



C SIS California School Information Services

Butte County Office of Education

Extraordinary Audit of the Blue Oak Charter School

November 16, 2017

Michael H. Fine
Chief Executive Officer





November 16, 2017

Timothy Taylor, Superintendent
Butte County Office of Education
1859 Bird Street
Oroville, CA 95965

Dear Superintendent Taylor:

In February 2017, the Butte County Office of Education and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement to conduct an AB 139 Extraordinary Audit of the Blue Oak Charter School pursuant to Education Code Section 1241.5 (c). The county office received reports and documentation to support the assertion that fraud, misappropriation of funds or other illegal practices may have occurred regarding the use of credit cards and cash handling practices by personnel of the charter school.

The primary focus of the review was to determine, based on the testing performed whether:

1. Adequate management and internal controls are in place regarding the charter school's reporting and monitoring of financial transactions, and
2. Based on that assessment, whether fraud, misappropriation of funds or other illegal fiscal practices may have occurred.

Specific audit objectives included evaluating the establishment, implementation and effectiveness of policies, procedures and internal control activities through the review of financial transactions recorded by the charter school. The specific focus of this review was the use of credit cards, expenditure of funds for personal or other noncharter business purposes and cash handling procedures.

This report contains the study team's findings and recommendations.

FCMAT appreciates the opportunity to serve you and extends thanks to all the staff of the Butte County Office of Education and the Blue Oak Charter School for their cooperation and assistance during fieldwork.

Sincerely,

Michael H. Fine
Chief Executive Officer

FCMAT

Michael H. Fine, Chief Executive Officer

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Table of Contents

About FCMAT	iii
Introduction	1
Audit Scope, Procedures and Fieldwork	3
Transaction Sampling	5
Definitions of Fraud, Internal Control and Gift of Public Funds	7
Findings	13
Internal Control Deficiencies	13
Fundraising and Foundations	21
Substantive Testing	25
AB 139 Extraordinary Audit Report Summary: Potential Fraud	39
Appendices.....	41

About FCMAT

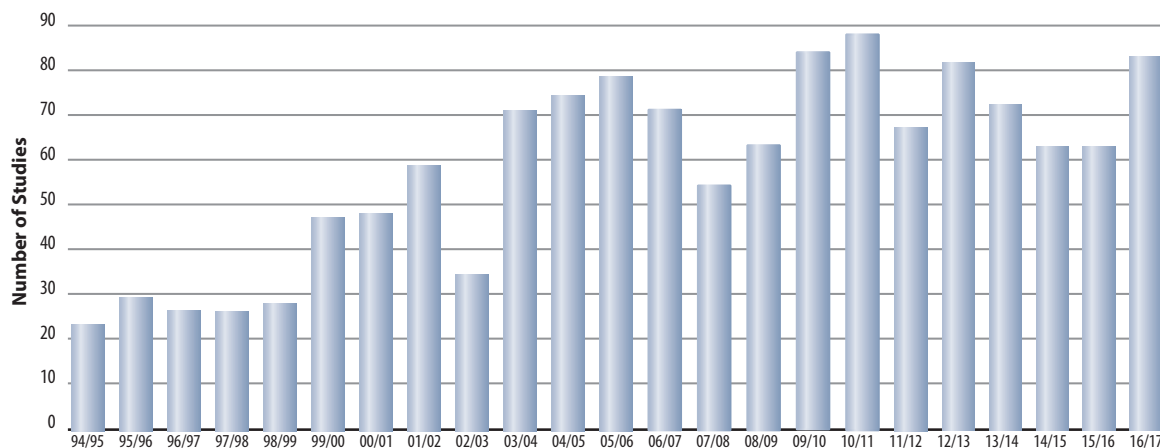
FCMAT's primary mission is to assist California's local K-14 educational agencies to identify, prevent, and resolve financial, human resources and data management challenges. FCMAT provides fiscal and data management assistance, professional development training, product development and other related 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, support the training and development of chief business officials and help to create efficient organizational operations. FCMAT's data management services are used to help local educational agencies (LEAs) meet state reporting responsibilities, improve data quality, and inform instructional program decisions.

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 LEA 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 has continued to make adjustments in the types of support provided based on the changing dynamics of K-14 LEAs and the implementation of major educational reforms.

Studies by Fiscal Year



FCMAT also develops and provides numerous publications, software tools, workshops and professional development opportunities to help LEAs operate more effectively and fulfill their fiscal oversight and data management responsibilities. The California School Information Services (CSIS) division of FCMAT assists the California Department of Education with the implementation of the California Longitudinal Pupil Achievement Data System (CALPADS). CSIS also hosts and maintains the Ed-Data website (www.ed-data.org) and provides technical expertise to the Ed-Data partnership: the California Department of Education, EdSource and FCMAT.

FCMAT was created by Assembly Bill (AB) 1200 in 1992 to assist LEAs to meet and sustain their financial obligations. AB 107 in 1997 charged FCMAT with responsibility for CSIS and its state-wide data management work. AB 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. AB 2756 (2004) provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans.

In January 2006, Senate Bill 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 Michael H. Fine, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

Introduction

Background

The Blue Oak Charter School is located in the northwest portion of Butte County in Chico California. The school was established in 2001 under a charter school petition approved by the Butte County Office of Education; subsequent authorization came from the Chico Unified School District, which remains as the school's authorizer under agreement through 2018. The charter school has grown from one kindergarten class in 2001 to serving approximately 400 students in grades K-8.

A seven-member council consisting of three parent representatives and four community members governs the charter school. Since 2012, three different administrators have led the school. At the time of FCMAT's fieldwork, the charter school was under the leadership of an interim executive director and an interim director of operations. The interim director of operations served the charter school in the business manager position before her retirement and also provided support managing student data and California Longitudinal Pupil Achievement Data System (CALPADS) reporting during the transition of her replacement. The interim director of operations serves as a governing board member for the Chico Unified School District, the charter school's authorizing agency.

After receiving several reports about the questionable business practices of the former business manager and superintendent/executive director, the Blue Oak Charter Council sought guidance from legal counsel and the Butte County Office of Education. In January 2017, the county office requested that FCMAT conduct an AB 139 extraordinary audit to determine if fraud, misappropriation of funds or other illegal activities may have occurred at the charter school.

Study and Report Guidelines (AB 139 Audit Authority)

Education Code Section 1241.5(c) permits a county superintendent of schools to review or audit the expenditures and internal controls of any charter school in the 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 basis of this review is to determine if sufficient evidence exists to further investigate the findings, or there is evidence of criminal activity that should be reported to the local district attorney's office for further investigation by law enforcement.

Based on the allegations and information provided, the Butte County Office of Education requested that FCMAT assign professionals to conduct an AB 139 extraordinary audit under the provisions of Education Code Section 1241.5(c). A contract was entered into on February 1, 2017. As part of the audit, FCMAT interviewed the individuals who submitted the allegations, past and present charter school management, staff and council members, and reviewed documents to determine if instances of fraud, misappropriation of funds or other illegal practices may have taken place that would warrant further investigation by the local district attorney's office.

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 plain language, discourages the use of jargon and capitalizes relatively few terms.

Study Team

The study team was composed of the following members:

Marisa A. Ploog, CPA, CFE, CICA, CGMA FCMAT Intervention Specialist Bakersfield, CA	Ellen Bolding FCMAT Consultant Bakersfield, CA
Leonel Martínez FCMAT Technical Writer Bakersfield, CA	Colleen Patterson FCMAT Consultant Bakersfield, CA

Each team member reviewed the draft report to confirm its accuracy and to achieve consensus on the final recommendation.

Audit Scope, Procedures and Fieldwork

Fraud investigations consist of gathering information and documentation pertaining to specific allegations, establishing an audit plan and performing various audit procedures to determine whether fraud may have occurred; evaluating the loss associated with the fraud; and determining who was involved and how it may have occurred.

Although there are many different types of fraud, occupational fraud, including asset misappropriation and corruption may occur 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; this includes taking cash and/or causing an entity to pay for goods or services procured for the personal benefit of the employee rather than for business purposes. 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

Scope and Procedures

The primary objective of FCMAT's review is to determine and report to the county office and the charter school governing board whether there are adequate management controls for the charter school's reporting and monitoring of financial transactions, and whether fraud, misappropriation of funds or other illegal activities may have occurred during the period under review. The specific objectives of the study include evaluating the charter school's policies, procedures, internal controls and transactions.

FCMAT visited the Blue Oak Charter School May 23-26, 2017 to conduct interviews, collect data and review documents. FCMAT interviewed charter school council members, current and former administrative personnel, business office staff, and parents to obtain an understanding of the school's general business practices and events that transpired during the period under review, including any alleged financial mismanagement, abuse or fraud. During interviews, FCMAT asked questions about the allegations; the internal control structure including control activities and lines of authority and oversight of charter school business activities; transactions and activities of the charter school. Open-ended questions were designed to elicit information about other possible irregularities regarding the scope of the study.

To investigate the allegations, the team evaluated policies, procedures and other internal control activities and tested transactions recorded by the charter school to verify the compliance and effectiveness of those controls.

Transaction Sampling

To accomplish the objectives of this study, FCMAT developed and conducted a number of audit test procedures to provide an analysis and understanding of the allegations and potential outcomes. Audit objectives, transaction sampling and substantive testing were based on the audit team's experience and professional judgment and did not include the testing of all available transactions and records. Sample testing and examination results are intended to provide reasonable but not absolute assurance on the accuracy of the transactions and financial activity and/or identify if fraud, misappropriation of funds or other illegal acts may have taken place during the period under review.

FCMAT reviewed, analyzed and tested business records including deposits, cash disbursements, bank reconciliations, general ledger activity, vendor payment history, financial reports, board policy and administrative regulations, board meeting minutes, and other relevant internal documents. The charter school's detailed general ledger, check register and other reports containing detailed transaction data for the 2014-15, 2015-16 and 2016-17 (through March 31, 2017) fiscal years were exported from the official financial record maintained by the charter school's back office provider Charter School Management Corporation (CSMC). FCMAT selected specific and random deposits and disbursement checks from these reports for review, and supporting documentation was requested from the charter school administration. FCMAT conducted a limited review of payments processed through payroll for specific employees and/or payments. FCMAT also reviewed credit card activity and available supporting documentation back to September 12, 2013.

Selected transactions were analyzed to determine compliance with board policy, operational procedures and industry standard or best practice procedures based on the team's judgment and technical expertise. Testing procedures and noted exceptions are detailed in the substantive testing section of this report. FCMAT's findings are the result of the above audit procedures, and interviews with former and current charter school staff, council members and parents.

Definitions of Fraud, Internal Control and Gift of Public Funds

Fraud

Fraud can include an array of irregularities and illegal acts characterized by intentional deception and misrepresentation of material facts. A material weakness is a deficiency in the internal control process that may lead to errors or fraud, or can be a violation of specific law or regulation. Because of the weakness, employees in the normal course of business may not detect errors in time to correct them.

Although all employees have some degree of responsibility for internal controls, the charter council, charter school superintendent/executive director and senior management are ultimately responsible for controls that employees under their supervision are expected to follow.

Occupational Fraud

Occupational fraud occurs when an organization's owners, executives, managers or employees use their occupation to deliberately misuse or misapply the employer's resources or assets for personal benefit. The three main types of occupational fraud are asset misappropriation, corruption, and financial statement fraud.

Asset misappropriation includes the theft or misuse of charter school assets and may take place in the form of cash skimming, falsifying expense claims and/or taking or using assets for personal benefit. Fraudulent reimbursement/expense schemes occur when an employee requests reimbursement or payment of personal expenses by mischaracterizing them as business related. Using charter school funds to pay for purchases that are personal, either through direct vendor payments or through the use of a charter school credit card, is another common approach to asset misappropriation.

Corruption involves an employee using his or her position of power and influence in the execution of business transactions to obtain a personal benefit that violates that employee's duty to the employer or the organization and may include entering into contracts with vendors and receiving something in exchange for entering into those contracts; for example money, meals, tickets to special events or vacations. Financial statement fraud includes the intentional misstatement or omission of material information in financial reports.

Occupational fraud is one of the most difficult types of fraud and abuse to detect; the most common method of detection comes from tips, which help prevent occupational fraud three times as often as any other detection method. According to the 2016 Report to the Nations conducted and published by the Association of Certified Fraud Examiners, asset misappropriation causes the smallest median loss (\$125,000), but is the most common form of occupational fraud, occurring in more than 83% of 2,410 reported cases. Corruption schemes accounted for 35.4% of the cases reported, with a median loss of \$200,000. There is a direct correlation between the perpetrator's position and authority in an organization and the losses incurred. Losses from fraud by owners and executives are four times higher than those from fraud by managers and seven times higher than losses incurred as a result of fraud by employees. Proper monitoring and effective oversight are also highly effective at preventing fraud.

Internal Control

The accounting industry defines the term “internal control” as it applies to organizations, including school agencies. Internal control is “a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.” [The Committee of Sponsoring Organizations of the Treadway Commission - May 2013] The reference to achievement of objectives fundamentally refers to an organization’s work of planning, organizing, directing, and performing routine tasks relative to operations, and monitoring performance.

An organization establishes control over its operations by setting goals, objectives, budgets and performance expectations. Several factors influence the effectiveness of internal control, including the social environment and how it affects employees’ behavior, the availability and quality of information used to monitor the organization’s operations, and the policies and procedures that guide the organization. Internal control helps an organization obtain timely feedback on its progress in meeting operational goals and guiding principles, producing reliable financial reports, and ensuring compliance with applicable laws and regulations.

Internal control is the principal mechanism for preventing and/or deterring fraud or illegal acts. Illegal acts, misappropriation of assets or other fraudulent activities can include an assortment of irregularities characterized by intentional deception and misrepresentation of material facts. Effective internal control provides reasonable assurance that operations are effective and efficient, the financial information produced is reliable, and the organization complies with all applicable laws and regulations.

Internal control provides the framework for an effective fraud prevention program. An effective internal control structure includes the board policy and administrative regulations established by the governing board and operational procedures used by staff, adequate accounting and information systems, the work environment, and the professionalism of employees. The five integrated components of internal control and their summarized characteristics are included in the table below.

Internal Control Component	Characteristics
Control Environment	The set of standards, processes and structures providing the basis for carrying out internal control across an organization. Includes the organization’s integrity and ethical values. Commonly referred to as the moral tone, 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.
Risk Assessment	Identification and assessment of potential events that adversely affect the achievement of the organization’s objectives and the development of strategies to react in a timely manner.
Control Activities	Actions established by policies and procedures to enforce the governing board’s directives. These include actions by management to prevent and identify misuse of the charter school’s assets, including preventing employees from overriding controls in the system.
Information and Communication	Ensures that employees receive information regarding policies and procedures and understand their responsibility for internal control. Provides opportunity to discuss ethical dilemmas. Establishes clear means of communication within an organization to report suspected violations.
Monitoring Activities	Ongoing monitoring to ascertain that all components of internal control are present and functioning, ensures deficiencies are evaluated and corrective actions are implemented.

The five components of internal control are supported by 17 underlying principles that help ensure an entity achieves effective internal control. Each of the five components listed above and their relative principles must be present and functioning in an integrated manner to be effective. An effective system of internal control can provide reasonable but not absolute assurance that the organization will achieve its objectives.

Control Environment

The internal control environment establishes the organization's moral tone. Although intangible, this 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 internal control components to be effective in achieving the goals and objectives 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 competence of employees.

The control environment can be weakened significantly by a lack of experience in financial management and/or comprehension of internal control.

Control Activities

Control activities are a fundamental element of internal control and are a direct result of policies and procedures designed to prevent and detect misuse of a charter school's assets, including preventing any employee from overriding system controls. Transaction control activities are implemented to reduce the risk in specific business processes. Examples of control and transaction 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. Supervisory controls, which assess whether the transaction control activities performed are accurate and in accordance with established policies and procedures.
5. 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 following basic concepts and procedures help ensure a strong internal control structure:

- System of checks and balances – Formal procedures should be implemented to initiate, approve, carry out, record and reconcile transactions. The procedures should identify the employees responsible for each step and the time period for completion. Key areas

requiring checks and balances include payroll, purchasing, accounts payable and cash receipts.

- Segregation of duties – Adequate internal accounting procedures should be implemented and necessary changes made to segregate job duties and protect the charter school'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.
- Staff cross-training – More than one employee should be able to perform each job. Each staff member should be required to use accrued vacation, and another staff member should be assigned to perform those duties at that time. Inadequate cross-training is often a problem regardless of the size of an organization.
- Use of prenumbered, preprinted, standardized documents – Checks, cash receipts, purchase orders, receiving reports, and tickets should all be printed by an entity independent of the charter school. Physical controls should be maintained over the check stock, cash receipt books and tickets. Using prenumbered documents without an independently reconciled log of numbers is insufficient.
- Asset security – Cash should be deposited daily, and the charter school's other property, such as computers and other equipment, should be secured and tracked. Access to supplies, including but not limited to stores, food, tools, and gasoline, should be restricted to designated employees.
- Timely reconciliations – An employee independent of the individual who is assigned to the original transaction and recording should reconcile bank statements and account balances monthly. For example, the office employee reconciling the checking account should not be the same person who maintains the check stock.
- Comprehensive annual budget – The annual budget should include sufficient detail for revenue and expenditures by school site, department and resource to identify variances and determine whether financial goals were achieved. Material variances in revenues and expenditures should be investigated promptly and thoroughly.
- Inventory records – Inventory records should be maintained that identify the items and quantities purchased, sold or designated as surplus. Physical inventory should be taken periodically and reconciled with inventory records. Inventoried items particularly susceptible to misappropriation include: technology equipment, warehouse supplies, food service commodities, and maintenance and transportation parts.

Independent auditors' reports on internal control over financial reporting are based on an audit of financial statements performed in accordance with government auditing standards. In planning and performing independent financial audits, auditors consider internal control over financial reporting to determine audit procedures that are appropriate in the circumstances. However, they will not express an opinion on internal control effectiveness because the auditors' consideration is not designed to identify all deficiencies that might be a material weakness or significant deficiency. This means that an organization may have material weaknesses or significant deficiencies that are not discovered during the audit. Therefore, the charter school should not rely on the annual independent audit as its only method for evaluating the sufficiency and effectiveness of internal control activities and/or as a means of determining fraud risk.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, detect and/or correct misstatements in a timely manner. A material weakness is a deficiency or combination of deficiencies in internal control that leads to a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or not be detected and corrected in a timely manner.

A significant deficiency is an internal control deficiency or combination of deficiencies that is less severe than a material weakness yet important enough to merit attention from those charged with governance. The following is a partial list of deficiencies and omissions that can cause internal control failures:

1. Failure to adequately segregate duties and responsibilities related to authorization.
2. Failure to limit access to assets or sensitive data (e.g. cash, fixed assets, personnel records).
3. Failure to record transactions, resulting in lack of accountability and the possibility of theft.
4. Failure to reconcile assets with the correct records.
5. Failure to detect unauthorized transactions, resulting in skimming, embezzlement or larceny.
6. Lack of monitoring or implementation of internal controls by the governing board and management, or because personnel are not qualified.
7. Collusion among employees where little or no supervision exists.

Fraud and the misuse of physical or cash assets occur when three factors converge: pressure, opportunity, and rationalization. This is known as the "fraud triangle." When two of the three factors are present, the probability that fraud will occur increases. When all three factors are present, it is almost certain that fraud will occur.

Employees should be regularly trained in what constitutes fraud and how it damages the organization. Employees should have several avenues for reporting improprieties and should be encouraged not to ignore warning signs. Risk training on suspicious situations that should be reported will help create a schoolwide culture of fraud awareness.

The charter school should also implement common fraud detection methods such as an anonymous employee hotline, surprise internal audits and/or fraud risk assessments. Knowing that someone is checking or could anonymously report suspicious behavior can deter fraudulent activity.

Gift of Public Funds

Article 16, Section 6 of the California Constitution specifies that the state Legislature cannot authorize any county, city, or other political subdivision to make any gift of public funds to an individual or corporation. Basically, Article 16 states that in the absence of a statute granting public local educational agencies (LEAs) the legal authority to make a special expenditure (e.g., for food, clothing, awards, etc.), the legality of any expenditure is determined by the "gift of

public funds” provision in the California Constitution, Article 16, Section 6. This constitutional provision prohibits making any gift of public money to any individual (including public employees), corporation, or other government agency. It states, “... the Legislature shall have no ... power to make any gift, or authorize the making of any gift, of any public money or thing of value to any individual ... whatever ...”

In general, the constitutional prohibition against the gift of public funds is not an issue when a direct and primary public purpose is accomplished so that the public receives a benefit from the expenditure. However, if the gift is to an employee or other individual, and there is no benefit to the public as a result, it can be considered a gift of public funds.

On the other hand, it is also well established that expenditures of public funds that involve a benefit to private persons (including public employees) are not gifts within the meaning of the California Constitution if those funds are expended for a public purpose. This means that public funds may be expended only if a direct and substantial public purpose is served by the expenditure and private individuals are benefited only incidentally to the promotion of the public purpose. To justify the expenditure of public funds, an LEA’s governing board must determine that it will benefit the education of students in its schools. Expenditures that most directly and tangibly benefit students’ education are more likely justified. Expenditures driven by personal motives are not justified even if they have been a longstanding local custom or are based on benevolent feelings.

If the LEA’s governing board has determined that a particular type of expenditure serves a public purpose, courts will almost always defer to that finding. Therefore, if the charter school has a board policy stating that specific items are allowable (e.g. scholarships or donations), it is more likely that the expenditure might be considered allowable.

The constitutional prohibition of gifts of public funds is designed to obstruct the misuse of public money. Gift of public funds violations occur under many circumstances. FCMAT’s experience regarding gift of public funds is that misuse often occurs under two circumstances.

1. Noble or Virtuous Purpose - An example of a noble or virtuous purpose that may be considered a gift of public funds is the purchase of flowers from charter school funds for the funeral of a student or family member of a governing board member.
2. Moral or Justifiable Obligation - A moral or justifiable obligation is the most common form of gift of public funds resulting from a desire to convey some form of gratitude. Staff members who are not formally trained in charter school and governmental policies and procedures often unknowingly participate in giving gifts of public funds because of a moral or justifiable obligation. For example, a coach may be grateful to a number of individuals who have helped with the sports program, or to individuals who are considered high-value supporters, well-known contributors, long-time friends of the program, contributed countless hours of assistance to the sport, or may not be able to afford attending an event. The coach may offer them free event tickets or distribute unsold tickets or other items.

Without a policy that has been adopted by the governing board and approved by the charter school’s legal counsel specifically approving the expenditure of charter school funds for noble, virtuous, or moral considerations such as those described above, expenditures of this type may be considered a gift of public funds.

Findings

Internal Control Deficiencies

At the Blue Oak Charter School, significant deficiencies or a complete absence in fundamental internal control elements have led to an environment with considerable risk for fraud, misappropriation of funds and misuse of assets. FCMAT identified significant weaknesses in multiple areas of internal control because of ineffective or complete lack of formalized procedures. Among these weaknesses were improper segregation of duties, improper application and/or enforcement of governing board policy, weak management and oversight of business activities, management override of limited control activities that were established, lack of oversight of internal control by the governing board and failure to detect unauthorized transactions, potential failure to record transactions and potential collusion among administrative staff.

During FCMAT's review, the team identified several circumstances that included all three factors of the fraud triangle. The opportunity for fraud varies throughout the charter school depending on the duties assigned to an employee, but includes the administrative and executive staff as well as a few specifically identified school office staff. The charter school's culture has been to use charter school assets for purposes that appear to have a personal benefit and/or for the benefit of friends, family, and community relations.

The charter school superintendent/executive director and business manager failed to demonstrate in practice an understanding of the foundational elements of fiscal management including, but not limited to, internal controls and segregation of duties, financial accounting and reporting, cost controls based on variable factors such as enrollment and free and reduced meal applications, and cash flow. (References to the superintendent/executive director and business manager throughout this report indicate the former staff members holding these positions.)

Failure to establish adequate internal controls, limiting the ability of the superintendent/executive director and business manager to access assets, combined with a lack of accountability significantly increased the risk for fraud, misappropriation of funds or other illegal acts.

While the charter school lacks formally established operational procedures for most administrative disciplines, staff members responsible for cash collections, procurement and accounts payable activities indicated they attempt to follow practices consistent with industry standard.

FCMAT's review of documentation for recorded cash collections and expenditure transactions under the previous administration demonstrated that the charter school administration and governing board failed to properly safeguard assets. While the charter school has some limited documentation on fiscal procedures, a review of transaction documentation demonstrated that proper controls consistent with industry standard and best practices were not established and/or followed. FCMAT's findings are outlined in greater detail in the substantive testing section of this report.

Employees widely question the integrity and ethical conduct practiced by the charter school administration, placing the moral tone of the organization in question. Interviews and observations made through the review of transaction documentation confirm assertions that the administration may have used its occupation and influence in making business transactions in ways that appear to deliberately misuse or misapply charter school resources or assets for personal benefit.

During interviews, staff indicated the charter school administration and some parent volunteer/community members intimidated and/or coerced them. Several staff members reported being threatened with the loss of their jobs when they inquired about questionable practices.

FCMAT found that the superintendent/executive director and business manager commonly circumvented procedures on purchasing, transaction processing and board policy. Vendor payments were processed without approved purchase request forms or other documented advanced authorization, including governing board approval, which was required for purchases of more than \$5,000. Numerous purchases, including reimbursements for the superintendent/executive director, were processed using checks issued by the business manager rather than the charter school's contracted financial service provider (back office provider) and frequently lacked proper supporting documentation. Additionally, credit cards were used for numerous purchases, most of which were not supported by proper (or any) supporting documentation.

The former business manager received purchases without any secondary observation, and did not document acknowledgment of receipt. Charter school records including supporting documentation for cash collections, deposits, cash disbursements and school inventories were lacking; charter school staff reported that many items including fixed assets remain unaccounted for.

The charter school is under the leadership of two interim administrators, but it lacks strong permanent leadership and experienced administrative staff. Proper segregation of duties are lacking across each discipline and in all functional areas including purchasing, accounts payable, accounts receivable/cash collections, human resources, payroll and asset management. Processes and procedures are not documented for most business and administrative disciplines, and guidelines are limited, weak and contradictory. The routine practices of the former administrative staff observed for the period under review are inconsistent with the industry standard and best practices. These weaknesses combined with the charter school council members' lack of sufficient oversight of the superintendent/executive director's actions have contributed to a climate that is vulnerable to fraud.

Board Policy and Operational Procedures

Board policies and administrative regulations are customarily based on laws and regulations in numerous documents, including the California Constitution, Education Code, California Code of Regulations and Government Code, federal regulations, Internal Revenue Code, case law, and industry practice. Board policies and regulations provide guidelines and directives for charter school operation and for its personnel and are a key component of internal control. It is important to ensure that board policies are developed, implemented, monitored and routinely updated to reflect changes in legislation.

As a part of this study, FCMAT requested copies of the charter school's board policies and administrative regulations on specific business and operational areas under review. While the charter school interim administration and staff struggled to provide established policy, a binder was ultimately produced containing a limited selection of established policy and other governance documents that included sections pertaining to board governance policy, fiscal policy, facilities/operations policy, curriculum and instruction policy, and the charter school advisory committee. The binder also contained the charter employee handbook and other nonpolicy-related materials. Most policies included in the binder were double-sided. FCMAT requested that charter school staff provide electronic copies of each policy; however, FCMAT was not provided complete copies of several policies despite numerous requests.

FCMAT reviewed the content of the policy binder while on site and did not observe any policy on the following:

- Management of charter school records
- Consultants
- Professional organization memberships
- Awards (staff and student)

FCMAT obtained additional policies during interviews of staff and board members and a thorough review of disorganized documentation stored in boxes that were housed in the charter school's server room. FCMAT uncovered the charter school email policy dated March 1, 2011 and the "Blue Oak School Governance and Decision Matrix" among accounts payable and attendance documents. The matrix provided a general outline of the roles and responsibilities of the governing board, school administration, faculty and parent council. A board member provided a copy of the charter schools nepotism policy that was adopted May 19, 2016, and a business office staff member provided two differing copies of the school's wellness policy, both with the same date. No administrative regulations were identified.

The employee handbook was updated August 23, 2016 and contained operational policy and procedures on the conditions of employment, leaves, wages and benefits, harassment, conflict of interest, nepotism, fundraising, cash handling and employee expense reimbursement. Sections on cash handling were much improved over practices preceding this date. Interviews with business office staff also indicate an understanding of the updated procedures and confirm that they are implemented.

The fiscal policy dated October 2005 contains limited direction on budget development, fiscal management, internal control, cash management and banking, procurement, records retention, inventory, payroll, attendance accounting, board compensation, contracts and fundraising.

While the governing board is responsible for establishing board policy and administrative regulations, management is responsible for designing and implementing operational procedures, including the system of internal control. This system should provide reasonable assurance that fraud, misappropriation of funds or other illegal acts are prevented or detected through normal operating procedures and corrected in a timely manner. When developing operating procedures, the charter school should carefully consider actions that protect its assets from misuse or fraud. The school's independent auditor should be consulted.

Once internal control activities are established and documented in policy and operational procedures, they must be implemented, and employees must be trained. Internal control activities must also be routinely monitored and evaluated for effectiveness and to verify that they are followed.

Cash Collection and Deposits

The charter school has procedural language pertaining to cash management incorporated into its board fiscal policy, employee handbook, and cash handling procedures in the business office operational procedures; however, these documents provide conflicting guidance.

Staff reportedly follow the employee handbook, updated on August 23, 2016. For the purpose of FCMAT review, the board fiscal policy and guidance in the operational procedures were used to evaluate cash collections and deposits recorded before August 23, 2016.

The charter school has limited documented guidance on cash handling procedures for fund-raising, Nutrition Services and classroom-collected donations. FCMAT was provided with a copy of “Cash Handling Procedures in the Business Office” dated December 2, 2015. A handwritten note on the procedures stated they were created and adopted in October 2015 because of a recommendation from the school’s independent audit. This document includes only cash collections procedures for teacher collections of donations for field trip or other class activities, parent sponsored fundraiser proceeds, and Nutrition Services payments; no reference is made to general cash collections for the charter school. These procedures do not cover general cash collections accepted in the charter school business office or making and recording deposits.

For teacher and parent collections, the Cash Handling Procedures in the Business Office state that a teacher or parent representative is to complete the cash count form, and the total of the deposit is to be initialed and the deposit submitted to the business office. The business office representative is to conduct a secondary count, initial and date the cash-count form confirming the deposit, and forward a copy of the verified cash-count sheet back to the initiator. If the business office is closed, the funds are to be placed in a locked business office deposit box located in the administration hallway.

The requirements and timelines for the deposit of cash receipts established in the Board Fiscal Policy under “Banking Arrangements” states “All funds received shall be deposited . . . in no event later than 48 hours after receipt.” This conflicts with the procedures for deposit timeline requirements described in the cash handling procedures in the business office, which states that parent sponsored fundraising proceeds are to be deposited into the Tri Counties Bank account no less than two times per month; procedures for teacher collected donations state that deposits will be kept in the business office safe until a deposit to the bank is processed, which would fall under the 48-hour rule according to the board fiscal policy.

For Nutrition Services receipts, cash received on site for student-purchased meals is to be forwarded to the business office representative twice monthly and deposited into the account at the Golden Valley Bank monthly. Federal and state reimbursements and proceeds received through the school’s meal service provider, OrderLunches.com, are to be deposited within 10 days of receipt.

Board Fiscal Policy section H Fundraising, Grant Solicitation, and Donation Recognition, states the following:

The board shall be notified no later than the next regular board meeting of the award or receipt of any funds and shall approve the receipt of any grants, donations, or receipts of fundraising proceeds prior to their deposit in the school’s accounts.

While there is conflicting guidance regarding the timing of deposits, policy clearly indicates the governing council anticipates reports from the administration on the receipt of donations and fundraising proceeds at regularly scheduled board meetings. FCMAT found no indication in minutes that activities were reported to the board or finance committee.

The charter school lacks procedures for documenting the acceptance of cash payments from parents and/or students for any of these purposes. Through interviews and review of documentation, FCMAT found that the charter school did not use prenumbered, preprinted, standard receipts to document the acceptance of individual cash payments received by teachers, parents, Nutrition Services staff or school office staff, and cash receipts logs were not created.

Board policy, internal controls and operational procedures are insufficient to ensure revenues are properly recorded and recognized, and the charter school's assets are properly safeguarded. A review of transactions and records indicate the existence of management override of those limited controls and procedures observed by FCMAT.

Purchasing

To provide for audit and fiscal controls, the charter council established fiscal management procedures that were incorporated into the fiscal policies and dated October 2005. Section B Controls, Budget, and Fiscal Management states the following:

The Blue Oak Charter School will maintain in effect the following principles in its ongoing fiscal management practices to ensure that:

1. Expenditures are authorized by and in accordance with amounts specific in the board approved adopted budget,
2. School's funds are managed and held in a manner that provides a high degree of protection of the school's assets, and
3. All transactions are recorded and documented in an appropriate manner.

Policy language goes on to indicate that all nonpayroll expenditures require a requisition form documenting the authorization by the administration and "all purchases over \$500 must include documentation of a good faith effort to secure the lowest possible cost for comparable goods and services;" however, the referenced attachment in the same policy states "the business manager must get competitive bids for orders over \$500."

Attachment A, Procurement Procedures and Guidelines, referenced under the purchasing procedures section of the fiscal policy, includes procedures indicating that expenditures can be initiated through one of three methods including the following:

1. Submitting the request for advance authorization and, once approved, items are ordered by the school's business manager.
2. Submitting the request for advanced authorization and using personal resources to make the purchase. Reimbursement can be made only when a reimbursement form is submitted accompanied by the completed requisition and the original receipt.
3. Purchase through the use of parent guild funds, which must be coordinated through the administration through a separate funding-request process.

Fiscal policy and referenced attachments have conflicting guidance. The lack of well-structured fiscal practices on purchasing and accounts payable partly demonstrates the inexperience of business office staff, management and governance.

Contracts, Bidding and Capital Outlay

The charter school has established limited language on the authority to enter into contracts, bidding and capital outlay. The Blue Oak Charter Council Fiscal Policy section G Authority to Enter into Contracts and Agreements states the following:

Contracts and agreements in excess of \$3,000 must be submitted for board approval and may be executed by the director or other person specifically designated by the Board after the Board has duly approved the contract or agreement.

In addition to the bid requirements, Fiscal Policy Section G states, “the director may enter into contracts and agreements *not to exceed \$2999 without board approval.*”

Board Governance Policy #5 states the following:

The Board confers with the administration, architects, consultants and staff to make final determination relative to matters of capital outlay with special reference to buildings, sites, major improvements and equipment over \$5,000.00 upon recommendation of the Director.

Travel, Conference and Employee Reimbursements

The charter school employee handbook includes limited guidance for employee expense reimbursement, stating the following:

Although incurring reimbursable expense is generally discouraged, BOS will reimburse employees for any reasonably necessary BOCS materials incurred while on assignment away from the normal work location.

The policy goes on to state, “All material purchases must have preapproval by the Executive Director.”

The tax treatment for employee expense reimbursement for travel, including meals, lodging and car expenses, is established through Internal Revenue Code (IRC). Specific guidance on the tax treatment of these expenditures is provided in several resources issued by the IRS including the following:

- Publication 463, Travel, Entertainment, Gift, and Car Expenses
- Publication 15 (Circular E) Employer’s Tax Guide
- Publication 15-B Employer’s Tax Guide to Fringe Benefits (Office of Federal, State and Local Governments)
- Limitations and specific requirements on the tax treatment of employee business expenses are described in detail in the above IRS publications. Each publication is available online at IRS.gov.

All ordinary and necessary employee business expenses for travel that would otherwise qualify for an employee tax deduction may be recognized by the employer, employee or partly by both depending on certain criteria. Employee reimbursements for each qualified business expense must meet specific conditions to determine the tax implications. The tax treatment is determined based on two paths for reporting employer paid advances, reimbursements and charges for employee business expenses; an accountable plan and a nonaccountable plan.

Under an accountable plan, allowances or reimbursements paid to employees for qualified deductible expenses incurred while performing services as an employee are excluded from wages and are not subject to taxation. The core elements demonstrating the establishment of an accountable plan are most commonly found in board policy and operational procedures and require the following:

- Identification of the business connection/purpose of the expenditure.

- Adequate accounting and substantiation of the expenditure by the recipient within a reasonable period of time.
- The return of any amounts advanced that were in excess of substantiated expenses within a reasonable period of time.

Adequate accounting is demonstrated when the employee provides documentation that verifies the date, time, place, amount, and business purpose of expenses. Receipts are required unless the reimbursement is made under a per diem plan [Reg. Section 1.62-2(e); Reg. section 1.274-5(b)(2)].

Travel expenditures including the cost to travel to, from and while at the business destination, meals, lodging and incidentals, are considered qualified when the expenses are incurred for temporary business travel outside the area of an employees' tax home. The tax home is defined in the IRS guidance as the general vicinity (including the entire metropolitan area) of the employees' primary place of business. The guide also states the following:

The statutory phrase "away from home" has been interpreted by the U.S. Supreme Court to require a taxpayer to travel overnight, or long enough to require substantial "sleep or rest."

Additionally, when meal per diems are used, reimbursement is to be prorated on the day travel begins and the day travel ends. This practice is routinely extended to meal reimbursements that are not paid at per diem rates as well.

Payments to employees for travel and other necessary expenses are classified under a nonaccountable plan and are treated as wages subject to taxation if one of the following occurs:

1. The employee is not required to **or does not** substantiate timely those expenses with receipts and/or other appropriate documentation,
2. The employee is not required to **or does not** return timely any amount he or she was advanced that was not used for qualified business expenses,
3. Payments are made to the employee regardless of whether the employer expects the employee to have qualified business expenses, or
4. The amount paid as a reimbursement would otherwise have been paid as wages.

The charter school lacks written fiscal procedures including a standardized travel request and/or reimbursement form for documenting preauthorization and adequate accounting information for business-related charter school travel and conference attendance and/or other employee reimbursements. No verification of departure or return time and actual certification of attendance is obtained and/or documented. No receipts were provided, and many of the claims reviewed by FCMAT did not include a description of travel purpose and/or destination.

The employee reimbursement policy should reflect current IRS guidelines since any reimbursements that are more than IRS limits are taxable income to the employee. This includes limits on travel and daily food reimbursements as well as automotive expenses.

Credit Cards

FCMAT requested any policy on the issuance and use of school credit cards, but charter school staff could not provide it.

Receiving

No process is established for documenting receipt of goods or services, signing for deliveries and using packaging slips to support payment. Interviews with staff describe items being received in the main office, generally by the business manager, who then forwarded contents to the staff member who requested the order.

Accounts Payable

There are no written procedures for an effective accounts payable process. Charter school procurement procedures are only specific as they relate to accounts payable reimbursements for authorized purchases. School business office personnel described the accounts payable practices followed by the business office, which FCMAT used as the basis for testing transactions.

Segregation of Duties

Segregation of duties is clearly lacking for all business activities including cash handling, purchasing and accounts payable. No single individual should have the authority to independently approve purchase requests, order items, receive goods, code expenses, maintain check stock, sign on the bank account, mail checks, receive cash, count cash, prepare the bank deposits, and take deposits to the bank. The business manager performed all of these tasks for the charter school, mostly independently of any review and/or approval.

Small school districts and charter schools generally cannot afford to staff administrative offices sufficiently to achieve ideal segregation. In these cases, the charter school should implement alternative control activities that require actions by a second party to complete any given process. The goal is to ensure that no single person can establish a vendor, create a purchase order, process a vendor invoice, sign a check (or approve the accounts payable for payment processing) and distribute payment. The charter school's business manager has the ability and responsibility to do all of the above.

Fundraising and Foundations

The Blue Oak Charter Parent Guild and the Parent Council Fundraising Committee worked together to establish the Blue Oak School Foundation. In January 2012, that foundation formally joined the North Valley Community Foundation. The Blue Oak School Foundation was a program of the North Valley Community Foundation and was required to follow the latter foundation's rules and regulations in exchange for using its tax exempt identification number. The Blue Oak School Foundation was governed by an administrative board of 5-9 members, with a minimum of three voting members. Interviews and records indicate that the spouse of the Blue Oak Charter School business manager was an officer of the foundation for an unidentifiable period of time.

Interviews indicate that the Blue Oak School Parent Council made the original deposit into the North Valley Community Foundation for approximately \$2,500. Blue Oak subsequently deposited few funds into the North Valley account, and the expenses paid from this account were minimal. Interviews indicate that disbursement guidelines for the use of funds from this account were conservative. The superintendent/executive director began efforts to become a signer on the North Valley account in June 2014. In October 2014 the superintendent/executive director advised the Blue Oak School Foundation board to close the North Valley account and transfer the account balance to the Blue Oak Charter School. The superintendent/executive director reportedly assured the foundation that the funds would be considered "restricted" and could not be accessed by other groups or the school's general fund.

On March 31, 2015 the North Valley Community Foundation issued six checks totaling \$9,369.41 to Blue Oak Charter School, closing the foundation account. The North Valley Foundation gave explicit written instructions to the charter school on each check representing donated funds and described how the funds were to be designated and spent by the school. There was no identifiable evidence that any of the foundation's funds were deposited into any account maintained by the charter school. FCMAT could not determine how the funds were accounted for and spent after the dissolution of the account. FCMAT's interviews indicated that the superintendent/executive director and the business manager each received \$5,000 stipends to reimburse them for dissolving the foundation, but there was no evidence of these transactions.

Subsequent to FCMAT's fieldwork, the team learned that the charter school had a second separate account with North Valley Community Foundation. However, the foundation denied FCMAT's request for these records and refused to discuss charter school accounts with FCMAT without the presence of legal counsel.

Interviews indicate that some time before 2015-16, a separate bank account was opened at Tri Counties Bank to process fundraising activities. FCMAT requested bank statements on this account for the 2014-15 fiscal year through April 2017, but was provided only those for the 2015-16 fiscal year forward.

Transactions reviewed by FCMAT for the 2014-15 fiscal year indicate that despite having established a separate bank account for fundraising activity, the business manager commingled fundraising revenue and expenditures with general operating funds. FCMAT's review of activity for each account during this timeframe found checks issued from the charter school primary operating account for fundraising expenditures and class field trips that should have been paid from the fundraising account. Additionally, \$65,000 from this account was drawn for "Steiner stipends" which are payments made to certificated staff for attending the Rudolf Steiner College. The amounts paid to employees are reportedly treated as reimbursements of tuition until defined educational objectives are met and paid as compensation afterward.

FCMAT's review of transactions for the 2015-16 fiscal year indicates that checks for fundraising expenses continued to be issued from the charter school primary operating account. Donations were also deposited directly into the primary charter school operating account during this same time. Expenditures drawn from the charter school general operating account included payments to an individual who established the failed Chico Green School Charter School with the spouse of the Blue Oak Charter School business manager. Also identified were expenditures for class field trips, reimbursements for expenditures at liquor stores coded to fundraising, and "Steiner stipends" paid to charter school employees, which should have been processed through payroll. The payment of stipends outside of payroll may have violated proper payroll tax and IRS reporting requirements. Interviews with the former business manager indicated that she failed to understand these requirements. Charter schools may be exempt from Education Code Section 32435(a), which states the following:

No school district, county board of education, or county superintendent of schools shall expend any public funds on the purchase of alcoholic beverages.

However, the intent of the legislature clearly indicates that this is not a proper use of taxpayer funds.

During the period under review, the business manager's spouse reportedly organized at least one fundraising event for the charter school that was deemed a financial failure by those interviewed; however, due to the poor accounting records this is not verifiable. Blue Oak Charter Council minutes dated June 9, 2015, indicate that one employee addressed the council declining to have her employment contract renewed largely because of issues that arose during the fundraising event's production and requested that the council further investigate matters. FCMAT received numerous reports of contentious relationships between staff members and parents with spouse of the business manager. Those interviewed further voiced concerns regarding the personal relationships between the superintendent/executive director, the business manager and her spouse and perceived there was a conflict in managing and overseeing financial activities for fundraising events.

The business manager issued most checks drawn from the charter school operating account. The back office provider reported that detailed supporting documentation for these transactions was often not provided. Instead, the business manager provided the vendor name, the amount of the check, and the nature of and/or account code for the transaction. The lack of control and proper accounting for donations and fundraising expenditures allowed for the comingling of funds received from donations and fundraising activities and school operating funds. Insufficient financial records were available to allow for the analysis of income generated, expenses paid and any remaining profitability for fundraising activities because of the lack of controls and accounting procedures.

According to the board fiscal policy, the administration must approve in advance all fundraising or grant solicitation activities on behalf of the school, and the board is to be notified no later than the next regular board meeting of the receipt of any fundraising proceeds "prior to deposit." The best practice is for the governing board to review and approve all proposed fundraising activities before any activity occurs. For each event and as a requirement for board approval, a budget, including an estimate of income and expenditures, should be prepared and presented. Once the event concludes, a comparison between the budget and actual amounts should be prepared, and the outcome should be reported to the board. The collection and deposit of fundraising revenue should follow best practices for cash handling procedures, which may require deposits to be made before the conclusion of fundraising activities.

If tickets are to be sold for an event they should be prenumbered, preprinted and accounted for in a ticket inventory for accountability. Prenumbered, preprinted receipts should be issued and/or a cash log should be maintained to record all ticket sales and cash collections. All unsold tickets should be returned to the staff member responsible for maintaining the ticket inventory and a reconciliation of ticket sales and unsold tickets should be prepared.

All expenses for fundraising activities should be processed following the accounts payable procedures; cash from ticket sales or other fundraising proceeds should not be used to reimburse individuals or pay vendors.

The cash count form should list:

- Name and date(s) of the event.
- Person(s) responsible for the event.
- Printed name(s) (initialed/signed) of those that counted the cash.
- Date and employee printed name (with signature) that received the fully counted funds from the counters.
- Date and employee printed name (with signature) that verified the funds and prepared the deposit for the bank.

An employee who did not participate in counting or verifying the cash should prepare the deposit and take it to the bank. Supporting documentation including the cash count form, the bank deposit slip, and copies of checks should be retained with each deposit. One copy of each receipt should remain in the receipt book, and all receipt books should be inventoried, accounted for and retained in a secure location once exhausted. Staff, parents, community members, and students working the event should be properly trained on established cash-handling and ticket-handling procedures.

The charter school relies heavily on parent participation and volunteerism both at the school and in fundraising activities. Interviews with staff and a review of expenditure documentation showed that the expenditures attributable to fundraising activities were frequently paid from the school operating account, while the income was posted to an account that generally was managed by the back office provider and was controlled by the business manager.

Interviews and a review of documentation failed to identify any established procedures for fundraising activities. Numerous interviews indicated fiscal activities were disorganized, including event planning and accounting for revenue and expenditures. There was no indication that revenue and expense projections were prepared before events or that accountings of event activities were reported to the governing board. Interviews with the former business manager and a review of documentation and general ledger activity indicate that proceeds and expenditures from fundraising events were comingled with other charter school operational revenue and expenditures. Thirty-two of 36 (or 89%) deposits for fundraising had insufficient documentation.

Because no accountability was enforced and no cash controls were implemented and/or followed, the risk of a cash-skimming scheme is extremely high.

Substantive Testing

FCMAT requested a list of bank accounts maintained in the name of the charter school, but school staff could not provide it. FCMAT identified the following bank accounts established and maintained in the name of Blue Oak Charter School:

- Wells Fargo Bank account ending in 3317 – defined as the school’s original general operating account used for processing vendor payments. Identified as NEWGEN in the school’s general ledger, this account was closed in January 2016 after questionable activity on the account was identified.
- Golden Valley Bank account ending in 0889 - opened in October 2015 became the new general operating account, identified as NEWGEN2 in the school’s general ledger.
- Tri Counties Bank account ending in 6391- defined as the account used to maintain proceeds and related expenditures from fundraising activities, identified as TRICOUNT in the school’s general ledger.

Recorded transactions were observed in all accounts noted above.

Bank Reconciliations

1. No board policy or written operational procedures on banking were identified; however, the management of all banking functions, including monthly reconciliations of all accounts, is part of the job duties in the superintendent/ executive director’s employment contract.
2. The charter school sends scanned copies of bank statements to the back office provider for reconciliation. Bank reconciliations were not prepared at the organizational level or reviewed by an employee of the charter school. The back office provider reported that to close out each month, monthly reconciliations were routinely forced to the bank statement balance by posting transaction items listed on the statements into suspense accounts until the business manager provided them with supporting documentation, transaction detail, explanation or other direction on how the transaction should be coded.
3. Representatives from the back office provider indicated they frequently had to contact the business manager to request backup for transactions coded to the suspense account, and delays were frequent even after the request, increasing during the 2015-16 fiscal year. Although the back office provider reconciled statements within one month, numerous items not included in the bank statements remained unrecorded in the charter school books.

Bank statements, reconciliations and the charter school’s general ledger were all reviewed to determine if the reconciliations were prepared timely and accurately, outstanding items cleared the bank timely or were written off within six months, bank fees were reasonable, beginning and ending account balances were not negative and no anomalies were found.

FCMAT’s review of bank statements found uncleared items over six months old on reconciliations as well as negative balances on several occasions over the period under review. Interviews indicated that the school frequently received parent complaints about their checks written to the charter school not being cashed timely.

The school also incurred numerous insufficient funds fees and other bank charges as a result of poor fiscal management. All of these concerns are indicative of fiscal inexperience and/or fiscal mismanagement.

Cash Receipts and Cash Handling

FCMAT selected deposit transactions for testing to evaluate the charter school's internal control structure including established operational procedures and to verify the validity and appropriateness of cash handling activities. FCMAT requested and obtained from the back office provider general ledger reports for the 2014-15, 2015-16 and 2016-17 fiscal years and selected deposit transactions for testing from each year. FCMAT requested from the charter school all supporting documentation for each deposit transaction selected and reviewed documentation to determine the following:

- There was adequate separation of duties for cash transactions.
- Supervisory personnel exercised adequate control over cash collections and/or fundraising activities.
- Prenumbered/preprinted receipts were used to document all cash collections other than those received via mail.
- Adequate control was maintained over new, issued and exhausted receipt books.
- At least two parties acknowledged and counted cash collections.
- Cash maintained at the school was properly safeguarded.
- Summarized cash collections were adequately documented to support each deposit.
- Recorded deposits were appropriate and supporting documentation was adequate.
- All cash collections were deposited and recorded in a timely manner.
- A secondary management position properly reconciled and reviewed bank statements.
- Bank reconciliations were prepared timely.

Interviews with staff indicated that the business manager instructed staff to direct all cash collections/payments through her office for verification, deposit preparation, and transfer to the bank. Several reports confirmed that although a lock box was outside the business manager's office for the placement of unverified deposits, individuals continued to leave cash collections on her desk when the business manager was not in the office and the door was open.

Interviews with the former business manager indicate that she did not use prenumbered, preprinted receipt books and instead used the cash count sheet to document cash collections. The cash count sheet documents the source of cash collected, the date of collection and the nature of the payment, e.g. currency, coin or check. The sheet also has a section for count confirmation initials and deposit date. Reports obtained during FCMAT interviews and a review of documents confirm that the cash count sheet was not used consistently.

Interviews with the business manager and staff indicated that the business manager's daughter at times counted cash in the office, sometimes as a student and other times as a paid employee. Staff reported several cash receipts/deposit transactions often awaited verification and deposit while on the business manager's desk. Reports also indicated that the business manager would routinely leave cash in the open if she left her desk while verifying cash collections and/or preparing deposits.

The lack of internal control over cash and other charter-school assets leave the school extremely vulnerable to theft. The lack of documentation makes it impossible to verify that all cash coming to the school was deposited and/or allocated to the appropriate accounts. This leaves the charter school vulnerable to cash-skimming schemes, where cash collections are taken before receipt is recorded.

The following table summarizes the number of deposits made by the charter school from July 1, 2014 through March 31, 2017 and reviewed by FCMAT as compared to the total deposits made in each given year.

Blue Oak Charter Deposits	2014-15	2015-16	2016-17 Through 3/31/2017	Totals
# Deposits Sampled	22	25	25	72
Total # Deposits	61	101	74	236
% Deposits Sampled	36%	25%	34%	31%
Value Deposits Tested	\$878,728	\$822,939	\$474,105	\$2,175,772
Value of Total Deposits	\$3,505,241	\$4,574,611	\$2,927,016	\$11,006,868
% Deposit Value Tested	25%	18%	16%	20%

FCMAT selected and reviewed supporting documentation for 72 of 236 (31%) deposits recorded by the charter school from July 1, 2014 through March 31, 2017; most contained multiple transactions. The total value of all deposits made was \$11,006,868; the value of deposits reviewed was \$2,175,772 (or 20%). The following table summarizes the exceptions noted during review of the documentation provided for deposits selected for testing.

Exceptions noted:	# Occurrences				% of Total Deposits Tested
	2014-15	2015-16	2016-17	Total	
1 No supporting documents available	13	0	2	15	20.8%
2 Supporting documents incomplete or missing	7	12	13	32	44.4%
3 No review or approval of cash count evident	1	10	7	18	25.0%
4 Deposit of cash collection untimely	20	22	13	55	76.4%
5 Documentation does not match deposit amounts	1	6	7	14	19.4%
6 Unable to verify timely deposit	20	12	13	45	62.5%
7 No exceptions noted	1	3	9	13	18.1%

FCMAT found exceptions in 81.9% of the deposits reviewed, and most deposits reviewed lacked appropriate documentation. Exceptions found by FCMAT included the following:

- Many deposits lacked sufficient documentation to determine the source of the funds, when they were received, or their purpose, e.g. class trip, fundraiser.
- Based on deposits that had copies of checks and/or dated cash count sheets, deposits were not made in a timely manner; many were deposited more than a month after receipt, and one check was dated four months before deposit.

- Of the 43 deposits that included cash, 33 had insufficient documentation to determine the actual number of individual cash transactions included in the deposit.
- In two instances, the total amount deposited matched the cash count sheets; however, cash was reduced and checks were increased by the same amount. This occurs when an individual takes cash from a deposit and replaces it with a personal check before making the deposit into the bank. Because copies of the checks were not retained with all deposits, FCMAT could not determine who substituted the cash for a personal check.
- In several instances, cash was taken from other cash count sheet deposits to start a cash box for other fundraising events or to reimburse parents for items purchased for fundraising expenses. FCMAT found no evidence indicating that reconciliation of the cash boxes were performed. Merchant receipts supporting expenditures were routinely absent when cash box or deposit proceeds were used to reimburse a teacher or parent.
- In 10 deposits, cash was removed and used to pay for items including fundraising income to another entity (2), ticket refunds (2), vendor payments or expenditure reimbursements (2), seed money for cash boxes (6), and to unknown parties with no reason given (2).
- The math for five deposits was inaccurate; one error was identified and corrected by the bank while other smaller amount differences do not appear to have been identified and/or corrected.
- On at least one occasion, cash from a deposit was reduced, citing a refund for two event tickets, which were attached. No paperwork identifying the party to which the refund was made was attached. Tickets sold for events were not prenumbered and did not have a ticket value printed on them. There is no way to verify that the tickets were in fact originals, the value of the original sale or that the refund was actually made to a party that actually purchased them. This is indicative of a fictitious reimbursement scheme.
- Many cash count sheets lacked a secondary verification.
- Two deposits credited to the parent council student store lacked any listing of what was sold, the initial cost of those items, or an accounting of any net profit.
- Preprinted, prenumbered receipt books were not used for general cash receipting. Only one receipt book was identified for the nutrition program, but only a small number of receipts had been issued.

Procurement and Cash Disbursements

FCMAT selected cash disbursement transactions for testing to evaluate the charter school's internal control structure including established operational procedures and to verify the validity and appropriateness of expenditure transactions. FCMAT requested and obtained from the back office provider check register reports for the 2014-15, 2015-16 and 2016-17 fiscal years and selected expenditure transactions for testing from each year. Transactions clearly recognizable and recorded in the categories of utilities, other governmental agencies, and/or known common vendors were excluded from selection consideration. Attention was given to payments to individuals, bankcard institutions, unknown vendors, object code/resource code combinations and comparatively large dollar amounts. Some unknown vendors were researched on the internet to determine the nature of their business, and that information was used in the judgment to select a payment. Patterns including dates, frequency of occurrence and account code classification were also considered in the selection process. FCMAT also obtained historical detail from the Amazon

accounts used for purchases by the business manager and superintendent/executive director, which identify the vendors and purchases charged to school credit cards.

FCMAT requested from the charter school all supporting documentation for each transaction selected and reviewed documentation to determine the following:

- Authorization was obtained and documented in advance of the expenditure consistent with established policy and procedures.
- The expenditure was appropriate, in accordance with charter school policy and allowable by law.
- Documentation included evidence that goods or services were received, and an obligation was incurred.
- Transactions were processed timely, accurately and properly recorded.

School business office personnel described the purchasing practices that were consistent with those outlined in the procurement procedures and guidelines documented in attachment A of the fiscal policies. Staff initiate purchases by completing a hard copy requisition that includes the chosen vendor, desired items and prices. The requisition is forwarded to the business manager, who generally procures the goods with the vendor and assigns the appropriate budget code. The district uses a purchase request form instead of standardized purchase orders. On occasion, a vendor may require a purchase order, the business manager would occasionally create an “unofficial purchase order (PO)” using an Excel template, which is then printed, signed by the business manager or superintendent/executive director and distributed to the vendor. FCMAT used these guidelines as the basis for testing transactions.

The table below summarizes the value of charter school disbursements processed by the charter school from July 1, 2014 through March 31, 2017 and reviewed by the team as compared to the total number of disbursement checks recorded in each given fiscal year.

Disbursement Transactions (nonpayroll)	2014-15	2015-16	2016-17	Total
# Checks Sampled	63	73	76	212
Value of transactions tested	\$156,453	\$253,551	\$69,778	\$479,781
Total value of all warrants *	\$2,240,575	\$2,389,709	\$1,742,704	\$6,372,988
% Total Disbursement Value	7%	11%	4%	8%

* Excludes canceled warrants

^ Totals are formula driven, variances in totals results due to rounding.

The total number of expenditure transactions is not provided since a significant amount of procurement was performed using charter school credit cards. Counting each credit card payment as a single transaction would significantly misrepresent the number of actual transactions reviewed by the team. Additionally, in addition to credit card transactions noted on the transaction listing FCMAT reviewed additional credit card statements, transactions and documentation while on site, the value of these additional credit card charges and payments is not included in this total sample, only those specifically selected from the disbursement registers is included.

FCMAT selected and reviewed supporting documentation for transactions attributable to 212 disbursement checks drawn by the charter school from July 1, 2014 through March 31, 2017, many of which contained multiple transactions. The total of all checks issued during this time was \$6,372,988. The value of all transactions reviewed was \$479,781 (or 8% of the total value of all checks). The table below summarizes the exceptions noted during a review of the documentation for the transactions selected for testing.

Exceptions noted:		# of Occurrences				% of Total Transactions Tested
		2014-15	2015-16	2016-17	Total	
1	No supporting documents available	5	24	0	29	13.7%
2	No documented advanced authorization (PR, PO, Travel Authorization or Reimb. Req.)	48	59	34	141	66.5%
3	No payment authorization noted	10	31	21	62	29.2%
4	No detailed receipt or invoice attached	9	39	23	71	33.5%
5	No Contract, Bid docs or board approval provided	52	59	53	164	77.4%
6	Invoice not paid timely	13	13	12	38	17.9%
7	Incorrect account coding for expenditure type	11	26	19	56	26.4%
8	Nature of expenditure questionable	16	28	16	60	28.3%
9	No receiving documentation	45	51	36	132	62.3%

FCMAT found exceptions with every transaction reviewed; most lacked advance authorization and/or should have been processed through the purchase request system to ensure adherence to the expenditure authorizations established in the board-approved budget.

The procedures described by charter school staff indicate that the business manager forwards invoices approved for payment to the back office accounting service provider. For payments on credit card accounts, expense data is summarized in an Excel spreadsheet, assigned account coding based on the charges and signed by the business manager indicating approval for payment. This spreadsheet is supposed to be forwarded to the back office provider along with scanned receipts and other transaction supporting documentation via email; however, this practice ended in 2015-16 when the business manager started paying the credit card using automatic bank and telephone payments.

The back office provider indicated they had increasing difficulties in obtaining supporting documentation on credit card charges, often receiving only the Excel spreadsheet listing vendor name, amount paid and the account code to be charged after numerous requests. Interviews with the business manager indicated that the telephone payments were made to expedite payments on the account because of her inability to process the credit card payments timely using the traditional process. Managing her workload admittedly became overwhelming, with interest charges and late fees resulting in numerous cases. Numerous credit card over-limit and late payment fee charges and interest rates of 28.24% were paid on credit cards because of unpaid balances.

The back office provider maintains the vendor file, and generates and prints the checks for vendor payments requested by the school. Checks require only one signature for issuance. The back office provider distributes the checks generated by that office. At the request of the business manager, the checks were occasionally returned to the business manager for distribution. No prelist is sent to the school for review, and the available funds are not verified before issuance.

The business manager maintained check stock for the above bank accounts in the school office, which was used to issue checks on site. If the business manager issued a check, the spreadsheet was forwarded with limited supporting documentation to the back office provider to post to the financial records. Interviews indicate that the back office provider was frequently not provided adequate, if any, documentation to support checks drawn by the business manager.

The deficiencies observed by FCMAT during the review of transactions include the following:

- 170 of the 212, or 80.2%, transactions reviewed lacked a purchase request or other documented authorization. Expenditure transactions are not routinely submitted to the governing board for review, few were documented in board minutes as discussed with the council, and none were approved with formal board action.
- 132 of the 212, or 62.3%, transactions lacked supporting documentation of proof of delivery, or other appropriate supporting documentation. This included a forensic audit with a formal “written report” as a contract deliverable, which was never delivered.
- 71 of the 212 transactions, or 33.5%, did not have detailed receipts or invoices attached (detail frequently necessary to properly code expenditures in the general ledger). The number of individual transactions lacking detail is significantly greater since credit card payments are counted as a single transaction and individual charges frequently lacked supporting documentation.
- 56 transactions, or 26.4%, were not coded appropriately for the expenditure type.
- 60 transactions, or 28.3%, were questionable in nature, many appear to be of personal benefit to the superintendent/executive director.

FCMAT’s review of expenditure transaction documentation found that the procedures as described were not routinely followed. There was no documentation to demonstrate that management initiated services with vendors and individuals following processes that ensure the school receives the most qualified services at the best price. FCMAT’s sample included 8% of all accounts payable transactions processed by the school over an approximately 2½-year period; however, the documentation that supported the transactions tested did not include any copies of purchase orders. Most of the transactions reviewed by FCMAT included no evidence of preapproval. Numerous transactions reviewed by FCMAT bypassed the described purchasing process. The superintendent/executive director and the business manager generally procured goods using credit card accounts established in the name of the charter school. FCMAT’s review of transaction documentation found no packing slips and/or other acknowledgment of receipt of goods/services for most of the transactions reviewed. There was no indication that shipping documents were matched and verified to vendor invoices prior to, or as a condition of, payment.

FCMAT requested a list of credit card accounts opened in the name of the charter school, but the charter school staff could not provide it. FCMAT identified the following credit card accounts established in the name of Blue Oak Charter School utilized by school administration for expenditures:

- American Express-Costco account ending in 9-21002 – Issued to superintendent/executive director
- Citi Costco Anywhere Visa account ending in 2684 – Issued to superintendent/executive director
- Wells Fargo Visa ending in 2385 – Issued to superintendent/executive director
- Wells Fargo Visa ending in 3607 – Issued to superintendent/executive director

- Wells Fargo Business Visa ending in 4881 – Issued to superintendent/executive director
- Wells Fargo Business Visa ending in 6203 – Issued to superintendent/executive director
- Wells Fargo Visa ending in 1796 – Issued to business manager
- Wells Fargo Visa ending in 5529 – Issued to principal

FCMAT obtained credit card statements and limited supporting documentation for the periods noted below for each credit card:

- American Express Costco ending in 9-21002 (May 2015-March 2016)
- Citi Costco Anywhere Visa ending in 2684 (June 2016)
- Wells Fargo Visa ending in 2385 (October 2013-December 2013)
- Wells Fargo Visa ending in 3607 (February 2014-April 2014, December 2014)
- Wells Fargo Business Visa ending in 4881 (January 2015-February 2016)
- Wells Fargo Business Visa ending in 6203 (March 2016-July 2016 & September 2016)
- Wells Fargo Visa ending in 1796 (February 2014 & January 2015-December 2015)
- Wells Fargo Visa ending in 5529 (September 2016)

The school has a severe lack of control over credit card use. FCMATs review of available credit card statements and supporting documentation identified excessive use by administrative staff for purchases that should have been processed following standardized procurement and employee reimbursement procedures. Payments for credit card statements reviewed by FCMAT routinely lacked sufficient documentation to support the charges on billing statements.

The superintendent/executive director and other administrators routinely charged expenses for travel costs and meals to school issued credit cards. The transactions reviewed by FCMAT did not include any documentation supporting written advanced authorization, conference/meeting documentation, description of travel destination and business purpose, dates of attendance or departure and return dates and times.

The charter school paid actual expenditures for travel including fuel and meals either through credit card charges or employee reimbursements regardless of IRS-approved mileage rates, per diem meal, and lodging rates. The school had no documentation indicating that verification was exercised to determine whether or not individuals traveled together. Meal reimbursements and/or charges were paid for breakfast, lunch, dinner, and sometimes, an additional late night supper, regardless of the duration of the event and distance of travel. The superintendent/executive director charged meals, snacks and beverages to school credit cards, but most of these items lacked receipts and an identifiable business purpose.

Several managers were paid for fuel even though there was no indication of other travel expenses. Fuel charges were made on the superintendent/executive director's credit card in two different cities on the same day, one where his wife worked and the family formerly lived, and the other while the administrator traveled to another part of the state. The superintendent/executive director frequently had fuel charges on his credit card despite the fact that he reportedly drove a hybrid car that he routinely charged at a school charging station. There was no documentation to verify departure or return times and no description of travel purpose and/or destination for travel.

The cost of transportation from residence to work location (temporary or permanent) is not an allowable business expense, and reimbursement should be treated as taxable income and reported on an employee's W-2.

The school does not use a standardized mileage rate and does not obtain any employee certifications before reimbursement to document departure or return times and a description of travel purpose and/or destination. Employee certification is intended to confirm that the travel is not personal and is from the work location to a secondary location for work-related purposes. Employers cannot determine the proper tax treatment of travel expenditures without documented travel details including dates, departure and return times, destination, business purpose and mileage. Reimbursing employees for full fuel costs makes it impossible to review and identify whether the expenditure(s) and payment are appropriate. Furthermore, allowing travel expenses to be charged to credit cards may be treated as a travel advance under a nonaccountable plan because of the lack of adequate accounting documentation.

Reimbursement of travel expenses should be based on actual detailed expenses as documented by receipts. Employees should be reimbursed for the use of their own private vehicles in the performance of assigned duties based on either a mileage reimbursement or monthly auto allowance. The mileage allowance should be less than or equal to the rate established by the IRS. Amounts paid in excess of the established IRS rate should be treated as taxable income to the employee.

The school should not reimburse personal travel expenses including, but not limited to, tips or gratuities, alcohol, entertainment, laundry, expenses of any family member who is accompanying the employee on charter school-related business, personal use of an automobile, and personal automotive expenses or traffic violation fees incurred while on school business.

FCMAT's review of accounts payable and credit card transactions found that the former superintendent/executive director extensively used credit cards established as charter school accounts and issued in his name for food, fuel and other purchases that have characteristics of personal benefit.

Other than health and welfare benefits and Association of California School Administrators (ACSA) association dues, the 2015-2018 employment agreement for the superintendent/executive director executed by the council on April 20, 2015 does not contain any fringe benefits. Item seven in the contract states the following:

BOS shall reimburse the employee for all documented actual and necessary expenses personally incurred within the scope of employment in accordance with applicable BOS policy and authorization.

The charter council members indicated during FCMAT interviews that there was no agreement, understanding or other authorization between the superintendent/executive director and the council for additional fringe benefits including fuel, cell phone, meals, gym or other memberships. Among the documentation reviewed, FCMAT identified questionable expenditures and charges as follows:

- Weapons, tactical gear and military radios.
- Birchbox monthly beauty product subscription service.
- A personal money order drawn as a "cash advance" from a charter school credit card.
- iTunes, Amazon On Demand and IndieFlix downloads.
- Numerous fast food purchases; and snack-type food and beverages accompanying other business related purchases.

- Numerous charges for fuel/gas. Credit card charges without receipts and reimbursements for fuel based on receipts from gas stations, including several purchases occurring on the same date, and many charged or submitted by the superintendent/executive director, despite the fact that the charter school had procured a battery charger for his hybrid vehicle.
- Clothing and accessories - TJ Maxx and Ross.
- Disney Resort transactions with no detailed support of expense.
- Liquor store transactions with no detailed support of expense.
- Laundry expenses charged to a hotel room reimbursed by the charter school.
- Beekeeping trainings and supplies.
- Self-help seminars and related travel expenses.
- Charges from an auto towing company and an auto parts store; the charter school does not have vehicles.
- Invoices indicating a “free gift with purchase” without specifying what the item(s) were, whether they were used to benefit the school, and how it benefitted.
- Charges that were not detailed and documented because they were applied to a store credit.
- Costco membership was established in the name of the superintendent/executive director, and the secondary card was issued to his wife, but the charter school paid the membership fee. No record was available describing how the annual rebate on the account was spent.
- More than \$3,990 in unsubstantiated expenditures to Costco were charged to the charter school credit card. There was no supporting documentation for purchases, including advance approval and receipts.

Because of the lack of documentation FCMAT could not verify the following:

- The out-of-state travel by the superintendent/executive director occurred for board-approved, school-related activities.
- Reimbursements for meal, fuel and travel expenditures qualify for exception from reporting as wages under IRS regulations.

Expenditures for all airline tickets and room reservations were for school-related activities and school employees/board members during the date(s) of travel. Several charges were from Expedia.com and Booking.com and contained no travel details, few reimbursements had detailed invoices attached, and one credit card charge was for a casino in a neighboring town.

FCMAT interviews indicated that the superintendent/executive director was a gun enthusiast who reportedly showed one staff member an automatic assault rifle stored in his car trunk while on school premises. Some staff reported that they were directly aware that the superintendent/executive director traveled out of state to Nevada on several occasions, intentionally timed to permit him to attend gun shows and other activities of personal interest while all travel costs were reimbursed by the school and/or charged with school-issued credit cards.

FCMAT reviewed charges incurred on the superintendent/executive director-issued credit card(s) and identified at least three multiple-day trips to Nevada from September 6, 2014 through April

30, 2016. The former business manager indicated that the superintendent/executive director occasionally attended “school security” conferences in Nevada; however, FCMAT did not find any conference registration payments or charges during the time of the expenditures.

Additional reports indicated that the superintendent/executive director frequently played “shooter video games” at the school. FCMAT identified multiple charges for iTunes downloads charged to the charter school credit cards as well as \$650 in charges to IndieFlix, a movie streaming website for mobile devices. FCMAT was provided with an email discussing the achievement of “new performance levels” in the game “Dictator” sent to the superintendent’s school email account.

A review of the superintendent/executive director’s credit card expenditure transactions identified numerous purchases that raise significant question about the nature of the transactions including the following:

- Out of state travel - Las Vegas, Nevada
- Tactical gear, weapons parts and small tools (Brownells, Keep Shooting, Sportsman’s Warehouse, Cheaper than Dirt, United Defense, SOG Specialty Knives, Trailhead Adventures, and Optics Planet)

Charter school staff could not account for several assets purchased on credit cards, some of which were shipped to home addresses including that of the superintendent/executive director, including the following:

- A veterinary surgical set including sutures, and a stomach stapler
- An Epson Home Cinema
- An Ipevo Ziggi High definition document camera
- An Arsen 120” pull down projector
- A Wohnhaus 10 in 1 steam clean mop
- Two CDW computers
- A Fuji underwater camera
- Folding knives
- An “easy up canopy”

The superintendent/executive director reportedly charged the expenses of becoming a beekeeper to the school and charged individuals to attend beekeeping classes that he taught. FCMAT reviewed documentation that confirmed that the charter school paid for at least \$5,039 in beekeeping training and supplies, and FCMAT could only identify a total of \$200 deposited into the school operating account attributed to beekeeping training.

FCMAT interviews indicate that the business manager used charter school accounts to order materials used to manufacture items that were sold to the community during fundraising events. Those interviewed also suggested that these materials may have been used for items she sold for her own personal fundraising efforts. While FCMAT has no method of verifying the use of these materials, a review of vendor history documentation indicated that near the time the business manager went on administrative leave, she incurred a large charge for beading supplies to her charter school credit card. Since her separation from employment, supply costs from the vendors identified in interviews have decreased by approximately 20%, and the bead vendor has not been used.

Stipends

FCMAT did not audit the charter school's payroll records. However, the team conducted a limited review of payroll checks issued through the vendor system and payments to employees for extra hours/work over contract. It also evaluated the consistency of hourly rates used to calculate payments issued on site using manual checks compared to rates for those employees documented in approved contracts submitted to the back office provider for payroll. FCMAT identified the following weaknesses in payroll practices:

- Two employees were paid concurrently as employees and 1099 independent consultants.
- Three employees were paid, with manual checks, at two different hourly rates.
- Payments using manual checks lacked proper supporting documentation.
- Payments made to management employees for stipends lacked proper supporting documentation.
- "Steiner Stipends" given to employees for continuing education were paid as "nontaxable employee benefits," potentially avoiding federal IRS Form W-2 reporting.

Contracts

FCMAT reviewed expenditure transactions that included contracts committing the organization to procure, executed by staff at all levels of the school (including teachers), that lacked evidence demonstrating multiple bids were sought. Additionally, documentation for purchases of technology and other equipment meeting the requirements for council approval, lacked documentation supporting this action.

Capital Outlay and Bidding

Board Governance Policy #5 states the following:

The Board confers with the administration, architects, consultants and staff to make final determination relative to matters of capital outlay with special reference to buildings, sites, major improvements and equipment over \$5,000.00 upon recommendation of the Director.

Board minutes provide documented support that the superintendent/executive director reviewed four proposals for a tenant improvement project with total costs exceeding \$100,000. Interviews with staff and council members indicate that the project was awarded to a building owner's relative even though the project bid was not the lowest received. Council members report that approval was for \$130,000 to \$150,000. No final copy of the tenant improvement contract was available on site, and a copy provided by the board president was incomplete.

There was no evidence of advertising (per board direction) to support that the school followed competitive bidding practices, documentation of project scope or a formal contractual relationship related to the energy conservation (Proposition 39) awards. The contractor charged to this funding source received \$212,423.20 in payments between March 13 and April 10, 2017. A review of board minutes indicated that the approved budget for Proposition 39 projects was \$96,652. The amount paid through April 10, 2017 was 220% more than the proposal presented to the board at the March 10, 2015 meeting.

Because of the lack of documentation FCMAT could not verify the following:

- The board was aware of the procurement and bid process used to award the tenant improvement project to Jerry Leen Construction and make payments totaling

\$156,509.21. Invoices on file lacked adequate supporting documentation necessary to verify “Cost of Work” charges in addition to contractor fees and markup. Documentation for one payment towards contractor reimbursable project costs included a purchase order for another client of the contractor whose name was crossed out and “Blue Oak Charter School” inserted. The contractor also billed the charter school for interest charges billed to the contractor by their vendor(s) and “Workers Compensation” for the contractor’s employees, in addition to “Supervision” and “Administrative fees.”

- The board was aware of the procurement and bid process used to award Green Construction Services payments totaling \$212,423.20.
- Contracts in excess of authorized spending authority were procured subsequent to consultation with the board.
- Transactions were not routinely split and/or reduced below the authorized spending authority to bypass board influence. FCMAT identified two payments for construction invoices made to Anaya Construction each for \$3,500; one dated June 18, 2014 and the second dated June 19, 2014.

FCMAT identified the following weaknesses in accounting practices:

- The charter school submitted spreadsheets listing credit 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 receipts for transactions and/or appropriate supporting documentation sufficient to ensure accurate expenditure account code classification.
- Invoices were frequently not required from professional consultants for payment, and payments were made from statements of account balances.
- Contracts, warrants/purchase requisitions/purchase orders not Blue Oak Charter Council-approved, including a large construction contract with no evidence of multiple bids.
- Employees, not part of school administration, executed contracts with vendors.
- Inability to read signature of transaction approver(s), and missing approval date(s) reduce audit trail and accountability standards.
- Complete copy of contract for construction not attached to payments and not provided to the council.
- Construction invoices do not have full detail of wages paid (hours and rates) to employees supporting payment requests.
- Construction invoices contain supporting documentation, which indicates some expenses may have been for a different project.
- Lack of accountability for accounting records and documentation supporting vendor payments.
- No inventory or asset management, tracking or accountability for items purchased with school funds.

AB 139 Extraordinary Audit Report Summary: Potential Fraud

Fiscal records and individual transactions reviewed by FCMAT support the assertion that fraudulent activity may have occurred during the period under review. Numerous transactions were characteristic of fraudulent reimbursement and mischaracterized expense schemes, which occur when an employee requests reimbursement or payment for overstated, fictitious and/or personal expenses claiming them to be business related. The primary mechanism for processing these potentially mischaracterized expenses was credit card accounts established in the name of the Blue Oak Charter School, issued to the former superintendent/executive director.

Because the superintendent/executive director had the perceived authority and ability to act independently of council authorization, he could eliminate the need to seek reimbursement for expenditures using the customary process by establishing and utilizing multiple lines of credit without any oversight or accountability. The use of school-paid credit cards as opposed to the use of personal resources and seeking reimbursement may not abrogate the potential taxability of the transaction for unsubstantiated goods, services and travel costs charged by the superintendent/executive director.

Deficiencies and exceptions noted during FCMAT's review of the financial records and the charter school's internal control environment increase the probability of fraud, mismanagement and/or misappropriation of funds. These findings should be of great concern to the Blue Oak Charter School, the Chico Unified School District (the authorizer) and the Butte County Office of Education. Immediate intervention should be exercised to limit the risk of fraud, mismanagement and/or misappropriation of assets or other illegal activities moving forward.

Based on the findings in this report, sufficient evidence exists to demonstrate that fraud, misappropriation of funds and/or assets or other illegal activities may have occurred in the specific areas reviewed. The existence of fraud is solely the purview of the courts and juries, and FCMAT will not make statements that could be construed as a conclusion that fraud has occurred. Based on the findings in this report, FCMAT recommends that the county superintendent, Chico Unified School District and the Blue Oak Charter School council act within their respective authority as needed to limit the risk of fraud and/or misappropriation of assets.

In accordance with Education Code Section 1241.5(c), the county superintendent shall report the findings and recommendations to the governing board of the charter school at a regularly scheduled board meeting, and provide a copy of the information to the chartering authority of the charter school, within 45 days of completing the review, audit or examination. The governing board of the charter school shall, no later than 15 calendar days after receipt of the report, notify the county superintendent and its chartering authority of its proposed response to the recommendations.

Recommendation

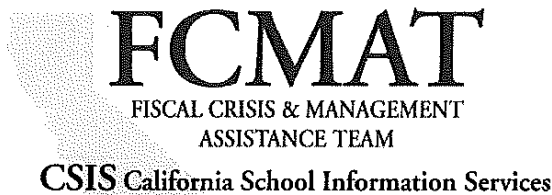
The county superintendent should:

1. Notify the governing boards of the Chico Unified School District (authorizer) and the Blue Oak Charter School Council, the state controller, the superintendent of public instruction, and the local district attorney, that the county office has completed its review and concludes that sufficient evidence exists to indicate that fraud, misappropriation of charter school funds and/or assets or other illegal activities may have occurred.

Appendix

A. Study Agreement

Appendix A. Study Agreement



FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM AB139 STUDY AGREEMENT January 30, 2017

The Fiscal Crisis and Management Assistance Team (FCMAT), hereinafter referred to as the team, and the Butte 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 local educational agencies (LEAs). Pursuant to the provisions of Education Code (EC) Section 1241.5 (c), a county superintendent of schools may review or audit the expenditures and internal controls of any charter 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

The Butte County Office of Education has requested FCMAT to assign professionals to conduct an AB 139 Extraordinary Audit. This audit will be conducted pursuant to Education Code Section 1241.5 (c). The COE has received documentation of possible fraud, misappropriation of funds or other illegal practices at the Blue Oak Charter School and is requesting that FCMAT review the internal controls and specifically the use of credit cards and cash handling on behalf of the charter.

The primary focus of this review is to determine, based on the testing performed, whether (1) adequate management and internal controls are in place regarding the district's reporting and monitoring of financial transactions, and (2) based on that assessment, whether fraud, misappropriation of funds or other illegal fiscal practices may have occurred. Management controls include the processes for planning, organizing, directing, and controlling program operations, including systems for measuring, reporting, and monitoring performance. Specific audit objectives will include evaluating the establishment, implementation and effectiveness of policies, procedures and internal control activities through the review of financial transactions recorded by the charter relative to the following:

- Use of credit cards
- Expenditure of funds for personal or other noncharter business purposes
- Cash handling

The team will review and test recorded transactions for fiscal years 2014-15 through 2016-17 to date to determine if fraud, misappropriation of funds or other illegal activities may have occurred. Testing for this review will be based on a sample of transactions and records for this period. Testing and review results are intended to provide reasonable but not absolute assurance regarding the accuracy of the district's financial transactions and activity to accomplish the following:

1. Provide reasonable assurance to management that the internal control system is established, implemented and monitored.
2. Prevent internal control activities from being overridden by management.
3. Help identify and correct inefficient processes.
4. Ensure that employees are aware of the proper internal control expectations.

The review will include but not be limited to the following:

1. Evaluation of the adequacy of the district's internal control structure including the development, implementation and monitoring of policies and procedures and other control activities
2. Evaluate whether lines of authority and responsibility are clearly established within and between the district's departments and are documented in organizational charts.
3. Evaluate whether proper segregation of duties exists.
4. Evaluate policies and procedures:
 - a. Review policies and procedures including, but not limited to, those in the areas related to specific engagement objectives noted above.
 - b. Review policies and procedures for recording and tracking assets to determine whether adequate controls are in place for safeguarding district assets.
 - c. Determine if procedures are appropriate and consistently followed.
5. Evaluate the reliability and integrity of financial transactions.

6. Assess internal control monitoring processes:
 - a. Evaluate monitoring procedures and verify that controls are operating properly.
 - b. Evaluate controls to determine that they are designed to prevent management from overriding internal controls to detect or deter misappropriation of funds.
- 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. Exit Meeting – The team will hold an exit meeting at the conclusion of the on-site review to inform the COE of any significant findings to that point.
 5. Draft Report – 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.
 6. 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.
 7. 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 FCMAT study team may also include:

- | | | |
|-----------|-------------------------|-------------------------|
| <i>A.</i> | <i>To Be Determined</i> | <i>FCMAT Staff</i> |
| <i>B.</i> | <i>To Be Determined</i> | <i>FCMAT Consultant</i> |

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 EC 42127.8 (d) (1) shall be:

- A. \$950 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 for all work performed.
- 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 \$37,000.

- 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 located at 1300 17th Street, CITY CENTRE, Bakersfield, CA 93301.

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 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 fieldwork; any delay in the receipt of the requested documents may affect the start date and/or completion 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 and will be established upon the receipt of a signed study agreement:

<i>Orientation:</i>	<i>To be determined</i>
<i>Staff Interviews:</i>	<i>To be determined</i>
<i>Exit Meeting:</i>	<i>To be determined</i>
<i>Preliminary Report Submitted</i>	<i>To be determined</i>
<i>Final Report Submitted</i>	<i>To be determined</i>

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 district and any other parties from which, in the team's judgment, it must obtain information. Once the team has completed its fieldwork, it will proceed to prepare a preliminary draft report and a final report. Prior to completion of fieldwork, the COE 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 fieldwork, 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 fieldwork 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 of 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 Butte County Office of Education named as additional insured, indicating applicable insurance coverages upon request, prior to the commencement of on-site 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 district 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: Timothy Taylor
Telephone: (530) 532-5761
E-mail: ttaylor@bcoe.org



Timothy Taylor, County Superintendent
Butte County Office of Education

2/01/17
Date



Michael H. Fine
Chief Administrative Officer
Fiscal Crisis & Management Assistance Team

January 30, 2017

Date