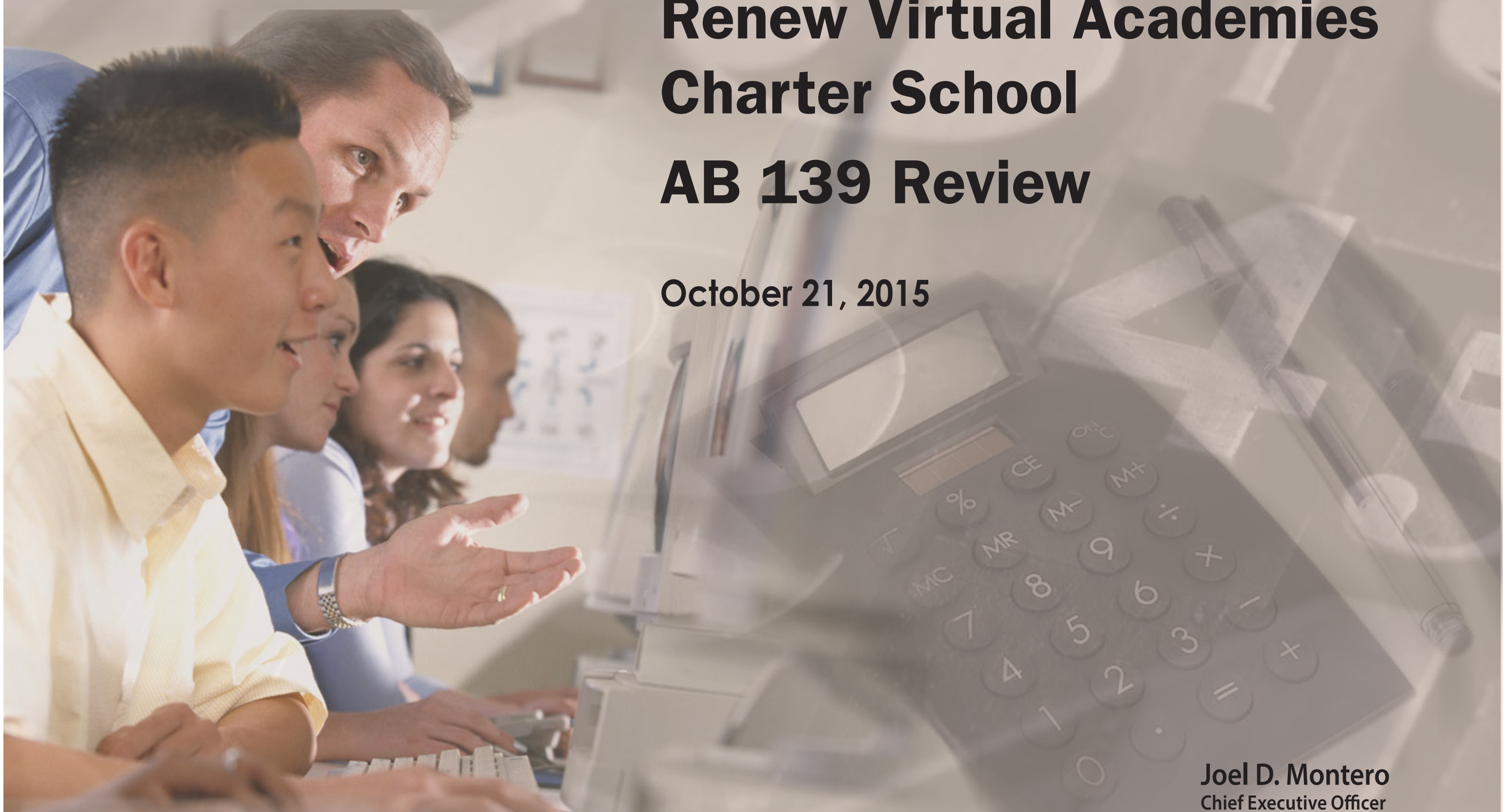
FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
CSIS California School Information Services

San Joaquin County Office of Education

Renew Virtual Academies Charter School

AB 139 Review

October 21, 2015



Joel D. Montero
Chief Executive Officer



October 21, 2015

James A. Mousalimas, Superintendent of Schools
San Joaquin County Office of Education
2901 Arch-Airport Road
Stockton, CA 95206

Dear Superintendent Mousalimas,

In April 2015, the San Joaquin County Office of Education and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement for an AB 139 review. Specifically, the agreement stated as follows:

The San Joaquin County Office of Education has requested that the team assign professionals to conduct an AB 139 extraordinary audit on behalf of the Renew Virtual Academies Charter School. Per Education Code Section 1241.5(c), the superintendent has reason to believe that fraud, misappropriation of funds, or other illegal practices may have occurred. The review of the charter will include but not be limited to the following:

The charter adopted a resolution in March 2015 voluntarily rescinding its charter due to financial insolvency. California law requires that closure procedures are stated through an agreement between the authorizing entity and charter school before the charter school begins operation in accordance with Education Code Sections 47604.32, 47605, 47605.6, 47607 and the California Code of Regulations, Title 5, Sections 11962 and 11962.1. These procedures must designate a responsible entity to conduct closure activities and identify how these activities will be funded. After the charter adopted its closure resolution, the superintendent of the authorizing agency, New Jerusalem School District, contacted the county office regarding allegations that the charter may have been involved with potential illegal or inappropriate activities.

Pursuant to Education Code Section 1241.5(b)(c), the county superintendent has reason to believe that fraud, misappropriation of funds or other illegal practices may have occurred and has requested a review of the Renew Virtual Academies Charter School conducting business as a California nonprofit organization. In addition to the authority granted under 1241.5(c) and 47604.3, the county superintendent may conduct an investigation of the charter school based on written complaints by parents or other information that justifies the review.

The primary focus of this review is to provide the county office with reasonable assurances, based on the testing performed, that adequate management, internal controls and closing procedures were in place for the reporting and monitoring of financial transactions. Specific review objectives will include the evaluation of policies, procedures, internal controls and transactions performed by the charter school.

Testing for this review will be based on sample selections; it will not include all transactions and records for this period. Sample testing and review results are intended to provide reasonable but not absolute assurance regarding the accuracy of the charter school's financial transactions, bank records and activity to accomplish the following:

1. Review internal controls to determine if policies were overridden by management during the fiscal year or the closing process.
2. Review the closing process to determine if state and federal regulations were followed and completed by the charter.
3. Provide assurance to the county office that the internal control system was sound.
4. Evaluate the charter's internal control structure, policies and procedures to test transactions and reporting processes to determine if adequate procedures were in place to safeguard assets, including physical objects, charter school data and intellectual property.
5. Evaluate the reliability and integrity of information used for internal management decisions and external agency reports including the closeout process.
6. Determine if authorization procedures were appropriate and consistently followed. Review administrator and manager approvals and whether signature authority was delegated only to authorized employees.
7. Determine whether proper segregation of duties existed. Evaluate personnel, payroll, accounts payable and cash transactions, including the following:
    a. Review the authorization process for cash receipts.
    b. Determine if protective measures were in place for safeguarding assets, processes and data.
8. Evaluation of Policies and Procedures:
    a. Review compliance with policies and procedures including, but not limited to, those related to human resources, finance, purchasing, granting agencies, and state and federal government.
    b. Review documents and records retention procedures to determine whether the charter provides reasonable assurance that asset records are safeguarded and transactions are correctly recorded.
    c. Determine whether the charter's petition and memorandum of understanding included policies and administrative regulations regarding conflicts of interest pursuant to Government Code Section 1090.

This final report contains the study team's findings and recommendations in the above areas of review. FCMAT appreciates the opportunity to serve the San Joaquin County Office of Education, and extends thanks to all the staff of the county office, New Jerusalem School District, and the Renew Virtual Academies Charter School for their assistance during fieldwork.

Sincerely,

Joel D. Montero
Chief Executive Officer

Table of Contents

About FCMAT

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

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

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

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

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

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

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

Introduction

In April 2015, the Fiscal Crisis and Management Assistance Team (FCMAT) received a request from the San Joaquin County Office of Education for an Assembly Bill (AB) 139 extraordinary audit of the Renew Virtual Academies K12#1 Charter School (RVA) authorized by the New Jerusalem School District on May 14, 2013. The county office received allegations of potential illegal or inappropriate activities at RVA. Concerned that these allegations may have violated various government and education codes related to fraud and/or misappropriation of assets, the county superintendent initiated an investigation to determine whether sufficient evidence of fraud, misappropriation of funds or other illegal activities may have occurred to report the matter to the local district attorney's office for further investigation.

Under the provisions of Education Code Section 1241.5(c) and 47604.4, FCMAT entered into a contract with the San Joaquin County Office of Education to conduct an AB 139 extraordinary audit, which provides for the assignment of professionals to study specific aspects of alleged fraud, misappropriation of funds or other illegal fiscal practices that may have occurred in the RVA that merit examination.

EC Section 42638(b) requires that when fraud or misappropriation of funds has occurred in a school district, the county superintendent shall notify the district board, state controller, superintendent of public instruction and district attorney. Although there is no such specific requirement with respect to charter schools, it would be sound practice, not prohibited by law, to give comparable notices in the event of fraud or misappropriation in a charter school.

Background

RVA was the first of what was intended by its founders to be an integrated trilogy of online learning strategies focused on delivering curriculum to at-risk and drop-out students in grades K-16 to meet high school graduation, college preparatory and advanced learning requirements. To accomplish this, the founder worked independently with legal counsel to establish three separate corporations (E-Trilogy) that included Renew Virtual Academies (RVA), Graduate Ready! Center and FJ Ringer Online University, each individual public benefit nonprofit corporations under section 501(c)(3) of the Internal Revenue Service code. Articles of Incorporation for the Renew Virtual Academies were filed by the founder with the California Secretary of State on January 23, 2013 and were stamped January 24, 2013.

The charter petition submitted to the district cited that RVA K12#1 charter school would be operated as a nonprofit public benefit corporation. The Memorandum of Understanding (MOU) ratified on October 14, 2014 specifically stated, "The Charter School has attained status as a nonprofit public benefit corporation." However, FCMAT was not provided any documentation that could substantiate that RVA actually obtained official authorization as a nonprofit 501(c)(3) organization, which is accomplished by filing IRS form 1023 and evidenced through an official IRS determination letter. Inquiries with RVA's founder/chief executive director (CED) revealed that the filing process with the IRS was not completed prior to her separation from RVA.

To set the E-Trilogy concept into motion between the months of January and December 2013 the founder/CED established a bank account with a federally insured banking institution as the sole signatory with a $30 deposit and submitted several charter school petitions to multiple potential authorizing LEAs. The table below identifies the timeline details for each of these petitions.

Charter Petition Timeline

Charter Petition	Proposed Authorizing LEA	Date Submitted	Date Revised	Date Approved	Date Withdrawn	Date Denied
RVA HS #1	Victor Valley USD	1/28/13	-	-	3/21/13	-
RVA HS #1	Victor Valley USD-Resubmitted	7/22/13	-	-	9/19/13	-
RVA MG #1	Victor Valley USD	1/28/13	-	-	3/21/13	-
RVA K12#1	New Jerusalem SD	4/4/13	5/9/13	5/14/13		-
RVA K12#3 *	New Jerusalem SD	9/13/13	-	-	**	-
RVA K12#2 *	New Jerusalem SD	12/13/13	-	-	**	-
RVA K12#2	West Placer County SD	9/13/13	-	-	10/9/13	-

Details of charter school petition submissions were provided by RVA founder/CED and were not confirmed or otherwise independently verified.

* RVA K12#3 was converted to RVA K12#2, switching from an independent to dependent WIA school.

** Exact dates for withdrawal were undeterminable, resubmission at a later date was intended.

The founder/CED submitted three charter school petitions to the New Jerusalem School District. The original charter school petition RVA K12#1 was submitted to the district on April 4, 2013. This petition was revised and resubmitted with edits on May 9, 2013, and was approved by the district governing board on May 14, 2013.

RVA K12#1 charter school was assigned State Charter School Number 1598 by the California Department of Education (CDE) on September 4, 2013 with an initial term of five years commencing July 1, 2014. The two remaining charter school petitions submitted to the district were ultimately withdrawn by the founder because agreeable terms of the petition were not reached by the two parties; however, the founder/CED stated it was intended to resubmit the petitions after the first charter school was sufficiently operational.

The founder/CED also applied with the CDE for the Public Charter School Grant Program (PCSGP) for four of the charter school petitions noted above, including RVA K12#1, RVA K12#2, RVA K12#3 and RVA HS#1.

The PCSGP application for RVA K12 #1 submitted to the CDE on November 26, 2013 was approved in January 2014 for $375,000, to be disbursed to the charter school over three years as follows:

Public Charter School Block Grant Disbursement Schedule

Description	2013-14 Planning Year	2014-15 Implementation Year 1	2015-16 Implementation Year 2
Books & Supplies	8,528	84,900	84,900
Services and Other Operating Expenditures	166,472	15,100	15,100
Total Amount Budgeted	$175,000	$100,000	$100,000

The three remaining applications were withdrawn by the founder/CED in October 2013.

In January 2014 RVA K12#1 conducted its first governing board meeting. No official approved minutes for this meeting were found by FCMAT through systematic review of board minutes; however, the following significant action items were on the agenda provided:

- Three individuals were appointed to the RVA governing board: a licensed certified public accountant, a licensed attorney and a representative of the authorizing district as required by the approved charter petition; this board member works directly for the district as an administrator overseeing both dependent and direct funded charter schools authorized by the district.
- Corporate officers were appointed with the founder/CED as president; director, instructional technology (son of the founder) as secretary and a board member as treasurer pro tem.
- An overview of actions taken by the founder/CED prior to the first board meeting, including those related to grant and loan applications, and ratification of those acts.
- Authorization to apply for tax exempt status.

In February 2014, the founder/CED submitted an application to the California School Finance Authority for the 2013-14 Charter School Revolving Loan Fund Program, requesting the maximum loan of $250,000 with a repayment term of five years. The charter school was granted the loan, receiving notification in June 2014 and funding July 1, 2014.

As the start of the first operational fiscal year approached, the pace and level of initial enrollment for RVA fell short of expectations. In August 2014, the county office and the district raised concerns regarding RVA's enrollment assumptions after the submission of the Pupil Estimates for New or Significantly Expanding Charters (PENSEC) data. The PENSEC report is used to determine advance state apportionment funding for new charter schools. Enrollment projections presented in the charter petition were estimated at 200 students for the 2014-15 fiscal year. However, RVA's PENSEC data submissions to the CDE estimated reduced enrollment figures for October 2014 of 150 and current enrollment of only 45. This would require the charter school to enroll 105 additional students over the subsequent two months to meet the new enrollment estimates. PENSEC data is used to provide advance apportionment funding to a new charter school; however, if the student enrollment projected fails to come to fruition, the charter school must repay the excess funding. Ultimately RVA was able to address the concerns raised by the county office and the district.

In December 2014, six months into the first operational fiscal year of the charter school and almost 20 months after authorization of the charter school petition, the district demonstrated greater fiscal interaction with RVA when it questioned the budget assumptions presented in RVA's First Interim Financial Report. Questions arose regarding RVA's ability to comply with the requirements of Senate Bill (SB) 740, nonclassroom based instruction and funding determination. This particular concern was ultimately mitigated by RVA as a misclassification of expenditures reported on its 2014-15 Nonclassroom-Based Funding Determination form submitted to the CDE, which was acknowledged by the charter school's back office provider and revised. However, after revisions were identified, questions still existed regarding the 2014-15 First Interim Financial Report.

In January 2015 the district had additional questions regarding RVA's fiscal condition as a result of lower than expected enrollment, and administrative staffing and salaries became the focus of potential expenditure reductions. Through this process the position of deputy executive director, business services (initially the director of instructional technology, but subsequently changed through board action) became the focus of potential elimination. The RVA founder/CED expressed her concerns about eliminating the position and stated that her reluctance was not because it was staffed by her son, but because the position was her primary support for instructional technology and marketing, the foundation on which online learning is built. Allegations soon followed by the district and its appointed RVA governing board member that it was not known that RVA's deputy executive director, business services was the son of the RVA founder/CED.

The founder/CED and the deputy executive director, business services were both released from their positions with the RVA charter school through board action in January 2015. This was immediately followed by the appointment of RVA's deputy executive director of student services as interim superintendent.

On February 11, 2015 the district informed the RVA governing board of its intention to conduct a thorough audit and review of RVA based on concerns of financial mismanagement, potential embezzlement of public funds, violations of conflict of interest laws, failure to follow applicable education code, failure to follow state regulations and failure to follow the charter as written. The notice further stated that if the investigation confirmed these concerns the district would proceed with revocation procedures. On February 23, 2015 the district contacted the CDE charter schools division expressing concerns over "severe financial irregularities" and to discuss possible revocation of the charter petition.

The RVA charter school governing board adopted a resolution on March 7, 2015, voluntarily rescinding its charter due to financial insolvency.

Study Guidelines

FCMAT provides a variety of services to school districts and county offices of education on request. Education Code Section 1241.5(b)(c) permits a county superintendent of schools to review or audit the expenditures and internal controls of any school district or charter school in that county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. According to the Education Code, the review or audit conducted by the county superintendent will focus on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and is to be conducted in a timely and efficient manner.

Therefore, FCMAT focused on the allegations of conflict of interest, poor internal controls, and inadequate closing procedures to determine whether Renew Virtual Academies Charter School and/or its personnel were involved in or committed fraudulent activities.

In writing its reports, FCMAT uses the Associated Press Stylebook, a comprehensive guide to usage and accepted style that emphasizes conciseness and clarity. In addition, this guide emphasizes plan language, discourages the use of jargon and capitalizes relatively few terms.

Study Team

The FCMAT study team was composed of the following members:

Marisa Ploog, CPA, CFE, CICA, CGMA
FCMAT Fiscal Intervention Specialist
Bakersfield, California

Michael W. Ammermon, CPA, CFE, DABFA
FCMAT Consultant
Laguna Niguel, California

Pam Viar
FCMAT Consultant
Sanger, California

Ellen Bolding
FCMAT Consultant
Petaluma, California

Laura Haywood
FCMAT Technical Writer
Bakersfield, California

Audit Fieldwork

Investigating allegations of fraud requires a number of steps that include interviewing potential witnesses and assembling evidence from internal and external sources. FCMAT met with key staff from the county office, the authorizing district and the charter school during the months of June, July and August 2015 to conduct interviews, collect data and review documents.

FCMAT reviewed, analyzed and tested business records including cash receipts, deposit history, disbursement history, general ledger activity, grant documents, financial reports, board policy, board minutes, charter petitions, memorandum of understanding and other documents including documentation of communications from various parties including independent third party sources.

The review also included interviews with RVA board members; the founder/former CED; former deputy executive director, business services; management personnel; business office staff; former charter school employees; district staff members, Charter School Management Corporation (CSMC) staff and the CDE to evaluate information concerning any alleged conflict of interest, mismanagement, fraud, or abuse. The team also visited the former RVA office located in Stockton, where assets including furniture and equipment acquired using grant and state apportionment funding were being retained.

FCMAT conducted preliminary meetings with the county office and the district to obtain an understanding of specific allegations including identifiable events, questionable transactions and other matters that raised the concern that fraud, misappropriation of funds or other illegal acts by RVA may have occurred. The specific concerns shared with FCMAT by the authorizing LEA were focused solely on nepotistic relationships within RVA including the founder/CED; deputy executive director, business services; and two other contracted consultants, one of which is the daughter-in-law of the founder and the wife of the deputy executive director, business services and the other of which is the sister of the founder. While nepotism and conflicts of interest were the primary allegations against RVA, FCMAT's fieldwork focused on determining whether there is sufficient information to ascertain fraud, misappropriation of funds, or conflict of interest, particularly with related-party transactions. Through this process FCMAT also took into account the internal control environment and established policies and procedures of RVA, the composition and the approval process of the charter school petition and MOU, and fiscal oversight procedures of the New Jerusalem School District.

Although there are many different types of fraud, a conflict of interest exists when officers or employees of the organization have a personal financial interest in a contract or transaction and is considered to be a form of misappropriation of assets.

All fraud has common elements including the following:

- Knowingly making an untrue representation or a false claim of a material fact;
- Intent to deceive, or concealment of the act;
- Reliance on untrue information; and
- Damages or a loss of money or property.

This report is the result of FCMAT's investigation and is divided into the following sections:

- Introduction
  - Background
  - Study Guidelines
  - Study Team
  - Audit Fieldwork
  - Scope and Procedures
- Findings and Recommendations
  - Internal Controls
  - Substantive Testing
  - Conflicts of Interest
  - Charter School Authorization and Oversight Procedures
  - AB 139 Extraordinary Audit Report Summary
- Appendices

Scope and Procedures

The primary focus of this review is to provide the San Joaquin County Office of Education sufficient information, based on the auditing performed that it may conclude with reasonable assurance whether fraud, misappropriation of funds or other illegal fiscal practices have occurred. Management controls include the processes for planning, organizing, directing, and controlling program operations, including systems for measuring, reporting, and monitoring performance.

Fraud investigations consist of gathering adequate information about specific allegations and performing audit test procedures to determine whether fraud may have occurred; evaluating the associated loss; determining who was involved and how it may have occurred. FCMAT conducted interviews and examined other data and contracts to determine if fraud, misappropriation of funds or other illegal activities may have occurred.

During the interviews, FCMAT's study team used open-ended questions designed to elicit information about other possible irregularities related to the scope of work. Team members asked questions pertaining to financial management practices; policies and procedures; job responsibilities; cash handling; purchasing and expenditure practices; transaction authorization; cash deposit practices; relationships and related parties within and external to RVA; conflicts of interest; RVA charter school governing board practices; district fiscal oversight practices; and other questions related specifically to the roles, duties and activities of the RVA founder/former CED and her son, the former deputy executive director, business services.

FCMAT also performed substantive testing procedures for all financial transactions identifiable during the period February 13, 2013 through July 31, 2015. Testing associated with this review is based on identifiable transactions recorded in the bank statements from the date the account was open through July 31, 2015. Review results are intended to provide reasonable but not absolute assurance as to the accuracy of the charter school's transactions and financial activity.

FCMAT did not audit or otherwise review for accuracy the financial content of RVA's budgets, financial reports, enrollment and ADA projections or other submissions during this review, as those procedures extend beyond the scope of this engagement; therefore, no validation as to their accuracy is provided in this report.

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

Transaction Testing

FCMAT obtained reports and exported financial data from the accounting software of RVA's back office service provider, Charter School Management Company (CSMC) for the period July 1, 2014 through March 24, 2015. RVA, the district, and the county office provided additional financial and transaction documentation including copied computer data containing financial information, board minutes, and other written communications.

Specifically, FCMAT performed audit procedures that include the following:

- Review the charter school's petition documents, MOU, articles of incorporation and bylaws.
- Review the governing board minutes.
- Review the charter school's fiscal policies and procedures.
- Review the charter school's Employee Handbook.

- Obtain an understanding of the charter school's internal control structure and established policy, administrative regulations, operational processes and procedures. Evaluate each to identify potential weaknesses subjecting the charter school to a higher level of risk that fraud, misappropriation of funds or other assets and/or criminal activity would not be prevented or would go undetected.
- Review the charter school's detailed accounting general ledger records from July 1, 2014 through July 31, 2015.
- Review bank statements January 2013 (account opening) through July 31, 2015.
- Reconstruct a record of all transactions presented in bank statements from January 2013 through July 31, 2015 and reconciled to the July 31, 2015 recorded bank balance.
- Review available documentation for each deposit and disbursement transaction from January 2013 through June 10, 2015, testing for authorization and appropriate supporting documentation.
- Test transactions for compliance with established internal controls noted above.
- Analyze purchases, disbursements, payroll, and contract agreements.
- Analyze the charter school's compliance with laws and regulations relating to conflict of interest and the Political Reform Act and review of Forms 700.
- Review the district's oversight procedures.

Bank statements, general ledger reports, and check registers were utilized to review financial transactions. Each transaction was identified within the bank statements and, where applicable, traced to the general ledger. Receipts, check copies and other supporting documentation were reviewed for each transaction, when available. Payroll transactions (both electronic and issued by check) were also reviewed. The payroll registers submitted by CSMC were verified to bank statements.

FCMAT did not audit the financial statements of RVA, transactions related to payroll, enrollment and/or attendance data submissions; nor did the team evaluate RVA's compliance with program, grant or other funding sources.

The following findings and recommendations are the result of the audit procedures and analysis performed.

Findings and Recommendations

Internal Controls

Internal controls are the principal mechanism for preventing and/or deterring fraud or illegal acts. Illegal acts, misappropriation of assets or other fraudulent activities can include an array of irregularities characterized by intentional deception and misrepresentation of material facts. Effective internal control processes provide reasonable assurance that a charter school's operations are effective and efficient, that the financial information produced is reliable, and that the organization operates in compliance with all applicable laws and regulations.

Internal control elements provide the framework for an effective fraud prevention program. An effective internal control structure includes the policies and procedures used by staff, adequate accounting and information systems, the work environment and the professionalism of employees. An effective internal control structure includes the five interrelated components of the control environment, fraud risk assessment, control activities, information and communication, and monitoring.

Internal Control Components

Control Environment	Commonly referred to as the moral tone of the organization, the control environment includes a code of ethical conduct; policies for ethics, hiring and promotion guidelines; proper assignment of authority and responsibility; oversight by management, the board or an audit committee; investigation of reported concerns; and effective disciplinary action for violations.
Fraud Risk Assessment	Identification and assessment of organization's objectives to establish and develop a strategy to react timely.
Control Activities	The development of policies and procedures to enforce the governing board's directives. These include the actions by management to prevent and identify misuse of the LEA's assets, including the prevention of override of controls in the system by any employee.
Information and Communication	The establishment of effective fraud communication. This includes ensuring that employees receive information regarding policies and opportunities to discuss ethical dilemmas. Establishing clear lines of communication in an organization to report suspected violations.
Monitoring	Ongoing monitoring that includes periodic performance assessments for fraud deterrence by managers and employees.

The following is a partial list of deficiencies and omissions that can cause internal control failures:

- Failure to adequately segregate duties and responsibilities related to authorization.
- Failure to limit access to assets or sensitive data (e.g., cash, fixed assets, personnel records).
- Failure to record transactions, resulting in lack of accountability and the possibility of theft.
- Failure to reconcile assets with the correct records.
- Unauthorized transactions, resulting in skimming, embezzlement or larceny.
- Lack of monitoring or implementation of internal controls by the governing board and management or by unqualified personnel.
- Collusion among employees where little or no supervision exists.
- Use of debit cards by multiple employees.

- Allowing cash withdrawals.
- Failure to prepare minutes of governing board meetings that include sufficient detail to reflect the full intent of the board.

A system of internal controls consists of policies and procedures designed to provide the governing board and management with reasonable assurance that the organization achieves its objectives and goals. Traditionally referred to as *hard* controls, these include segregation of duties, limiting access to cash, management review and approval, and reconciliations. Other types of internal controls include *soft* controls such as management tone, performance evaluations, training programs, and maintaining established policies, procedures and standards of conduct. Established controls must also be implemented and monitored to ensure their effectiveness.

Although RVA was aware of what sound fiscal policies and procedures meant from a conceptual perspective, the RVA charter school failed to establish and implement sound fiscal policies and procedures, which was apparent to FCMAT during its review of the transactions conducted by RVA between the months of February 2013 and June 2014. The transactions conducted during this time frame were not accounted for in any form of accounting software, were not summarized in a financial reporting format consistent with industry standards, were not presented to or reviewed by the authorizing district, and were not audited. Additionally, RVA did not have established policies documenting procedures for purchases and expenditures.

Control Environment

The internal control environment is critical because it establishes the moral tone of the organization. Though intangible, it begins with the leadership and consists of employees' perception of the ethical conduct displayed by the governing board and executive management.

The control environment is a prerequisite that enables other components of internal control to be effective in achieving the goals and objectives necessary to prevent and/or deter fraud or illegal acts. It sets the tone for the organization, provides discipline and control, and includes factors such as integrity, ethical values and employee competence. The control environment can be weakened significantly by a lack of experience in financial management and internal controls.

Control Activities

Control activities are a fundamental element of internal controls, and are a direct result of policies and procedures designed to prevent and identify misuse of a charter school's assets, including preventing any employee from overriding controls in the system. Control activities include the following:

1. Performance reviews, which compare actual data with expectations. In accounting and business offices, this most often occurs when budgeted amounts are compared with actual expenditures to identify variances and followed up with budget transfers to prevent overspending.

2. Information processing, which includes the approvals, authorizations, verifications and reconciliations necessary to ensure that transactions are valid, complete and accurate.

3. Physical controls, which are the processes and procedures designed to safeguard and secure assets and records.

4. Segregation of duties, which consists of processes and procedures that ensure that no employee or group is placed in a position to be able to commit and conceal errors or fraud in the normal course of duties. In general, segregation of duties includes separating the custody of assets, the authorization or approval of transactions affecting those assets, the recording or reporting of related transactions, and the execution of the transactions. Adequate segregation of duties reduces the likelihood that errors will remain undetected by providing for separate processing by different individuals at various stages of a transaction and for independent review of the work.

The study team found that the RVA founder/CED did not understand foundational elements of fiscal management including, but not limited to, internal controls and segregation of duties, budget development and revision, financial accounting and reporting, cost controls based on variable factors such as enrollment and average daily attendance projections, cash flow, and multiyear financial projections. Additionally, RVA board minutes lacked detail, at times making the board's full intentions unclear.

A strong system of internal controls that consists of all five elements can provide reasonable but not absolute assurance that the organization will succeed in achieving its goals and objectives. The failure to establish adequate internal controls limiting the ability of the founder/CED and family members to access assets coupled with a lack of accountability to the governing board created an environment for gross financial negligence to occur.

Substantive Testing

FCMAT conducted interviews with management personnel, business office and other charter school staff to obtain information on general business practices and the events that occurred during the course of RVA's operations, including any alleged mismanagement, fraud or abuse.

Although there are many different types of fraud, occupational fraud is common when employees are in positions of trust and have access to assets. Embezzlement occurs when someone who is lawfully entrusted with property takes it for his or her personal use. Common elements in all fraud include the following:

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

A well-structured process for purchasing activities begins with a requisition, which is used to initiate each purchase request. Once approved the requisition is used to create a purchase order that encumbers the identified budget and formally authorizes the purchase. Ideally an electronic financial system is used that includes an integrated purchasing module that facilitates an efficient process of electronic routing for appropriate approvals. While a system of manual requisitions and purchase orders can be used in the absence of an automated financial system, essential tracking of approved purchase orders and available budget balances for fiscal management becomes extremely challenging when managed this way.

All purchases should be encumbered using a purchase order prepared in advance of each vendor transaction, even those where an employee will use their personal funds and submit for reimbursement and routine operating expenses such as lease payments and utilities. Open purchase orders can be created for vendors where multiple purchases are expected throughout the year, but should be closely monitored. Contracts and agreements should be reconsidered and reviewed annually prior to renewal.

Purchase orders are forwarded to the vendor or an order can be placed online referencing the purchase order number. When items are received a receipt or packing slip is retained and matched to the vendor invoice. The invoice is verified to the receipt or packing slip prior to payment. RVA's invoices should have been forwarded to CSMC.

The use of credit cards is common practice in business and may be necessary when vendors do not accept purchase orders or an online purchase is required. Debit cards are also a convenient way to make purchases; however, they carry risks that credit cards do not. Protections offered for debit cards are fewer, and fraudulent activity could cost more with debit card use. Cash flow is more challenging to monitor when multiple employees use debit cards. FCMAT observed numerous instances where RVA staff used debit cards for purchases. Additionally, FCMAT was unable to identify the existence of documented policy or operational procedures for debit card use by RVA staff.

RVA did not have documented policies and procedures for procurement. FCMAT did find procedures for expenditures in RVA's employee handbook, which was approved by the governing board in October 2014; no documentation showed that employees were provided and read the employee handbook. The procedures outlined in the employee handbook state the following:

> "All expenditures of school funds must receive prior and final approval by the CED. To order supplies, a purchase requisition must be completed listing item description, quantities, cost, tax, and complete vendor information including address, phone, and fax. All completed purchase requisitions must be e-mailed to the CED for approval."
> "Prior written approval must be obtained first by the CED when purchasing anything without a requisition. All prior approval requests must be made in writing on the Reimbursement Request form (Appendix H) with an itemization of how much will be spent, vendor information, and an explanation why the purchase cannot be made with a standard requisition. All approvals must be signed by the CED authorizing the purchase and then turned into the Administration Office. Once the reimbursement request is approved, the employee can purchase items. Include the reimbursement authorization form and original receipts when requesting reimbursement. If a credit card was used for purchase you must include a copy of your credit card statement. Failure to obtain prior approval will result in non-reimbursement of personal funds used for purchase."

The charter school did not follow the instructions in the employee handbook and did not use a formal purchasing process including the use of purchase requisitions and purchase orders for advance approval of transactions, which are necessary for purchasing, spending and budgetary controls. FCMAT observed the use of debit cards for numerous high-dollar transactions for multiple types of purchases including cash withdrawal. Many transactions reviewed lacked appropriate supporting documentation including receipts. FCMAT observed many instances where employees using personal funds for purchases were reimbursed without documented advance authorization. Some of these purchases were not supported by receipts. FCMAT found that most expenditure transactions reviewed did not have documentation of prior approval.

Adequate internal accounting procedures must be implemented to segregate job assignments and protect the LEA's assets. No single employee should handle a transaction from initiation to reconciliation and no single employee should have custody of an asset, such as cash, and maintain the records of its transactions and activity. RVA did not properly segregate duties to establish proper internal controls. While RVA engaged a back office provider for vendor payments and financial accounting, RVA staff continued to write manual checks and frequently used debit cards for purchases. RVA did not have control of assets.

FCMAT reviewed bank statements from February 2013 through July 2015. The team identified 868 transactions, and 19 voided or otherwise skipped sequential transactions that did not result in expenditure. FCMAT identified 151 transactions for the review period that lacked supporting documentation; of these transactions the following were questionable in nature and could not be verified by FCMAT:

Questionable Expenditures Lacking Backup Documentation

Transaction Date	Check # Other	Received From / Payee	Amount	Description	Comments
5/24/14	2018	Ellen Ringer	$ 3,000.00	Per Founder/CED - Incorporation Costs, CSMC shows Travel Reimb	No documentation
5/24/14	2020	Chris Walenta	$ 634.49	Computer Warranty, Printer, Equipment Reimbursement	No documentation
7/1/14	2039	Chris Walenta	$ 401.63	Reimbursement - Supplies and Outreach	No documentation
7/3/14	2042	Chris Walenta	$ 863.73	Reimbursement	No documentation
7/15/14	100002	Stephanie Lytle	$ 1,862.00	In part - COBRA Insurance Reimbursement	No board approval for $1573.51 Cobra
7/18/14	00100012	Christopher Walenta	$ 903.10	In part - COBRA Insurance Reimbursement	No board approval for $763.31 Cobra
7/31/14	50001	Christopher Walenta	$ 652.00	Employee Advance	No repayment identifiable through review of payroll records & deposits
9/30/14	00100098	Stephanie Lytle	$ 437.13	Health & Welfare Benefits	Non-signed Reimbursement Form / missing receipts
9/30/14	00100099	Ellen Ringer	$ 640.47	Health & Welfare Benefits	Non-signed Reimbursement Form / missing receipts
9/30/14	00100100	Christopher Walenta	$ 2,534.79	Health & Welfare Benefits	Non-signed Reimbursement Form / missing receipts
11/18/14	00100164	Stephanie Lytle	$ 437.13	Worker Compensation Insurance	No documentation
11/18/14	00100166	Christopher Walenta	$ 639.79	Worker Compensation Insurance	No documentation
11/24/14	00100174	Ellen Ringer	$ 8,512.72	Reimbursement - Legal Services and Audit	No documentation
12/18/14	EFT	Ellen Ringer-Payroll	$ 900.00	Stipend	No evidence of board approval, not in contract, & no backup
12/18/14	EFT	Chris Walenta-Payroll	$ 900.00	Stipend	No evidence of board approval, not in contract, & no backup
12/18/14	EFT	Stephanie Lytle-Payroll	$ 900.00	Stipend	No evidence of board approval, not in contract, & no backup

FCMAT identified the following weaknesses in policy/procedures:

- No documented policies/procedures for purchasing were noted other than those in the employee handbook, which went to the board on 10/15/14. FCMAT could not confirm board approval of the handbook or if it had been distributed to and discussed with all employees.
- Procedures in the employee handbook were not followed, no purchase requisitions noted, only 11 purchase orders found, and no documentation of approval prior to expenditures.
- No policy addressing the use of debit cards, thus allowing cash withdrawal of funds and large expenditures without prior approval or board oversight.
- No documentation supporting management's communication of policies or procedures to staff.

- Submission of receipts, invoices and other supporting documentation of expenditure was not required for all transactions and no evidence was present indicating that this issue was addressed for debit card purchases.
- Reimbursements to staff were made without advance approval and/or receipts.
- RVA submitted spreadsheets listing debit card purchases and manual checks issued for expenditures to the back office provider as supporting documentation for each transaction for data entry in the accounting system. These lists did not include timely acknowledgment and receipts for transactions or applicable accurate expenditure account coding.
- Invoices were not required from professional consultants for payment.

FCMAT identified the following weaknesses in segregation of duties:

- Single signature required on checks.
- Single approver for all expenditures and most contracts.
- Same person approving expenditures (when it happened) also writing checks.
- Manual checks and debit transactions continued after CSMC was hired, thus bypassing financial processes and controls.

FCMAT identified the following weaknesses in purchasing practices:

- No established system for purchasing controls including the use of purchase requisitions and/or purchase orders.
- No purchase orders showing items ordered, made it difficult to determine what was purchased based on online invoices, which only showed item numbers without descriptions.
- No documentation of advance approval of expenditure transactions.
- No governing board approval/ratification of purchase orders or vendor payments.
- Purchases made using the name and address of the founder/CED, not RVA.
- Use of debit card without pre-approval or controls.
- Large dollar purchases on debit card (22 purchases between $1,000 - $4,999, four purchases between $5,000 - $9,999 and five purchases over $10,000).
- Absence of tax reporting (FCMAT could not confirm that RVA prepared and filed tax returns or issued 1099s before engaging a back office provider in July 2014).

FCMAT did not audit RVA's payroll records. FCMAT conducted a limited review of payroll records in conjunction with sample tests performed on manual checks drawn by RVA for payments to employees for extra hours/work over contract. FCMAT evaluated the accuracy of hourly rates used to calculate payments to employees based on approved contracted salaries of those reviewed.

FCMAT identified the following weaknesses in payroll practices:

- Two processes for payroll were used simultaneously: back office provider and manual checks written and signed by the founder/CED.
- Payments using manual checks lacked proper supporting documentation.
- Payments made to management employees for stipends lacked proper supporting documentation.
- Required federal Forms W2 were not issued.

FCMAT identified the following weaknesses in accounting practices:

- No accounting system/general ledger recording prior to July 1, 2014.
- No preparation of bank reconciliations until July 2014 and then not reconciled consistently.
- Bank reconciliations not reviewed by management.
- Receipts for expenditures made directly by RVA not forwarded to the back office provider in a timely manner for recording in the financial system.
- No routine comparison of budget to actuals was found.
- No reports to the governing board of financial status were found.
- No management of cash flow was found.
- No debt service plan was evident and revenue was not set aside to repay loans secured by RVA. (As of 3/20/15 California School Finance Authority was owed $200,002 and as of 4/27/15 Charter Asset Management was owed $91,950.)

Conflicts of Interest

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

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

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

No appellate court has ruled that charter schools are exempt from the provisions of Government Code Section 1090. Many authorizing agencies require compliance with that statute in the approved charter petition or MOU. Appendix E of the authorized petition incorporated a draft conflicts of interest policy that included two additional exhibits: Exhibit A, Designated Reporters, and Exhibit B, Disclosure Categories. The RVA disclosure categories are specific to reporting interests in real property and investments and do not include language prohibiting the hiring of family members in the charter school.

Political Reform Act – Disclosure, Conflicts of Interest and Enforcement

The Political Reform Act (PRA), Government Code Sections 81000 - 91014, was enacted by Proposition 9 in June 1974. The stated intent of the act was to establish a process for most state and local officials as well as certain designated employees to publicly disclose their personal income and assets as follows:

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

The PRA provisions are enforced by the Fair Political Practices Commission and require every state and local governmental agency to adopt a conflict-of-interest code. The commission is the state agency responsible for interpreting the provisions of the law and issuing California Form 700 – Statement of Economic Interests. Because charter school governing board members are considered public officials and governing boards are considered legislative bodies, board members and certain designated individuals must file Form 700 annually, or upon taking office/position. Generally, Form 700 must be filed by April 1 for the calendar year, and most filers file within 30 days of assuming or leaving office unless an exception applies.

A consultant to the organization "who makes, participates in making, or acts in a staff capacity for making governmental decisions" may be required to complete Form 700 if this provision is designated in the organization's conflict of interest code.

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

1. Is the individual a public official?
2. Is the public official making, participating in making, or influencing a governmental decision?
3. Does the public official have one of the six qualifying types of economic interests?
4. Is the economic interest directly or indirectly involved in the governmental decision?
5. Will the governmental decision have a material financial effect on the public official's economic interests?
6. Is it reasonably foreseeable that the economic interest will be materially affected?
7. Is the potential effect of the governmental decision on the public official's economic interests distinguishable from its effect on the general public?
8. Despite a disqualifying conflict of interest, is the public official's participation legally required?

Although nepotism is not illegal in California, it can raise issues about fairness and possible conflicts of interest. Hiring of family members often is considered favoritism because it is viewed as unfair and may bring to mind concepts such as cronyism. Hiring of dependents has a direct effect on the income of the person making or recommending the hiring decision, in contravention of conflict statutes and policies. There are laws and policies in the public sector that prohibit nepotism; however, those laws and policies often deal with human resources and procurement such as awarding of contracts. In local governmental agencies such as school districts and charter schools, board policies and administrative regulations may have been established addressing the hiring of family members; however, most of those policies allow a family member to work for the organization but prohibit family members from serving on the interview panel of a family member, directly supervising a family member or working in the same line of supervision as a family member.

The PRA and Government Code Sections 1090 and 87100 do not prohibit the hiring of family members in a charter school. Conflicts of interest are primarily related to conflicts that arise from influencing and being a party to business interests, contracts, loans, and other economic interests. Unless the RVA governing board adopted its own policy for nepotism or the district as a condition for approving the RVA charter petition required that family members not work in the charter school together, hiring of family members is not prohibited.

FCMAT was not provided and was unable to find any policy established by the RVA governing board or language in the RVA K12#1 charter petition or MOU related to hiring of family members. The final approved RVA K12#1 charter petition at page 115 states,

> "The Charter School has adopted a conflicts code which complies with the Political Reform Act, Corporations Code of Conflicts of Interest rules, and which shall be updated with any charter school specific conflicts of interest laws or regulations. As noted above, this Conflicts Code is attached within Appendix E. As required, the Conflicts Code will be submitted to the County Board of Supervisors for approval."

A comprehensive conflicts of interest code that adopts the Political Reform Act of 1974, California Government Code Section 87100, et seq., and designates those who must report conflicts of interest in Form 700, including consultants, was included in RVA's final K12#1 charter petition, Appendix E. The RVA conflicts of interest code also states,

> "Each Designated Reporter shall file a Form 700 Statement of Economic Interest at the time and manner prescribed by California Code of Regulations, Title 2, Section 18730, disclosing his/her financial interests as assigned in Exhibit A."

The RVA charter petition's conflict of interest code Exhibit A, at Designated Reporters, states that the board of directors, founder/chief executive director, assistant superintendent, educational services, director of instructional technology, principal and consultants must file Form 700. The RVA conflict of interest code disclosure categories are referenced in the RVA charter petition's conflict of interest code Exhibit B, and are specific to reporting interests in real property and investments but do not prohibit the hiring of family members in the charter school.

A Memorandum of Understanding (MOU) originally drafted by RVA was ratified by the district on October 14, 2014 and was signed both by RVA and the district in November 2014. Recitals section D of the MOU states,

> "By approving the RVA-K12#1 charter petition ('Charter') on May 14, 2013, the District became the sponsoring district of the Charter School. This Agreement is intended to outline the parties' agreements governing their respective fiscal and admin-

> istrative responsibilities and their legal relationship and other matters of mutual interest not otherwise addressed or resolved in the terms of the School's Charter." (Emphasis added)

The RVA K12#1 charter school petition approved May 14, 2013 included a limited draft conflicts of interest policy, while the MOU was silent on this matter. The RVA draft conflict of interest code in its charter petition and the November 2014 MOU are both silent as to prohibiting family and other related party employment or consultant contracts of RVA and also fail to especially prohibit any activities regarding those relationships. Without any specific references in the approved RVA K12#1 charter petition or MOU to related parties and family type relationships by either RVA or the district, such relationships are allowable and are subject to best business practices and the oversight of the RVA governing board and RVA's external independent auditors.

The RVA K12#1 charter petition at page 115 states,

> "The Charter School has adopted a conflicts code… As required, the Conflicts Code <u>will be submitted to the County Board of Supervisors</u> for approval." (Emphasis added)

However, FCMAT confirmed that RVA did not submit its conflicts of interest code to the County Board of Supervisors for approval. Additionally, no documentation was provided to FCMAT demonstrating that the district, responsible for oversight of RVA, followed up and requested confirmation from RVA that the RVA conflicts of interest code was submitted to and approved by the County Board of Supervisors. Even though the conflicts of interest policy described in the RVA K12#1 charter petition may not have been submitted and approved by the County Board of Supervisors, FCMAT considers the charter petition conflicts of interest code to represent RVA's conflicts of interest policy.

Based on the documents provided to FCMAT, only the four RVA governing board members and replacement executive director/superintendent have filed Form 700 in February 2015 covering the annual period of January 1, 2014 through December 31, 2014. No Form 700s were available for any RVA board members, officers, employees or consultants prior to that filing or subsequent indicating the date they left office. FCMAT was not provided any Form 700 for the former RVA founder/CED or her son, the director, information technology/deputy executive director, business services.

Of the available RVA Form 700s examined by FCMAT, no Form 700s completed by RVA board members and the replacement superintendent included any declaration of financial interest in the schools' affairs or disclosed any conflict of interest that would result in personal financial gain.

The former RVA founder/CED and her son were paid as independent contractors/consultants from January 2014 through June 30, 2014, which was prior to the first operational year of the charter school that began on July 1, 2014. The former RVA founder/CED and her son were added as employees to RVA's payroll administered by CSMC as of July 1, 2014; however, employment agreements were not executed until December 2014. The founder/CED's position in the employment agreement remained as CED, while her son's position was titled deputy executive director, business services.

Form 700 instructions state a consultant to the organization "who makes, participates in making, or acts in a staff capacity for making governmental decisions" may be required to complete Form 700 if this provision is designated in the organization's conflict of interest code. Interviews with these staff members indicate they did not submit these forms.

The RVA K12#1 charter petition conflicts of interest code identifies consultants as parties required to file Form 700 unless there is a written exclusion specific to the consultant. FCMAT was not provided any documents that excluded consultants from filing Form 700. The RVA founder/CED and her son were both consultants acting in staff capacity for making governmental decisions and should have filed Form 700 for calendar year 2014.

Facts mitigating the allegation of conflicts of interest of the RVA founder/CED and her son, the RVA information technology director/deputy executive director, business services include:

- The RVA founder/CED and her son do not have the same last name, which a few individuals indicated led them to believe the two were not related. However, FCMAT's interview of management and staff of RVA, the district, the county office, RVA board members and others external to these entities indicated there were both individuals who were and may not have been aware that the RVA founder/CED and the deputy executive director, business services were related. Both the RVA founder/CED and her son were described as speaking to each other professionally in the workplace setting and not as a mother and son.

California Code of Regulations, Title 2, Division 6, Chapter 7, Article 2, Section 18730, Provisions of Conflict of Interest Codes,

> (9) Section 9. Disqualification.
>
> No designated employee shall make, participate in making, or in any way attempt to use his or her official position to influence the making of any governmental decision which he or she knows or has reason to know will have a reasonably foreseeable material financial effect, distinguishable from its effect on the public generally, on the official or a member of his or her immediate family…"

As the next two bullet points describe, the RVA governing board was experienced, and the RVA Executive Compensation, Finance and Audit Committee is the authorizer of the RVA founder/CED's son to the position of deputy executive director, business services.

- As described in the initial agenda of the RVA governing board, "three of the four RVA governing board members are very experienced. One board member is an attorney with thirty years practicing law, another is a certified public accountant with nine years of public accounting experience, and the third board member holds an Ed.D. and is a long-time educator and NJSD representative on the RVA governing board." Based on FCMAT's interviews and review of RVA board minutes, the RVA governing board members are not uninformed individuals when it comes to business operations and organizational behavior.
- The October 15, 2014 governing board minutes of RVA were approved at its November 19, 2014 meeting and included an Executive Compensation, Finance and Audit Committee recommendation for the position held by the founder's son. The committee chairman/RVA board member reported that the committee recommended approval of an employment agreement for the son as deputy executive director, business services. The committee chair requested a motion regarding the employment agreement for this position and the motion was unanimously approved with no nays or abstentions.
- To evaluate the qualifications and proposed salary of the RVA deputy executive director, business services position, the Executive Compensation, Finance and Audit Committee retained an independent human resources consulting firm, HRtoGo located in

Sacramento, to prepare a salary report for the duties of the position. The report, sent to the committee as an attachment in an email dated October 13, 2014, states that the deputy executive director, business services position will serve as the chief technology officer, chief marketing officer, and general financial administrator. The Executive Compensation, Finance and Audit Committee also reviewed other salary reports for comparison from PayScale.com specific to chief marketing officer and chief technology officer positions.

- The salary paid to the RVA deputy executive director, business services was based on recommendations and research from an independent salary study from HRtoGo, by additional research into executive salaries at PayScale.com, approved by the RVA Executive Compensation, Finance and Audit Committee, and formally approved at the October 15, 2014 RVA governing board meeting.
- FCMAT has not found any evidence that the founder/CED or her son, the RVA deputy executive director, business services had any outside vendor relationships from which they may have benefited financially.
- Both the RVA founder/CED and her son changed from consultants to employees of RVA July 1, 2014 when CSMC took over processing payroll for RVA even though employment agreements were not executed until December 2014.
- Based on FCMAT's experience, it is not uncommon for charter school operators, especially in the start-up phase and first three years of charter operation, to enlist help from and pay friends and family to be charter school employees, consultants, or unpaid board members. This is not a prohibited or unusual activity, and unless specifically disallowed by the charter school or authorizing school district, it is allowable provided no financial conflict of interest exists. The district and RVA charter petition do not prohibit employing family members.

FCMAT's review of RVA transactions, contracts, charter petitions, the MOU, and other available documents fails to indicate that the RVA founder/CED or her son, the RVA deputy executive director, business services had a material economic interest in RVA sufficient to represent a conflict of interest.

Charter School Authorization and Oversight Procedures

Charter School Petitions and Memorandum of Understanding (MOU)

In December 2013, seven months after approval of the petition, the founder/CED submitted an MOU to the district to further memorialize the responsibilities and agreement between the RVA and the district. This MOU was finalized and approved by the district and RVA governing boards in October and November 2014 respectively. The purpose of the MOU is to provide specific detail as to the requirements of the charter school and conditions of authorization not specifically spelled out in the charter petition. It is best practice for authorizing agencies to be specific about the form and frequency of fiscal oversight practices to ensure expectations are clearly defined.

RVA prepared the MOU. Normally, the district would prepare such an MOU to ensure the terms and conditions necessary to preserve its rights in performing its oversight responsibilities. The authorizer should possess enough power to sufficiently review and monitor the charter school to ensure fiscal solvency. Additionally, it is best practice to prepare and execute an MOU in conjunction with the charter petition to clearly define the oversight activities required of the charter prior to or at the time the school is authorized.

FCMAT found little detail regarding fiscal monitoring and review of the RVA charter school in either the petition or the MOU. There was little to no clarifying detail as to how the district would monitor the charter school's progress in meeting the goals established in the petition including enrollment and average daily attendance projections, which ultimately determine the amount of funding RVA would receive to support the budgeted expenditures. FCMAT found no evidence that the district conducted any routine monitoring of RVA's student recruitment activities and/or progress during the first 20 months after the charter petition was approved.

Charter School Authorizer Oversight Procedures

The details of how the authorizing agency executes its oversight authority of a charter school are not prescribed in law; rather, they are left to be defined through agreement between the authorizing LEA and the charter school by language established in the charter petition and/or MOU. The RVA governing board is responsible for fiscal accountability and proper governance over all financial transactions of the charter school and the district is responsible for the oversight of RVA.

Education Code Section 47604.32(a)-(d) requires each chartering authority to identify at least one staff member as a contact person for the charter school, visit each charter school at least annually, ensure that each charter school under its authority complies with all reports required of it by law, and monitor the fiscal condition of each charter school under its authority. While the district did identify a staff member for fiscal accountability, it did not actively engage in fiscal oversight practices until December 2014 in conjunction with the 2014-15 first interim reporting period and more than 18 months after approval of the charter petition.

The district did not demonstrate any active oversight between May 2013 and December 2014, although there was some indication that traditional meetings that convey routine business information to a group of LEAs did take place. While the first 12 months after the approval of the charter school petition was a planning period for RVA prior to its first year of operation, much financial activity took place during that time. FCMAT's review of financial records for

May 2013 through June 30, 2014 identified 113 financial transactions, including cash receipts totaling $228,618 and 102 disbursement transactions totaling $216,947.80. RVA conducted an additional 456 financial transactions between July 1, 2014 and October 31, 2014, the first interim financial reporting period, including cash receipts totaling $1,089,662 and cash disbursements totaling $744,449.28; payroll transactions were counted as a single transaction. FCMAT did not find that the district assessed the volume of spending by RVA during the months leading up to the school's opening on July 1, 2014, even though the district loaned RVA funds on two occasions during that time in advance of grant funding. These funds were primarily used to pay salaries to the founder/CED, the deputy executive director of business services and a related party consultant.

The first sign that the district engaged in fiscal review of the charter school was in December 2014, when RVA submitted its first interim report to the district. Language included in the approved RVA K12#1 petition related to fiscal oversight by the district was extremely general, simply stating the requirements outlined in EC 47605(g) for a projected budget including startup costs and a cash flow projection for the first three years of operation. Additional language in the petition cited the traditional reporting cycle for school districts: preliminary budget by July 1, first interim report of financial activity by December 15, second interim report of financial activity by March 15 and unaudited actuals financial activity by September 15.

The MOU between RVA and the district was not executed until November 2014, after the end of the first interim reporting period and more than 17 months after the authorization of the charter school petition. The MOU included basic language associated with budget monitoring, but it too lacked detail essential to ensuring that fiscal oversight during RVA's first few years of operation was effective. Furthermore, the MOU placed the establishment of all the criteria for budget monitoring in the hands of the charter school, not the authorizing agency responsible for fiscal oversight.

Oversight language incorporated in the MOU briefly described the interpretation of the term "supervisorial oversight" as used in Education Code Sections 47613 and 47604.32. No specific language was included in the charter school petition or the MOU describing the monitoring necessary to evaluate the progress in meeting proposed expectations originally outlined in the charter petition and accompanying budget, including those associated with preparing the charter school for its first year of operation.

Frequent routine fiscal monitoring should take place by the authorizing agency immediately after authorization of a charter school petition and should continue until the authorizing agency is confident that the charter school has developed process and procedures necessary to create a strong internal control environment and that they are fully implemented, have become routine and are sustainable. Additionally, the authorizing agency should evaluate the charter school's progress in meeting the projections in the petition that led to authorization including those related to enrollment and average daily attendance, revenue, expenditures and debt. Because charter schools are primarily funded based on average daily attendance and enrollment data, authorizing agencies need to ensure that the charter school conducts student recruitment activities that are successful in generating the enrollment and attendance used as the foundation for approval of the charter school petition. The lack of timely oversight by the district presents considerable risk to both LEAs.

The following table outlines the financial transaction activity by the founder/CED and RVA K12#1 from February 2013 through June 30, 2015:

Annual Transaction Summary

Fiscal Year	# Transactions	Deposits	Disbursements	Increase / (Decrease)	Balance
2012-13	1	$ 30.00	$ -	$ 30.00	**$ 30.00**
2013-14	113	$ 228,618.00	$ 216,947.80	$ 11,670.20	**$ 11,700.20**
2014-15	774	$ 1,217,530.53	$ 1,228,594.69	$ (11,064.16)	**$ 636.04**
	888				
2014-15 1st Interim	456	$ 1,089,662.00	$ 744,449.28		

While the charter school was officially established in September 2013 with the assignment of its CDS code and the charter school engaged in considerable financial activity during the 2013-14 fiscal year, the district did not conduct or require an independent audit. It is FCMAT's understanding that the one remaining RVA governing board member and the district had secured an independent audit firm to conduct a closeout audit of RVA that was scheduled to perform those services beginning July 2015.

From July 1, 2013 through June 30, 2014 significant financial activity including PCSGP funding, revolving loan funding, and 2014-15 advance apportionment funding was received by the charter school. RVA engaged the services of back office provider CSMC beginning July 1, 2014. Interviews with CSMC staff indicated they had great difficulty obtaining sufficient financial information to establish the 2014-15 beginning balance.

FCMAT found these weaknesses in the oversight practices of the authorizing agency:

- Failure to monitor progress in submitting and obtaining official non-profit status.
- Failure to monitor progress in submitting and obtaining approval of conflicts of interest code with the County Board of Supervisors.
- Failure to monitor in a timely manner enrollment projections against actual enrollment to ensure adequate progress toward achieving the projected enrollment.
- Failure to monitor fiscal conditions in a timely manner to ensure revenue and expenditure projections were realistic, obtainable or appropriately revised.
- Failure to ensure that the charter school established and implemented adequate internal controls and operational procedures.
- Failure to ensure that RVA was accountable for all financial activities and engaged in proper financial accounting and reporting procedures prior to securing a back office provider in July 2014.
- No independent audit of the charter school's financial activities.

AB 139 Extraordinary Audit Report Summary

FCMAT concludes that the following factors led to the charter school's closure:

- The inability of the RVA founder/CED and governing board to exercise due diligence over the fiscal matters of the charter school.
- A lack of adequate internal controls, and the ability of the former founder/CED to spend charter school funds without sufficient accountability.
- Inadequate oversight by the district.

Based on the findings in this report, there is insufficient evidence to demonstrate that fraud, misappropriation of funds and assets or other illegal activities may have occurred. However, during the course of FCMAT's investigation significant deficiencies in the charter's internal control environment were found, increasing the potential for fraud and/or abuse. It is FCMAT's opinion that these weaknesses could have been avoided in part through stronger requirements and more extensive oversight practices incorporated in the charter petition and subsequent MOU approved by the district. These findings should be of great concern to the charter's governing board, the authorizing LEA, and the San Joaquin County Office of Education and require immediate intervention to limit the risk of fraud and/or misappropriation of assets in the future.

Recommendation

The county superintendent should:

1. Notify the governing boards of RVA and the district that insufficient documentation exists to indicate that fraud, misappropriation of charter funds and/or assets or other illegal activities may have occurred and that the county office has concluded its review.

Appendices

Appendix A – Study Agreement

Appendix B - Letter to FCMAT from Law Offices of Young, Minney and Corr

Appendix C - Letter to New Jerusalem Elementary School District from FCMAT

Appendix A

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

FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
AB139 STUDY AGREEMENT
April 20, 2015

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

1. **BASIS OF AGREEMENT**

The team provides a variety of services to school districts and county offices of education upon request. Pursuant to the provisions of Education Code Section 1241.5 (b), a county superintendent of schools may review or audit the expenditures and internal controls of any school in his or her county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. The extraordinary audits conducted by the county superintendent shall be focused on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and shall be conducted in a timely and efficient manner.

All work shall be performed in accordance with the terms and conditions of this agreement.

2. **SCOPE OF THE WORK**

A. Scope and Objectives of the Study

The San Joaquin County Office of Education has requested that the team assign professionals to conduct an AB 139 extraordinary audit on behalf of the Renew Virtual Academies Charter School. Per Education Code Section 1241.5(c), the superintendent has reason to believe that fraud, misappropriation of funds, or other illegal practices may have occurred. The review of the charter will include but not be limited to the following:

The charter adopted a resolution in March 2015 voluntarily rescinding its charter due to financial insolvency. California law requires that closure procedures are stated through an agreement between the authorizing entity and charter school before the charter school begins operation in accordance with education code sections 47604.32, 47605, 47605.6, 47607 and the California Code of Regulations, Title 5, sections 11962 and 11962.1. These procedures must designate a responsible entity to conduct closure activities and identify how these activities will be funded. After the charter adopted its closure resolution, the superintendent of the authorizing agency, New Jerusalem School District,

1

contacted the county office regarding allegations that the charter may have been involved with potential illegal or inappropriate activities.

Pursuant to Education Code Section 1241.5 (b)(c), the county superintendent has reason to believe that fraud, misappropriation of funds or other illegal practices may have occurred and has requested a review of the Renew Virtual Academies Charter School conducting business as a California nonprofit organization. In addition to the authority granted under 1241.5 (c) and 47604.3, the county superintendent may conduct an investigation of the charter school based on written complaints by parents or other information that justifies the review.

The primary focus of this review is to provide the county office with reasonable assurances, based on the testing performed, that adequate management, internal controls and closing procedures were in place for the reporting and monitoring of financial transactions. Specific review objectives will include the evaluation of policies, procedures, internal controls and transactions performed by the charter school.

Testing for this review will be based on sample selections; it will not include all transactions and records for this period. Sample testing and review results are intended to provide reasonable but not absolute assurance regarding the accuracy of the charter school's financial transactions, bank records and activity to accomplish the following:

1. Review internal controls to determine if policies were overridden by management during the fiscal year or the closing process.
2. Review the closing process to determine if state and federal regulations were followed and completed by the charter.
3. Provide assurance to the county office that the internal control system was sound.
4. Evaluate the charter's internal control structure, policies and procedures to test transactions and reporting processes to determine if adequate procedures were in place to safeguard assets, including physical objects, charter school data and intellectual property.
5. Evaluate the reliability and integrity of information used for internal management decisions and external agency reports including the close out process.
6. Determine if authorization procedures were appropriate and consistently followed. Review administrator and manager approvals and whether signature authority was delegated only to authorized employees.
7. Determine whether proper segregation of duties existed. Evaluate personnel, payroll, accounts payable and cash transactions, including the following:
   a. Review the authorization process for cash receipts.
   b. Determine if protective measures were in place for safeguarding assets, processes and data.
8. Evaluation of Policies and Procedures:
   a. Review compliance with policies and procedures including, but not limited to, those related to human resources, finance, purchasing, granting agencies, and state and federal government.

2

b. Review document and records retention procedures to determine whether the charter provides reasonable assurance that asset records are safeguarded and transactions are correctly recorded.

c. Determine whether the charter's petition and memorandum of understanding included policies and administrative regulations regarding conflicts of interest pursuant to Government Code Section 1090.

B. Services and Products to be Provided

1. Orientation Meeting - The team will conduct an orientation session at the district to brief management and supervisory personnel on the team's procedures and the purpose and schedule of the study.

2. On-site Review - The team will conduct an on-site review at the district office and at school sites if necessary; and will continue to review pertinent documents off-site.

3. Progress Reports - The team will inform the COE of material issues as the review is performed.

4. Draft Reports – When appropriate, electronic copies of a preliminary draft report will be delivered to the COE's administration for review and comment on a schedule determined by the team.

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

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

3. PROJECT PERSONNEL

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

A. Marisa Ploog, CPA, CFE, CICA, CGMA	FCMAT Fiscal Intervention Specialist
B. To Be Determined	FCMAT Consultant

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

4. PROJECT COSTS

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

A. $800 per day for each staff team member while on site, conducting fieldwork at other locations, presenting reports, or participating in meetings. The cost of independent FCMAT consultants will be billed at their actual daily rate.

B. All out-of-pocket expenses, including travel, meals and lodging.

Based on the elements noted in Section 2A, the total estimated cost of the study will be $15,000.

C. Any change to the scope will affect the estimate of total cost.

Payments for FCMAT services may be reimbursed from funds pursuant to EC 1241.5 set aside for this purpose. Other payments, when deemed necessary, are payable to Kern County Superintendent of Schools - Administrative Agent.

5. RESPONSIBILITIES OF THE COE AND/OR DISTRICT

A. The district will provide office and conference room space during on-site reviews.

B. The district will provide the following if requested:

1. Policies, regulations and prior reports addressing the study request
2. Current or proposed organizational charts
3. Current and two (2) prior years' audit reports
4. Any documents requested on a supplemental list. Documents requested on the supplemental list should be provided to FCMAT only in electronic format; if only hard copies are available, they should be scanned by the district and sent to FCMAT in an electronic format
5. Documents should be provided in advance of field work; any delay in the receipt of the requested documents may affect the start date of the project. Upon approval of the signed study agreement, access will be provided to FCMAT's online SharePoint document repository where the district shall upload all requested documents.

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

Pursuant to EC 45125.1(c), representatives of FCMAT will have limited contact with pupils. The district shall take appropriate steps to comply with EC 45125.1(c).

6. PROJECT SCHEDULE

The following schedule outlines the planned completion dates for different phases of the study:

Orientation:	*April/May 2015*
Staff Interviews:	*To be determined*
Exit Interviews:	*To be determined*
Preliminary Report Submitted	*To be determined*
Final Report Submitted	*To be determined*

7. COMMENCEMENT, TERMINATION AND COMPLETION OF WORK:

FCMAT will begin work as soon as it has assembled an available and appropriate study team consisting of FCMAT staff and independent consultants, taking into consideration other jobs FCMAT has previously undertaken and assignments from the state. The team will work expeditiously to complete its work and deliver its report, subject to the cooperation of the COE and any other parties from whom, in the team's judgment, it must obtain information. Once the team has completed its field work, it will proceed to prepare a preliminary draft report and a final report. Prior to completion of field work, the district may terminate its request for service and will be responsible for all costs incurred by FCMAT to the date of termination under Section 4 (Project Costs). If the COE does not provide written notice of termination prior to completion of field work, the team will complete its work and deliver its report and the COE will be responsible for the full costs. The COE understands and agrees that FCMAT is a state agency and all FCMAT reports are published on the FCMAT website and made available to interested parties in state government. In the absence of extraordinary circumstances, FCMAT will not withhold preparation, publication and distribution of a report once field work has been completed, and the COE shall not request that it do so.

8. INDEPENDENT CONTRACTOR:

FCMAT is an independent contractor and is not an employee or engaged in any manner with the COE. The manner in which FCMAT's services are rendered shall be within its sole control and discretion. FCMAT representatives are not authorized to speak for, represent, or obligate the COE in any manner without prior express written authorization from an officer of the COE.

9. INSURANCE:

During the term of this agreement, FCMAT shall maintain liability insurance in an amount not less than $1 million unless otherwise agreed upon in writing by the COE, automobile liability insurance in the amount required under California state law, and workers compensation as required under California state law. FCMAT shall provide certificates of insurance, with additional insured endorsements, indicating applicable insurance coverages prior to the commencement of work.

10. HOLD HARMLESS:

FCMAT shall hold the COE, its board, officers, agents and employees harmless from all suits, claims and liabilities resulting from negligent acts or omissions of its board, officers, agents and employees undertaken under this agreement. Conversely, the COE shall hold FCMAT, its board, officers, agents and employees harmless from all suits, claims and liabilities resulting from negligent acts or omissions of its board, officers, agents and employees undertaken under this agreement.

11. CONTACT PERSON

Contact: James Thomas, Deputy Superintendent
Telephone: (209) 468-4807
FAX: (209) 468-9076
E-mail: jthomas@sjcoe.net

4/23/15

James Thomas, Deputy Superintendent
San Joaquin County Office of Education
Date

April 20, 2015

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

6

Appendix B

LAW OFFICES OF YOUNG, MINNEY & CORR, LLP

SACRAMENTO ▪ LOS ANGELES ▪ SAN DIEGO ▪ WALNUT CREEK

JANUARY 6, 2016

VIA: U.S. MAIL AND EMAIL

Joel Montero, CEO
Fiscal Crisis and Management Assistance Team
1300 17th Street – CITY CENTRE
Bakersfield, CA 93301

RE: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review

Dear Mr. Montero:

Our office represents New Jerusalem Elementary School District ("NJESD" or the "District".) NJESD Superintendent, David Thoming recently provided our office with a copy of the San Joaquin County Office of Education's ("SJCOE") Renew Virtual Academies Charter School ('RVA" or the "Charter School") AB 139 Review ("Report"), performed by the Fiscal Crisis and Management Assistance Team ("FCMAT").

While we certainly understand the desire to conduct a review of RVA's activities, the Report questionably turns its attention to the practices and procedures of NJESD. The Report includes an entire section alleging failures on the part of NJESD, despite the fact that NJESD is not the subject of the Report. Furthermore, most, if not all, of the allegations made in the Report regarding NJESD are either factually incorrect, inconsistent with the statements made by FCMAT earlier in the Report, and/or failed to take into consideration the documentation proving that such allegations against NJESD are false.

Additionally, we do not necessarily agree with the way in which FCMAT is applying the standards, regulations and laws governing charter schools. Many of the "weaknesses" or areas where the Report takes issue with NJESD are not requirements under the Charter Schools Act. However, FCMAT treats such issues as indicating a failure on the part of the authorizer, NJESD in this case, and unilaterally devises new requirements by which FCMAT based its evaluation of NJESD's performance. Specifically, the statements made in the Report indicate an entirely new standard for charter school authorizers and attempts to abrogate the protections built into the Charter Schools Act for an authorizer that conducts itself in line with the oversight requirements listed in the Charter Schools Act. FCMAT is neither the Legislature nor a body authorized to promulgate regulations applicable to charter schools – rather, its role

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Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
January 6, 2016
Page 2 of 8

is to conduct audits based on statutes and regulations adopted by those vested with that authority.

The purpose of this letter is to highlight the errors and inconsistencies in the Report as they relate to NJESD as well as charter authorizers generally. We sincerely request that you consider this letter, review the Charter Schools Act, and work with our office to revise the Report accordingly.

I. PROCEDURAL ISSUES

Initially we wish to address the failure of the Report to abide by the terms of the scope of work, and the failure to provide due process to NJESD. The scope of work for the audit did not include an investigation of NJESD procedures and, in fact, mentions nothing about NJESD whatsoever. NJESD was not provided notice of any issues or an investigation of the authorizer's procedures, and we are not aware of any allegation of impropriety against NJESD that would provide a basis for an investigation under Education Code section 1241.5(c). As such, the inclusion of the section and the performance of an investigation regarding NJESD are inappropriate and clearly outside the scope of the Report and should be removed. Conversely, it is our belief that the Report should focus exclusively on the actions of RVA - the only entity under investigation according to the scope of the Report and not NJESD as the authorizer.

Even if an investigation of NJESD's oversight practices had been included within the scope of the work requested, FCMAT did not provide NJESD the requisite and procedural due process normally afforded to other agencies. The common practice for FCMAT and other state investigatory agencies, when conducting an audit or other review of another agency, is to provide that agency with notice of the complaints against the agency, notice of the scope of the audit or investigation, and to provide a preliminary draft of the proposed report so the audited or investigated agency can rebut any errors or deficiencies in the audit or investigation. If the investigating agency does not agree with the rebuttal or revisions the investigated agency makes to the report for final publication, the investigating agency prints the rebuttal along with the final report. None of the above notices or opportunities were provided to NJESD, and as such SJCOE and FCMAT failed to provide NJESD with due process of any kind. Given the "weaknesses" published in the Report and the inference of liability, this lack of due process is likely to cause NJESD substantial harm.

II. OVERSIGHT DUTIES OF AUTHORIZERS

In addition to the procedural issues with the scope of the Report, there are assertions made that considerably stretch, and in some cases create entirely new, oversight duties and requirements for authorizers. While these will be specifically addressed below, it is important to revisit the requirements of an authorizer under the law.

While the NJESD was required to perform oversight duties with regards to RVA as RVA's authorizer, RVA was only subject to the management and direction of its own Board of Directors and executive staff. The authorizer is not considered the final responsible party for management or governance decisions of a charter school it authorizes. The board of directors of

YM&C

Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
JANUARY 6, 2016
Page 3 of 8

each charter school is vested with such authority and responsibility. RVA was incorporated as a nonprofit public benefit corporation independent of NJESD and is not considered a subdivision of NJESD, but rather RVA is an independent non-profit quasi-governmental agency, independently subject to both California charter school law and California nonprofit corporations law. (*Cal. School Bds. Assn. v. State Bd. of Ed.* (2010) 186 Cal.App.4th 1298, 1305.) Charter schools were created for the express purpose of operating *independently*, with their goals being the improvement of student learning, increasing learning opportunities, innovating teaching methods, creating professional opportunities for teachers, providing expanded choice to parents, changing from a rule-based to a performance-based accountability paradigm, and to provide competition with traditional public schools. (Cal. Ed. Code section 47601; *Cal. School Bds. Assn., supra*.; *Wilson v. State Bd. of Ed.* (1999) 75 Cal.App.4th 1125.)

NJESD had served as authorizer, which is an obligation placed on a school district by statute when a school district finds that a charter petition has all elements required by law. Once a petition meets this standard, the law requires the applicable District Board to approve it. Such approvals are not discretionary. Once that obligation is placed on a district, its duty is to provide specific oversight in key areas – but not to interfere with the operations of the charter school or second guess its management decisions unless violations of law or the charter have occurred, there is an imminent threat of health and safety of pupils, or there is financial mismanagement. The role of an authorizer is limited in scope and is intended to foster charter schools that "operate[s] independently from the existing school district structure." (Ed. Code section 47601.) To that end the Legislature did not provide authorizers general jurisdiction over charter schools, but instead identified their limited duties as follows:

1. Identify a charter liaison;
2. Visit the charter school at least once a year;
3. Confirm that the charter school submits all required reports;
4. Monitor the fiscal condition of the charter school; and
5. Provide notice to the California Department of Education ("CDE") if:
   a. A charter is granted or denied;
   b. A charter is revoked; or
   c. A charter school ceases operations. (Ed. Code section 47604.32.)

In comparing the statutorily imposed oversight duties and those asserted in the Report, it is clear that the Report applies standards and requirements that are well above and beyond the requirements imposed by law. To the extent that the Report attempts to impose a standard above the law, it must be revised to comport with the actual legal requirements.

III. SUBSTANTIVE ISSUES

Setting aside the procedural failures and the attempt to expand the scope and definition of the obligations of a charter school authorizer, the Report contains significant errors of fact and law, as well as infers standards and liabilities that stand in direct contravention of the Charter Schools Act. FCMAT's discussion of NJESD's oversight is inaccurate in many respects. In lieu of describing every mistake in detail in this correspondence, we are requesting a meeting with FCMAT to address these errors in greater detail. However, we do want to address some of the

YM&C

Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
January 6, 2016
Page 4 of 8

larger mistakes to give you a sense of what the Report does distill and the errors contained in the discussion that were broken down into seven (7) alleged "weaknesses" attributed to NJESD, which are addressed in turn below:

1. <u>Failure to monitor progress in submitting and obtaining official non-profit status</u>.

   Initially, there is no requirement in law for an authorizer to specifically monitor the application for tax-exempt status. In fact, the Charter Schools Act does not even require a charter school to have obtained tax-exempt status. Instead, the Act provides that a charter school "may be operated by a nonprofit public benefit corporation" – note that nowhere does it include the requirement that the authorizer check-up and monitor a schools progress if such a school desires to obtain tax-exempt status. As you will note from the language, the Articles of Incorporation of RVA establish it as a "non-profit public benefit corporation" well before its application for tax exempt status. (see Attachment A.) Additionally, a nonprofit corporation that desires to seek federal tax-exempt status is given up to twenty-seven (27) months to prepare and file their application with the Internal Revenue Service (Internal Revenue Service Form 1023 Application for Tax Exempt Status for charitable organizations, Part VII, Q.2.). In this instance, RVA was closed prior to the expiration of the twenty-seven-month window for application.

   As there is no requirement under the Charter Schools Act that an authorizer monitor a charter school's tax-exempt application process, and as RVA was closed prior to the end of the tax-exempt application window, the assertion that NJESD somehow failed in a duty here is clearly misplaced. We therefore respectfully request this assertion be removed from the Report.

2. <u>Failure to monitor progress in submitting and obtaining approval of conflicts of interest code with the county board of supervisors</u>.

   Here, NJESD had appropriately reviewed the conflict of interest policy of the Charter School during the Charter School's petitioning process, as well as RVA's proposed Conflict of Interest Code. While RVA did include a Conflict of Interest Code that was to be submitted by the Charter School to the County Board of Supervisors in RVA's petition, NJESD did not have a duty to confirm that such a code was submitted and approved. Rather, NJESD's obligation was to ensure conflict of interest provisions were in place - which it did. To find otherwise would be to suggest that school districts must ensure that charter schools comply with <u>every</u> state and federal law and regulation. There would be no way to do that absent the district running the school, which is not contemplated by the charter schools act or this charter. We therefore request this assertion be removed from the Report.

YM&C

Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
JANUARY 6, 2016
Page 5 of 8

3. <u>Failure to monitor in a timely manner enrollment projection against actual enrollment to ensure adequate progress towards achieving the projected enrollment</u>.

   As stated above, this "weakness" is highly confusing; given the admission earlier in the Report that NJESD had raised concerns to SJCOE about enrollment prior to the first opening year. NJESD was consistently monitoring RVA in a proper manner and requested information to enable NJESD to perform its oversight duties, an example of which is attached. (See Attachment B.) When concerns were expressed by NJESD, RVA responded with information, which appeared to satisfy the concern. Further, both the SJCOE and NJESD had to review and sign-off on the "reasonable estimate" of the anticipated pupil counts in August 2014 – providing clear evidence that the SJCOE had received notice of pupil enrollment, that NJESD had conducted monitoring of the enrollment as required under the Education Code, and that the SJCOE believed such was sufficient. (See Attachment C.) NJESD was in communication with RVA frequently, at least once a month, to monitor the enrollment issues that were arising; which, ironically, led to NJESD bringing the matter to SJCOE's attention.

   Additionally, the projected enrollment during a preparatory year will frequently fluctuate and change depending on the multitude of circumstances surrounding the opening of the school, so it is difficult to effectively predict enrollment until the school begins educational operations. Here, as soon as accurate and meaningful information was available, NJESD began to increase its monitoring of enrollment to confirm the financial viability of RVA. Once again, immediately after issues began to appear from this monitoring, NJESD began the process of addressing them with the Charter School to develop strategies to increase enrollment – which were unfortunately unsuccessful. In actuality, NJESD did in fact perform sufficient monitoring of the Charter School within NJESD's obligations under the law; and while it is unfortunate that enrollment did not increase, such was not caused by any failure of NJESD's monitoring. As such, we request the Report be revised to remove the erroneous assertion that NJESD did not monitor enrollment.

4. <u>Failure to monitor fiscal conditions in a timely manner to ensure revenue and expenditure projections were realistic, obtainable or appropriately revised</u>.

   Again, the Charter Schools Act does not require the authorizer to constantly manage the budget, expenditures, or other assumptions by the charter school, which operates as its own independent local education agency. When RVA submitted its petition, the financial plan, budget, and enrolment assumptions were reasonable and within the bounds of the law and were therefore approved. The "start-up" year prior to the first year of operation provided for appropriate expenditure plans in relation to the anticipated enrollment. During this initial year, RVA applied for and received state funding through the Public Charter Schools Grant Program ("PCSGP"), which required its own independent financial

YM&C

Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
JANUARY 6, 2016
Page 6 of 8

reporting under the PCSGP legislation and regulations. Given that the "start-up" year (which was in actuality a planning year) did not have any enrollment, instruction or other activities, an annual audit outside the scope of the PCSGP program would not be necessary. The PCSGP report provided NJESD with an accurate depiction of the school's financial state; which was immediately questioned and reported out to the County as soon as indications of financial instability came forward. NJESD and RVA were in close contact during the initial opening of the school and after reporting the fiscal issues that had arisen, as well as working with the RVA staff to remedy the problem, but ultimately NJESD's Superintendent determined that it would be appropriate to seek the closure of the school.

As such, NJESD followed and conducted the appropriate monitoring of the Charter School throughout this time. It was this oversight that led the District Superintendent to recommend commencement of the revocation process. In other words, the process contained in the charter schools act worked. When the NJESD had concerns, it raised them. When RVA failed to address and cure them, revocation procedures were initiated. Based on the above, we reiterate our request that you revise the Report to remove the section regarding NJESD's oversight practices.

5. Failure to ensure that the charter school established and implemented adequate internal controls and operational procedures.

FCMAT again distorts the actual requirements of the Charter Schools Act, which does not require the NJESD to approve the Charter Schools operating procedures. Indeed, the internal controls and fiscal procedures are to be reviewed and addressed in the independent audit, which is then provided to the NJESD, who then works with the Charter School to address any deficiencies. (Ed. Code 41020.) Since RVA had only completed its "start-up" year (which was operating under the PCSGP independent financial reporting requirements) and had not finished the first school-year prior to its closure, the independent audit of the Charter School's processes and procedures had not been completed. Furthermore, immediately prior to the beginning of the initial school-year, and upon the prodding of the District, RVA engaged the services of a highly respected business back-office service provider, so that standard, clear fiscal controls would be ensured, as well as to aid in the general fiscal operations of the school. If RVA had followed the standard fiscal policies recommended by the business services provider, the District would have been confident in the Charter School's internal controls and operational procedures. District concerns about RVA's compliance with such policies led to the Superintendent's decision to recommend revocation.

At this time, RVA is undertaking its "closeout" audit as required under Education Code section 47605. Fiscal deficiencies that arose during the year will be analyzed during that "close-out" audit, and the District will use such information to improve the monitoring of the other authorized charter schools.

YM&C

Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
JANUARY 6, 2016
Page 7 of 8

However, it is inaccurate to say that NJESD failed in its oversight duties when 1) the School had yet to receive its first audit, 2) the School initially pledged that it would follow industry standard internal control and operational policies, and 3) NJESD commenced revocation procedures once it became evident that RVA was not forthright with NJESD regarding its finances and operations. As NJESD is following appropriate procedures, we request the Report be amended to remove the assertion of failure to monitor.

6. <u>Failure to ensure that RVA was accountable for all financial activities and engaged in proper financial accounting and reporting procedure prior to securing a back office provider in July 2014</u>.

As stated above, prior to the first operational school year (July 2014), RVA had only received and operated with PCSGP funds. The PCSGP program provides for "start-up" funding for charter schools, which schools must provide multiple financial reports and budgets; including evidence of proper accounting and reporting. Furthermore, the PCSGP requires its own independent financial reporting of activities with funds received, which RVA took part in. These results were disclosed to NJESD. (PCSGP Guidelines.) Thus, even in the initial "start-up" year, NJESD was closely monitoring the fiscal activities of RVA and the development of the school. Nothing in that initial start-up year caused a concern regarding fiscal management of the School.

Further, in speaking to the review processes of the PCSGP, the California Department of Education ("CDE") may require site-visits and other actions to ensure the correct use of the funds. In order to continue receiving funds, the CDE claims they will verify their information with authorizing entities and will provide findings if warranted. The PCSGP guidelines lay this out in stating that "a rigorous process of review by a third party external reviewer, not affiliated with the charter school's authorizing entity, is required of all grantees' schools by the end of the grant project period." (PCSGP Guidelines.) The CDE's guidance on the monitoring of the PCSGP funds reserves such activities to the state, and does not require the local authorizer to monitor or assess the use of such funds.

In this case, since the grant period was not over, and RVA had only recently received additional funds from the state, the requirement to have an external reviewer would not have been triggered before RVA closed. Specifically the CDE requires:

> A rigorous process of review by a third party external reviewer, not affiliated with the charter school's authorizing entity, or any member of the charter school's governing board, faculty, or staff, is required of all sub-grantees' schools one month prior to the end of the grant period. A copy of the report must be submitted to the CDE and a copy must be kept on file at the school site. If a sub-grantee fails to conduct the external review before the end of the

YM&C

Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
January 6, 2016
Page 8 of 8

grant period or if any items in the review are less than satisfactory, the CDE may invoice the sub-grantee for a base amount of 10 percent of the total sub-grant award, up to the total amount of the Implementation Year 1, or Year 2 funds.

Thus, we request the Report be amended to remove the assertion that NJESD failed to ensure that RVA was accountable for all financial activities.

7. No independent audit of the Charter School's financial activities.

We assume FCMAT meant "the district failed to ensure an independent audit of the charter school's financial activities was completed." This assertion is false, as we have explained above. The Charter Schools Act calls for an independent audit, which is being completed for the "start-up" year through PCSGP's requirements and in accordance with the law, as well as a "close-out" audit of the year a charter school closes. (Ed. Code 47605(b)(5)(P); PCSGP Guidelines.) RVA did not complete a full year of instruction in year two, but instead was closed, creating a situation where the most appropriate audit to perform would be the "close-out" audit. This "close-out" audit covers the entire period of the Charter School's first academic year. As a result of this audit and in combination with the PSGCP financial reporting, the standards required in the Charter Schools Act have been satisfied. As a result, all funds have been audited.

IV. CONCLUSION

As set forth above, the "weaknesses" alleged by FCMAT in the Report are inaccurate or false, misstated or ignored the applicable law, provide no citation to authority for the positions and are seemingly devoid of any factual information that would indicate a violation of law or a forfeiture of the liability protection provided authorizers under Education Code section 47604. Even when the Report is taken as a whole, none of the discussion points involve a violation of charter school law or the actual legal obligations of a charter authorizer and thus, the Report fails to establish a situation where an Education Code section 1241.5(c) investigation would be appropriate.

As the inclusion of the chapter regarding NJESD's authorizing practices fails to abide by the concepts and practices of due process, and due to the considerable inaccuracies, assumptions and expanded "requirements" in the Report, we respectfully request that the entirety of the section regarding NJESD's authorizing practices be removed from the Report according to our requests above. If FCMAT does not agree to remove these references to the District entirely, NJESD respectfully requests a meeting with FCMAT to discuss the concerns raised in this letter as well as other concerns, as NJESD anticipates that will be able to provide evidence addressing all of these issues and demonstrate that the conclusions reached by FCMAT are not fully accurate. Should FCMAT fail to revise the report or agree to a meeting to review additional documentation and evidence, NJESD reserves the right to seek any and all available legal remedies.

YM&C

Re: SJCOE/FCMAT Renew Virtual Academies Charter School AB 139 Review
JANUARY 6, 2016
Page 9 of 8

If you wish to discuss this letter and/or the Report in any way, please do not hesitate to contact me directly at 916-646-1400.

Sincerely,
LAW OFFICES OF
YOUNG, MINNEY & CORR, LLP

Kristopher L. Carpenter
ATTORNEY AT LAW

ENCL.

ATTACHMENT A – ARTICLES OF RVA

ATTACHMENT B – EMAIL EXCHANGE WITH RVA

ATTACHMENT C - PENSEC REPORT

CC: SUPERINTENDENT MOUSALIMAS, SAN JOAQUIN COUNTY OFFICE OF EDUCATION

Attachment A

ARTICLES OF INCORPORATION
OF
RENEW VIRTUAL ACADEMIES

I.

The name of the Corporation shall be Renew Virtual Academies.

II.

The Corporation is a nonprofit public benefit corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Public Benefit Corporation Law for public and charitable purposes. The specific purposes for which this Corporation is organized are to manage, operate, guide, direct and promote one or more public charter schools.

The Corporation is organized and operated exclusively for educational and charitable purposes pursuant to and within the meaning of Section 501(c)(3) of the Internal Revenue Code or the corresponding provision of any future United States Internal Revenue Law. Notwithstanding any other provision of these articles, the Corporation shall not, except to an insubstantial degree, engage in any other activities or exercise of power that do not further the purposes of the Corporation. The Corporation shall not carry on any other activities not permitted to be carried on by: (a) a corporation exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code; or (b) by a corporation, contributions to which are deductible under Section 170(c)(2) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

III.

The name and address in the State of California of this Corporation's initial agent for service of process is:

Paul C. Minney
Young, Minney & Corr, LLP
701 University Avenue, Suite 150
Sacramento, CA 95825

IV.

All corporate property is irrevocably dedicated to the purposes set forth in the second article above. No part of the net earnings of the Corporation shall inure to the benefit of, or be distributable to any of its directors, members, trustees, officers or other private persons except that the Corporation shall be authorized and empowered to pay reasonable compensation for services rendered, and to make payments and distributions in furtherance of the purposes set forth in Article II.

No substantial part of the activities of the Corporation shall consist of the carrying on of propaganda, or otherwise attempting to influence legislation, and the Corporation shall not participate in, or intervene in (including the publishing or distribution of statements) any political campaign on behalf of or in opposition to any candidate for public office.

Subject to the provisions of the nonprofit public benefit provisions of the Nonprofit Corporation Law of the State of California, and any limitations in the articles or bylaws relating to action to be approved by the members or by a majority of all members, if any, the activities and affairs of this Corporation shall be conducted and all the powers shall be exercised by or under the direction of the board of directors.

The number of directors shall be as provided for in the bylaws. The bylaws shall prescribe the qualifications, mode of election, and term of office of directors.

V.

The authorized number and qualifications of members of the corporation, if any, the different classes of membership, the property, voting and other rights and privileges of members, and their liability for dues and assessments and the method of collection thereof, shall be set forth in the bylaws.

VI.

Upon the dissolution or winding up of the Corporation, its assets remaining after payment of all debts and liabilities of the Corporation, shall be distributed to a nonprofit fund, foundation, or association which is organized and operated exclusively for educational, public or charitable purposes and which has established its tax exempt status under Section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purpose. Any such assets not so disposed of shall be disposed of by a court of competent jurisdiction of the county in which the principal office of the Corporation is then located, exclusively for such purposes or to such organization or organizations, as said court shall determine which are organized and operated exclusively for such purposes.

VII.

The initial street address and initial mailing address of the Corporation is as follows:

780 Sun Bonnet Court
Rockin, CA 95765

Dated:_______________

____
Kimberly Rodriguez, Incorporator

Attachment B

[redacted]

[redacted]

Good morning,

Yes, I can provide that to you no later than Friday. I have a meeting scheduled with my business manager on Thursday to discuss this very thing!

Could you provide me with an update on the MOU? I have a Board meeting on Wednesday and I would like to provide them with an explanation as to why we do not have one even though school has begun.

Thank you, David.

Ellen

On Monday, September 22, 2014, David Thoming <dthoming@njes.org> wrote:
Good Morning Ellen,

It was great to see cooler heads prevailed and SB 1263 was vetoed. That bill could have made things very difficult for all of us to operate in the areas most in need of school choice.

One of the items we ask for of new charter schools when they first open (a lesson learned the hard way) is an updated budget based on current ADA. We do this to ensure the school is in a position to honor its financial commitments as well as serve the students effectively.

Could you please provide us with an updated budget with the following information:

-Current ADA/Enrollment
-Projected ADA/Enrollment
-Position control noting the “all in” cost of all employees
-Other fixed expenses such as rent, insurance, etc.

It doesn't have to be in any particular format, just something to give us a snapshot as to your financial wellbeing.

Thanks,
David

David Thoming, Superintendent
New Jerusalem Elementary School District
Delta Charter School
31400 S. Koster Road
Tracy, CA 95304
(209) 830-6363
""Behold the turtle. He makes progress only when he sticks his neck out." James Bryant Conant

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--
Ellen Ringer, Ed.D.
Founder, **E-Trilogy**

A K-16 Integrated Education System
* Renew Virtual Academies
* Graduate Ready! Center
* F.J. Ringer Online University

916.833.2241 (cell)
916.253.9355

www.e-trilogy.com

From: Ellen Ringer [mailto:ellen.ringer@e-trilogy.com]
Sent: Friday, September 26, 2014 8:14 PM
To: David Thoming <dthoming@njes.org>
Subject: Renew Virtual Academy's Updated information

Hi David,

We have had a very good beginning of school. The students are motivated and the teaching staff is great, really digging in and learning how to be high quality online instructors. They are doing a great job!

As promised, here is the information you requested for Renew Virtual Academy:

Current ADA/Enrollment: Our current enrollment is 90 and have 10 more enrolling on Monday for a total of 100 students for our 20 day count. We have had only 3 students dis-enroll and one was because she moved out of state. We consistently are enrolling 10 students a week. Current ADA is around 89-90.

Projected ADA/Enrollment: We consistently are enrolling 10 students per week. Based on this figure and our continued Outreach Program our projected enrollment for P1 is 150 students. Projected ADA is 95. We have implemented an Attendance Program and it is already making a difference

I have attached our adjusted budget based on 150 students. The budget includes your requested information (and much more). Please note that our fixed expenses are relatively low (e.g. our rent is only $1275!) We also submitted an application to the Treasury Department to have our utilities reduced by 50% (also includes Internet services) and just received the approval! Please note the adjusted budget was provided to Renew's Board as an information item only. Charter School Management Corporation (Renew's business services) explained to the Board that schools typically adjust their budgets after their P1 count and they suggest Renew do the same. Please also note, that the 2014-15 budget figures on the attachment is the only year that was adjusted for your request. The other 4 years do not reflect adjustments. I will continue to work with CSMC as we walk through this year.

Thank you, David, for your continued support of Renew Virtual Academy. I am looking forward to receiving our review in January and sharing our program with you. Please let me know if there is any additional information you would like to receive.

Regards,

Ellen

Ellen Ringer, Ed.D.
Founder, **E-Trilogy**

A K-16 Integrated Education System
* Renew Virtual Academies
* Graduate Ready! Center
* F.J. Ringer Online University

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916.253.9355

www.e-trilogy.com

Attachment C

Pupil Estimates for New or Significantly Expanding Charters (PENSEC)

Data Certification

2014-15 Fiscal Year

County: San Joaquin

District: New Jerusalem Elementary

Charter School: Renew Virtual Academy K12 #1

CDS Code: 39-68627-0129361

Charter Number: 1598

Charter School Status: New Charter

Data Submitted to the California Department of Education: 8/11/2014 2:35:31 PM

Charter School, Authorizing District, and County Office of Education PENSEC Certification

Pursuant to Education Code Section 47652, I hereby certify that to the best of my knowledge and beliefs the 2014-15 information shown in this certification and reported to the California Department of Education is true and correct and that the data provided herein represents a reasonable estimate of the school's anticipated pupil counts. (Note: For non-certification, see the following page.)

Ellen Ringer — 8/11/14

Signature of Charter School Representative — Date

Ellen Ringer — 916.833.2241

Printed Name — Telephone

8/12/14

Signature of Superintendent of Authorizing District — Date

David Thoming — (209) 830-6363

Printed Name — Telephone

MICK FOUNTS
SUPERINTENDENT OF SCHOOLS
SAN JOAQUIN COUNTY OFFICE OF EDUCATION

8.14.14

Signature of County Superintendent of Schools — Date

BY Deputy

Carla Schafer — (209) 468-4829

Printed Name — Telephone

California Department of Education Page 2 of 3 Printed: 8/11/2014 2:35:46 PM

Appendix C

FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM

CSIS California School Information Services

March 3, 2016

David Thoming, Superintendent
New Jerusalem Elementary School District
31400 S. Koster Road
Tracy, CA 95304

RE: SJCOE/FCMAT Renew Virtual Academies Charter School AB139 Extraordinary Audit

Dear Superintendent Thoming:

FCMAT was engaged by the San Joaquin County Office of Education (SJCOE) to conduct an AB 139 Extraordinary Audit of the Renew Virtual Academy Charter School (RVA). The New Jerusalem Elementary School District (NJESD) was the authorizing agency for the charter school and has oversight responsibility for it. The County Office provided you with a copy of our draft report and we invited you to submit detailed questions or concerns to us. We received a letter dated January 6, 2016 from attorney Kristopher L. Carpenter of the Young, Minney & Corr law firm, which we understand to be the district's response to that invitation.

The purpose of this letter is to give you FCMAT's response to the matters asserted in the January 6, 2016 letter. A courtesy copy will be sent to Mr. Carpenter.

The letter from YM&C contends that NJESD was not a proper subject of FCMAT's engagement with the SJCOE and that any references to the district's practices or procedures as they relate to oversight of RVA are not relevant or applicable. It is further stated in the letter that findings in our report pertaining to the role of NJESD are factually incorrect, inconsistent, or overlook the documentation provided by NJESD. FCMAT disagrees with these positions.

The letter takes issue with our procedures for investigating an allegation of fraud, misappropriation of funds or other illegal acts of the charter school authorized by NJESD. It is stated that our report fails to abide by the scope of work and does not provide NJESD with due process. We do not agree that the evaluation of NJESD oversight procedures falls outside the scope of our agreement or was uncalled for or otherwise inappropriate.

As the authorizer of the charter school being investigated, NJESD has a responsibility to ensure that the operations of the charter school, including its internal control structure, are established, functioning and monitored to ensure that the assets of the charter school are properly safeguarded. There is a direct correlation between lack of internal control and the potential for fraud and misappropriation of public funds. While NJESD's oversight was not the primary focus of our review, it was an integral component that contributed to a climate of lax internal controls and weak operating procedures within RVA.

FCMAT
Joel D. Montero, Chief Executive Officer
1300 17th Street - City Centre, Bakersfield, CA 93301-4533 • Telephone 661-636-4611 • Fax 661-636-4647
755 Baywood Drive, 2nd Floor, Petaluma, CA 94954 • Telephone: 707-775-2850 • Fax: 661-636-4647 • www.fcmat.org
Administrative Agent: Christine L. Frazier - Office of Kern County Superintendent of Schools

Evaluation of NJESD's oversight procedures was essential to our investigation of RVA to determine how fraud or other illegal acts could have taken place and what transpired that led NJESD to bring forth accusations of fraud, misappropriation of funds or other illegal acts. As such, NJESD's actions or inactions are important to our opinion. Many of the weaknesses and concerns pertaining to RVA could have been addressed early on in the charter's first year had NJESD monitored the charter school's operational practices in a timely manner. We do state that NJESD's oversight practices are lacking; however, we do not state that the district is the final responsible party for management or governance decisions of the charter school.

The Legislature has imposed oversight responsibilities on authorizing agencies and has called for oversight to be addressed in memoranda of understanding or other documents establishing procedures agreed to between authorizers and charters.

> ***Education Code (EC) 47604(c)*** *An authority that grants a charter to a charter school to be operated by, or as, a nonprofit public benefit corporation is not liable for the debts or obligations of the charter school, or for claims arising from the performance of acts, errors, or omissions by the charter school, if the authority has complied with all oversight responsibilities required by law, including, but not limited to, those required by Section 47604.32 and subdivision (m) of Section 47605.[emphasis added]*
>
> *EC* ***47604.32.*** *Each chartering authority, in addition to any other duties imposed by this part, shall do all of the following with respect to each charter school under its authority:*
>
> . . .
>
> *(d) Monitor the fiscal condition of each charter school under its authority. [emphasis added]*
>
> . . .
>
> *(f) The cost of performing the duties required by this section shall be funded with supervisorial oversight fees collected pursuant to Section 47613.*

The Charter Schools Act (Act) is a framework to be used as a launching point for establishing best practices within and among charter schools and their authorizers, and the language of the Act has been constructed for this purpose. Language in the Act clearly indicates that the procedures of each charter school are established through agreement between the petitioning charter school and its authorizing LEA. Excerpts from the Education Code that demonstrate this point include the following:

> ***EC 47605(g)*** *The governing board of a school district shall require that the petitioner or petitioners provide information regarding the proposed operation and potential effects of the charter school, including, but not limited to, the facilities to be used by the school, the manner in which administrative services of the school are to be provided, and potential civil liability effects, if any, upon the school and upon the school district. [emphasis added]*
>
> ***EC 47607(c)(1)*** *A charter may be revoked by the authority that granted the charter under this chapter if the authority finds, through a showing of substantial evidence, that the charter school did any of the following:*
>
> *(A) Committed a material violation of any of the conditions, standards, or procedures set forth in the charter. [emphasis added]*
>
> *. . .*
>
> *(C) Failed to meet generally accepted accounting principles, or engaged in fiscal mismanagement. [emphasis added]*

The importance placed by the Legislature on oversight is demonstrated by the requirement in EC 47616.5 that the Legislative Analyst evaluate the effectiveness of the charter school approach with respect to a number of factors, including:

> *(j) The governance, fiscal liability and accountability practices and related issues between charter schools and the governing boards of the school districts approving their charters." [emphasis added]*
>
> *(k) The manner in which governing boards of school districts monitor the compliance of the conditions, standards, and procedures entered into under a charter. [emphasis added]*

The letter states that our report applies standards and requirements that are well above and beyond the requirements imposed by law. As noted above, Education Code 47604.32(d) requires the authorizer to monitor the fiscal condition of a charter school. The only way to discover financial mismanagement is to actually comply with this mandate.

The law does not prevent authorizers from establishing realistic and appropriate oversight requirements that include reasonable monitoring activities, or from making appropriate inquiries sufficient to evaluate whether the new charter school is effectively executing what was described in the approved petition. EC 47604.3 requires a charter school to respond to any reasonable request for information from, among others, its authorizing agency and the county superintendent of schools. For a brand new start-up charter school, with no established track record of successful implementation of a charter petition, it is essential that the authorizing LEA monitor activities and evaluate progress in implementing the plan in a timely manner as described in the petition.

FCMAT engaged with the administration and staff of the NJESD during our fieldwork and in the days that followed. NJESD provided FCMAT with numerous documents including a flash drive containing 7,315 items. Additionally, 196 pages of communications were provided to FCMAT by NJESD to demonstrate its engagement with RVA. From all of this it was apparent that the first inquiry made into the charter's fiscal matters was initiated by the SJCOE in August 2014. This was 15 months after approval of the charter petition, and was made in conjunction with RVA's submission of its Pupil Estimates for New or Significantly Expanding Charters (PENSEC) report. There was no evidence of any question or concern from NJESD regarding RVA's 2014-15 budget or its PENSEC. The first evidence that NJESD had questions and demonstrated concern took place in December 2014 in conjunction with RVA's 2014-15 Non-Classroom Based Funding Determination Form and its 2014-15 First Interim Budget Report. This interaction took place just short of 19 months after authorization.

Authorizer oversight begins when the charter petition is approved. Timely monitoring of the progress of implementing the plan described in the charter petition, both from the fiscal standpoint and the operational standpoint, and offering support and guidance in areas where struggles occur, is beneficial to all parties. Delaying monitoring activities until halfway through a charter's second year is an oversight failure. RVA is a prime example of what can go wrong when oversight is delayed. In fact, RVA failed to execute several foundational components of the approved charter petition, including finishing the process for obtaining official nonprofit status as a 501(c)(3) nonprofit public benefit corporation. The founder acknowledged that the paperwork was never completed and submitted, and no letter of determination was issued by the Internal Revenue Service.

The letter states that "There is no requirement in law for an authorizer to specifically monitor the application for tax-exempt status." To this we would generally agree. However, this requirement was established

3

in the charter petition and agreed upon by NJESD and the charter school as a condition of approval. Language in the petition states,

> "The charter school will be a directly funded independent charter school and will be operated by Renew Virtual Academies, a California Nonprofit Public Benefit Corporation, pursuant to California law upon approval of this charter." *[emphasis added]*

We believe that a charter school authorizer has a duty to verify and/or confirm that the conditions of a charter school petition are satisfied and/or followed by the charter school. Filing Articles of Incorporation is only one of several steps in the process for becoming a California Nonprofit Public Benefit Corporation; federal and state tax exemptions must also be obtained. The founder of the charter school admitted to FCMAT that she had not completed and/or submitted IRS Form 1023, application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. RVA technically was not a California Nonprofit Public Benefit Corporation at all, let alone prior to the approval of the charter petition. Thus, NJESD failed in its duty to verify that this condition of the petition was met, prior to approval of the petition.

Further, the memorandum of understanding between NJESD and RVA in Section II (Designation of School), item A, states the following:

> "The Charter School shall be known as Renew Virtual Academy – K12#1. The Charter School **has attained status** as a nonprofit public benefit corporation and shall operate as one pursuant to California law." *[emphasis added]*

This too is factually inaccurate. Another example of NJESD failing to follow the terms agreed upon in the charter petition and MOU relates to the conflict of interest code. The letter states that the NJESD did not have a duty to confirm that RVA submitted and received approval of its conflict of interest code. Charter schools are bound by the Political Reform Act of 1974, and/or California Government Code Section 87100; and a conflict of interest code was incorporated into the charter petition and as such is considered to be a condition of approval.

The creation and adoption of a conflict of interest code is only part of the process. It must be submitted to the code reviewing body for approval. While the letter states that NJESD's obligation was to ensure a conflict of interest policy was in place, it was also necessary to verify the completion of the process to formalize and/or implement the policy; ensuring that it is in fact "in place."

Additional findings in our report that you question include the following:

- *Failure to monitor in a timely manner enrollment projection against actual enrollment to ensure adequate progress is achieved in meeting the requirements presented in the petition submitted for approval. [emphasis added]*

  Charter schools are approved based on the content of their petition, which includes estimates and assumptions. The authorizer has a vested interest in monitoring and confirming that the charter is making progress toward implementing the plan outlined in the petition and/or making modifications to the plan where necessary.

  The letter states that FCMAT reported that NJESD raised concerns prior to RVA's first opening year, which we did not. In fact, we made it clear that the concerns were raised in August 2014, after the SJCOE questioned the data submitted by the charter school in its PENSEC. This was

4

a year and three months *after* NJESD authorized the charter, which is not timely. The budget assumptions incorporated in the charter petition were based on enrollment of 200 students. The district should have been reviewing the charter school's progress in actually recruiting the 200 students prior to the start of the first operational year as a means of monitoring the proposed budget included in the charter petition.

- *Failure to monitor fiscal conditions <u>in a timely manner</u> to ensure revenue and expenditures projections were realistic, obtainable or appropriately revised. [emphasis added]*

  We reiterate the importance of performing oversight activities in the first year of a new charter school as opposed to waiting for the first operational year. A great deal of work is performed by a new charter school during the planning stage which is accompanied by a great deal of financial activity. It is essential to the success of any new business, let alone charter school, that the activities conducted during this planning year are in line with the plan outlined in the petition and that those actions are leading to the projected outcome. If not, modifications must be made to the budget to ensure fiscal solvency. It is not necessary or prudent to wait until the PENSEC report is submitted to monitor recruitment and enrollment activity. This report should simply confirm or contradict the content of preceding communications between the charter and the authorizing LEA.

  NJESD provided FCMAT with more than 7,315 files containing documentation and communications from and between both NJESD and RVA. Additionally, NJESD provided 196 pages of communications to substantiate its engagement and interaction with and between RVA and SJCOE. FCMAT reviewed all of the documentation provided by NJESD. Nowhere in this documentation was there evidence that NJESD was monitoring RVA until well into the first operational year, more than a year and 3 months after authorization. Furthermore, inquiries with NJESD staff provided significant inconsistencies in activities conducted by all parties involved in the fiscal oversight practices.

- *Failure to ensure that the charter school established and implemented adequate internal controls and operational procedures.*

  The authorizer of a charter school has the responsibility to demonstrate that it exercised due diligence in fiscal oversight of a charter school. Internal controls are the principal mechanism for preventing and/or deterring fraud or illegal acts. In our opinion EC 47605(g), previously cited, sets the groundwork for authorizing LEAs.

  It is necessary for the authorizing LEA to inquire about the business practices of a start-up charter school to ensure that internal controls and best practices for fiscal management are established. This includes the processes established by the charter school for accounting for revenue and expenditures. We found no evidence of such practices prior to the engagement by the charter school of a back office provider in July 2014. This was a year and two months after authorization of the charter school and six months before NJESD reported RVA's fiscal failure.

  As stated in our report, 114 financial transactions were conducted prior to July 1, 2014. FCMAT identified 11 cash receipt transactions totaling $228,648 and 102 cash disbursements totaling $216,947.80 in bank statements of the charter school for the period May 2013 through June 30, 2014. The back office provider reported to FCMAT it struggled to obtain historical financial documentation from RVA for the timeframe preceding the engagement. This financial activity was not monitored or reviewed by RVA and no independent audit was engaged or conducted.

While the independent auditor is required to assess the LEA's internal controls in conjunction with the independent audit, it is the LEA that should establish these controls, long before the audit takes place. Additionally, EC 47605(b)(5)(I) is clear that it is the language in the charter petition that describes the process for an independent charter schools audit. EC 47605(m) requires a charter school to transmit its annual independent financial audit to the authorizer, the Controller, the county superintendent and the CDE by December 15 of each year. This same requirement is stated on pages 138 and 158 of RVA's charter.

We note that the charter school did not have independent audits during its first two fiscal years after authorization, ending June 30, 2013 and June 30, 2014 respectively. This failure by RVA to file the independent financial audit report for the first two fiscal years should have raised reasonable concerns by NJESD. By contrast, the audit you refer to is the close out audit of the charter school, and at the time of FCMAT's fieldwork NJESD was still working on getting that audit performed.

Additionally, it artificially limits accountability to suggest that as the recipient of the Public Charter School Grant Program (PCSGP) funding, the charter school is accountable only to the authority granting those funds. LEAs are recipients of funding from multiple sources and authorities, and must comply with the funding requirements for each. LEAs are accountable not only to the funding agency, but also to their stakeholders and oversight agencies as provided in law.

The first annual independent audit should occur after an approved charter school has spent or received any money (from any source), obtained its first asset and/or incurred its first obligation. In most every case, the first independent audit would be due the first fiscal year ending after the charter petition is approved.

We have given careful consideration to the matters raised in your letter. For the reasons stated above, we believe our emphasis on the oversight role and responsibilities of NJESD as the authorizing agent of RVA is relevant to our inquiry and consistent with the requirements of the statutes and the memorandum of understanding between the district and RVA.

Sincerely,

Joel D. Montero
Chief Executive Officer

Marisa A. Ploog, CPA, CFE, CICA, CGMA
Fiscal Intervention Specialist

CC: Kristopher L. Carpenter, Esq., Young, Minney & Corr
James A. Mousalimas, Superintendent, San Joaquin County Office of Education