conditions. Our audit objectives were to determine whether: (1) GDSI's internal controls over pupil enrollment and financial operations were adequate and that any claims made against the State were proper and adequately supported, and (2) program activities and claims for GDSI's CDP and NSP costs were in compliance with applicable requirements, laws, and regulations.

7.3 GDSI contends that the SCO improperly conducted a second financial and compliance audit and claims such audits are illegal pursuant to Education Code section 8448. This performance audit was conducted pursuant to the SCO's audit authority and at the request of the CDE. We agree that, pursuant to Education Code section 8448, "...if independent audits arranged for by direct service contractors meet generally accepted auditing standards, the State Department of Education shall rely on those audits and any additional audit work shall build upon the work already done." This section further provides that, "...Nothing in this article precludes the state from conducting, or contracting for the conduct of, contract performance audits which are not financial and compliance audits." In 1999, GDSI had unsuccessfully appealed a similar instance to the Court of Appeal, Third District (Golden Day Schools, Inc. v. Department of Education, Case No. C026767).

Nevertheless, as this matter is outside the audit scope, we recommend, upon issuance of this final report, that GDSI address this administrative matter with the CDE.

**FINDING 8—
Unsubstantiated auto
allowance**

GDSI reported \$36,000 in auto expenses as depreciation and use allowance. GDSI's accounting records revealed a \$1,000 monthly auto allowance charge. The director explained that these allowances were bus-related depreciation expenses. CDE's LSR had deemed that busses had been completely depreciated. No source documents were provided to substantiate that these charges were for un-depreciated GDSI busses.

Furthermore, if these allowances were indeed for undepreciated GDSI vehicles, specifically, buses, our review of field-trip and related expenses revealed that GDSI hired an outside bus service for transportation. No accounting records and source documents were provided to substantiate that the GDSI vehicles were used for program-related transportation services.

GDSI reported \$113,678 in additional depreciation expenses; however, we only examined these recurring auto allowance costs.

California State Preschool Programs Funding Terms and Conditions for FY 2008-09, FY 2009-10, and FY 2010-11, Section V. Costs, Earnings, and Reimbursement, A. Reasonable and Necessary Costs, states, in part, "Contractors will be reimbursed for actual costs that are reasonable and necessary to the performance of the contract. . . ."

Recommendation

Although GDSI no longer participates in the CDP, we recommend that the CDE calculate the reimbursement limit and determine overpayments, as net program costs discussed in this and the previous findings have been significantly disallowed. We further recommend that the CDE promptly recover these overpayments.

GDSI's Response

The Use allowance was for three vehicles used to distribute supplies, furniture, fixtures and food between the different child care locations. Since GDSI owned these vehicles they could only charge a use allowance. The GDSI auditor verified and certified that these cost were necessary and reasonable and allowable. See FT&C Section III (A) -- Depreciation and Use Allowance. This section also states as follows:

"Taxes, insurance and maintenance may be claimed as part of actual allowable costs for buildings or building improvements related to the child development program and equipment necessary for the operation of the program."

SCO's Comments

The finding remains unchanged.

GDSI clarified that these are not bus-related depreciation expenses, but allowances for vehicles used for transportation of supplies, furniture, fixtures, and food. However, GDSI did not provide records and source documents to substantiate these allowances. Furthermore, the general ledger shows various auto-related fuel and repair costs recorded as program costs. Although these costs were not examined, GDSI did not provide any records to substantiate that these use allowances were in addition to the above-mentioned vehicle costs.

**FINDING 9—
Unallowable legal fees**

GDSI reported \$25,000 in legal fees for unallowable activities. Specifically, the CDE denied an itemized expense on a claim. The legal fees were incurred to defend that the CDP fund advances were expended on allowable and reimbursable activities. GDSI reported approximately \$115,000 in additional legal expenses that we did not examine.

California State Preschool Programs Funding Terms and Conditions for FY 2008-09, FY 2009-10, and FY 2010-11, Section V. Costs, Earnings, and Reimbursement, states:

- A. Reasonable and Necessary Costs, "Contractors will be reimbursed for actual costs that are reasonable and necessary to the performance of the contract as defined in Section 1 above."
- G. Nonreimbursable Costs, "The following costs shall not be reimbursed under the child development contract 4. Costs of fines or penalties... 12. Costs of legal consulting and accounting services incurred in prosecution of claims against the state..."

Recommendation

Although GDSI no longer participates in the CDP, we recommend that the CDE calculate the reimbursement limit and determine overpayments, as net program costs discussed in this and the previous findings have been significantly disallowed. We further recommend that the CDE promptly recover these overpayments.

GDSI's Response

GDSI provided a detailed narrative, but no comments specific to this finding.

SCO's Comment

The finding remains unchanged.

**FINDING 10—
Unallowable costs:
previous years' non-
reimbursed instructional
supplies**

GDSI reported \$94,607 (\$23,025 in FY 2008-09, \$56,513 in FY2009-10, and \$15,069 in FY 2010-11) for instructional supplies. Our audit revealed \$18,344 in recorded expenses for FY 2009-10 that were for previous fiscal years. GDSI created three distinct journal entries, as shown below, to record these unallowable expenses.

Journal Entry Description	Amount
To reverse accrual of income from prior year that was never received	\$ 14,607
To reverse accrual of income from prior year that was never received	2,078
To reverse accrual of income from prior year that was never received	1,659
Total	<u>\$ 18,344</u>

General Child Care & Development Funding Terms and Conditions and Program Requirements for Child Development Programs for FY 2009/2010 Section V, Subsection H Charging of Expenditures states, "Net reimbursable program costs must be incurred during the contract period. Contractors shall not use current year contract funds to pay prior or future year obligations."

counts to the CDE. GDSI's accounting records substantiated the reported meals counts. Based on the preset rates, the CDE reimbursed GDSI for the quantity of each meal type served. As the reimbursements are for actual costs incurred, we requested GDSI to provide all accounting records and source documents, including those of TFSI, to substantiate the incurred costs.

GDSI provided us an overview of the food service operations. During the audit period, kitchen facilities at all four locations were in operation and, per the director, food service related services at all locations were only for GDSI students. Currently, only a kitchen at site 2, 4508 Crenshaw Blvd, is operational as this is the only location that presently operates the CDP. Our examination of GDSI's general ledger revealed various vendor transactions for milk, produce, meals, etc. In addition, accounting records identified costs for various classifications of staffing, including cooks, teachers' aides, and clerical; and other staff time and expenses being charged for the food services program. As previously mentioned, the director identified and instructed the outsourced accountant regarding the extent of labor activities to be charged for each respective employee. According to the director, the meal services for TFSI were provided by Royal Dining, an outside food catering business that cooked, prepared, and served all meals for TFSI.

In order to determine whether the recorded food services costs were indeed for GDSI, we requested but the director refused to provide related entity records, arguing that TFSI was unrelated. Absent the TFSI's accounting records and source documents, we couldn't ascertain that the claimed food services costs were for GDSI. Thus, the entire amount reimbursed for the food services program remained unsubstantiated. Furthermore, we found that the CDE overpaid GDSI \$501,746 for claimed meal services costs that were in excess of reported food services costs as follows:

Reimbursements:	Fiscal Year				Total
	2008-09	2009-10	2010-11	2011-12	
SNP	\$ 201,137	\$ 213,816	\$ 189,649	\$ 288,981	\$ 893,583
CACFP	336,132	304,930	386,212	370,215	1,397,489
Total	537,269	518,746	575,861	659,196	2,291,072
Reported food services expenses:					
Personnel	94,342	94,200	93,318	85,594	367,454
Food supplies	380,946	386,809	367,473	286,644	1,421,872
Total	475,288	481,009	460,791	372,238	1,789,326
Overpayment	\$ (61,981)	\$ (37,737)	\$ (115,070)	\$ (286,958)	\$ (501,746)

Statements of Financial Accounting Standards 57 defines a related party as "an entity that can control or significantly influence the management or operating policies of another entity to the extent one of the entities may be prevented from pursuing its own interests. A related party may be any party the entity deals with that can exercise that control. Examples of related parties include members of management, the governing board, and their immediate families."

California Education Code section 38091 states, "The cafeteria fund shall be used only for those expenditures authorized by the governing board as necessary for the operation of school cafeterias. . . ."

Title 2, *Code of Federal Regulations*, section 225, Appendix B, section 8, Part h, subsection 4 states, "Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation..." Subsection 5 states, "Personnel activity reports or equivalent documentation must meet the following standards: a) They must reflect an after-the-fact distribution of the actual activity of each employee, b) They must account for the total activity for which each employee is compensated, c) They must be prepared at least monthly and must coincide with one or more pay periods, and d) They must be signed by the employee."

Recommendation

As GDSI continues to participate in the SNP, we recommend that the CDE require GDSI to implement internal control standards, including policies and procedures, to ensure that claimed costs related to food service are properly authorized, recorded, and substantiated. We further recommend that the CDE take action to recover the entire amount reimbursed during the audit period, as GDSI has failed to provide related-party records and source documents to substantiate claimed nutrition services.

GDSI's Response

TFSI, Spectrum Surveillance System, Natural Solutions and Pacific Books & Supplies are not related parties of Golden Day Schools, Inc. Neither GDSI nor the Administrator, Dr. Clark E. Parker, have authority to make the books and records of these corporations or any other corporation available to the SCO for audit. The GDSI's necessary and reasonable incurred cost that the SCO has stated they will recommend to be disallowed due to GDSI's failure to provide another corporation's books and records available to the SCO for their audit is an illegal action. GDSI does not have the authority to comply with this legal request. These corporate entities are not related parties to GDSI. The Golden Day Schools, Independent outside auditor, Steven A. Flores CPA, has published three (3) certified and unqualified opinion audits stating all recorded costs and expenses set forth in his GDSI audits were incurred by the Golden Day and they were properly charged to the GDSI CDE funded Child Development program for the year in which they were recorded.

SCO's Comment

The finding remains unchanged.

As aforementioned, during our walkthrough of the GDSI operations, the director informed us that meals for the jointly functioning TFSA's charter school program was provided by an outside vendor, Royal Dining. Absent TFSA records, we attempted to obtain account and records of Royal Dining for TFSA meal services.

Royal Dining informed us that it did not provide any meal services to TFSI during the audit period (school years 2008-09, 2009-10, 2010-11, and 2011-12). Royal Dining began providing meal services to TFSI effective school year 2012-13 for two of five TFSI locations; 2301 E Rosecrans Avenue, Compton, CA; and 3405 West Imperial Highway, Inglewood, CA. Neither of these locations involved GDSI programs.

As we were unable to substantiate TFSI meal program costs due to lack of TFSI records, GDSI's meal program costs remain unsupported, and therefore, unallowable.

Golden Day Schools, Inc.

Child Development and Nutrition Services Programs

**Attachment—
GDSI's Response to
Draft Audit Report**

Golden Day Schools

4508 Crenshaw Blvd Los Angeles, CA 90043 (323) 296-6280 fax (323) 296-0601

September 8, 2014

Mr. Andrew Finlayson, Chief
State Agency Audits Bureau
California State Controller
3301 C Street, Suite 705
Sacramento, CA 95816

Re: Draft Audit Report for Golden Day Schools

Dear Mr. Finlayson:

I have enclosed herewith our response to the following proposed audit **FINDINGS**.

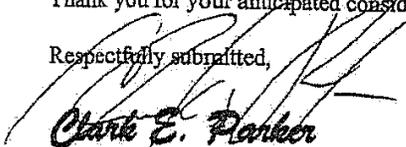
- **FINDING 1** - Lack of internal controls over related party transactions
- **FINDING 2** - Ineligible attendance
- **FINDING 3** - Unsupported salaries,
- **FINDING 4** - Unsupported employee benefits,
- **FINDING 5** - Unsupported administrative salaries,
- **FINDING 6** - Unallowable triple-net lease: rent, property taxes, and renovation and repair,
- **FINDING 7** - Unallowable expenses; insurance, utilities, housekeeping, and other expenses,
- **FINDING 8** - Unsubstantiated auto allowance,
- **FINDING 9** - Unallowable legal fees,
- **FINDING 10** - Unallowable costs: previous years' non-reimbursed instructional supplies,
- **FINDING 11** - Unallowable interest expenses
- **FINDING 12** - Unallowable nutrition program costs

Golden Day Schools

4508 Crenshaw Blvd Los Angeles, CA 90043 (323) 296 - 6280 fax (323) 296 - 0601

Thank you for your anticipated consideration of our request.

Respectfully submitted,



Clark E. Parker

Clark E. Parker Ph.D.
President/Administrator
Golden Day Schools, Inc.
4508 Crenshaw Blvd.
Los Angeles, CA 90043

cc: Chris Prasad

1

GOLDEN DAY SCHOOLS RESPONSE TO THE SCO DRAFT AUDIT REPORT

FINDING 1

Lack of Internal Controls over related party transactions

The SCO makes several unsubstantiated allegations regarding Golden Day's involvement in various related-party transactions with the director, and his wife, as well as several other related entities.

1.1

It is true that Golden Day leases its classroom facilities from Clark and Jeanette Parker which is a related party transaction. However that transaction has been scrutinized by CDE, the courts, the IRS and the California Attorney General and all have found it to be in compliance with all applicable laws and regulations governing related party transactions with a California non-profit corporate organization.

Therefore, the SCO's allegation that this transaction is not proper cannot be substantiated and no further discussion is warranted at this time.

Now, as to the other entities that the SCO allege is a related party to Golden Day the statement is not correct for the following reasons;

TFSI, Spectrum Surveillance Systems and Pacific Books & Supplies are not related parties to GDSI.

1.2

Golden Day Schools has never done business with Spectrum Surveillance Systems, the auditors has confused Spectrum Electronics, which is a burglar alarm company that provides burglar alarm monitoring service for the GDSI sites, with Spectrum

Golden Day Schools Response to SCO Draft Audit Report FINDING #1 – September 8, 2014

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Surveillance System, the two entities are not related. Neither the Director nor anyone in his family has an interest financial or otherwise in Spectrum Electronics.

Golden Day has not done business with Pacific Books in over 6 years and it is not a related party to GDSI. It is not owned or controlled by GDSI. Neither of the Parkers or any member of their family have an interest in Pacific Books nor have they ever received any direct or indirect benefits from this entity. Pacific Books is a DBA entity of TFSI. It has not existed for approximately 6 years. Anyway, it is not a related party to GDSI. On information and belief it was a dba entity created by TFSI to allow TFSI to purchase student books at wholesale prices from the textbook publishers for the students who attended TFSI. In other words, this entity allowed TFSI to purchase their student textbooks at wholesale prices instead of having to pay retail prices. Pacific Books used its name to secure discounted copying and printing services from a local printer at discounted prices for making their parent manuals and doing binding of their internal documents. Golden Day had its parents and classroom manuals printed by the local Pacific Book printer which saved GDSI over 35% less than the quotes obtained from other local printers. Pacific Books never charged GDSI one penny more than the printer billed Pacific Books for the work they did on behalf of GDSI.

1.3

Natural Solutions is not and has never been a company owned by Clark E. Parker Sr., a Director of Golden Day Schools. Clark E. Parker, Jr., the director's adult son, has a financial interest in Natural Solutions. Natural Solutions sells cleaning products to Golden Day Schools. Natural Solutions sold cleaning products to GDSI long before the director's son had any ownership position in the company. This transaction has been vetted by the Golden Day Board and other governing entities and all arms length rules and laws governing conflict of interest and related party have been adhered to for transparency. Neither Clark E. Parker Sr, nor Jeanette Parker has ever voted on any contract(s) or purchases that occurred between the two entities. Again this matter has been looked at for over 18 years and all conflict of interest and arm length rules have been adhered to regarding this matter.

1.4

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The draft audit report makes an inaccurate allegation at page 13 which is untrue, it states "also, during the fieldwork, the director failed to provide written accounting policies and procedures. These were only made available after the presentation of our findings at the exit conference." Again, the draft audit report has made statements that are untrue and cannot be substantiated; all requested documents were made available to the team of auditors as they requested them during their fieldwork.

1.5

What should be stated that the draft audit report fails to state is the following: - the SCO had several audit teams that came to GDSI to do fieldwork and they only had a small scanner to copy the documents they reviewed. Many documents were given to and discussed with the auditors by the director some were copied by the auditors and some were not. Every document that was requested was given to and made available to the SCO's field auditors and the director asked many times in writing for the auditors to put in writing any requested documents they wanted that was not or had not been provided to them. Each time the director received a request it was fulfilled within the time agreed upon. At the time of the exit conference there was no written request from the auditors that had not been fulfilled. There were many SCO auditors that came and went during the field work assignment. At the exit conference the director stated to Mr. Finlayson, Mr. Prasad and Mr. Kurokawa, (Mr. Kurokawa replaced Mr. Ken Harris as the field supervisor during the middle of the audit fieldwork), that he indeed had presented the accounting procedure manual to the auditors and if they did not make a copy of the accounting manual, it was not GDSI fault, however, the director agreed to make a copy of the accounting manual along with the executed engagement letter between the CPA accounting firm and GDSI and send it to the SCO by mail. They could not wait for the director to make a copy of the documents because they stated they were in a hurry to catch a plane back to Sacramento.

GDSI's CPA is the Miller Accounting Firm; they prepare and publish the schools books and financial records from source documents. The Accounting Manual document was discussed with and made available to the field auditors in 2013

Golden Day Schools Response to SCO Draft Audit Report FINDING #1 – September 8, 2014

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shortly after they began their fieldwork. The only additional document they requested from the director was that he obtain from the accounting firm a breakdown of the way the General Ledger was organized and a description of the chart of accounts and their meaning, which he obtained and gave to the auditors as requested.

1.5

Now to say this Accounting and Procedure manual was never given and/or shown to the field auditors is disingenuous and troubling. This should not be a game of – I got you – but rather what are the facts. The facts are - this Accounting and Procedure manual exist and has always existed and it was discussed with and shown to the SCO auditors during their fieldwork.

The statement made by the draft audit report that the GDSI's CPA did not have access to source documents for audit documentation is without merit and is not true. GDSI independent outside auditors, Steve Flores and associates, take great exception to this statement because it impugns their reputation and professionalism. This matter will be later addressed by the auditors in our later response.

1.6

The statement in the draft audit that states, GDSI lacked prudent procurement practices to ensure fair values of related party transactions is untrue and cannot be substantiated. GDSI has followed every known procedure that was required for it to substantiate all related party transactions including following the California Corporation Code, the CDE Funding Terms and Conditions regarding obtaining Independent Appraisals at the time of the applicable transaction and Board Member recusal(s) as applicable, along with prior disclosure to the Board of Directors of any direct or indirect related party involvement in any financial transaction by any member of the board. This matter was never discussed or mentioned as a matter of concern by the SCO auditors with the director/administrator during the SCO fieldwork and how the SCO can now propose to publish such a conclusion is puzzling and troubling.

1.7

The California Department of Education Accounting Manual defines Internal Controls as follows:

1.8

Golden Day Schools Response to SCO Draft Audit Report FINDING #1 – September 8, 2014

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"A plan of organization under which employees' duties are so arranged and records and procedures so designated as to provide a system of self-checking, thereby enhancing accounting control over assets, liabilities, revenue, and expenditures. Under such a system the employees' work is subdivided so that no one employee performs a complete cycle of operation; such procedures call for proper authorization by designated officials."

1.8

Therefore, based on CDE's own accounting manual's definition it is a **BIG LEAP** for the SCO to contend that GDSI did not have adequate Internal Controls over financial operations for the entire period. During their audit every financial expense record they requested and reviewed contained a copy of the source document and a copy of the check that was recorded in the G/L or the revenue and the ledger from which it was recorded and received in and later posted in the G/L.

The SCO in the draft audit report makes disparaging statements about GDSI, its Board of Directors, its accounting firm and its independent outside auditors without citing any facts. Further, the draft audit report states the following: "There is significant doubt as to whether a governing board actually existed." The Draft audit report goes further to say GDSI lacked an adequate recordkeeping system, maintaining accounting bookkeeping purposes and source documents to substantiate costs reported in the financial statements, etc". The SCO's allegations, beliefs, doubts, and unfounded assumptions do not cite one shred of evidence to support their finding and conclusion.

1.9

These outrageous statements show an actual bias attitude and a callous position of prejudice by the SCO's author(s) of this draft audit report, against GDSI and everyone associated with GDSI, these statements cannot be justified. The bias and prejudicial conclusions reached by the author(s) of the draft audit report cannot be responded to with a degree of dignity and professionalism because the allegations are so outrageous they do not warrant a further response.

1.10

Therefore, I will close by saying these statements are very disingenuous and troubling and they exhibits a great degree of actual bias. The state auditor's job should have been to perform a performance audit and to build on the financial

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and compliance audit completed by the GDSI independent outside auditor which was completed in accordance with the criteria set forth in Education Code Section 8448 et. seq., and GAAS. However, the SCO has performed a complete new audit by undermining the outside independent auditor's reports as they were submitted for the audit period in question.

1.10

This attack has allowed the SCO author of this draft audit report to make unfounded allegations and reach unsupported outrageous conclusions that have not and cannot be supported with a shred of evidence. The unsupported allegations have included attacks against the Director/Administrator, the Board of Directors, the GDSI accounting firm and the GDSI outside independent auditors.

Therefore, without going further we will conclude by saying these statements and unfounded conclusions made by this draft audit report' author(s) are Defamatory, Libelous and Untrue and the SCO auditors know it or should know it.

GDSI has a plan of organization and a system in place to enhance self-checking over the steps involving the procedures for each of the areas set forth in the Internal Controls definition. GDSI has an Accounting Manual that defines the role of each employee in the accounting process and their respective function regarding the GDSI accounting procedures as they relate to the GDSI assets, liabilities, revenue and expenditures.

1.8

GDSI has an engagement agreement with their outside accounting firm, which the SCO has a copy of, GDSI receives monthly financial statements created from inputted source documents from their accounting firm, and they receive monthly checking account(s) bank reconciliations, monthly payroll journals for all payroll payments and copies of all fiscal government reports as they are filed. These are the necessary documents needed to allow them to enhance their accounting controls for each of these procedures and to comply with the strict definition of Internal Controls as it is set forth above and taken from the CDE Accounting Manual.

1.5

It is very disturbing when a government agency results to these types of reckless, defamatory and libelous allegations and attacks, about another's character,

1.10

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reputation and professionalism without one shred of evidence to support their statements and conclusions. And they have done it with impunity.

The audit report makes statements about Dr. Clark Parker's salaries that are repeated in FINDING 5 which will be addressed in more detail when GDSI responds to FINDING 5. However, GDSI disagree with the SCO's conclusion and therefore, contend that Dr. Parker's salary was reasonable and in accordance with other comparable Executive Directors that have the same education, experience and responsibility as does Dr. Parker. He only received percentage increases equaling to the same percent CDE gave annually to all child care agencies and GDSI passed on to all employees during his tenure.

1.11

However, for the record the SCO's statements regarding View Park Estates Development, Inc. and Spectrum Surveillance Systems' income and employees are incorrect. Although Dr. Clark Parker has for over 50 plus years of his business career been involved in several businesses he was not involved in any of those activities during the audit period in question. Dr. Parker was appointed to the SCAQMD governing board two years ago and they meet once per month for 1-1/2 hours per month for 11 months per year. The SCO's source for this information is unreliable and it is based on speculation at best, it should be deleted from this audit report as it relates to Dr. Clark E. Parker.

Dr. Parker held no other corporate, or appointed committed time positions during the audit period. Dr. Parker's duty statement submitted to the SCO's auditor's stands as submitted for the audit period.

1.10

The SCO know or should know that the author of this draft audit report as shown actual bias or has shown the appearance of bias and if either is true due process demands that he be removed from further involvement with this audit.

With that said, GDSI will conclude by saying we do have adequate internal controls and same have been verified by two CPA firms, one being an independent outside audit firm who was retained and engaged to perform an independent audit in accordance with Generally Accepted Auditing Standards (GAAS), and the CDE Audit Guide, which he performed and submitted his unqualified audit of Golden Day Schools as set forth in Education Code Section 8448 to the California Department of Education. Therefore, we stand on our record as presented herein for this FINDING 1.

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1

GOLDEN DAY SCHOOLS RESPONSE TO THE SCO DRAFT AUDIT REPORT

FINDING 2

We have presented herewith our response to the proposed eligibility and attendance findings for the 96 children and family files the SCO allege they found errors with. Each stack of names addresses a certain issue that the SCO raised in their draft audit report.

We disagree with all error findings set forth in your finding Number 2 except two income calculation errors that have no bearing on the family's eligibility for subsidized child care.

The sample error method the SCO propose to use to randomize the error rate across the total population of approximately 1600 family files is improper. The data is not homogeneous and as such a randomize error rate sample is not appropriate for a data base with these many variables. There are over 32 variable scenarios that must be taken into consideration in order to use a stratum that will work in this scenario. For example the attendance is broken down into 5 different categories and can vary this much for one child over any time period. The categories for eligibility varies by 7 eligibility criteria (e.g., Limited English Deficiency, Handicapped, Special Needs, No Special needs, Infants/Toddlers, Preschool and School Age) and for different time periods within these categories, half-time, three-quarter time, full-time and full-time plus. A child can go from one category to the next within one week and multiple times within the same month. Any type of randomizing error sampling technique must be limited to a homogenous group for all categories because the standard deviation (r^2) will vary greater than $>.0.50$ for any group and this will render the sample error results void for a lack of homogeneity.

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*State Allege Errors For**11 - Children not on the disallowed attendance report*

2.1

However, they made no difference because they were not charged to the State on the 9400 for the audit period 07/01/2008 – thru 06/30/2010

Golden Day Schools Response:

Most current variation for the 9600 was for a period 03/08/2012

1. [REDACTED] – Outside of audit period for CDE child care program – see most current recent 9600 and NOA dated 03/08/2012 this was a change in service transaction, not a recertification next recertification was completed 09/03/2012 therefore, no income verification was required for the updated form 9600 date- 09/30/12. This is not a CDE Auditable.
2. [REDACTED] – Custodial parental documentation is in file – see power of attorney letter in file appointing Norma Gamboa to take custody of child.
3. [REDACTED] – There's an affidavit signed by parent [Chanae Penn] giving guardianship to Carla Penn child was not under mother or father's care (Parents were incarcerated see attached documentation in file.
4. [REDACTED] – Child enrolled 06/18/2008 – new regulation 18100(a)(2) was not effective until 10/01/2008 child was dropped 09/30/2008.
5. [REDACTED] – Child recertified 08/29/2007 – new regulation 18100(a)(2) was not effective until 10/01/2008 – no father's name on child's birth-certificate child dropped 08/29/08.
6. [REDACTED] – Attendance days claimed between recertification are reasonably claimed on 9400 recertification was started 08/07/2009 – see release form signed and dated 08/07/2009 by parent.
7. [REDACTED] – Child enrolled 09/17/2007 new regulation 18100(a)(2) was not effective until 10/01/2008 Child was dropped 01/31/2008 - No father's name on birth-certificate – outside of audit period.
8. [REDACTED] – Child recertified 02/08/2008 new regulation 18100 (a)(2) was not effective until 10/01/2008 child was dropped 08/29/2008.
9. [REDACTED] – Even if income calculation was in error parent was still eligible for subsidized child care:
10. [REDACTED] – Parent was incapacitated on 08/06/2010 not seeking employment from 08/06/2010 to 10/04/2010 – see incapacity documentation dated from: 05/08/2009 to 08/10/2010
11. [REDACTED] – Parent enrolled 03/09/2009 Documentation to support single parent in home per new regulation 18100(a)(2) – see utility bill in file.

STATE DISALLOWED Eligibility and Attendance for Twelve (12) Children

Reason for disallowance – "Gap in recerts between days"

Golden Day Schools Response:

2.2

Recertification section 18103, only requires contractors to update family application. Update application is defined under section 18078 (r) it does not require a date to be inserted on the updated application.

1. [REDACTED] – Attendance days claimed between 12/01/2008 thru (39days)
01/07/2009 was reasonably claimed on 9400. Recertification was started before the expiration of the 12month eligibility period. –see definition of recertification section 18103 and definition of "UPDATE" section 18078 (r).¹
2. [REDACTED] – Attendance days claimed between 09/14/2010 thru (144days)
10/06/2010 was reasonably claimed on 9400. Recertification was started – before the expiration of the 12month eligibility period – see definition of recertification section 18103 and definition of "UPDATE" section 18078 (r). (see footnote 1 below)
3. [REDACTED] – Attendance days claimed between 06/10/2009 thru (23days)
06/19/2009 was reasonably claimed on 9400. Recertification was started 06/11/2009 – see release form to employer signed and dated 06/11/2009 by parent. (see footnote 1 below)
4. [REDACTED] – Attendance days claimed between 08/07/2009 thru 09/14/2009 (43days)
was reasonably claimed on 9400. Recertification was started 08/06/2009 – see release form to employer signed and dated 08/06/2009 by parent. (see footnote 1 below)

¹ Section 18103 (a) defines recertification as follows: "(a) after initial certification and enrollment the contractor shall verify need and eligibility and recertify each family/child as follows:

(3)... Families shall be recertified at least once each contract period and at intervals not to exceed (12) months,;

(b) contractors shall update the family's application to document continued need and eligibility as specified in Education Code Section 8263 (a)(1) and (a)(2)...as follows,;

Section 18078 (r) defines update the application as follows: (r) update the application means the process of revising the application... The application shall be revised by inserting the latest family information that documents the continued need and eligibility for child care and development services.

Please Note – Sections 18103 and 18078 (r) do not require a date to be placed on the application but only required that the application be updated and that the process to begin within a 12 month time frame after the initial enrollment or Re-certification.

5. [REDACTED] -- Attendance days claimed between 02/06/2009 thru 02/09/2009 (79days)
-02/09/2010 thru 03/23/2010 and 03/23/11 thru 03/28/2011 was reasonably claimed on 9400.
Recertification was started before the expiration of 12months -- see definition of recertification 18103 and definition of "UPDATE" 18078(r). (see footnote 1 below)
6. [REDACTED] -- Attendance between recertification 01/29/2009 thru (209days)
02/23/2009 was reasonably claimed on 9400. Recertification was started 02/04/2009 -- see release form to employer sign and dated 02/04/2009 by parent -- see definition of recertification 18103 and definition of "UPDATE 18078(r) (see footnote 1 below)
7. [REDACTED] -- Child enrolled 09/30/2008 new regulation 18100(a)(2) (250days)
was not effective until 10/01/2008 also attendance was reasonably claimed on 9400 for -- see Notice of Action date given to parent to start September 30, 2008 and the Estimated recertification date September 30, 2009 in file. (see footnote 1 below)
8. [REDACTED] -- Child enrolled 07/15/2008 -- child was dropped 07/15/2009 (35days)
(see footnote 1 below)
9. [REDACTED] -- Attendance claimed between 08/30/2010 thru 12/31/2010 (4days)
was reasonably claimed on 9400 -- see documentation -- seeking employment 06/30/2010 thru 08/30/2010 and in training from 08/30/2010 thru 12/19/2010 (see footnote 1 below)

Section 18103 (a) defines recertification as follows: "(a) after initial certification and enrollment the contractor shall verify need and eligibility and recertify each family/child as follows:

3).... Families shall be recertified at least once each contract period and at intervals not to exceed (12) months;

(b) contractors shall update the family's application to document continued need and eligibility as specified in Education Code Section 1263 (a)(1) and (a)(2)...as follows;

Section 18078 (r) defines update the application as follows: (r) update the application means the process of revising the application... The application shall be revised by inserting the latest family information that documents the continued need and eligibility for child care and development services.

Please Note - Sections 18103 and 18078 (r) do not require a date to be placed on the application but only required that the application be updated and that the process to begin within a 12 month time frame after the initial enrollment or Re-certification.

10. [REDACTED] – Attendance one(1) days claimed between 09/19/2009 thru (14days)
09/30/20 was reasonably claimed on 9400. Recertification was started before the expiration of
12month eligibility period – see definition of recertification section 18103 and definition of "UPDATE"
section 18078 (r). (see footnote 1 below)
11. [REDACTED] – Child enrolled 06/01/2010 there is no attendance claimed on (43days)
9400 for the period in question – see permit to start dated 06/01/2010 notice of action dated 06/01/2010
indicating date child was added to program (see footnote 1 below)
12. [REDACTED] – Attendance of ten (10) days claimed between 10/08/2010 thru (21days)
10/25/10 was reasonably claimed on 9400 recertification was started before the expiration of 12months –
see definition of recertification section 18103 and definition of "UPDATE" 18078 (r). (see footnote 1 below)

¹ Section 18103 (a) defines recertification as follows: "(a) after initial certification and enrollment the contractor shall verify need and eligibility and recertify each family/child as follows:

(3)... Families shall be recertified at least once each contract period and at intervals not to exceed (12) months;

(b) contractors shall update the family's application to document continued need and eligibility as specified in Education Code Section 8263 (a)(1) and (a)(2) as follows;

Section 18078 (r) defines update the application as follows; (r) update the application means the process of revising the application... The application shall be revised by inserting the latest family information that documents the continued need and eligibility for child care and development services.

Please Note – Sections 18103 and 18078 (r) do not require a date to be placed on the application but only required that the application be updated and that the process to begin within a 12 month time frame after the initial enrollment or Re-certification.

STATE DISALLOWED

Eligibility and Attendance for five (5) children

2.3

Reason for disallowance – "No seeking employment documentation in family data file"

Golden Day Schools Response:

1. [REDACTED] – Child enrolled 09/05/2008 regulation 18086.5(b) was not effective (17days)
until 10/01/2008 – Additional seeking employment documentation was not a requirement prior to 10/01/2008
2. [REDACTED] – Child enrolled 09/26/2008 regulation 18086.5(b) was not effective (45days)
until 10/01/2008 – Additional seeking employment documentation was not a requirement prior to 10/01/2008
3. [REDACTED] – Child enrolled 09/08/2008 regulation 18086.5(b) was not effective until (56days)
10/01/2008 – Additional seeking employment documentation was not a requirement prior to 10/01/2008
4. [REDACTED] – Child enrolled 09/16/2008 regulation 18086.5(b) was not effective (33days)
until 10/01/2008 – Additional seeking employment documentation was not a requirement prior to 10/01/2008
5. [REDACTED] – Outside of audit period. Seeking employment documentation (672days)
01/30/2008 - 03/30/2008, New seeking employment regulation is not subject to this family- new regulation 18086(b) was not effective until 10/01/2008 – see court order Custodial parent is the father this is the documentation to support single parent in home see child support documentation in file. Recertification section 18103 only requires that we update section 18078(r) the family application. Recertification was started on 04/01/2009 before the expiration of prior eligibility period. – see file documentation.

STATE DISALLOWED

Eligibility and Attendance for six (6) children attending
Reason for disallowance – "Family change in income -no documentation"

2.4

Golden Day Schools Response:

1. [REDACTED] -- Income calculation was corrected at time of initial enrollment (0days)
parent was advised to notify the school within five(5)days of any changes in income -- see regulation 18102 changes to family circumstances and signed receipt of notice signed 11/17/2008 - notice in file
2. [REDACTED] -- Child recertified 05/30/2008 -- Child dropped 08/29/2008 (0days)
3. [REDACTED] -- Family has two(2)files -- see attached 9600 child enrolled 01/08/2008 (135days)
4. [REDACTED] -- Parent started recertification 09/16/ 2008 before new (234days)
regulation became effective on 10/01/2008 there is a parent release form for recertification year 09/16/2009 in file
5. [REDACTED] -- Documentation to support single parent in home- see utility bill (261days)
in file. The days 07/06/2009 thru 07/17/2009 showed adjustments for best interest absent days -- no adjustments for the months of August 2009 and September 2009 - was made. This is allowed by the regulations -- 10 days for best interest absences is allowed per fiscal year.
6. [REDACTED] -- This form was filed in the family data file the personal data side of (87days)
family data file -- see -- attached 9600 application. Auditors overlooked this form.

DISALLOWANCE - ELIGIBILITY and Attendance for 62 Families for the following periods

55 - Children For The Audit Period 07/01/2008 - 06/30/2011

2.5

Reason for disallowance - "No documentation indicating the presence or absence of father, nable to verify all sources of income due to no documentation regarding father's address"

Golden Day Schools Response:

1. [REDACTED] - Child recertified on 07/14/2008 new regulation 18100(a)(2) was not effective until 10/01/2008. (48days) (see footnote (1) below)
2. [REDACTED] - Child recertified 02/27/2008 new regulation 18100(a)(2) was not effective until 10/01/2008. (99days) (see footnote (1) below)
3. [REDACTED] - Child enrolled 07/08/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - no father's name on birth-certificate there was no recertification - child was terminated 09/30/2008. (47days) (see footnote (1) below)
4. [REDACTED] - Child recertified 09/06/2007- new regulation 18100(a)(2) was not effective until 10/01/2008 last recertification 09/06/2007 - outside of audit period - 9400 show no attendance therefore, no charge was made to the State subsidized child care program. Kyler Clarke's birth-certificate is in the family data file- no father's name on birth-certificate nor on application. (0days) (see footnote (1) below)
5. [REDACTED] - Child enrolled 08/08/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - no father's name on birth-certificate. (0days) (see footnote (1) below)
6. [REDACTED] - Child recertified 11/06/2007 new regulation 18100(a)(2) was not effective until 10/01/2008 - no father's name on birth-certificate child terminated 11/06/2008. (0days) (see footnote (1) below)
7. [REDACTED] - Family recertified 02/08/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - See rent receipt for father dated Feb 2009 Family dropped from program 02/06/2009. (123days) (see footnote (1) below)
8. [REDACTED] - Child recertified 03/20/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - See rent receipt for father dated Feb 2009 father was in home on 03/20/2009 and the family of 4 is correct and the fee as calculated is correct. family. (187days) (see footnote (1) below)
9. [REDACTED] - Child recertified 12/10/2007 new regulation 18100(a)(2) was not effective until 10/01/2008. (41days) (see footnote (1) below)
10. [REDACTED] - Child enrolled 11/02/2007 new regulation 18100(a)(2) was not effective until 10/01/2008 child dropped 11/03/2008. (0days) (see footnote (1) below)

Regulation 18100 (a) and (b) that was in effect prior to 10/01/2008 only required documentation of family size of the parent's household that child was living with as certified by the custodial parent. New regulation 18100 (a)(2) effective 10/01/2008 pressed new documentation requirements if father's name was stated on birth certificate or other data file applications and he is not living in the same household with the child. For these 55 children this new regulation did not apply.

- Child recertified 09/22/2008 new regulation 18100(a)(2) was not effective (164days)
until 10/01/2008 – no father's name on child's birth-certificate nor on application. (see footnote (1) below)
12. [REDACTED] – Child recertified 05/19/2007 new regulation 18100(a)(2) was not (0days)
effective until 10/01/2008. (see footnote (1) below)
13. [REDACTED] – Child enrolled 07/21/2008 new regulation 18100(a)(2) was not (32days)
effective until 10/01/2008 – child was dropped 09/30/2008 – no father's name on child's
birth-certificate. (see footnote (1) below)
14. [REDACTED] – Child recertified 02/14/2008 new regulation 18100(a)(2) was not (93days)
effective until 10/01/2008 – child dropped 07/31/2008 from program. (see footnote (1) below)
15. [REDACTED] – Child enrolled 09/23/2008 new regulation 18100(a)(2) was not (24days)
effective until 10/01/2008 – child was dropped 10/23/2008. (see footnote (1) below)
16. [REDACTED] – Child recertified 06/15/2008 new regulation 18100 (a)(2) was not (0days)
effective until 10/01/2008 – no father's name on child's birth- certificate. (see footnote (1) below)
17. [REDACTED] – Child recertified 03/10/2008 new regulation 18100(a)(2) was (125days)
not effective until 10/01/2008. (see footnote (1) below)
18. [REDACTED] – Child recertified 02/25/2008 new regulation 18100(a)(2) was not (0days)
effective until 10/01/2008. (see footnote (1) below)
19. [REDACTED] – Child enrolled 09/17/2008 new regulation 18100(a)(2) was not (15days)
effective until 10/01/2008 – no father's name on child's birth-certificate. (see footnote (1) below)
20. [REDACTED] – Child enrolled 07/29/2008 new regulation 18100(a)(2) was not (19days)
effective until 10/01/2008 – child was dropped 09/30/2008. (see footnote (1) below)
21. [REDACTED] – Child recertified 03/18/2008 new regulation 18100(a)(2) was not (0days)
effective until 10/01/2008 – no father's name on child's birth-certificate. (see footnote (1) below)
22. [REDACTED] – Child enrolled 07/02/2008 new regulation 18100(a)(2) was not (42days)
effective until 10/01/2008 – child was dropped 08/29/2008 (see footnote (1) below)

Regulation 18100 (a) and (b) that was in effect prior to 10/01/2008 only required documentation of family size of the parent's household that child was living with as certified by the custodial parent. New regulation 18100 (a)(2) effective 10/01/2008 pressed new documentation requirements if father's name was stated on birth certificate or other data file applications and is not living in the same household with the child. For these 55 children this new regulation did not apply.

- ... new regulation 18100(a)(2) was not effective until 10/01/2008 - Family dropped 04/24/2009. (see footnote (1) below) (208days)
24. ██████████ - Child recertified 08/04/2008 new regulation 18100(a)(2) was not effective until 10/01/2008. (see footnote (1) below). (43days)
25. ██████████ - Child recertified 03/28/2008 new regulation 18100(a)(2) was not effective until 10/01/2008. (see footnote (1) below) (0days)
26. ██████████ - Child recertified 03/18/2008 new regulation 18100(a)(2) was not effective until 10/01/2008. (see footnote (1) below) (0days)
27. ██████████ - Child recertified 01/09/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - child dropped 09/30/2008. (see footnote (1) below) (0days)
28. ██████████ - Child enrolled 07/11/2008 new regulation 18100(a)(2) was not effective until 10/01/2008. (see footnote (1) below) (35days)
29. ██████████ - Child recertified 03/03/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - no father's name on child's birth-certificate (see footnote (1) below) (134days)
30. ██████████ - child enrolled 03/12/10 - see documentation in file to support single parent - see utility bill in file child terminated 08/31/2010. (see footnote (1) below) (50days)
31. ██████████ - Child recertified 09/15/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - child was dropped 08/31/2009. (see footnote (1) below) (269days)
32. ██████████ - Child recertified 07/17/2008 Documentation - New regulation 18100 (a)(2) was not effective until 10/01/2008 - for recert 07/20/2009 documentation to support single parent was on file. Child was dropped 08/31/2009. (see footnote (1) below) (293days)
33. ██████████ - Child enrolled 07/09/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 - No indication of father on the birth-certificate - child dropped 07/09/2009. (see footnote (1) below) (293days)
34. ██████████ - Child enrolled 02/23/2010 - documentation letter from Vilma Cruz in file to support single parent in file no indication of who the father is on birth-certificate - child dropped 01/20/2011. (see footnote (1) below) (227days)
35. ██████████ - Child recertified 09/03/2008 regulation 18100 (a)(2) was not effective until 10/01/2008 - See documentation Court papers to support single parent in file and utility bill for recertification of 2009 and 2010 - no indication of who the father is on birth-certificate child terminated 03/31/2011. (see footnote (1) below) (233days)

regulation 18100 (a) and (b) that was in effect prior to 10/01/2008 only required documentation of family size of the parent's household that child was living with as certified by the custodial parent. New regulation 18100 (a)(2) effective 10/01/2008 assessed new documentation requirements if father's name was stated on birth certificate or other data file applications and not living in the same household with the child. For these 55 children this new regulation did not apply

- effective until 10/01/2008 – see documentation for January 2009 utility bill in file to support single parent in home for 01/12/2009 recertification child terminated 08/31/2009. (see footnote (1) below) (258days)
37. [REDACTED] – Child enrolled 01/10/2011 – see documentation rent receipt in file to support single parent – no indication of father on birth-certificate child dropped 06/30/2011. (see footnote (1) below) (114days)
38. [REDACTED] – Child enrolled 05/11/2009 - see Documentation for 2009-2010 and 2011 for Recertification utility bill in file to support single parent in home - no father's name on child's birth-certificate child dropped 06/30/2011. (see footnote (1) below) (524days)
39. [REDACTED] – Child enrolled 09/05/2006 – see Documentation utility bill for 2008 – section rent voucher 2008 utility bill for 2009 in file to support single parent in home child terminated 10/31/2010. (see footnote (1) below) (240days)
40. [REDACTED] – Child enrolled 09/13/2010 see documentation utility bill 2010 and 2011 and envelope indicating father is incarcerated in file to support single parent in home child dropped 05/10/2011. (see footnote (1) below) (224days)
41. [REDACTED] – Child enrolled 12/13/2010 see documentation utility bill to support single parent in home in file child dropped 06/30/2011. (see footnote (1) below) (140days)
42. [REDACTED] – Child recertified 09/20/2008 regulation 18100 (a)(2) was not effective until 10/01/2008 child dropped 08/29/2009. (see footnote (1) below) (262days)
43. [REDACTED] – Child recertified 08/12/2008 new regulation 18100 (a)(2) was not effective until 10/01/2008 – no father's name on birth-certificate child dropped 08/31/2009. (see footnote (1) below) (266days)
44. [REDACTED] – Child enrolled 07/03/2008 new regulation was not effective until 10/01/2008 child dropped 08/31/2009. (see footnote (1) below) (269days)
45. [REDACTED] – Child recertified 05/19/2010 – see documentation utility bill in file to support single parent in home child dropped 06/30/2011. (see footnote (1) below) (431days)
46. [REDACTED] – Child recertified 08/04/2008 new regulation 18100 (a)(2) was not effective until 10/01/2008 child dropped 08/04/2009. (see footnote (1) below) (293days)
47. [REDACTED] – Child recertified 08/04/2008 regulation 18100 (a)(2) was not effective until 10/01/2008 child dropped 09/30/2010. (see footnote (1) below) (309days)
48. [REDACTED] – Child recertified 10/30/2008 see – utility bill for 2008 and 2009 in file to support single parent in home child dropped 06/30/2011. (see footnote (1) below) (315days)

Regulation 18100 (a) and (b) that was in effect prior to 10/01/2008 only required documentation of family size of the parent's household that child was living with as certified by the custodial parent. New regulation 18100 (a)(2) effective 10/01/2008 addressed new documentation requirements if father's name was stated on birth certificate or other data file applications and is not living in the same household with the child. For these 55 children this new regulation did not apply.

- documentation rental agreement and utility bill in file to support single parent in home child dropped 02/28/2011. (see footnote (1) below) (81days)
50. [REDACTED] - Child enrolled 03/08/2011 see -- documentation utility bill in file to support single parent in home no father's name on birth-certificate child dropped 06/30/2011. (see footnote (1) below) (82days)
51. [REDACTED] Child recertified 06/27/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 not a requirement under old regulation. (see footnote (1) below) (319days)
52. [REDACTED] - Child enrolled 09/29/2008 new regulation 18100(a)(2) was not effective until 10/01/2008 child dropped 06/16/2009. (see footnote (1) below) (223days)
53. [REDACTED] - Child enrolled 01/28/2008 new regulation 18100 (a)(2) was not effective until 10/01/2008 child dropped 01/23/2009. (see footnote (1) below) (230days)
54. [REDACTED] - Child enrolled 05/10/2011 see -- documentation utility bill in file to support single parent in home - child dropped 06/30/2011. (see footnote (1) below) (37days)
55. [REDACTED] - Child enrolled 03/12/2010 -- see documentation letter from Mary Ann Moore to support single parent in home in file -- no father's name on birth-certificate child dropped 03/11/2011. (see footnote (1) below) (216days)

Regulation 18100 (a) and (b) that was in effect prior to 10/01/2008 only required documentation of family size of the parent's household that child was living with as certified by the custodial parent. New regulation 18100 (a)(2) effective 10/01/2008 pressed new documentation requirements if father's name was stated on birth certificate or other data file applications and is not living in the same household with the child. For these 55 children this new regulation did not apply.

STATE DISALLOWED

Eligibility and Attendance for seven (7) children
Reason for disallowance- "Incorrect income calculation"

Golden Day Schools Response:

2.6

1. [REDACTED] — Even if Income calculation was recalculated parent was still eligible to (22days)
receive subsidized child care - New regulation 18096(a) — gap between 08/31/2008 and 06/30/2009
claimed on 9400 see definition for recertification section 18103 and definition for UPDATE the application
section 18078(r).¹ (see footnote (1) below)

2. [REDACTED] — Even if the employment letter used on 01/31/2006 was changed (165days)
by the employer and the employer used the same body and contents of the letter for 02/04/2008 that
was submitted by Ms. Harvey to GDS on 02/04/2008 for recertification, Golden Day Schools' employee
verified Ms. Harvey's employment further by contacting the employer by phone. Ms. Harvey certified
under penalty of perjury that she did work for the employer and that she earned the salary stated on the
02/04/2008 letter. The GDS employee who did the verification by phone reasonably believed that the
information contained on the letter was accurate and she used her best judgment to verify employment
by making contact with the employer by phone who did verify the parent's employment with their firm.
Pursuant to CCR title 5 regulation 18084(d) which was effective at the time of the recertification (02-04-
2008). It states as follows: "if the parent does not have documentation of his/her income, he/she may
make a declaration of the amount of income". The employee did make such a declaration under penalty
of perjury which is in the file, anyway this time period is not within the audit period (03/01/2008).

3. [REDACTED] — Child enrolled 11/21/2007 — not within audit period (100days)
— see 9600 form dated 11/20/2008 show family fee of \$8.50.

¹ Section 18103 (a) defines recertification as follows: "(a) after initial certification and enrollment the contractor shall verify need and eligibility and recertify each family/child as follows:

(3).... Families shall be recertified at least once each contract period and at intervals not to exceed (12) months;

(b) contractors shall update the family's application to document continued need and eligibility as specified in Education Code Section 8253 (a)(1) and (a)(2)....as follows:

Section 18078 (r) defines update the application as follows: (r) update the application means the process of revising the application... The application shall be revised by inserting the latest family information that documents the continued need and eligibility for child care and development services.

Please Note - Sections 18103 and 18078 (r) do not require a date to be placed on the application but only required that the application be updated and that the process to begin within a 12 month time frame after the initial enrollment or Re-certification.

4. [REDACTED] - Child enrolled 07/08/2008 Even if income calculation was in error - the family was still eligible to receive subsidized child care. Employment release form signed by parent was not a requirement prior to 10/01/2008 - Family dropped from program 11/28/2008. (72 days)
5. [REDACTED] - Child recertified 02/01/2008 and this is outside of the audit period. Regulation 18100(a)(2) was not effective until 10/01/2008 - Parent dropped 06/30/2009. (62 days)
6. [REDACTED] - New regulation 18096(a) income calculation bi-monthly instead of bi-weekly income calculation was in error, however, the family size was seven (7) [five (5) children and (2) adults] the auditors verified the family size see their comments, birth certificates are in file family file. did not have to pay a fee and was eligible to receive subsidized child care based on family size no family fee was required. (48 days)
7. [REDACTED] - Child recertified 07/31/2008 new regulation 18100 (a)(2) was not effective until 10/01/2008 - no father's name on birth-certificate even if income calculation was in error and recalculated parent was still eligible for subsidized child care. (238 days)

GOLDEN DAY SCHOOLS RESPONSE TO THE SCO DRAFT AUDIT REPORT

FINDING 3

Unsupported salaries

GDSI disagrees with the SCO'S conclusion that the salaries expended and reported for fiscal years 2008 – 2011 were not properly supported.

3.1

The SCO'S basis for disallowing these salaries is without merit for the following reasons:

- Golden Day Golden Schools, Inc. (GDSI) conducted and administered one program – It's Subsidized Child Care and Development Program funded by CDE.

- Today's Fresh Start is a separate entity. TFS is a non-profit California Corporation and it has its own separate programs, it is a public funded Charter Grade School offering Education for Children in Grades K – 8.

- Today's Fresh Start Charter School's Program is authorized by the California State Board of Education.

- The SCO'S has misrepresented the applicability of Funding Terms and conditions (FT&C) Section VI.E. The FT&C Section VI.E states as follows:

(E). General Report Keeping Requirements

"If the contractor has more than one CDE program, then the method used to allocate administrative cost must be documented." [*Golden Day Schools had only one CDE funded program and therefore, this FT&C Section does not apply to this*

issue. GDSI maintained and produced original Time Card source documentation signed by the employees and the employees' immediate supervisor as support for 3.2

this issue. The timecards were reviewed by the SCO auditors as required by the contract terms.] 3.1

"If an **employee is multi-funded** on a time accounting basis then the employee's time sheet must indicate the actual amount of time spent in each program per day." [Golden Day did not have multi-funded employees. The employees worked for GDSI only during the time reported on their time cards and GDSI had only one CDE funded program. This FT&C Section does not apply to any GDSI employee.]

"State employees or representatives shall be allowed access to all programs related or fiscal records during normal work hours." [The CDE representative, SCO, was allowed access to all GDSI program and fiscal related records] 3.2

- Golden Day Schools, Inc. only hired employees who were qualified and expressed employment availability for the time periods required by GDSI, (The employees did not work for another employer during the hours they were employed by GDSI). Simply put, these employees were not working for Today's Fresh Start or any other employer during the times recorded on their time card for which they were paid by GDSI. 3.3

- Golden Day Schools, Inc. is a not-for-profit California Corporation controlled by an independent Board of Directors. Dr. Jeanette Parker was not a member of the Board of Directors of Golden Day Schools during the audit period under review. Dr. Clark E. Parker was a member of the Board of GDSI during this period. 1.1, 1.3

- GDSI held Child Care Center Licenses issued by the California Department of Social Services and as required by its contract with CDE it was required pursuant to the terms of its contract with CDE to comply with Title 22 of the California Code of Regulations, specifically Section 101216 of said regulation. 3.4

CCR Title 22 Section 101216(e) and (f) - Provides as follows:

(e) All personnel shall be given on-the-job training in the areas listed below, or shall have related experience that demonstrates knowledge of and skill in those areas.

3

Such training or experience shall be appropriate to the job assigned and shall be evidenced by safe and effective job performance.

- (1) Principles of nutrition, food preparation and storage, and menu planning.
- (2) Housekeeping and sanitation principles, including universal health precautions.
- (3) Provision of child care and supervision, including communication.
- (4) Assistance with prescribed medication that are self-administered.
- (5) Recognition of early signs of illness and the need for professional assistance.
- (6) Availability of community service and resources.

(f) At least one staff member who is trained in pediatric cardiopulmonary resuscitation and pediatric first aid pursuant to Health and Safety Code Section 1596.866 shall be present when children are at child care center or offsite for center activities.

- Golden Day sets hours for its employees based on CDE's required staffing ratios. 3.4

Title 5 CCR Section 18290(a) – (e) – Provides as follows:

Contractors shall maintain at least the following minimum ratios in all centers:

- (a) Infants (birth to 18 months old)-1:3 adult-child ratio, 1:18 teacher ratio.
- (b) Toddlers (18 months to 36 months old)- 1:4 adult-child ratio, 1:16 teacher-child ratio.
- (c) Preschool (36 months to enrollment in kindergarten)-1:8 adult-child ratio, 1:24 teacher-child ratio.
- (d) Children enrolled in kindergarten through 14 years old-1:14 adult-child ratio, 1:28 teacher-child ratio.
- (e) Compliance with these ratios shall be determined based on actual attendance.

4

SCO'S Basis for Disallowing These Salary Costs Is Based on Nothing More Than a False and Inaccurate Assumption

SCO Does not dispute:

- These individuals employed by Golden Day are properly qualified. 3.4
- Golden Day submitted all time cards for each of the employees to the SCO auditors for their review; demonstrating and certifying the hours they worked on behalf of Golden Day. 3.2
- The time cards were signed by each employee and the employee's immediate supervisor – The site director. 3.2
- That GDSI paid these employees a salary for the time they worked for GDSI. 3.2

Instead:

- The SCO takes issue with the mere fact that these employees worked for both Golden Day and Today's Fresh Start, at different times of the day and for hours Today's Fresh Start does not offer grade school classes. 3.2, 3.3
- The SCO incorrectly assumes that because these individuals are also Today's Fresh Start employees although for different hours (e.g. 9AM -3PM) all work done is only attributable to Today's Fresh Start, and thus the SCO seeks to disallow any cost associated with these employees by GDSI.

This position by the SCO is not only meritless but has no basis in fact. 3.6

First, the SCO makes a false assumption that GDSI and TFS are related parties, for financial reasons. This is untrue, GDSI and TFS are not related parties for any reason. The reasons stated below set forth why the two Corporations are not Related Parties:

- GDSI is a not-for-profit California Corporation controlled by a separate and independent Board of Directors. The mission of GDSI is to provide Child Care and Development Services primarily to preschool age children and Before and After School Child Care for children 5 to 12 years of age, for 251 days per year.
- Today's Fresh Start Charter School is a separate not-for-profit California Corporation whose mission is to provide Grade School Education to children in Grades K-8 for 180 days per year. TFS has its own separate independent Board of Directors who make all financial and administrative decisions concerning the

5

operation of TFS. TFS is not controlled by Clark Parker who is not a Board Member of TFS, nor is it controlled by Jeanette Parker, she is one of seven (7) unrelated Board of Directors.

- Even if it was determined that GDSI and TFS were related parties they are not prohibited from doing business with each other, as long as the conflict of interest rules are followed and any transaction they may engage in is reasonable and necessary and conducted at arms length. Both Corporations have conflict of interest codes they follow to remove even the appearance of a conflict of interest when in actuality none exist. 1.1

The SCO does not cite one example of an un-allowed related party transaction that the two Corporations have engaged in that the conflict of interest rules as set forth in the California Corporation Code were not followed, rather the SCO recommends that *"CDE should calculate the reimbursement limit and determine overpayments, as the net program costs have been significantly disallowed due to unsupported labor costs."* They further allege, *"...as a result the recorded salaries were deemed unallowable."* The SCO base this conclusion and recommendation on the premise that Jeanette Parker and Clark Parker would not make the payroll records of Today's Fresh Start Charter School available to them for their audit. Notwithstanding, the fact that neither Clark Parker nor Jeanette Parker have the authority to make the TFS books and financial records available to the SCO for auditing the SCO has proceed illegally to punish GDSI unfairly. GDSI believes the SCO does not have the authority to mandate that GDSI make the records of Today's Fresh Start available and to punish them for their failure to do so. 3.2, 3.3

The action and position taken by the SCO is unmitigated retaliation plain and simple. 3.1, 3.2, 3.3
Neither Clark Parker nor Golden Day Schools have the authority to require another nonaffiliated Corporation to make their books and records available to the SCO for an alleged audit purpose which appears to be for simply put plain harassment. The SCO should follow the applicable law and regulation regarding this issue. There is no basis in law for their action toward GDSI, neither the California Education Code nor the Title 5 Regulations, or the contractual Funding Terms and Conditions (FT&C) give them the authority to mandate such a request and to make the proposed recommendation to CDE.

The SCO auditors have set out to punish Golden Day by using the proverbial carrot and stick routine. In other words, the SCO has taken the position - if Golden Day Schools does not make another independent non-related and non-affiliated corporation's financial

Golden Day Schools Response to SCO Draft Audit Report FINDING # 3 -- September 8, 2014

records available to them to audit and harass they are going to hit Golden Day Schools across the head with the stick. However, if Golden Day complies with their illegal request and produce the requested documents they will give Golden Day a bite off the carrot. To say the least, this is outrageous behavior for an alleged independent state agency to engage in. The SCO's action is mean-spirited, it clearly shows a reckless disregard for the basic rules of fairness and independence. It further shows the SCO's bias attitude toward Golden Day Schools. The SCO auditors, pursuant to Education Code Section 8448(h) have conducted an illegal financial and compliance audit; see Education Code Section 8448(h).

The draft audit report incorrectly states that the GDSI's Administrator was previously informed by the SCO that the SCO would disallow all GDSI salaries if he personally did not make the books and records of Today's Fresh Start Charter School available to the SCO auditors for them to audit and harass. The first time the GDSI's Administrator was informed of this outrageous conclusion and recommendation was when he read it in this

draft audit report. On or about February 27, 2014, the SCO's field Supervisor, Mr. Chris Prasad, requested that the Administrator, Dr. Clark Parker, make the Today's Fresh Start's books and records available to him for audit, Dr. Parker informed Mr. Prasad that he did not have the authority to make any documents from TFS available to the SCO for audit.

Now, the SCO has incorrectly stated the Administrator knew the SCO would disallow all GDSI salaries, even the salaries of the employees who did not work for both TFS and GDS. This is blatant retaliation at its worst because there is no legal basis for the SCO to make such a request in the first place, secondly, the source documents in this case supports the fact that the times reported on the GDSI employees' time cards are true and accurate. The action by the SCO auditors is troubling and it shows actual bias.

The position the SCO has taken is a display of outrageous behavior, especially in this case. The SCO was given all original source documents of time cards signed by the GDSI's employees and their immediate supervisors for their review. The SCO was given evidence of only one contract being held by GDS from CDE and the G/L gave proof that there was no other contract(s) held by GDSI from any other entity, the SCO was given copies of cancelled payroll checks evidencing that the employees were paid the salaries charged to the GDS CDE funded program contract(s), they were given copies of the GDSI's General Ledger showing that the salary cost was properly recorded in the financial statements of Golden Day Schools, showing that all was recorded in accordance with General Accepted Accounting Principles (GAAP). The SCO was given copies of the unqualified organizational wide audits performed by GDSI's independent outside CPA auditing firm certifying that the three (3) audits completed for the audit period, 2008 – 2011, were completed in Golden Day Schools Response to SCO Draft Audit Report FINDING # 3 – September 8, 2014

accordance with General Accepted Auditing Standards (GAAS), the audits were unqualified and showed no exceptions. The audits were also completed in accordance with the instructions and guidelines set forth in the Audit Guide specifically created by CDE for use by the auditors when they audit CDE funded Child Development Contractors.

The SCO further contends that GDSI source documents, which includes the properly signed employee time cards, for the employees who did not work for TFS were also unsupported and were therefore, unallowable. 3.11

This type of statement shows a retaliatory bias attitude towards GDSI that is arbitrary and capricious. The SCO's auditors are supposed to be independent and unbiased and they are mandated to follow the applicable Education Code(s), the applicable Title 5 regulations, the CDE FT&C and the facts regarding this issue. By this action to disallow all salaries of GDSI the SCO has clearly shown they are not interested in following the applicable law regarding this issue. They are forbidden by statute from acting arbitrary and capricious; however, they have proceeded down this path in their attempt to conspire with CDE to destroy GDSI. 1.10

3.1, 3.2, 3.3, 7.1

GDSI has concluded that it has complied with the applicable Title 5 regulations, the CDE FT&C and the applicable Education Code Section(s) regarding this issue as same relates to this alleged unsupported salary issue. The SCO's conclusion is incorrect - the GDSI employees' salaries were reasonable and necessary cost and they are allowable.

The contract between CDE and GDSI states that Golden Day may claim reimbursement against their CDE contract for all cost incurred in their CDE Child Development funded Program that are reasonable and necessary cost based on its net earned and calculated reimbursable income calculated based on the number of eligible children served times the days they were served times the reimbursable rate. The cost to be reimbursed will not exceed their net calculated maximum reimbursable contract amount.

The California Code of Regulation (CCR) of Title 5 Regulation at Section 18013(s) defines "Reasonable and Necessary Costs" as follows: 7.1

(s) " Reasonable and Necessary Costs means expenditures that, in nature and amount, do not exceed what an ordinarily prudent person would incur in the conduct of a competitive business."

This same cost definition is also set forth in Education Code Section (8208)(n).

(n) "Reasonable and Necessary Cost - are cost that in nature and amount, do not exceed what an ordinary prudent person would incur in the conduct of a competitive business."

The SCO must give deference to this definition as it relates to the "conduct of a competitive business" this implies that the decisions of the business judgment of the Corporate Directors must take precedent over the second guessing of the SCO'S auditors. Simply put, if the decision of the corporate Directors was reasonable then the SCO and the CDE must accept them as the court explained in the following case.

Deference Must Be Given to Golden Day Schools' Board of Directors in Making its Business Decisions

- There is "a judicial policy of deference to the business judgment of corporate directors in the exercise of their broad discretion in making corporate decisions." *Lee V. Interinsurance Exchange*, 50 Cal.App.4th 694, 711 (1996). 1.8, 1.9
- The rule is based on the premise that those to whom the management of a business organization has been entrusted, and not the courts [or governmental administrative agencies], are best able to judge whether a particular act or

transaction is helpful to the conduct of the organization's affairs or expedient for the attainment of its purposes. *Id.*

- Golden Day has been in operation for nearly a half of a century, with Dr. Clark Parker as its Executive Director. It is the only Child Care Organization of its kind to remain in operation for that amount of time in the Los Angeles area. 1.8, 1.9
- Golden Day's Executive Director and Staff are eminently qualified to make decisions about reasonable employee salaries and learning experiences that are required and needed to advance and secure welfare of the children under their care. 3.1, 3.2, 3.3

In conclusion, GDSI rejects the conclusion and recommendation of the SCO that GDSI's salaries in the amount of \$5,415,417.00 is unsupported and disallowable. The salaries as set forth in GDSI three (3) audits for audit period(s) 2008-2011 is supported by original source documents and GDSI produced these source documents which the SCO auditors reviewed. Therefore, there are no reasons that the SCO auditors should disallow these

9.

salaries, other than their bias and predisposition to be unfair towards GDSI. The SCO's auditors has not followed the CDE FT&C, the applicable Title 5 Regulations and the applicable Education Code Section regarding this issue. The SCO's action and recommendation is **Arbitrary and Capricious**.

GDSI has complied with and produced the required source documents needed to fully and completely support the claimed salaries as set forth in the audits submitted to CDE for the audit period 2008-2011.

3.2

The SCO has ignored the requirements and limitations of Education Code Section 8448 (h) which states in pertinent part; *"However, if independent audits arranged for by direct service contractors meet generally accepted auditing standards, the State Department of Education shall rely on those audits and any additional audit work shall build upon the work already done,"* (emphasis added)

7.3

In other words, the SCO auditors must accept the work of the GDSI outside independent auditor, Steven A. Flores, CPA, who completed the three (3) audits for the audit period 2008 – 2011 and timely submitted them directly to CDE because those audits were completed in accordance with General Accepted Auditing Standards (GAAS). The **SCO and CDE cannot undermine those audits** by stating that if Golden Day Schools and or its Administrator does not make another Corporation's (TFS) books and financial records available to the SCO for audit they will disallow all salary expenses incurred by Golden Day Schools for all of its employees.

This action by the SCO is outrageous and unlawful, and it shows a bias attitude toward Golden Day Schools. To even propose such an action is outrageous and reprehensible and the SCO should remove those auditors from this audit because they have violated the tenet of due process and fairness, their minds are made up before they hear the other side. They have demonstrated the appearance of bias if not showing of actual bias. In any case the courts have stated both actions (actual bias or the appearance of bias) are unacceptable, especially when committed by an administrative agency, while sitting in judgment of its citizens.

1.10

The SCO throughout this draft audit report makes improper reference to the ruling of the ALJ in the matter of *Golden Day Schools V. California Department of Education (2013)*, heard in the *Office of Administrative Hearings (OAH)*, any reference to this case in this draft audit report or the final audit report is improper. The OAH case is being appealed

3.5

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and therefore, the ALJ's ruling in that case is not final. The OAH case has a long way to go before it is final and it could be completely overturned by the court or substantially altered. The California Civil Code of Procedure states once a matter has been appealed the ruling being appealed is stayed until the final Appellate Court has ruled and then and only then will the Appellate Court's ruling become final. It could take years before this matter becomes final and it is improper and prejudicial for the SCO to cite any ruling or comment from that case. Even CDE has attempted to get the ruling changed. The matter is now scheduled to go before the Los Angeles Superior Court later this year for its first Court hearing. All references to that case should be deleted from the draft audit report and any final audit report.

On March 18, 2014, the SCO wrote a letter to CDE setting forth the same erroneous conclusions they have set forth in this draft audit report. The SCO auditors wrote this letter to CDE setting forth their conclusions and recommendations before Golden Day was given an opportunity to respond to the many inaccurate statements contained in the draft audit report. Therefore, without question the SCO is recklessly attempting to prove that their erroneous conclusory and unsupported letter written to CDE is correct, they have done this with impunity toward Golden Day Schools. This is reckless and callous auditing that is troubling and it raises grave concerns about the SCO's fairness and due process toward Golden Day's rights. In other words, the SCO reached incorrect conclusions and published them before hearing the other side from GDSI. As set forth in GDSI response to FINDING 2 many of the alleged errors of family eligibility were not errors at all, rather they were misinterpretations of the effective date of the 2008 Title 5 regulations that was not applicable and effective for the cited purported error.

The most serious concern by Golden Day Schools is this letter written by the SCO's on March 18, 2014, because the letter concluded by stating that CDE should "*Retain the SCO*

for 18 months to perform an audit of Today's Fresh Start Charter School and Golden Day Schools and they (the SCO) were sure they can get CDE a refund of millions of dollars from Today's Fresh Start and Golden Day School because the SCO now know how to do it".

HOW TROUBLING AND SAD !!!!!

Once this outrageous and illegal conspiracy was discovered by Today's Fresh Start, Today's Fresh Start raised serious questions about its propriety, the SCO when confronted by Today's Fresh Start immediately rescinded the letter regarding Today's Fresh Start, however, the harm to Golden Day's reputation had been done. The March 18, 2014, letter erroneously stated Golden Day had improperly spent \$16.1 Million dollars of state funds. It set forth the same libelous and erroneous conclusions that are

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Steve Flores' Financial And Compliance Audit

Activities and Costs

- Traditional Auditing, Including Confirmation of Work
- Review Contract Performance, Including Attendance Records

Cash Management

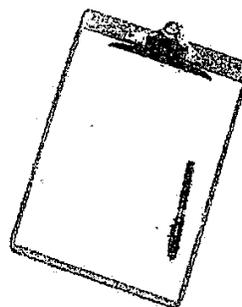
- Prepare Depreciation Schedules and Test for Depreciation
- Review Accounts Receivable
- Test for Capital Expenditures
- Test for Administrative Expenses
- Review Financial Statements

Eligibility

- Verify Qualification to Participate
- Test for All Students Eligible For Federal meal Program

Equipment

- Test for Repairs & Maintenance
- Perform Equipment Inventory
- Verify Equipment Categories



Steve Flores' Financial And Compliance Audit Continued...**Matching**

- Matching Expenditures by Contract
- Verify Accurate Contribution Values

Program Income

- Test Whether Program Income Accurately Charged and Collected
- Test Whether Program Income Used According to Requirements

Procurement

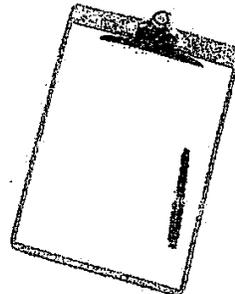
- Review Vendor Receipts and Confirm Equipment Purchases to Verify That No Less Than 3 Bids Are Solicited

Reporting

- Test Reports by Comparing to Accounting and Performance Records

Subcontract Monitoring

- Review Subcontractor Contracts and Performance to Test Whether Compliance Tracked





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DECLARATION OF NORMA MILLER, CPA

I, Norma Miller, declare as follows:

1. I am a California Licensed Certified Public Accountant who maintains the financial books and records of Golden Day Schools, Inc. I have performed this task for Golden Day Schools for over ten years. I was the CPA for Golden Day and kept their books and records that were audited by Steven A Flores for the following three fiscal (3) years; 2008-2009, 2009-2010 and 2010-2011. I make this declaration of my own personal knowledge, and if called as a witness, could and would testify competently to the following facts.
2. I am a CPA in the Miller Accountancy Corporation firm. Our firm has an executed engagement letter with Golden Day Schools, Inc.
3. The Miller Accountancy firm performs financial bookkeeping work for Golden Day Schools. We process Golden Day Schools payroll and we file all federal and state payroll tax returns as they become due. We reconcile all bank accounts monthly. We ensure that all workers' compensation premium reports are timely filed and processed. We perform all these tasks in accordance with the Golden Day Schools Accounting and Payroll Procedure Manual that exists between the parties and is a part of our engagement letter.

Member

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Schools. We only consult with Dr. Clark Parker if and when we have to ask for his approval on a matter that we need further clarification from him or the Board of Directors on. We make the determination as to where an expense should be booked into the general ledger because most expenses are recurring and they do not need clarification each month. All newly hired employees go through a very extensive vetting process before they are put on the payroll through the submittal of an approved new employee employment form signed by the Site Director and the Administrator.

9. In the ten years we have performed accounting work for Golden Day Schools we can confirm they have had only one CDE funded program and none from any other source or entity.

10. We believe the work we perform for Golden Day Schools, and the financial statements we prepare for them accurately and fairly reflect the financial position of the organization at the time we prepare them.

11. The State Controller's auditors visited my office August 2013 to review my work papers and to discuss the procedures we employed to carry out our scope of work. They made no comment to me nor did they raise any concerns regarding my files. I find it quite disturbing that they have now raised concerns regarding allowability of all of Golden Day's expenses when in fact no such concern was ever expressed to me. I believe the income and expenses as recorded in the books and records of Golden Day Schools by our firm, Miller Accountancy, were accurate, correct and fairly represented the financial position of the organization when we issued our monthly financial statements to the Board of Directors. I personally entered the income and expenses into the Golden Day general ledger. I relied on the instruction from the California Schools Accounting Manual for direction and guidance as to what account number the items should be posted to. I

prepared the general ledger and firmly disagree, as per the draft audit report, that Clark Parker prepares the general ledger. I told the SCO auditors who visited my office that if I encountered a particular question that I would contact Clark Parker to get a better understanding. Apparently, per the draft report, the SCO auditors incorrectly concluded this statement to mean that Clark Parker had complete control of preparing the general ledger. I prepared the general ledger in accordance with GAAP, and I told the auditors that I would inform Clark Parker of all necessary adjustments and corrections.

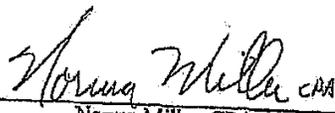
Two of the four SCO auditors who came to my office behaved completely unprofessional. Throughout their visit, whenever one of the SCO auditors asked me a question, two of the SCO auditors seated behind him would make laughing and snickering gestures. I found this very distracting. I finally had to ask them what was so funny because I didn't think any of the questions were humorous. I was completely distracted to the point I had to ask that the two offensive auditors leave my office so I could concentrate on the questions asked.

I also showed the SCO auditors the twenty boxes I brought from our storage which contained my copies of the Golden Day records. Not one of the auditors opened a box to review the documents which led me to believe they had no concerns regarding source documents.

12. At the end of the year we worked closely with Golden Day's outside auditor, Steven A. Flores CPA, when they performed the annual audits.

13. We stand by the financial reports we produced each month for Golden Day Schools, and we believe they should be accepted by the State Controller's Office because our books and records were kept in accordance with GAAP accounting principles.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration is executed on September 8, 2014.



Norma Miller, CPA

1

GOLDEN DAY SCHOOLS RESPONSE TO THE SCO DRAFT AUDIT REPORT

FINDING 4

Unsupported Employee Benefits

This FINDING 4 seeks to disallow the mandatory employee State and Federal tax benefits that all employers are required to pay for their employees. The employee benefits in question included but were not limited to payments made for Social Security Benefits, State Unemployment Taxes, Employee Medical Insurance and State Disability Taxes sufficient to cover the Golden Day Schools' employees as paid.

When the employee's salaries are determined to be allowed then the employee benefits totaling \$1.115 million must also be determining to be allowed.

Therefore, GDSI restates its argument put forth in FINDING3 as support for this FINDING 4's allowability.

The SCO states the GDSI employee's Pension Program contributions, administered by a third party administrator, (Merrill Lynch), are also unallowable for this audit.

The GDSI Pension Program was authorized by the GDSI Board of Directors approximately 20 years ago. Prior to the initiation of the Pension Program it was approved by the Internal Revenue Service, the Federal Department of Labor and the Golden Day Schools' Board of Directors. Dr. Clark Parker abstained from voting for the Pension Program. The allowability of the Pension Program contributions for the audit period under review is based on the same argument put forth in FINDING 4 and FINDING 5 as they relate to the administrative salaries.

These employee benefits, taxes and Pension contributions were reasonable and necessary and they are allowable as per the definition set forth in Education Code Section 8208(n) and CCR Title 5 Section 18013(s).

2

GDSI disagrees with the SCO'S conclusion and recommendation. The employee benefits and pension contributions expended by GDSI and the corresponding salaries were reasonable and necessary and allowable for this audit period 08-11.

GOLDEN DAY SCHOOLS RESPONSE TO THESCO DRAFT AUDIT REPORT

FINDING 5

UNSUPPORTED ADMINISTRATIVE SALARIES

The Salary of the Administrator Dr. Clark E. Parker that was charged to the CDE program was not \$350,000 per year as reported by the SCO for the three (3) audit years under review (2008-2011). The correct salary charged to the CDE funded child development program for the three year audit period was an average of approximately \$300,000 per year. The Administrator's salary was determined to be necessary and reasonable by the Golden Day School's Independent Board of Directors for the position and responsibilities he was given and carried out for the Golden Day Schools, Inc.

5.1

His salary and the employee benefits attached to his employment have been stated to be necessary and reasonable by the Golden Day Board of Directors, the CDE, the IRS and the California Attorney General non-profit Division.

5.2

The SCO has taken a resume' of the Administrator's accomplishment over his life span and juxtaposed a big leap to raise an issue regarding the Administrator's ability to perform his administrative and executive duties for Golden Day because of his other affiliations and past accomplishments .

Simply put, the Administrator has lived a long life and his resume' speaks for itself. His resume' reflects the many accomplishments he has achieved over his total life span, which none has ever interfered with his executive and administrative duties at Golden Day.

4

The Administrator's resume and his daily duties speak for themselves. The Administrator is assisted daily by other individuals within Golden Day who assist him in carrying out his many administrative tasks.

It is ironic that the SCO auditors question the Administrator's job responsibilities in their failed argument in FINDING 1 regarding Golden Day's alleged lack of Internal Controls. They stated in this FINDING 5 that the Administrator cannot have reasonably performed the tasks set forth in his resume and still have effectively functioned as the Chief Executive Officer of Golden Day. The Administrator has performed the required administrative and executive task needed to fulfill his daily responsibilities. He has and he continues to work an average of 73 hours per week pursuing his Golden Day Schools' responsibilities and required task. He has done this continuously for over 50 years.

5.2

It should be noted, the Board of Directors of Golden Day Schools has never granted the Administrator a merit salary increase, he has only received cost of living increases (COLA) which were equal in percentage to what the state of California gave to its Child Care funded agencies over the last 31 years. The COLA salary increases received by the Administrator were the same percentage increases received by all Golden Day employees in any particular year. The Administrator's base salary started in April 1, 1980, and it proportionally increased annually based on the California Department of Education's Cost Of Living Adjustment (COLA) increases that they gave to GDSI along with all other child development contractors throughout California.

The Child Care daily reimbursement rate that CDE gave to its Child Development Contractors was \$14.09 per day for a 250 day year; as of July 1, 1980, (see Education Code Section 8265. ($\$3,563\text{-yr} / 250\text{ day year} = \14.09 per day).

As of July 1, 2000, twenty years later the funded child development daily reimbursement rate had increased to \$26.62 per day. Simply put, the COLA percentage of increase for the child care reimbursement rate the California Legislature voted to give all Child Development Contractors had increased to

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188.9% as of July 1, 2000. Therefore, for the period July 1, 1980 through June 30, 2000 the child development daily reimbursement rate had increased 88.9% for the 20 year period 1980 to 2000. $[88.90\% (x) \$14.09 = \12.53 plus the rate it started from of \$14.09 is equal to \$26.62 $[\$12.53 (+) \$14.09 = \$26.62$ per day]].

5.2

Golden Day's Administrator's employment contract was executed April 1, 1980, with a salary of \$140,000 per year and it was increased each time the California Legislature gave all Child Development Contractor's a cost of living (COLA) contract increase. All GDSI employees including the Administrator was granted a comparable COLA salary increase by the GDSI Board of Directors based on the CDE COLA given to the CDE funded child development contractors.

In conclusion, the fact that the daily child development reimbursement rate was \$14.09 per day on July 1, 1980 and it increased to \$34.28 on July 1, 2007 (see Education Code Section 8267 and Golden Day Contract No. 6150) the daily child development reimbursement rate had increased to 244% $[\$34.08/\$14.09=2.44]$. Therefore, when you apply the 244% to the Administrator's beginning 1980 salary it was reasonable that the Board of Directors increased the Administrator's salary by a like cost of living adjustment percentage over the same 30 year period, $[2.44\% (x) \$140,000 = \$341,603.97]$.

This is the same salary you get after applying the annual COLA percentage given each applicable year during the 27 year period given by the California Legislature to all funded child development contractors $[\$342,525.11$ vs. $\$341,603.97]$

The Administrator's salary was necessary, reasonable and therefore allowable. The SCO's rationale for its rejection cannot be supported when applying the law (the applicable Title 5 regulations and the applicable Education Code Sections) against comparable salaries for individuals performing the same scope of work that the Golden Day's Administrator performed; Especially when comparing his salary and employee benefits to comparable CEO's salaries in private and public funded Child Care and Educational organizations within the Los Angeles area.

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The Administrator's Pension contribution made by GDSI was not only reasonable but his participation in the Golden Day Pension Program and the GDSI's contribution to the Pension Program was required by Federal Law. The Administrator received the same employee proportional pension benefits that was required and mandated by State and Federal law regarding an employer's contribution to a duly authorized Pension Program created by an employer.

5.3

Again, the SCO's position shows bias and its statement of disallowable is disingenuous. There are no factual basis for the SCO to make an allegation that the Administrator's salary is excessive, when compared to other comparable Los Angeles Child Care and Educational CEO's making comparable salaries and receiving comparable employee benefits for doing comparable work in the Los Angeles area. All Golden Day Schools' employees received the same percentage COLA increases in salary and employee benefits that the Administrator received which was reasonable, necessary and fair. They were not excessive.

5.2

If the percentage of COLA increase were excessive then the allegation of excessive COLA increases must be attributed to the California Legislature and not to the Golden Day Board of Directors who merely passed along the cost of living increases to its employees as same were received from the California Department of Education and authorized by the state Legislature and the Governor.

To say the least, the COLA salary increases were not excessive rather they were reasonable and necessary to allow the GDSI's employees to keep up with the rising cost of living in Los Angeles. (e.g., food, housing, clothing, fuel, utilities, child-care and education expenses, etc.)

As stated above, the CDE, The IRS and the non-profit section of the California Attorney General's office has reviewed the Administrator's salary and employee benefits and have found them to be necessary, reasonable and fair within the last five years.

5.2, 5.3

Finding 5's conclusion and recommendation made by the SCO is meritless. Golden Day contends the Administrator's salary and his employee benefits were

Golden Day Schools Response to SCO Draft Audit Report #5 – September 8, 2014

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reasonable and necessary for the efficient operation of Golden Day Schools during the audit period in question, 2008-2011.

The conclusion and recommendation as set forth in this draft audit report by the SCO are unfounded and they should be rejected because they cannot be substantiated based on the evidence and rebuttal facts produced by GDSI regarding this issue. The SCO's position is meritless, arbitrary and capricious.

1

GOLDEN DAY SCHOOLS RESPONSE TO THE SCO DRAFT AUDIT REPORT

FINDING 6

Unallowable Triple-Net Lease: Rent, Property Taxes, Renovation and Repair

The SCO incorrectly contends that GDSI did not make the current lease between Golden Day Schools and Clark and Jeanette Parker available to the SCO Auditors, rather they contend only the lease dated in 1980 was made available to them, this is untrue. 6.1

Why would the SCO disingenuously contend that GDSI only made a 30+ year old lease available to them and not the current lease? Because by contend that GDSI did not provide the current lease the SCO auditors' aim and motivation is to imply, because they did not have the current lease available to them they reached their erroneous and forfeiture conclusion as set forth in this Finding 6 of their draft audit report. The correct fact is the current lease was given to the SCO auditor, Mr. Ken Harris, he was the SCO audit field Supervisor at the time the audit began in 2013. It was given to him by the GDSI Administrator personally along with a copy of the latest MAI appraisal. An additional copy of the current lease is attached hereto for your immediate reference. 6.1

The SCO further contends in the draft audit report that Golden Day Schools should have treated the current lease for the six (6) properties leased from the Administrator as a capital lease on their financial statements. They contend that GDSI should have only charge depreciation for the lease properties to their CDE funded child development contract for the applicable audit years. This conclusion and contention finds no support in the facts and the Financial Accounting Standards Board's definition for a capital lease. 6.2

The Golden Day lease is an operating lease. The SCO relies on the misplaced assumption and belief that the GDSI lease is a capital lease because the term of 6.2

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the lease exceeded 75% of the economic life of the properties being leased. This contention and belief is incorrect and it cannot be substantiated by the facts. The leased properties have been consistently updated by the lessor to extend their economic (useful) life. The current lease for the audit period is a ten (10) year lease. Several of the properties have been newly rebuilt since the original lease was executed in 1980. The ten (10) year lease term of the current lease was not more than 75% of the economic life of the properties.

The SCO incorrectly quotes the IRS regulations for depreciating commercial property to be 31 years, this is incorrect. The IRS requires that commercial properties be depreciated over a 40 year period. Nevertheless, the Golden Day lease in question does not meet one of the four (4) criteria to be a capital lease.

6.3

The four (4) criteria are as follow:

6.2

1. Ownership of the asset is transferred to the lessee at the end of the lease term; *[Not applicable in this lease transaction]*
2. The lease contains a bargain purchase option to buy the equipment at less than fair market value; *[Not applicable in this lease transaction]*
3. The lease term equals or exceeds 75% of the asset's estimated useful life;¹ *[Not applicable in this lease transaction]*
4. The present value of the lease payments equals or exceeds 90% of the total original cost of the property. *[Not applicable in this lease transaction]*

These are called the 7(a)-7(d) tests, named for the paragraphs of FASB 13 in which they are found.

¹ SFAS No. 6 - Footnote 23 defines Economic Life as follows: "Economic Life of a leased property is the estimated remaining period during which the property is expected to be usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term".

The IRS regulation that the SCO relies on to support their contention that the lease was a capital lease is misplaced and offer no support for their position. First, the IRS regulation they cite sets the time period the government allows for depreciation of residential owned and purchased properties not for commercial property and it can and is changed by the U. S. Government from time to time to either stimulate or slow down the economic conditions of the country. In other words, the U. S. Government can stimulate the economy by allowing a shorter period of time to depreciate purchased property or allowing a longer depreciating period to slow the economy down. Simply put, Shorter depreciating period, less taxes paid to the Government – longer depreciating period, more taxes paid to the Government.

"Remaining Useful Life" is an estimation by the parties of the remaining useful life of the property being leased. IRS depreciation periods set by the government and the useful life periods estimated by the parties for property, are two separate and different accounting principles, they are not in any way related. Government depreciation periods cannot and should not be used for determining when a transaction is or is not a capital lease.

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If any one of the above are met, the lease would be considered a capital lease and must be disclosed on the lessee's, Golden Day Schools', balance sheet.

Conversely, if none of the criteria are met, the lease is an operating lease and all cost must be expensed on the Lessee's, Golden Day School's, financial statement.

It is indisputable, that in or about April, 1980, Clark Parker and Jeannette Parker entered into a twenty-year lease agreement with Golden Day, and that lease contains an inflation escalation clause calling for annual adjustments to the base lease amounts based on the consumer price index.

6.1

It is indisputable, that in or about March of 2000, a new lease agreement was created for ten (10) years for the subject properties.

It is indisputable, that at the time of the transaction, this lease new agreement and the lease amount was necessary, reasonable, and conducted at arm's length. The fair market rate lease cost was established by an independent MAI appraisal.

It is indisputable, that on or about December of 1996, Golden Day obtained a fair market rental estimate of the properties, and that this number was used in calculating the base rent and subsequent increases based on the consumer price index going forward.

It is indisputable, that at the time of this transaction, this lease amendment was fair, necessary, reasonable, and conducted at arm's length.

It is indisputable, that in or about August of 2001 Golden Day obtained a fair market rental estimate for the six properties at \$50,377 per month, and that this number was used in calculating the base rent and subsequent increases based on the consumer price index going forward.

It is indisputable, that CDE was charged a lesser percentage of this rent.

It is indisputable, that in or about May of 2002, CDE conducted a limited scope review of Golden Day's fiscal operations and legal compliance, and as a result of this audit, there was no finding of impropriety, including the lease agreement or the rental/lease amount charged. During this review CDE reviewed the lease and its extension provisions.

6.4

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It is indisputable, that over the next ten (10) years, per the inflation escalation clause, the rent increased. 6.4

It is indisputable, that by June of 2008, the rent eventually increased to \$70,755 per month. 6.4

The disallowance of the lease payments for the audit period under review would create a forfeiture of the rent payments to the State Department of Education. The law abhors forfeitures and windfalls. ["Statutes and contracts are construed strictly against forfeitures or as liberally as possible to prevent them, a statute declaring a forfeiture is not to be extended beyond its direct meaning by implication, unless such implication is imperatively necessary by reason of the subject matter or terms of the statute. A forfeiture for breach of a condition in a contract is enforced only when there is such a breach shown as it was the clear and manifest intention of the parties to provide for."]; (Palo & Dodiniv. City of Oakland (1947) 79 Cal.App.2d 739, 748) 6.5

Civil Code Section 1442 states: ["A condition involving a forfeiture must be strictly interpreted against the party for whose benefit it is created."]

["Forfeiture of a contractual right is not favored in the law"]; (Chase v. Blue Cross of California (1996) 42 Cal.App.4th 1142, 1157)

["Acknowledging the "statutory doctrine" that the law abhors forfeitures and will indulge a strict construction against the party seeking to benefit from the forfeiture"]; (Deutsch v. Phillips Petroleum Co. (1976) 56 Cal.App.3d 586, 592)

["The law abhors a forfeiture.... It cannot arise by implication, but can be effected only by clear and unambiguous language"]; (Ballanv. Rainey (1952) 115 Cal.App.2d 10, 18)

["Where there are two possible interpretations of a contract, one that leads to a forfeiture and one that avoids it, California law requires the adoption of the interpretation that avoids forfeiture, if at all possible"]; (Milenbachv. C.I.R (2003) 318 F.3d 924, 936)

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Damages Must Be Real, Not Hypothetical or Speculative.

("The fourth step will consist of an analysis of the sufficiency of the evidence offered to prove damages, without regard to whether liability has been proved. This follows necessarily, for even if liability be proved no recovery is permissible unless there is proof by competent evidence of actual damages suffered, as opposed to speculative damages.") California Shoppers, Inc. v. Royal Globe Ins. Co. (1985) 175 Cal.App.3d 1, 42.

6.5

CDE cannot prove they were damaged in any regard because the child care services were rendered to eligible families and children as per the terms of the contract between the parties, the leased licensed child care properties were necessary to carry out the terms of the contract, and the lease amount(s) were reasonable and at fair market rates. The SCO's conclusion and recommendation regarding this FINDING 6 must be rejected by CDE.

Pursuant to its contract with CDE, Golden Day Schools provided subsidized child care services to eligible families and children. In order to fulfill its contractual responsibilities it needed to lease licensed child care facilities to provide the child care service.

The leased properties provided those licensed facilities and as stated above it is indisputable that Golden Day provided the child care service to eligible families and children all in accordance with the contract terms at the lease properties in question.

Therefore, GDSI contends that it fulfilled its end of the contract and provided the child care services per the terms of the contract between GDSI and CDE. The leased properties were necessary to carry out those contractual services. The lease rental rates were reasonable and at fair market rates. The fair market rental rates were determined by the appraisals received from the MAI Appraiser for the subject properties. The current lease was executed at arm's length between GDSI and the Lessor, Clark and Jeanette Parker.

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b

The SCO auditors has lumped all the rent, property taxes, and renovation and repair expenses recorded in this account in the general ledger as unallowable expenses for specious reasons. Not all expenses recorded in this account in the G/L by GDSI were paid to or on behalf of the properties leased from Clark and Jeanette Parker. The SCO's contention of unallowable payments for these other property cost amounts cannot be supported by the facts. There are other associated property cost in this category that were necessary and reasonable cost incurred to provide child care to eligible families and children that is allowable pursuant to the contract terms that exist between the parties. The SCO's contention of unallowable cost in this category is vague as to why these expenses were not allowed and therefore, this contention must be rejected.

6.6

Golden Day reserves its right to further respond to this Finding 6 once the SCO provides more specific reason(s) as to why these other property expenses are unallowable. At that time GDSI will respond with more specificity regarding the SCO's contention and rationale as to why they believe these additional expenses are unallowable.

The lease payments charged to the GDSI CDE funded child care program are allowable and to rule otherwise is tantamount to declaring a forfeiture against Golden Day and granting a windfall to the California Department of Education. Eligible families and children were provided child care pursuant to terms of the contract between Golden Day and the California Department of Education. Forfeitures and windfalls are abhorred by the law in California.

6.1

Golden Day Schools' damages are real. The CDE has not experience any damages whatsoever. Golden Day paid the allowable and contract lease amounts to the lessor in good faith. Golden Day made those lease payments to the Lessor based on the existing lease terms as set forth in the lease between the lessee and the lessor. Golden Day's independent outside auditor, Steven A. Flores, has confirmed in his three (3) audits that the lease amounts charged to the CDE funded Child Development Program by GDSI was necessary and reasonable and they should be

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allowed as reimbursable expenses as set forth in his audits of GDSI for fiscal years 2008-2009, 2009-2010 and 2010-2011.

benefit of any statute now or hereafter in effect which would otherwise afford Lessee the right to make repairs at Lessor's expense or to terminate this Lease because of Lessor's failure to keep the premises in good order, condition and repair.

7.5 Alterations and Additions. **-\$25,000**

(a) Lessee shall not, without Lessor's prior written consent, make any alterations, improvements, additions, or Utility Installations in, on or about the Premises, except for nonstructural alterations not exceeding \$50,000 in cost. As used in this Paragraph 7.5 the term "Utility Installation" shall mean bus ducting, power panels, wiring, fluorescent fixtures, space heaters, conduits, air conditioning equipment and plumbing. Lessor may require that Lessee remove any or all of said alterations, improvements, additions or Utility Installations at the expiration of the term, and restore the Premises to their prior condition. Lessor may require Lessee to provide Lessor, at Lessee's sole cost and expense, a lien and completion bond in an amount equal to one and one-half times the estimated cost of such improvements, to insure Lessor against any liability for mechanic's and materialmen's liens and to insure completion of the work. Should Lessee make any alterations, improvements, additions or Utility Installations without the prior approval of Lessor, Lessor may require that Lessee remove any or all of the same.

(b) Any alterations, improvements, additions or Utility Installations in or about the Premises that Lessee shall desire to make and which requires the consent of the Lessor shall be presented to Lessor in written form, with proposed detailed plans. If Lessor shall desire to consent the consent shall be deemed conditioned upon Lessee acquiring a permit to do so from appropriate governmental agencies, the furnishing of a copy thereof to Lessor prior to the commencement of the work and the compliance by Lessee of all conditions of said permit in a prompt and expeditious manner.

(c) Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use in the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than ten (10) days' notice prior to the commencement of any work in the Premises, and Lessor shall have the right to post notices of non-responsibility to or on the Premises as provided by law. If Lessee shall, in good faith, contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend itself and Lessor against the same and shall pay and satisfy any such adverse judgment that may be rendered (hereon before the enforcement thereof against the Lessor or the Premises, upon the condition that if Lessor shall require, Lessee shall furnish to Lessor a surety bond satisfactory to Lessor, in an amount equal to such contested lien, claim or demand indemnifying Lessor against liability for the same and holding the Premises free from the effect of such lien or claim. In addition, Lessor may require Lessee to pay Lessor's attorneys fees and costs in participating in such action if Lessor shall decide it is in its best interest to do so.

(d) Unless Lessor requires their removal, as set forth in Paragraph 7.5(a), all alterations, improvements, additions and Utility Installations (whether or not such Utility Installations constitute trade fixtures of Lessee), which may be made on the Premises, shall become the property of Lessor and remain upon and be surrendered with the Premises at the expiration of the term. Notwithstanding the provisions of this Paragraph 7.5(d) Lessee's machinery and equipment, other than that which is affixed to the Premises or which cannot be removed without material damage to the Premises, shall remain the property of Lessee and may be removed by Lessee subject to the provisions of Paragraph 7.2.

8. Insurance Indemnity.

8.1 Insuring Party. As used in this Paragraph 8, the term "insuring party" shall mean the party who has the obligation to obtain the Property Insurance required hereunder. The insuring party shall be designated in Paragraph 16.26 hereof. Whether the insuring party is the Lessor or the Lessee, Lessee shall, as additional rent for the Premises, pay the cost of all insurance required hereunder, if Lessor is the insuring party Lessee shall within ten (10) days following demand by Lessor, reimburse Lessor for the cost of the insurance so obtained.

8.2 Liability Insurance. Lessee shall, at Lessee's expense obtain and keep in force during the term of this Lease a policy of Combined Single Limit, Broad Form Property Damage and Theft, and Liability Insurance covering the Premises and all areas superintended thereon. Such insurance shall be a combined single limit policy in an amount not less than \$500,000. The policy shall contain cross liability endorsements and shall insure performance by Lessee of the indemnity provisions of this Paragraph 8. The limits of said insurance shall not, however, limit the liability of Lessee hereunder. In the event that the Premises constitute a part of a larger property said insurance shall have a Lessor's Protective Liability endorsement attached thereto. If Lessee shall fail to procure and maintain said insurance Lessor may, but shall not be required to procure and maintain the same, but at the expense of Lessee. No more frequently than each 5 years, if, in the reasonable opinion of Lessor, the amount of liability insurance required hereunder is not adequate, Lessee shall increase said insurance coverage as required by Lessor. Provided, however that in no event shall the amount of the liability insurance increase be more than fifty percent greater than the amount thereof during the preceding five years of the term of this lease. However the failure of Lessor to require any additional insurance coverage shall not be deemed to relieve Lessee from any obligations under this Lease.

8.3 Property Insurance.

(a) The insuring party shall obtain and keep in force during the term of this Lease a policy or policies of insurance covering loss or damage to the Premises, in the amount of the full replacement value thereof, as the same may exist from time to time, which replacement value is now set on the date hereof but in no event less than the total amount of promissory notes secured by liens on the Premises against all parties included within the classification of fire, extended coverage, vandalism, malicious mischief, special extended perils (all risk) and sprinkler leakage. Said insurance shall provide for payment of loss thereunder to Lessor or to the holders of mortgages or deeds of trust on the Premises. The insuring party shall, in addition, obtain and keep in force during the term of this Lease a policy of rental income insurance covering a period of six months, with loss payable to Lessor, which insurance shall also cover all real estate taxes and insurance costs for said period. If the insuring party shall fail to procure and maintain said insurance the other party may, but shall not be required to, procure and maintain the same, but at the expense of Lessee. If such insurance coverage has a deductible clause, Lessee shall be liable for the deductible amount.

(b) If the Premises are part of a larger building, or if the Premises are part of a group of buildings owned by Lessor which are adjacent to the Premises, then Lessee shall pay for any increase in the property insurance of such other building or buildings if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

(c) If the Lessor is the insuring party the Lessor will not insure Lessee's fixtures, equipment or tenant improvements unless the tenant improvements have become a part of the Premises under paragraph 7, hereof. But if Lessee is the insuring party the Lessee shall insure its fixtures, equipment and tenant improvements.

(d) Not more frequently than each three years, if, in the opinion of Lessor, the amount of property insurance required hereunder is not adequate, the insuring party shall increase said insurance coverage as required by Lessor. However such increase may be more frequent than each three years if required by the insurance carrier in order to maintain insurance for the full replacement value of the Premises.

8.4 Insurance Policies. Insurance required hereunder shall be in companies holding a "General Policyholders Rating" of B plus or better as set forth in the most current issue of "Best's Insurance Guide". The insuring party shall deliver to the other party copies of policy such insurance or certificates evidencing the existence and amounts of such insurance with loss payable clauses satisfactory to Lessor. No such policy shall be cancellable or subject to reduction of coverage or other modification except after ten (10) days' prior written notice to Lessor. If Lessee is the insuring party Lessee shall, within ten (10) days prior to the expiration of such policies, furnish Lessor with renewals or "binders" thereon, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee upon demand. Lessee shall not do or permit to be done anything which shall invalidate the insurance policies referred to in Paragraph 8.3. If Lessee does or permits to be done anything which shall increase the cost of the insurance policies referred to in Paragraph 8.3, then Lessee shall forthwith upon Lessor's demand reimburse Lessor for any additional premiums attributable to any act or omission or operation of Lessee causing such increase in the cost of insurance. If Lessor is the insuring party, and if the insurance policies maintained hereunder cover other improvements in addition to the Premises, Lessor shall deliver to Lessee a written statement setting forth the amount of any such insurance cost increase and showing in reasonable detail the manner in which it has been computed.

8.5 Waiver of Subrogation. Lessee and Lessor each hereby waive any and all rights of recovery against the other, or against the officers, employees, agents and representatives of the other, for loss of or damage to such waiving party or its property or the property of others under its control to the extent that such loss or damage is insured against under any insurance policy in force at the time of such loss or damage. The insuring party shall, upon obtaining the policies of insurance required hereunder, give notice to the insurance carrier or carriers that the foregoing mutual waiver of subrogation is contained in this Lease.

8.6 Indemnity. Lessee shall indemnify and hold harmless Lessor from and against any and all claims arising from Lessee's use of the Premises, or from the conduct of Lessee's business or from any activity, work or things done, permitted or suffered by Lessee in or about the Premises or elsewhere and shall further indemnify and hold harmless Lessor from and against any and all claims arising from any breach or default in the performance of any obligation on Lessee's part to be performed under the terms of this Lease, or arising from any negligence of the Lessee, or any of Lessee's agents, contractors, or employees, and from and against all costs, attorney's fees, expenses and liabilities incurred in the defense of any such claim or any action or proceeding brought thereon; and in case any action or proceeding be brought against Lessor by reason of any such claim, Lessee upon notice from Lessor shall defend the same at Lessee's expense by counsel satisfactory to Lessor. Lessee, as a material part of the consideration to Lessor, hereby assumes all risk of damage to property or injury to persons, in, upon or about the Premises arising from any cause and Lessee hereby waives all claims in respect thereof against Lessor.

8.7 Exemption of Lessor from Liability. Lessee hereby agrees that Lessor shall not be liable for injury to Lessee's business or any loss of income therefrom or for damage to the goods, wares, merchandise or other property of Lessee, Lessee's employees, invitees, customers, or any other person in or about the Premises, nor shall Lessor be liable for injury to the person of Lessee, Lessee's employees, agents or contractors. Whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures, or from any other cause, whether the said damage or injury results from conditions arising upon the Premises or upon other portions of the building of which the Premises are a part, or from other sources or places, and regardless of whether the cause of such damage or injury or the means of repairing the same is accessible to Lessee, Lessor shall not be liable for any damages arising from any act or neglect of any other tenant, if any, of the building in which the Premises are located.

9. Damage or Destruction. 9.1 Partial Damage - Insured. Subject to the provisions of Paragraphs 8.2 and 8.4, if the Premises are damaged and such damage was caused by a casualty covered under an insurance policy required to be maintained pursuant to Paragraph 8.3, Lessor shall at Lessor's expense repair such damage but not Lessee's fixtures, equipment or tenant improvements unless the same have become a part of the Premises pursuant to Paragraph 7.5 hereof as soon as reasonably possible and this Lease shall continue in full force and effect. Notwithstanding the above, if the Lessee is the insuring party, and if the insurance proceeds received by Lessor are not sufficient to effect such repair, Lessor shall give notice to Lessee of the amount required in addition to the insurance proceeds to effect such repair. Lessee shall contribute the required amount to Lessor within ten days after Lessee has received notice from Lessor of the shortage in the insurance. When Lessee shall contribute such amount to Lessor Lessor shall make such repairs as soon as reasonably possible and this Lease shall continue in full force and effect. Lessee shall, in no event, have any right to remove or alter any such amount so contributed.

...the date of the occurrence of such damage. In the event Lessor elects to give such notice of Lessor's intention to cancel and terminate this Lease, Lessee shall have the right within ten (10) days after the receipt of such notice to give written notice to Lessor of Lessee's intention to repair such damage at Lessee's expense, without reimbursement from Lessor, in which event this Lease shall continue in full force and effect, and Lessee shall proceed to make such repairs as soon as reasonably possible. If Lessee does not give such notice within such 10-day period this Lease shall be cancelled and terminated as of the date of the occurrence of such damage.

9.3 Total Destruction. If at any time during the term hereof the Premises are totally destroyed from any cause whether or not covered by the insurance required to be maintained pursuant to Paragraph 8.3 (including any total destruction required by any authorized public authority) this Lease shall automatically terminate as of the date of such total destruction.

9.4 Damage Near End of Term. If the Premises are partially destroyed or damaged during the last six months of the term of this Lease, Lessor may at Lessor's option cancel and terminate this Lease as of the date of occurrence of such damage by giving written notice to Lessee of Lessor's election to do so within 30 days after the date of occurrence of such damage.

9.5 Abatement of Rent; Lessor's Remedies. (a) If the Premises are partially destroyed or damaged and Lessor or Lessee repairs or restores them pursuant to the provisions of this Paragraph 8, the rent payable hereunder for the period during which such damage, repair or restoration continues shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired; provided, however, that the aggregate amount of abatement hereunder shall not exceed the total of rent payable under Paragraph 4 for a period of six months. Except for abatement of rent, if any, Lessee shall have no claim against Lessor for any damage suffered by reason of any such damage, destruction, repair or restoration.

(b) If Lessor shall be obligated to repair or restore the Premises under the provisions of this Paragraph 9 and shall not commence such repair or restoration within 90 days after such obligation shall accrue, Lessee may at Lessee's option cancel and terminate this Lease by giving Lessor written notice of Lessee's election to do so at any time prior to the commencement of such repair or restoration. In such event this Lease shall terminate as of the date of such notice.

9.6 Termination - Advance Payments. Upon termination of this Lease pursuant to this Paragraph 9, an equitable adjustment shall be made concerning advance rent and any advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's security deposit as has not theretofore been applied by Lessor.

9.7 Waiver. Lessee waives the provisions of California Civil Code Sections 1932 (2) and 1933 (4) which relate to termination of leases when the thing leased is destroyed and agrees that such event shall be governed by the terms of this Lease.

10. Real Property Taxes.

10.1 Payment of Taxes. Lessee shall pay all real property taxes applicable to the Premises during the term of this Lease. All such payments shall be made at least ten (10) days prior to the delinquency date of such payment. Lessee shall promptly furnish Lessor with satisfactory evidence that such taxes have been paid. If any such taxes paid by Lessee shall cover any period of time prior to or after the expiration of the term hereof, Lessee's share of such taxes shall be equitably prorated to cover only the period of time within the tax fiscal year during which this Lease shall be in effect, and Lessor shall reimburse Lessee to the extent required. If Lessee shall fail to pay any such taxes, Lessor shall have the right to pay the same. In which case Lessee shall repay such amount to Lessor with Lessee's next rental installment together with interest at the rate of 10% per annum.

10.2 Definition of "Real Property" Tax. As used herein, the term "real property tax" shall include any form of assessment, license fee, commercial rental tax, law, penalty or tax (other than inheritance or estate taxes), imposed by any authority having the direct or indirect power to tax, including any city, county, state or federal government, or any school, agricultural, lighting, drainage or other improvement district thereof, as against any legal or equitable interest of Lessor in the Premises or in the real property of which the Premises are a part, as against Lessor's right to rent or other income herefrom, or as against Lessor's business of leasing the Premises or any tax imposed in substitution, partially or totally, of any tax previously included within the definition of real property tax, or any additional tax the nature of which was previously included within the definition of real property tax.

10.3 Joint Assessment. If the Premises are not separately assessed, Lessee's liability shall be an equitable proportion of the real property taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.4 Personal Property Taxes.

(a) Lessee shall pay prior to delinquency all taxes assessed against and levied upon trade fixtures, furnishings, equipment and all other personal property of Lessee contained in the Premises or elsewhere. When possible, Lessee shall cause said trade fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor.

(b) If any of Lessee's said personal property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. Utilities.

Lessee shall pay for all water, gas, heat, light, power, telephone and other utilities and services supplied to the Premises, together with any taxes thereon. If any such services are not separately metered to Lessee, Lessee shall pay a reasonable proportion to be determined by Lessor of all charges jointly metered with other premises.

12. Assignment and Subletting.

12.1 Lessor's Consent Required. Lessee shall not voluntarily or by operation of law assign, transfer, mortgage, sublet, or otherwise transfer or encumber all or any part of Lessee's interest in this Lease or in the Premises, without Lessor's prior written consent, which Lessor shall not unreasonably withhold. Any attempted assignment, transfer, mortgage, encumbrance or subletting without such consent shall be void, and shall constitute a breach of this Lease.

12.2 Lessee Assignable. Notwithstanding the provisions of paragraph 12.1 hereof, Lessee may assign or sublet the Premises, or any portion thereof, without Lessor's consent, to any corporation which controls, is controlled by or is under common control with Lessee, or to any corporation resulting from the merger or consolidation with Lessee, or to any person or entity which acquires all the assets of Lessee as a going concern of the business that is being conducted on the Premises, provided that said assignee assumes, in full, the obligations of Lessee under this Lease. Any such assignment shall not, in any way, affect or limit the liability of Lessee under the terms of this Lease even if after such assignment or subletting the terms of this Lease are mutually changed or altered without the consent of Lessee, the consent of whom shall not be necessary.

12.3 No Release of Lessee. Regardless of Lessor's consent, no subletting or assignment shall release Lessee of Lessee's obligation to Lessor from any other person shall not be deemed to be a waiver by Lessor of any provision hereof. Consent to one assignment or subletting shall not be deemed consent to any subsequent assignment or subletting. In the event of default by any assignee of Lessee or any successor of Lessee, in the performance of any of the terms hereof, Lessor may proceed directly against Lessee without the necessity of exhausting remedies against said assignee. Lessor may consent to subsequent assignments or subletting of this Lease or amendments or modifications to this Lease with assignees of Lessee, without notifying Lessee, or any successor of Lessee, and without obtaining its or their consent thereto and such action shall not relieve Lessee of liability under this Lease.

12.4 Attorney's Fees. In the event Lessee shall assign or sublet the Premises or request the consent of Lessor to any assignment or subletting or if Lessee shall request the consent of Lessor for any act that Lessee proposes to do then Lessee shall pay Lessor's reasonable attorneys fees incurred in connection therewith, such attorneys fees not to exceed \$250.00 for each such request.

13. Defaults; Remedies.

13.1 Defaults. The occurrence of any one or more of the following events shall constitute a material default and breach of this Lease by Lessee:

(a) The vacating or abandonment of the Premises by Lessee.

(b) The failure by Lessee to make any payment of rent or any other payment required to be made by Lessee hereunder, as and when due, where such failure shall continue for a period of three days after written notice thereof from Lessor to Lessee.

(c) The failure by Lessee to observe or perform any of the covenants, conditions or provisions of this Lease to be observed or performed by Lessee other than described in paragraph (b) above, where such failure shall continue for a period of 30 days after written notice thereof from Lessor to Lessee; provided, however, that if the nature of Lessee's default is such that more than 30 days are reasonably required for its cure, then Lessee shall not be deemed to be in default if Lessee commenced such cure within said 30-day period and thereafter diligently pursued such cure to completion.

(d) (i) The making by Lessee of any general assignment, or general arrangement for the benefit of creditors; (ii) the filing by or against Lessee of a petition to have Lessee adjudged a bankrupt or a petition for reorganization or arrangement under any law relating to bankruptcy (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not returned to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discontinued within 30 days.

(e) The discovery by Lessor that any financial statement given to Lessor by Lessee, any assignee of Lessee, any subtenant of Lessee, any successor in interest of Lessee or any guarantor of Lessee's obligations hereunder, and any of them, was materially false.

13.2 Remedies. In the event of any such material default or breach by Lessee, Lessor may at any time thereafter, with or without notice or demand and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such default or breach:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Lessee shall immediately surrender possession of the Premises to Lessor. In such event Lessor shall be entitled to recover from Lessee all damages incurred by Lessor by reason of Lessee's default including, but not limited to, the cost of recovering possession of the Premises; expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorney's fees, and any real estate commission actually paid; the worth at the time of award by the court having jurisdiction hereof of the amount by which the unpaid rent for the balance of the term after the date of such award exceeds the amount of such rental loss for the same period that Lessee proves could be reasonably avoided; that portion of the leasing commission paid by Lessor pursuant to Paragraph 15 applicable to the unexpired term of this Lease.

Initials _____

... shall not be in default if Lessor commences performance within such 30-day period and thereafter diligently prosecutes the same to completion.

13.4 Late Charges. Lessee hereby acknowledges that late payment by Lessee to Lessor of rent and other sums due hereunder will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed on Lessor by the terms of any mortgage or trust deed covering the Premises. Accordingly, if any installment of rent or any other sum due from Lessee shall not be received by Lessor or Lessor's designee within ten (10) days after such amount shall be due, Lessee shall pay to Lessor a late charge equal to 8% of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of late payment by Lessee. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's default with respect to such overdue amount, nor prevent Lessor from exercising any of the other rights and remedies granted hereunder.

14. Condemnation. If the Premises or any portion thereof are taken under the power of eminent domain, or sold under the threat of the exercise of said power (all of which are herein called "condemnation"), this Lease shall terminate as to the part so taken as of the date the condemning authority takes title or possession, whichever first occurs. If 3 or more of the 5 leased locations are substantially

written only within ten (10) days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within ten (10) days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to a portion of the Premises remaining, except that the rent shall be reduced in the proportion that the floor area taken bears to the total floor area of the building situated on the Premises. Any award for the taking of all or any part of the Premises under the power of eminent domain or any payment made under threat of the exercise of such power shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold or for the taking of the fee, or as severance damages; provided, however, that Lessee shall be entitled to any award for loss of or damage to Lessor's trade fixture and removable personal property. In the event that this Lease is not terminated by reason of such condemnation, Lessor shall, to the extent of severance damages received by Lessor in connection with such condemnation, repair any damage to the Premises caused by such condemnation except to the extent that Lessee has been reimbursed therefor by the condemning authority. Lessee shall pay any amount in excess of such severance damages required to complete such repair.

15. Broker's Fee. Upon execution of this Lease by both parties, Lessor shall pay to no broker involved a licensed real estate broker, a fee as set forth in a separate agreement between Lessor and said broker, or in the event there is no separate agreement the sum of \$ 300 for brokerage services rendered by said broker to Lessor in this transaction. Lessor further agrees that if Lessee exercises any option granted herein or any option substantially similar thereto, either to extend the term of this Lease, to renew this Lease, to purchase any or part thereof or any adjacent property in which Lessor may own or in which Lessor has an interest, or to exercise any other option granted herein, or if said broker is the procuring cause of any other lease or sale entered into between the parties pertaining to the Premises and/or any adjacent property in which Lessor has an interest, then as to any of said transactions, Lessor shall pay said broker a fee in accordance with the schedule of said broker in effect at the time of execution of this Lease. Lessor agrees to pay said fee not only on behalf of Lessor but also on behalf of any person, corporation, association, or other entity having an ownership interest in said real property or any part thereof, when such fee is due hereunder. Any transfer of Lessor's interest in this Lease, by accepting an assignment of such interest, shall be deemed to have assumed Lessor's obligation under this Paragraph 15. Said broker shall be a third party beneficiary of the provisions of this Paragraph.

16. General Provisions.

16.1 Estoppel Certificate. (a) Lessee shall at any time upon not less than ten (10) days' prior written notice from Lessor execute, acknowledge and deliver to Lessor a statement in writing (i) certifying that this Lease is unmodified and in full force and effect (or, if modified, stating the nature of such modification and certifying that this Lease, as so modified, is in full force and effect) and the date to which the rent and other charges are paid in advance. If any, and (ii) acknowledging that there are not, to Lessee's knowledge, any uncured defaults on the part of Lessor hereunder, or specifying such defaults if any are claimed. Any such statement may be conclusively relied upon by any prospective purchaser or encumbrancer of the Premises.

(b) Lessee's failure to deliver such statement within such time shall be conclusive upon Lessee (i) that this Lease is in full force and effect, without modification except as may be represented by Lessor, (ii) that there are no uncured defaults in Lessor's performance, and (iii) that not more than one month's rent has been paid in advance or such failure may be considered by Lessor as a default by Lessee under this Lease.

(c) If Lessor desires to finance or refinance the Premises, or any part thereof, Lessee hereby agrees to deliver to any lender designated by Lessor such financial statements of Lessee as may be reasonably required by such lender. Such statements shall include the most recent years' financial statements of Lessee. All such financial statements shall be received in confidence and shall be used only for the purposes herein set forth.

16.2 Lessor's Liability. The term "Lessor" as used herein shall mean only the owner or owners at the time in question of the fee title or a lessee's interest in a ground lease of the Premises, and except as expressly provided in Paragraph 15. In the event of any transfer of such title or interest, Lessor herein named (and in case of any subsequent transfer the then grantor) shall be relieved from and after the date of such transfer of all liability as respects Lessor's obligations hereunder to be performed, provided that any funds in the hands of Lessor or the then grantor at the time of such transfer, in which Lessee has an interest, shall be delivered to the grantee. The obligations contained in this Lease to be performed by Lessor shall, subject as aforesaid, be binding on Lessor's successors and assigns, only during their respective periods of ownership.

16.3 Severability. The invalidity of any provision of this Lease as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

16.4 Interest on Past-due Obligations. Except as expressly herein provided, any amount due Lessor not paid when due shall bear interest at 10% per annum from the date due. Payment of such interest shall not excuse or cure any default by Lessee under this Lease, provided, however, that interest shall not be payable on late charges incurred by Lessee nor on any amounts upon which late charges are paid by Lessee.

16.5 Time of Essence. Time is of the essence.

16.6 Captions. Article and paragraph captions are not a part hereof.

16.7 Incorporation of Prior Agreements. Amendments. This Lease contains all agreements of the parties with respect to any matter mentioned herein. No prior agreement or understanding pertaining to any such matter shall be effective. This Lease may be modified in writing only, signed by the parties in interest at the time of the modification. Except as otherwise stated in this Lease, Lessee hereby acknowledges that neither the real estate broker named in Paragraph 15 hereof nor any cooperating broker on this transaction nor the Lessor or any employees or agents of any of said persons has made any oral or written warranties or representations to Lessee relative to the condition or use of the Premises and Lessee acknowledges that Lessee assumes all responsibility regarding the Occupational Safety Health Act or the legal use of adaptability of the Premises and the compliance hereof to all applicable laws and regulations enforced during the term of this Lease except as otherwise specifically stated in this Lease.

16.8 Notices. Any notice required or permitted to be given hereunder shall be in writing and may be given by personal delivery or by certified mail, and if given personally or by mail, shall be deemed sufficiently given if addressed to Lessee or to Lessor at the address noted below the signature of the respective parties, as this case may be. Either party may by notice to the other specify a different address for notice purposes except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for notice purposes. A copy of all notices required or permitted to be given to Lessor hereunder shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate by notice to Lessee.

16.9 Waivers. No waiver by Lessor of any provision hereof shall be deemed a waiver of any other provision hereof or of any subsequent breach by Lessee of the same or any other provision. Lessor's consent to or approval of any act shall not be deemed to render unnecessary the obtaining of Lessor's consent or approval of any subsequent act by Lessee. The acceptance of rent hereunder by Lessor shall not be a waiver of any preceding breach by Lessee of any provision hereof, other than the failure of Lessee to pay the particular rent so accepted, regardless of Lessor's knowledge of such preceding breach at the time of acceptance of such rent.

16.10 Recording. Lessee shall not record this Lease without Lessor's prior written consent, and such recordation shall, at the option of Lessor, constitute a non-curative default of Lessee hereunder. Either party shall, upon request of the other, execute, acknowledge and deliver to the other a "short form" memorandum of this Lease for recording purposes.

16.11 Holding Over. If Lessee remains in possession of the Premises or any part thereof after the expiration of the term hereof without the express written consent of Lessor, such occupancy shall be a tenancy from month to month at a rental in the amount of the last monthly rental plus all other charges payable hereunder, and upon all the terms hereof applicable to a month-to-month tenancy.

16.12 Cumulative Remedies. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

16.13 Covenants and Conditions. Each provision of this Lease performed by Lessee shall be deemed both a covenant and a condition.

16.14 Binding Effect. Choice of Law. Subject to any provisions hereof restricting assignment or subletting by Lessee and subject to the law of the State in which the Premises are located, their personal representatives, successors and assigns. This Lease shall be governed by the laws of the State in which the Premises are located.

16.15 Subordination. (a) This Lease, at Lessor's option, shall be subordinate to any ground lease mortgage, deed of trust, or any other hypothecation for security now or hereafter placed upon the real property of which the Premises are a part and to any and all advances made on the security thereof and to all renewals, modifications, consolidations, replacements and extensions thereof. Notwithstanding such subordination, Lessee's right to quiet possession of the Premises shall not be disturbed if Lessee is not in default and so long as Lessee shall pay the rent and observe and perform all of the provisions of this Lease, unless this Lease is otherwise terminated pursuant to its terms. If any mortgage, trustee or ground lease shall elect to have this Lease prior to the lien of its mortgage, deed of trust or ground lease, and shall give written notice thereof to Lessee, this Lease shall be deemed prior to such mortgage, deed of trust, or ground lease, whether this Lease is due prior or subsequent to the date of said mortgage, deed of trust or ground lease or the date of recording thereof.

court. The provisions of this paragraph shall inure to the benefit of the broker named herein who seeks to enforce a right hereunder.

16.17 Lessor's Access. Lessor and Lessor's agents shall have the right to enter the Premises at reasonable times for the purpose of inspecting the same, showing the same to prospective purchasers, or lenders, or lessees, and making such alterations, repairs, improvements or additions to the Premises or to the building of which they are a part as Lessor may deem necessary or desirable. Lessor may at any time place on or about the Premises any ordinary "For Sale" signs and Lessor may at any time during the last 120 days of the term hereof place on or about the Premises any ordinary "For Lease" signs, all without rebate of rent or liability to Lessee.

16.18 Signs and Auctions. Lessee shall not place any sign upon the Premises or conduct any auction thereon without Lessor's prior written consent insofar as Lessee shall have the right, without the prior permission of Lessor to place ordinary and usual for rent or sublet signs thereon.

16.19 Merger. The voluntary or other surrender of this Lease by Lessee, or a mutual cancellation thereof, or a termination by Lessor, shall not work a merger, and shall, at the option of Lessor, terminate all or any existing subtenancies or may, at the option of Lessor, operate as an assignment to Lessor of any or all of such subtenancies.

16.20 Corporate Authority. If Lessee is a corporation, each individual executing this Lease on behalf of said corporation represents and warrants that he is duly authorized to execute and deliver this Lease on behalf of said corporation, in accordance with a duly adopted resolution of the Board of Directors of said corporation or in accordance with the Bylaws of said corporation, and that this Lease is binding upon said corporation in accordance with its terms. If Lessee is a corporation Lessee shall, within thirty (30) days after execution of this Lease, deliver to Lessor a certified copy of a resolution of the Board of Directors of said corporation authorizing or ratifying the execution of this Lease.

16.21 Consents. Wherever in this Lease the consent of one party is required to an act of the other party such consent shall not be unreasonably withheld.

16.22 Guarantor. In the event that there is a guarantor of this Lease, said guarantor shall have the same obligations as Lessee under Paragraphs 16.1 and 16.20 of this Lease.

16.23 Quiet Possession. Upon Lessee paying the fixed rent reserved hereunder and observing and performing all of the covenants, conditions and provisions on Lessee's part to be observed and performed hereunder, Lessee shall have quiet possession of the Premises for the entire term hereof subject to all of the provisions of this Lease.

16.24 Options. In the event that the Lessee, under the terms of this Lease, has any option to extend the term of the Lease, or any option to purchase the Premises or any right of first refusal to purchase the Premises or other property of Lessor, then each of such options and rights are personal to Lessee and may not be exercised or be assigned, voluntarily or involuntarily, by or to any one other than Lessee except that it may be exercised by or assigned to any of the entities described in paragraph 16.2 hereof for whom Lessee does not need the consent of Lessor to assign this Lease. In the event that Lessee hereunder has any multiple options to extend this Lease a later option to extend the Lease cannot be exercised unless the prior option has been so exercised. Lessee has no option to extend or purchase.

16.25 Multiple Tenant Building Rules and Regulations. In the event that the Premises are part of a larger building or group of buildings then Lessee agrees that it will abide by, keep and observe all reasonable rules and regulations which Lessor may make from time to time for the management, safety, care, and cleanliness of the building and grounds, the parking of vehicles and the preservation of good order therein as well as for the convenience of other occupants and tenants of the building. Further, Lessee will promptly pay its pro rata share, as reasonably determined by Lessor, of any maintenance or repair of such portion of the Premises or such portion of the property of which the Premises are a part, which are common areas or used by Lessee and other occupants thereof. The violations of any such rules and regulations, or the failure to pay such pro rata share of costs, shall be deemed a material breach of this Lease by Lessee.

16.26 Insuring Party. The insuring party under this lease shall be the Lessee. If there are additional provisions place the same here.

In the event of any default under the Note of the undersigned dated April 1, 1980 to the Lessor, Lessor may, at Lessor's option, terminate the term of this Lease by reason of such default.

The parties hereto have executed this Lease at the place and on the dates specified immediately adjacent to their respective signatures.

If this Lease has been filled in it has been prepared for submission to your attorney for his approval. No representation or recommendation is made by the real estate broker or his agents or employees as to the legal sufficiency, legal effect, or tax consequences of this Lease or the transaction relating thereto.

Executed at Los Angeles, California
on as of April 1, 1980
Address 4508 Crenshaw Boulevard
Los Angeles, California 90043
Clark Parker
By Jeanette Parker
LESSOR

Executed at Los Angeles, California
on as of April 1, 1980
Address 4508 Crenshaw Boulevard
Los Angeles, California 90043
By Title
* Name is being, or has been, changed to Golden Day Schools, Inc.
LESSEE (Corporate Seal)

THE SIX LOCATIONS ARE DESCRIBED BY STREET ADDRESS AS FOLLOWS:

1. 2255-57 WEST ADAMS BOULEVARD
LOS ANGELES, CALIFORNIA 90018
2. 4470 CRENSHAW BOULEVARD
LOS ANGELES, CALIFORNIA 90043
3. 4476-80 CRENSHAW BOULEVARD
LOS ANGELES, CALIFORNIA 90043
4. 4500 CRENSHAW BOULEVARD (PARKING LOT)
LOS ANGELES, CALIFORNIA 90043
5. 4508 CRENSHAW BOULEVARD
LOS ANGELES, CALIFORNIA 90043
6. 6422 CRENSHAW BOULEVARD
LOS ANGELES, CALIFORNIA 90043

LEASE
EXHIBIT A

AMENDMENT

This is an amendment to the Lease dated April 1, 1980 between Clark Parker and Jeanette Parker, (therein called "Lessor"), and Golden Day Schools, Inc., (therein called "Lessee"), to Lease the Premises that are described on Exhibit "A" thereto.

Paragraph 3.1, (Term), therein is amended as follows:

The month, day and year of the ending of this Lease Agreement shall be June 30, 2000.

Paragraph 16.11, (Holding Over), therein is amended to read as follows:

"If Lessee remains in possession of the Premises or any part thereof after the expiration of the term hereof without the execution of a new written Lease executed by and between Lessee and Lessor, such occupancy shall be a tenancy from year-to-year payable monthly at a rental amount equal to the fair monthly rental plus cost of living adjustments calculated in accordance with Exhibit "B" attached hereto. the fair monthly rental amount shall be based on the most recent appraisal by an independent certified and licensed appraiser for the properties that are included on Exhibit "A" attached hereto, plus all other charges payable hereunder, and upon all the terms hereof."

Exhibit "A" attached thereto is amended to add the following premise:

"7. 4514 Crenshaw Blvd., Los Angeles, California 90043"

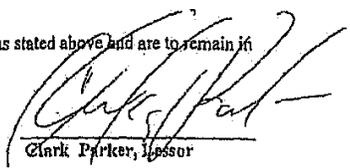
All other terms of the Lease are unchanged except as stated above and are to remain in full force and effect.

Executed at Los Angeles, California

On as of March 20, 2000

Address: 4508 Crenshaw Boulevard

Los Angeles, California 90043


Clark Parker, Lessor


By: George Rogers, For Lessee
Golden Day Schools, Inc.

COST OF LIVING ADJUSTMENT

The instrument to which this Exhibit is attached calls for a cost of living adjustment on each April 1 in the amount of rent otherwise payable under the terms thereof on that date and during the subsequent twelve month period. For purposes of such cost of living adjustment, the base month shall be January of 1980, and the comparison month will be the January preceding the April 1 date upon which an adjustment for the next twelve months is to commence. The Index to be used for the adjustment will be the Consumer Price Index, All Urban Consumers, Los Angeles-Long Beach-Anaheim Area, All Items, 1967 equals 100, prepared by the Department of Labor of the United States. In the event that such Index is not available at any time when its use is called for, the most nearly comparable Index prepared by the United States shall be used instead, with an appropriate conversion from the original Index to the alternate Index so selected. The annual cost of living adjustment shall be made by multiplying each payment with respect to which an adjustment is applicable, by that fraction the numerator of which is the Index for the comparison month and the denominator of which is the Index for the base month.

EXHIBIT B OF LEASE

GOLDEN DAY SCHOOLS RESPONSE TO THE SCODRAFT AUDIT REPORT

FINDING 7

UNALLOWABLE EXPENSES

The Center of this dispute is whether Costs Charged to the GDSI Child Development Program are reasonable. 7.1

Generally, there is no dispute that Golden Day charged the disputed items to CDE and that the cost of the item is in fact what was charged to CDE.

Instead, the dispute is whether each item charged was necessary and reasonable under the applicable law. And the applicable Funding Terms and Conditions.

Under Definitions set forth in Section I of the FT&C it states - "Reasonable and necessary cost", "means expenditures that, in nature and amount, do not exceed what an ordinarily prudent person would incur in the conduct of a competitive business". This is the same definition that is set forth in Education Code Section 8208(n) and CCR Title 5 Section 18013(s), this definition is clear, plain and unambiguous. However, the SCO has interpreted it to mean that they can ignore this plain and clear meaning of the statute, regulation and the contract terms. They have failed to give credence to the fact that the discretion as to what cost is allowable does not rest with their misguided interpretation of the law and contract by when in doubt outside of those broad definitions they can refer to the contract terms between the parties. Specifically FT&C Section V. (f) and (g) states, specific items of Reimbursable Costs and Nonreimbursable Costs, respectively. Outside of those the discretion lies with the Golden Day Board of Directors.

CDE's representative, the SCO, states it can conduct "contract performance audits" in connection with CDE's Categorical Program Monitoring authority which it is required to perform once every three years. CDE and the SCO will most undoubtedly refer to what they have done as merely conducting a "Performance Audit" of GDSI for the fiscal years 2008 through 2011. That term, however, is misleading here because the SCO actually conducted a second Financial and Compliance audit. To this end, GDSI is aware of CDE's own criteria for conducting a Performance Audit review, which is contrary and lends no support to the SCO's conduct in this audit. Simply put the SCO conducted a full second Financial and Compliance audit of GDSI books and records. They now seek to supplant the Financial and Compliance audits completed by Steven A. Flores, CPA. 7.2

Golden Day Schools Response to SCO Draft Audit Report FINDING #7 – September 8, 2014

As taken from CDE's "Instrument for Categorical Program Monitoring" we have and set forth below, what CDE believes it is supposed to do when it conducts a Performance Audit review of a contractor every three (3) years using "the following interrelated seven dimensions": The instrument that CDE uses set forth the following 7 criteria are as follows:

7.3

- (1) involvement
- (2) governance and administration
- (3) funding (Not to be reviewed during Child Development CMR or CPM.)
- (4) standard, assessment, and accountability
- (5) staffing and professional development
- (6) opportunity and equal educational access
- (7) teaching and learning

Please note as set forth next to point (3) – which involves "funding" – CDE writes a description of this category, "Allocation and use of funds meet statutory requirements for allowable expenditures" and then, next to that, in a parenthetical, "Not to be reviewed during Child Development CMR or CPM." In other words, CDE's own policies and regulations states that it is not supposed to be examining the allocation and use of funds for contractors such as Golden Day, and yet that it precisely what the SCO has done here as they have stated in th CCR Title 5 Section 18038 states the criteria as to how this regulation should be implemented and interpreted by CDE. To interpret this Education Code Section and the applicable regulation any other way will render the statute a nullity, which the SCO and CDE' cannot do. Further, the SCO wants the CDE to state that what they have done was not to conduct a Financial and Compliance audit but rather a "Performance Audit, if this is the case then this is tantamount to stating that by their actions they have ruled that Education Code Section 8448 (l) and (h) has no meaning and its meaning would therefore be ruled a nullity. For the SCO to recommend that CDE should rule that Education Code Section 8448(h) and CCR 5 Section 18072 have a new and different meaning means and stands for they would be asking CDE to confirm an Underground Regulation which is illegal.

The courts in *Clovis Unified School District V. Chiang* (No. 3 Civ. C061696. -- September 21, 2010) stated that all underground regulations are void and unenforceable. There were two (2) primary test that the courts used to determine if a policy or procedure should be a regulation promulgated pursuant to the Administrative Procedures Act as set forth in the Government Code.

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First, is the policy and meaning is intended to apply generally to all persons in the same class? In this case it is intended to apply to all 800 plus child care contractors that contract with the state department of education.

Secondly, is the policy that is being applied meant to interpret and/or enforce a statute or regulation? Again, in this instance the answer is yes. Then that policy and or interpretation should have been promulgated pursuant to the APA. If it was not then it must be declared an underground regulation which is void and unenforceable. In other words CDE and their representative, the SCO, knew or should have known that their now definition of what they are contending the meaning of Section 18072 was never presented to the public nor was it promulgated pursuant to the APA. More importantly neither CDE nor the SCO have the authority to issue such a draconian regulation meaning that is contrary to what the courts has stated how a regulation should be interpreted. In other words the courts has stated that a regulation cannot be interpreted in a manner to render the enabling statute a nullity or in a manner that it comes to a meaning that cannot be reconciled with the plain language of the statute or that would make its meaning so misleading to the contractors without going through the public process to create, or amend the regulation.

Clovis, supra, makes it clear that a Government Agency may not have hidden meaning and policies that for a regulations that pursuant to the Government Code have not been exposed to public scrutiny through the APA and if they do those new and different meanings will be struck down and deemed void and unenforceable.

The SCO is proposing to recommend to CDE that it should recoup "any payments made for costs expended by GDSI for this FINDING 7 because in their opinion GDSI has not produced source documents to support their allowability.

This rationale is not only untrue but it completely ignores the prohibition in Education Code Sections 8448(i) and (h) that states the CDE or its representative the SCO, cannot conduct a second Financial and Compliance audit if the Child Care Contractor has had such an audit completed by an Independent Certified Accountant, completed in accordance with General Accepted Auditing Standards (GAAS).

GDSI contends that the SCO has conducted a second Financial and Compliance of Golden Day Schools, Inc. for the fiscal Years 2008-2009, 2009-2010 and 2010-2011, which is illegal for them to do pursuant to the plain language set forth in Education Code Section 8448 et. seq. GDSI disagree that it failed to produce and provide all accounting records and source documents to substantiate all of its expenses. The SCO has not taken any exception to any specific amount of any particular expense items rather it has broadly stated that GDSI has failed to provide all accounting records and source documents to substantiate GDSI-related expenses. Every GDSI expense cost item requested and recorded in the GDSI general ledger charged to its CDE funded Child Care Program was provided to the SCO auditors. These statements are very disingenuous, arbitrary and capricious and they show bias because they are untrue and the SCO know they are untrue.

Golden Day Schools Response to SCO Draft Audit Report FINDING #7 – September 8, 2014

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The SCO statements of why all costs are disallowable are vague and ambiguous and it is difficult to address any one item with any specificity. All cost charged to the CDE funded Child Care Program by GDS was necessary and reasonable.

GDSI have copies of every written request for expense records made to GDSI by the SCO auditors and we have written copies of every response GDSI made when they provided the requested original source document records to the SCO auditors. The auditors have misrepresented their visits to two prominent CPA firms by stating that the CPA's did not have access to source documents when they performed their respective tasks. The CPA firms by their declarations herein have denied these allegations as untruths and disingenuous behavior. Simply put, the SCO auditors are not being truthful when they make such allegations and they are libelous and reckless and they have to regard for the reputations of the entities involved. This type of behavior is mean-spirited and it should not be tolerated by the State Controller or those Supervisorial individuals in charge of the auditors who performed this audit.

GDSI deny every allegation as being untrue, meritless and unsubstantiated as set forth in FINDING 7. GDSI request that CDE reject each of the conclusions, misstated facts, and recommendations contained therein.

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GOLDEN DAY SCHOOLS RESPONSE TO THE SCO DRAFT AUDIT REPORT

FINDING 8 - 9 -10 – 11&12

*Unsubstantiated Auto Allowance - Unallowable Legal fees – Unallowable Costs:
Previous Years Non-Reimbursed Instructional Supplies – Unallowable Interest
Expense – Unallowable Nutrition Program Costs*

It is apparently obvious the SCO has taken the position that if Golden Day Schools does not provide the books and records of Today's Fresh Start Charter School for the SCO to audit then they will recommend to the California Department of Education to disallow all the expenses for the above referenced cost categories and accounts. They have reiterated their position in each of the above FINDINGS;

"GDSI reported X-dollars but failed to provide all accounting records and source documents to substantiate GDSI-relatedexpenses. As mentioned in Findings 1 and 6, because GDSI shares the premises with related entities, (TFSI, Pacific Books & Supplies, Spectrum Surveillance Systems, and Natural Solutions), we requested related-entity, specifically TFSI accounting records and source documents to determine whether the claimed charges were indeed for GDSI operations. The director [Administrator] refused to provide accounting records and source documents of the related entities. The Director insisted that TFSI, Pacific Books & Supplies, and Natural Solutions were unrelated to GDSI, that each entity maintains its accounts and records, and that these claimed operating costs were only for GDSI. We explained to the director that without accounting records and source documents for TFSI, Pacific Books & Supplies, and Natural Solutions, we would not be able to ascertain whether these claimed costs were for GDSI operations and that the recorded expenses were reasonable and necessary. As these expenses remain unsubstantiated, we deemed them to be unallowable."

This position by the SCO is meritless and there is no Education Code, Regulation or Funding Term and Condition contract term to support their position.

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Education Code Section 8448 provides as follows;

8448. As used in this article:

(a) "Financial and compliance audit" means a systematic review or appraisal to determine each of the following:

(1) Whether the financial statements of an audited organization fairly present the financial position and the results of financial operations in accordance with generally accepted accounting principles.

(2) Whether the organization has complied with laws and regulations that may have a material effect upon the financial statements.

(b) "Public accountants" means certified public accountants, or state licensed public accountants.

(c) "Independent auditors" means public accountants who have no direct or indirect relationship with the functions or activities being audited or with the business conducted by any of the officials or contractors being audited.

(d) "Generally accepted auditing standards" means the auditing standards set forth in the financial and compliance element of the "Government Auditing Standards" issued by the Comptroller General of the United States and incorporating the audit standards of the American Institute of Certified Public Accountants.

(e) "Direct service contract" means any contract with any public or private entity for child care and development programs, resource and referral programs, and programs contracting to provide support services as defined in Section 8208.

(f) "Nonprofit organization" means an organization described in Section 501(c)(3) of the Internal Revenue Code of 1954 which is exempt from taxation under Section 501(a) of that code, or any nonprofit, scientific, or educational organization qualified under Section 23701d of the Revenue and Taxation Code.

(g) Annually, there shall be a single independent financial and compliance audit of organizations that contract with the state under a direct service contract. Any such audit shall include an evaluation of the accounting and control systems of the direct service contractor and of the activities by the contractor to comply with the financial requirements of direct service contracts received by the contractor from the state agency. The financial and compliance requirements to be reviewed during the audit shall be those developed and published by the State Department of Education in consultation with the Department of Finance. Audits carried out pursuant to this section shall be audits of the contractor rather than audits of individual contracts or programs. In the case of any contractor that receives less than twenty-five thousand dollars (\$25,000) per year from any state agency, the audit required by this section shall

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be conducted biennially, unless there is evidence of fraud or other violation of state law in connection with the direct service contract. The cost of the audit may be included in direct service contracts.

The organization receiving funds from the state shall be responsible for obtaining the required financial and compliance audits of the organization and any subcontractors, except for direct service subcontracts and other subcontracts exempt from State Department of Education review, as agreed to by the Departments of Finance and General Services. The audits shall be made by independent auditors in accordance with generally accepted auditing standards. The audit shall be completed by the 15th day of the fifth month following the end of the contractor's fiscal year. A copy of the required audit shall be filed with the State Department of Education upon its completion. In the event an audit is not filed, the State Department of Education shall notify the organization of the contract violation. The audit report filed shall be an integral part of the direct service contract file.

(h) (1) Nothing in this article limits the authority of the State Department of Education to make audits of direct service contracts. However, if independent audits arranged for by direct service contractors meet generally accepted auditing standards, the State Department of Education shall rely on those audits and any additional audit work shall build upon the work already done.

(2) Nothing in this article precludes the state from conducting, or contracting for the conduct of, contract performance audits which are not financial and compliance audits.

(3) Nothing in this article limits the state's responsibility or authority to enforce state law or regulations, procedures, or reporting requirements arising pursuant thereto.

Simply put, the law is clear the appellate court has spoken plainly and clearly. In the case of Golden Day Schools, Inc. v. Department of Education, (69 Cal.App.4th 69), the court stated;

"Section 8448, subdivision (1)(2) says the Department [CDE] is not prohibited from conducting contract performance audits "which are not financial and compliance audits". This suggests the only activity section 8448 precludes is a "financial and compliance audit," i.e., "a systematic review or appraisal" designed to determine if the organization's financial statements accurately reflect its overall financial position. (§ 8448, Subd. (a).)"

The court went further to explain,

"We will not presume that if the Department is given access to plaintiff's records it will use them to perform a financial and compliance audit". Id

In this case that is exactly what the SCO has done, performed a financial and compliance audit once they were given access to GDSI records.

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The California Appellate Court has decided this issue, the SCO cannot undermine a Financial and Compliance audit completed by an Independent Auditor, in accordance with generally accepted auditing standards. Golden Day's audits were completed by Steven A. Flores, CPA, in accordance with these standards. (see declaration of Steven A. Flores, CPA attached hereto.)

The audit conclusions and recommendations set forth in this draft audit report are illegal. They contradict and are inconsistent with and go against the plain language of the statute (sec. 8448) and the controlling interpreted law regarding this issue.

Not only is the SCO threatening GDSI with the nuclear bomb of total destruction but they are recommending that CDE disallow all cost expended by Golden Day Schools for all of its expenses, (\$16.2 million dollars), if GDSI does not make other non-related entities books and records available to the SCO to perform a second audit of GDSI. This is retaliation at its worst. The Government is saying with impunity we will destroy you if you do not give into our outrageous demands even when the plain and unambiguous language of the law say our actions are illegal.

GDSI believe the SCO know or should know their actions are specious if not illegal, however, they believe they are exempt from having to abide by the law. In this case they have misapplied inapplicable regulations, misquoted FT&C and been very disingenuous regarding their communication with GDSI and the Administrator, stating documents were not provided to them when the evidence speaks otherwise. This is egregious behavior at its worst. The SCO has conspired with CDE to carry out a mean-spirited scheme of retaliation in their collective attempt to destroy GDSI.

The position taken by the SCO regarding disallowing the GDSI cost for the specious reasons set forth in the Draft Audit Report is outrageous, and illegal, it shocks the conscious of fairness.

Education Code Section 8448 (a)(1) states:

(h) (1) "... if independent audits arranged for by direct service contractors meet generally accepted auditing standards, the State Department of Education shall rely on those audits and any additional audit work shall build upon the work already done."

The phrase, build upon work already done, in 8448 (h)(1) does not mean to perform a second financial and compliance audit or to do further audit work that will render Section 8448 (h) a nullity. This section states emphatically that the Department of Education Shall Rely on those audits if they were done in accordance with generally accepted auditing standards.

In the case of Michigan v. Bay Mills Indian Community, The Supreme Court noted, "This court does not revise legislation... just because the text as written creates an apparent anomaly as to some subject it does not address".

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In the case of; Utility Air Regulatory Group v. EPA, the court opined, "An agency has no power to tailor legislation to bureaucratic policy goals by rewriting unambiguous statutory terms".

Simply stated, the SCO should follow the law plain and simple.

TFSI, Spectrum Surveillance System, Natural Solutions and Pacific Books & Supplies are not related parties of Golden Day Schools, Inc. Neither GDSI nor the Administrator, Dr. Clark E. Parker, have authority to make the books and records of these corporations or any other corporation available to the SCO for audit. The GDSI's necessary and reasonable incurred cost that the SCO has stated they will recommend to be disallowed due to GDSI's failure to provide another corporation's entities books and records available to the SCO for their audit is an illegal action. GDSI does not have the authority to comply with this illegal request. These corporate entities are not related parties to GDSI. The Golden Day Schools, Independent outside auditor, Steven A. Flores CPA, has published three (3) certified and unqualified opinion audits stating all recorded costs and expenses set forth in his GDSI audits were incurred by Golden Day and they were properly charged to the GDSI CDE funded Child Development program for the year in which they were recorded.

8.2

Education Code Section 8448 (h) states the SCO as CDE's representative SHALL RELY on those audits because they were done in accordance with generally accepted auditing standards.

There are two matters that GDSI would like to address as they are set forth in the draft audit report are as follows:

In Finding 8 – Unsubstantiated auto Allowance – The Use allowance was for three vehicles used to distribute supplies, furniture, fixtures and food between the different child care locations. Since GDSI owned these vehicles they could only charge a use allowance. The GDSI auditor verified and certified that these cost were necessary and reasonable and allowable. See FT&C Section III (A) - Depreciation and Use Allowance. This section also states as follows:

8.1

"Taxes, insurance and maintenance may be claimed as part of actual allowable costs for buildings or building improvements related to the child development program and equipment necessary for the operation of the program."

All cost incurred regarding these items were reasonable and necessary and allowable. GDSI complied with all the rules governing the operation of its CDE funded Child Development Program. The SCO is attempting to make their regulation interpretation so as to render the Statute, Education Code Section 8448, a nullity.

The SCO's position in this matter is deeply problematic on many levels. First, the corporate entities that the SCO is requiring that GDSI produce their records have their rights not to be coerced by the government. The SCO is attempting to make it appear that GDSI is not operated as an independent public benefit corporation but rather as a puppet entity of the Administrator. They are wrong; GDSI has a functional Board of Directors and it employed hundreds of staff to carry out its scope of work and to assist it with fulfilling its

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corporate obligations. The liabilities of the corporation are not attributed to the Directors as long as the Directors of the corporation carry out their responsibilities as per its corporate charter, by-laws and perform and comply with all legal reporting requirements. GDSI is a federal tax exempt 501(c)(3) Corporation and as such it does not have stock holders. It is a California Public Benefit Corporation and it has benefited over 300,000 families and children since its inception almost 50 years ago, all within the greater Los Angeles County community.

As stated in Finding 3 GDSI believes the SCO should delete all references from the draft audit report that relates to the OAH case involving GDSI and the CDE that is now under appeal. It is prejudicial to quote any rulings from that case because the rulings from that case is under appeal and could be changed by the courts. Civil Code of Procedures Section 916 states all rulings under appeal are stayed pending the final ruling on the merits by the Appellate Court of the matter under appeal. The first hearing of the appeal of the ALJ's ruling in the matter will not be heard for several months in the Los Angeles Superior Court.

In Conclusion we reject the conclusions in these Findings 8, 9, 10, 11, and 12 and we urge CDE not to follow their recommendations.

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