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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF THE ROBERT M. HUGHES ACADEMY CHARTER SCHOOL

JULY 1, 2000 TO JUNE 30, 2004

OFFICIAL AUDIT REPORT

AUGUST 3, 2005

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INTRODUCTION 1

The Robert M. Hughes Academy Charter School (RMH) was organized in January 1999 as a nonprofit organization to operate a public charter school under the provisions of Chapter 71, Section 89, of the Massachusetts General Laws. The Commissioner of Education, while considering RMH's five-year charter renewal application for the period from July 1, 2004 to June 30, 2009, had concerns over RMH's governance and the roles of its Board of Trustees and school administration. In this regard, on January 29, 2004, the Department of Education's (DOE) Associate Commissioner for Charter Schools requested that RMH's Board Chairperson provide detailed information regarding the resignation of RMH's principal on January 22, 2004, Board of Trustees members serving beyond their term limit, potential conflicts of interest, and whether members of RMH's Board of Trustees failed to disclose such potential conflicts of interest to the State Ethics Commission. The Chairperson provided a limited response on February 6, 2004, and on February 24, 2004 the Board of Education, in accordance with Chapter 71, Section 89, of the General Laws and 603 Code of Massachusetts Regulations 1.00, granted RMH a conditional five-year renewal of its school charter. RMH's charter renewal was explicitly predicated upon certain conditions, and RMH was warned that failure to meet any of these conditions could result in its being placed on probation or having its charter revoked by the Board of Education. (See Appendix I.)

DOE also referred its concerns about RMH to the Office of the State Auditor (OSA). To address these concerns, on March 20, 2004 the OSA began a review of RMH, including RMH's governance, administrative leadership, financial management operations, related-party transactions, and potential conflicts of interest involving some Board of Trustees members. Our audit, which covered the period July 1, 2000 to June 30, 2004, had the following objectives: (1) determine whether RMH had established an adequate system of internal controls over revenues, expenses, and fixed assets and (2) assess RMH's business practices and its compliance with applicable laws, rules, and regulations.

Our audit revealed that RMH had not implemented an adequate system of internal controls over its financial operations, which resulted in numerous financial problems for RMH, including noncompliance with laws, rules, and regulations governing Commonwealth charter schools. Specifically, we found that management deficiencies concerning RMH's financial operations have resulted in operating deficits, cash-flow problems, and questions about its current and long-term financial health.

Our general observation was that RMH's teachers and administrative staff were dedicated to helping students succeed. However, it appears that the Board of Trustees was not sufficiently meeting its fiduciary and oversight responsibilities.

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1. FINANCIAL MANAGEMENT PROBLEMS HAVE RESULTED IN SIGNIFICANT CASH-FLOW PROBLEMS AND QUESTIONS ABOUT RMH'S CURRENT AND LONG-TERM FINANCIAL HEALTH 8

Our audit found deficiencies in the management of RMH's financial operations, which has placed RMH in a difficult financial position. Clear indicators of fiscal problems being experienced by RMH include a deteriorating cash-flow position, operating deficits for the last two years, and dwindling reserves. During fiscal years 2003 and 2004, RMH experienced a rapid deterioration of its cash position, which required RMH to maximize its line of credit in order to maintain operations. Specifically, as of June 30, 2002, RMH's available cash totaled approximately $535,925, and its line of credit balance was zero. However, as of June 30, 2004, RMH's cash position had sharply declined to $368,371 (31%), and its line of credit balance had skyrocketed to $248,000. Consequently, in just two years, RMH's cash position effectively declined from $535,925 to $120,371 ($368,371 - $248,000), or 78%. Further illustrating the fiscal decline of RMH are its operating results for each of the last two fiscal years. RMH incurred operating deficits of $199,304 for the fiscal year ended June 30, 2003 and $164,934 for the fiscal year ended June 30, 2004.

A charter school's net assets (the difference between assets and liabilities) represents one way to measure its financial health or financial position. Over time, increases and decreases in a charter school's net assets indicate whether its financial health is improving or declining. Over the past two fiscal years, RMH incurred operating losses totaling $364,238, which caused its net assets to decrease from $715,340 to $351,102, or 51%. Thus, since June 30, 2002, RMH's financial health has been in serious decline. Moreover, RMH has a significant portion of its net assets invested in fixed assets. Consequently, these amounts are not available for use by RMH. Therefore, the net assets balance available for use by RMH was actually $140,807 ($351,102 - $210,295) on June 30, 2004.

Finally, our review of RMH's financial condition included an examination of non-financial factors such as RMH's control environment, staffing patterns, lines of communication, and facilities. We found weaknesses in each of these areas that over time, have adversely impacted RMH's financial operations.

2. RMH MADE UNALLOWABLE AND QUESTIONABLE LEASE PAYMENTS TOTALING $279,055 TO A RELATED PARTY THAT DID NOT SATISFACTORILY COMPLETE RENOVATIONS NECESSARY FOR RMH TO OBTAIN A CERTIFICATE OF OCCUPANCY 21

During our audit period, RMH leased a building located at 91 School Street, Springfield, from School Street Properties, Inc. (SSPI), a related party. RMH utilized the property to operate its commonwealth charter school. RMH's lease agreement required RMH to make rent payments based upon a percentage of SSPI's loan obligations on the property. However, our audit found that RMH's rent payments had been inflated by SSPI over the past three years. Specifically, from September 1, 2001 to June 30, 2004, RMH paid SSPI rent totaling $279,055. This amount was based upon billing invoices prepared by SSPI and paid by RMH with state funds. However, based upon the rent formula specified

within its lease agreement with SSPI, RMH should have paid only $223,169. The difference, $55,886, represents an excessive charge to RMH and an unallowable cost against state contracts under DOE's charter school guidelines.

In addition, contrary to DOE's guidelines, RMH did not maintain adequate documentation to substantiate its monthly lease payments to SSPI. Under the terms of its lease agreement, RMH is required to make monthly payments equal to 1.1 times SSPI's monthly loan obligations on the 91 School Street property. These loans totaled $840,000 and included amounts for both the purchase and renovation of the building. However, RMH did not maintain any documents relative to SSPI's loan obligations, such as the purchase and sale agreement, closing documents, architect renovation plans and cost estimates, Requests for Bids, contractor agreements, and contractor invoices. Moreover, SSPI was unwilling to share any information with us relative to the matter. Consequently, RMH cannot assure the Commonwealth that its related-party lease payments totaling approximately $279,000 through June 30, 2004 represent reasonable, allowable, and allocable costs to state contracts.

RMH also experienced significant problems with the General Contractor hired by SSPI to initially renovate the 91 School Street property. Specifically, the General Contractor's electrical and plumbing work did not pass inspection by local building code officials. Under state law and regulations, charter schools are required to obtain a Certificate of Occupancy from the local building inspector prior to opening its charter school facility. However, as of June 30, 2004, RMH had been unable to obtain a Certificate of Occupancy from the City of Springfield, and according to local code enforcement officials, RMH has illegally occupied the 91 School Street property since September 1, 2001.

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4. RMH'S CHAIRPERSON AND TREASURER MAY HAVE VIOLATED THE STATE'S CONFLICT OF INTEREST LAW IN THE INVESTMENT OF $150,000 OF RMH'S FUNDS 36

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DEW. At the time, RMH's Chairperson served as DEW's Chief Executive Officer (CEO) and RMH's Board Treasurer also served on DEW's Board of Directors. Moreover, DEW was apparently experiencing financial difficulties, as evidenced by the National Credit Union Association's (NCUA) placing DEW into conservatorship on February 21, 2003. No evidence (e.g., board meeting minutes) was provided to document and support any decision to deposit these funds at DEW, nor was there evidence to demonstrate that the Chairperson and the Treasurer were not involved in the decision.

5. RMH PURCHASED COMPUTER EQUIPMENT TOTALING $116,357 WITHOUT THE BENEFIT OF COMPETITIVE BID PROCEDURES **40**

During our audit period, RMH did not use competitive bid procedures while purchasing computer equipment totaling $116,357. RMH's actions, which were controlled by the Board of Trustees, directly violated procurement guidelines provided by the Department of Education (DOE) to all charter schools. Specifically, RMH repeatedly used the same vendor for practically all of its computer-related needs. RMH did so without due consideration of other vendors and without regard for the best interest of RMH and its funding source. Moreover, based upon comments made by several current and former school officials, as well as our review of RMH's internal records and its computer request and complaint log, the computer equipment supplied by RMH's primary vendor was of inferior quality, required frequent repairs, and adversely affected RMH's administrative and educational activities. In addition, we found that a concerted effort by RMH's former principal to improve RMH's procurement process was dismissed by the Board of Trustees.

6. RMH AWARDED QUESTIONABLE CONSULTANT CONTRACTS TOTALING AS MUCH AS $240,187 **46**

Our audit found that RMH awarded consultant contracts that resulted in questionable payments totaling as much as $240,187. Contrary to guidance provided by DOE to all charter schools, RMH did not award consultant contracts based upon competitive-bid procedures; develop detailed agreements specifying required consultant services, maximum obligations, service delivery periods, and authorizing signatures; maintain documentation to support consultant charges; limit consultant charges to agreed-upon maximum obligations; and ensure the delivery of consultant services and products. Consequently, RMH cannot assure the Commonwealth that the state funds it expended on consultant services represented reasonable, allowable, and allocable costs.

7. INADEQUATE INTERNAL CONTROLS OVER ADMINISTRATIVE, ACCOUNTING, AND OPERATIONAL FUNCTIONS **50**

Our audit identified that the RMH needs to establish internal controls over its administrative, accounting, and operational functions. Specifically, RMH has not implemented policies and procedures to ensure that all its transactions are authorized, documented, recorded, reported, and in compliance with applicable state laws, rules, and regulations. Consequently, from July 1, 2000 to June 30, 2004, the RMH did not (a) ensure that Board of Trustees members filed their annual financial interest disclosure forms with the Commonwealth; (b) maintain time and attendance records that supported employee salaries, wages, and fringe benefits totaling $3,998,257; (c) maintain inventory

records that supported purchases, transfers, and the disposal of furniture and equipment totaling $237,858; and (d) maintain purchase requisitions, purchase orders, vendor invoices, and other documents to ensure that general operating expenses were reasonable, allowable, and allocable.

8. RMH'S BOARD OF TRUSTEES NEEDS TO IMPROVE OVERSIGHT OF RMH'S FINANCIAL OPERATIONS **61**

Our audit revealed that from fiscal year 2001 through fiscal year 2004, RMH's Board of Trustees did not provide adequate oversight over RMH's financial operations. Specifically, the Board of Trustees did not maintain adequate documentation in the form of meeting minutes detailing discussions, votes, and other actions taken by the board, and functioned without the benefit of current financial statements from RMH's Business Manager. In addition, several board members were frequently absent from scheduled board meetings, and the majority of board members served terms beyond the maximum period allowed by RMH's corporate bylaws. These problems prevented the board from achieving a quorum, exercising proper oversight over RMH's fiscal operations, and effectively carrying out their duties as board members.

9. RMH DID NOT TRANSFER WITHHOLDINGS TO THE MASSACHUSETTS TEACHERS' RETIREMENT SYSTEM ON A TIMELY BASIS, RESULTING IN A LOSS OF POTENTIAL INTEREST INCOME TO THE RETIREMENT SYSTEM AND IN THE UNAUTHORIZED USE OF EMPLOYEE CONTRIBUTIONS **67**

We found that, contrary to Chapter 32, Section 22, of the General Laws, RMH did not transfer funds on a monthly basis that it withheld from its teachers' and other eligible staffs' earnings to the Massachusetts Teachers' Retirement System (MTRS). In fact, RMH instead used these employee payroll withholdings to improve its cash flow and pay for various operational expenses of RMH. As a result, the MTRS lost the opportunity to invest these funds in a way that maximizes the returns on the pensions of state retirees. In addition, RMH risked the loss of these employee retirement contributions.

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INTRODUCTION

Background

The Robert M. Hughes Academy Charter School (RMH) was organized in January 1999 as a nonprofit organization to operate a public charter school under the provisions of Chapter 71, Section 89, of the Massachusetts General Laws. Charter schools are public schools that, to a large extent, operate administratively and financially independent of the conventional school district structure. Chapter 71, Section 89, of the General Laws defines a Commonwealth charter school as "a public school, operated under a charter granted by the board of education, which operates independently of any school committee and is managed by a board of trustees." The law further states, "The board of trustees of a commonwealth charter school, upon receiving a charter from the board of education, shall be deemed to be public agents authorized by the commonwealth to supervise and control the charter school."

According to the Massachusetts Department of Education (DOE), the main difference between charter schools and public schools deals with freedom and accountability. In contrast to other public schools, parents, teachers, businesses, not-for-profit organizations, or community leaders can establish all charter schools, including Commonwealth charter schools. These schools are given the freedom to organize around their own core curriculum, theme, or teaching method and are allowed to control their own finances, staffing, school design, schedule, and other resources. In return for this freedom, a charter school must attract students and produce quality educational results within five years or risk having its charter revoked.

According to DOE, because charter schools have a greater measure of autonomy than other public schools, they are held to a more rigorous level of accountability. Specifically, according to DOE, the determination of whether a charter school should continue to receive public funds is guided by the following three central questions:

- Is the academic program a success?
- Is the school a viable organization?
- Is the school faithful to the terms of its charter?

A charter school must demonstrate its ability to achieve fiscal and operational viability as well as fulfill the objectives of its charter within the five-year period of its initial charter issuance in order to gain DOE approval for an extension of its charter.

Commonwealth charter schools receive funding (tuition reimbursement) directly from the State Treasurer's Office. Payments to Commonwealth charter schools are funded through deductions from the local aid accounts (Chapter 70 of the General Laws) of the districts in which charter school students reside, or the sending district, and are generally based on the per-pupil tuition rate of the sending district.

In addition to state tuition payments, charter schools, like other public schools, may receive federal and state grant funds. Charter schools, however, are not eligible for the Commonwealth's School Building Assistance Bureau grant funding for costs associated with capital projects, including school construction, reconstruction, or improvement work. Under the charter school law, charter schools may incur temporary debt in anticipation of receiving funds, provided that the terms of repayment not exceed the duration of the school's charter without the permission of the Board of Education (BOE). Charter schools may also receive funds and other donations from private contributors.

In January 1999, the BOE granted RMH a five-year charter, and RMH officially began operating in September 1999. During the period of our audit, RMH received tuition reimbursements from the state and other revenue, as detailed in the following table:

Robert M. Hughes Academy Charter School
Summary of Revenue
Fiscal Years 2001 through 2004

Revenue Source	FY 2001	FY 2002	FY 2003	FY 2004
Commonwealth of MA/DOE Tuition Reimbursement	$ 1,062,435	$ 1,406,024	$ 1,412,120	$ 1,477,030
Grants (Federal and State)	276,839	133,276	182,490	406,939
Contributions, In-Kind	160,732	182,594	201,510	217,255
Contributions, In-Cash	1,300	-	10,600	11,476
Miscellaneous Income	4,921	1,002	-	9,317
Interest Income	133	991	4,582	1,384
Total	$ 1,506,360	$ 1,723,887	$ 1,811,302	$ 2,123,401

While considering a renewal of RMH's charter for the five-year period ending June 30, 2009, the Commissioner of Education (Commissioner) in a memorandum dated February 17, 2004 to the members of the Board of Education stated: "RMH has faced challenges with respect to governance and the roles of the Board of Trustees and the school administration. At the time of the renewal inspection, we believed that the school had successfully addressed most of these issues. It has become apparent, however, that the school still faces some challenges with respect to governance and administrative leadership." Relative to this matter, the Associate Commissioner for Charter Schools, in a letter dated January 29, 2004 (see Appendix II) requested RMH's Chairperson to provide detailed information to address DOE's concerns about the resignation of RMH's principal on January 22, 2004; Board of Trustees Members serving beyond their term limit; conflicts of interest; and Board of Trustees Members failing to disclose potential conflicts to the State Ethics Commission. The Board of Trustees, in a letter dated February 6, 2004, provided some initial information to DOE relative to its request (see Appendix III).

DOE also referred its concerns to the Office of the State Auditor (OSA) and the State Ethics Commission. To address these concerns, on March 20, 2004 the OSA began a review of RMH, which included an examination of RMH's governance, administrative leadership, financial management operations, related-party transactions, and potential conflict-of-interest situations involving some Board of Trustees members.

On February 24, 2004 the Board of Education, in accordance with Chapter 71, Section 89, of the General Laws and 603 Code of Massachusetts Regulations (CMR) 1.00, granted RMH a conditional renewal of its school charter for the five-year period from July 1, 2004 through June 30, 2009. As shown in Appendix I, RMH's charter renewal was explicitly predicated upon the following conditions, and RMH's failure to meet any of these conditions could result in the school being placed on probation or having its charter revoked by the Board of Education.

> *1. The Robert M. Hughes Academy Charter School ("School") will make Adequate Yearly Progress in the aggregate as determined by the Department of Education based upon the results of the spring 2004 and spring 2005 administration of the Massachusetts Comprehensive Assessment System.*
>
> *2. Members of the Board of Trustees who also served as members of the board of directors, officers, executives, advisors, consultants, and in any other capacity for the D. Edward Wells Federal Credit Union must immediately request an opinion from the State Ethics Commission regarding their failure to disclose this interest on their financial disclosure forms and their participation in any decisions made regarding deposits of the*

funds of the School with the D. Edward Wells Federal Credit Union, including deposits made in excess of the "maximum insured sum" as noted in the auditor's report for FY03 on page 14 in number 14 of the Notes to Financial Statements. If the State Ethics Commission determines that any members of the Board of Trustees violated either the Commonwealth's conflict of interest or financial disclosure laws, those members must immediately resign from the Board of Trustees.

3. The Board of Trustees must hire a consultant by April 15, 2004 with experience working with board of trustees of charter schools regarding board practice and governance. Such consultant must be acceptable to the Department of Education and must not have any personal relationships with any members of the Board of Trustees. The consultant shall perform an evaluation of the Board of Trustees' performance of its governance and oversight duties and submit a written report to the Department of Education by June 30, 2004. The Board of Trustees shall submit an action plan based upon this report by September 13, 2004 to the Department of Education for approval and for use in the ongoing evaluation of the school.

4. The Board of Trustees must comply with, or revise in a manner acceptable to the Department of Education, the bylaws for the School regarding terms of members by June 30, 2004.

5. Members of the Board of Trustees must cooperate with the Department of Education and the Office of the State Auditor to fully address the questions and issues raised by the Department.

During our review, we requested RMH to provide us with documentation supporting its compliance with the charter renewal conditions. However, RMH did not respond to our request.

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine certain financial and operational activities of RMH for the period July 1, 2000 to June 30, 2004. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States and, accordingly, included such procedures and tests, as we considered necessary under the circumstances. Our specific audit objectives consisted of the following:

- Obtaining an understanding of RMH's financial operations during the audit period,
- Assessing internal control systems to determine whether management's recording, reporting and monitoring of financial activity was adequate to ensure that resources are safeguarded and are being used economically and efficiently, and
- Assessing RMH's business practices and its compliance with applicable laws, rules, and regulations, as well as various fiscal requirements as stated in its charter.

To achieve our audit objectives, we assessed RMH's system of internal controls over its operations to obtain an understanding of management's attitude, the control environment, and the flow of

transactions through RMH's accounting system. The assessment was used in planning and performing our audit tests. We conducted interviews of various RMH officials and reviewed organizational charts, minutes of board meetings, internal policies and procedures, enrollment reports, and other records, including RMH's original charter application and subsequent annual reports submitted to DOE. We conducted telephone interviews with officials from DOE's Charter School office and reviewed all applicable laws, rules, and regulations. We examined RMH's financial statements, budgets, cost reports, invoices, and other pertinent records to determine whether expenses incurred by the charter school were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws and regulations.

Prior to commencing our audit fieldwork, DOE provided reports, documents, and correspondence to the OSA that detailed concerns it had over certain RMH activities relative to governance, financial activities, and administration. Consequently, in addition to our regular planned audit tests, we designed additional audit steps, as deemed necessary, to address DOE's concerns. We have reported upon any deficiencies found relative to these matters within this report.

During our audit engagement, RMH's management conducted various activities that limited our ability to perform our audit testing. A scope limitation occurs during an audit engagement when an auditee places restrictions on the scope of the auditor's work. These restrictions result in a disruption in the timing of the work, including the ability to apply all the audit procedures considered necessary in the circumstances of the engagement. Specifically, the OSA is authorized by its enabling legislation, Chapter 11, Section 12, of the General Laws to perform audits of entities such as RMH that contract with the Commonwealth to "determine compliance with provisions and requirements of such contracts or agreements and the laws of the Commonwealth."

This statute further mandates that "the state auditor shall have access to such records at reasonable times and said department [the OSA] may require the production of books, documents, vouchers, reports and other records relating to any matter within the scope of the audit." In addition, Chapter 71, Section 89(hh), of the General Laws authorizes the OSA to audit the activities of charter schools by stating, in part:

> *[The State Auditor] may investigate the budget and finances of charter schools and their financial dealings, transactions and relationships, and shall have the power to examine the records of charter schools and to prescribe methods of accounting for the rendering of periodic reports.*

Despite these statutory requirements, during the conduct of our audit fieldwork, RMH did not make all of its records available to us at reasonable times or in many cases did not provide the documents we requested. Specifically, we requested information relative to a related-party lease agreement between RMH and School Street Properties, Inc., (SSPI). RMH and SSPI share common Board of Trustee members, and therefore the lease agreement between RMH and SSPI represents a related-party transaction. Moreover, based upon Chapter 71, Section 89 (hh), such relationships are subject to audit by the OSA.

RMH referred the matter to its outside legal counsel, who in a letter dated June 24, 2004 stated, "Although RMH would be happy to provide you with the requested information, it is unable to do so because that information is not in its possession nor under its control." Consequently, on two separate occasions, we requested the required information from SSPI's Chairperson, who also serves as Treasurer of RMH's Board of Trustees. However, SSPI's Chairperson did not respond to either of our written requests.

On another occasion, we met with RMH's Board of Trustees to discuss RMH's failure to provide requested information to the audit staff. At the request of RMH's Chairperson, we provided her with a complete list of documents that the audit staff had requested but was still waiting to receive, including information relative to RMH's lease agreement with SSPI. However, as of our fieldwork completion date, RMH's Chairperson neither provided the required documents nor offered the audit staff an explanation for this failure to comply with our final information request.

This resulted in a protraction of the audit process and prevented the audit team from reviewing RMH's related-party lease payments to SSPI and determining whether the amounts were reasonable, allowable, and allocable to state contracts. In addition, RMH's lease payments to SSPI include amounts for leasehold improvements to the school building totaling $470,000. It was our intention to review these leasehold improvements to ensure that contract awards were based upon competitive-bid procedures, contracted work was complete and met building code requirements, and expenditures of state funds were supported by adequate documentation. Consequently, the results of our audit work are based solely on the limited amount of information made available to us by RMH, information we obtained from the City of Springfield Code Enforcement Bureau, and our observations of improvements made to the school building.

Our review was not made for the purpose of forming an opinion on RMH's financial statements. We also did not assess the overall quality of education being provided to RMH's students or the adequacy of the curriculum being followed. Rather, our report was intended to provide conclusions and recommendations aimed at improving the economy, efficiency, and effectiveness of RMH's operations.

AUDIT RESULTS

1. FINANCIAL MANAGEMENT PROBLEMS HAVE RESULTED IN SIGNIFICANT CASH-FLOW PROBLEMS AND QUESTIONS ABOUT RMH'S CURRENT AND LONG-TERM FINANCIAL HEALTH

Our audit found deficiencies in the management of Robert M. Hughes (RMH's) financial operations, which has placed RMH in a difficult financial position. Clear indicators of fiscal problems being experienced by RMH include a deteriorating cash-flow position, operating deficits for the last two years, and dwindling reserves. During fiscal years 2003 and 2004, RMH experienced a rapid deterioration of its cash position, which required the charter school to maximize its line of credit in order to maintain operations. Specifically, as of June 30, 2002, RMH's available cash totaled approximately $535,925 and its line of credit balance was zero. However, as of June 30, 2004, RMH's cash position had sharply declined to $368,371 (31%), and its line of credit balance had significantly increased to $248,000. Consequently, in just two years, RMH's cash position effectively declined from $535,925 to just $120,371 ($368,371 - $248,000), or 78%. Further illustrating the fiscal decline of RMH are its operating results for each of the last two fiscal years. RMH incurred operating deficits of $199,304 for the fiscal year ended June 30, 2003 and $164,934 for the fiscal year ended June 30, 2004.

A charter school's net assets (the difference between assets and liabilities) represents one way to measure the school's financial health or financial position. Over time, increases and decreases in a charter school's net assets indicate whether the school's financial health is improving or declining. Over the past two fiscal years, RMH incurred operating losses totaling $364,238, which caused its net assets to decrease from $715,340 to $351,102, or 51%. Thus, since June 30, 2002, RMH's financial health has been in serious decline. Moreover, RMH has a significant portion of its net assets invested in fixed assets. Consequently, these amounts are not available for use by RMH. By reducing RMH's June 30, 2004 net assets by these amounts, the net assets balance available for use by RMH is $140,087 ($351,102 - $210,295).

Finally, our review of RMH's financial condition included an examination of non-financial factors such as RMH's control environment, staffing patterns, lines of communication, and facilities. We found weaknesses in each of these areas that over time have adversely impacted RMH's financial operations.

RMH Cash Flow Problems

On May 20, 1999, RMH obtained a $200,000 working capital line of credit from its primary bank of deposit, which carried an initial variable interest rate of 7.75%. The purpose of the line of credit was to support the annual operating expenses of the charter school. As security for the line of credit, RMH provided the lender a perfected first position on all assets of RMH. Lastly, the line of credit was payable on demand, required monthly payments of interest only, and was subject to annual review.

During fiscal years 2003 and 2004, RMH experienced a rapid deterioration of its cash position that required the charter school to maximize its line of credit in order to remain financially solvent. Specifically, as of June 30, 2002, RMH's available cash reserves totaled approximately $535,925 while its line of credit balance was zero. Thus, RMH had completed fiscal year 2002 and entered fiscal year 2003 in a sound financial position. However, as of June 30, 2004, RMH's cash position had sharply declined to $368,371 (31%) while its line of credit balance had increased to $248,000. Consequently, in just two years, RMH's cash position effectively declined from $535,925 to just $120,371 ($368,371 - $248,000), or 78%.

In most instances, RMH utilized its line of credit in order to maintain liquidity within its primary checking account. For example, on February 27, 2003, RMH borrowed $126,000 because it had overdrawn its checking account by $11,393, and its next quarterly tuition payment from the Department of Education (DOE) was not due until March 31, 2003. Consequently, RMH needed the $126,000 loan to cover its negative checking account balance and to help pay for its March 2003 operating expenses, which totaled $164,088.

However, our audit found that on two occasions RMH borrowed funds from its line of credit injudiciously, which resulted in unnecessary bank finance charges totaling $632. First, on September 27, 2000, RMH borrowed $50,000 while maintaining a checking account balance on that date totaling approximately $330,000. Similarly, on December 29, 2000, RMH borrowed $30,000. At that time, RMH's checking account balance totaled approximately $346,000. In both these instances, RMH had sufficient cash reserves available to meet its current liabilities, which were averaging approximately $98,000 per month at the time.

At the end of our audit period, June 30, 2004, RMH's cash position had deteriorated to such an extent that it began relying upon its quarterly tuition revenue to fund prior period expenses rather than current period operating costs. In this regard, RMH's June 30, 2004 tuition payment totaled $361,158. However, at the time, this amount was barely sufficient to offset its negative checking account balance ($44,739) and $248,000 outstanding line of credit balance. Moreover, in considering these two debts, RMH's non-obligated cash totaled only $68,419 ($361,158 - $292,739), which was certainly insufficient to meet its quarterly operating expenses that were averaging approximately $568,883. Consequently, RMH was forced to increase its level of debt to remain financially solvent through September 30, 2004.

In this regard, as of July 1, 2004, RMH increased its maximum line of credit limit from $200,000 to $400,000. Although the increase could help RMH meet its short-term obligations, financing such additional debt could become very costly over time and only add to RMH's financial problems. Specifically, as of June 30, 2004, RMH's line of credit required monthly interest payments totaling approximately $760. Should RMH maximize its $400,000 borrowing limit, the charter school's monthly finance charge on this amount would increase to approximately $1,333 based upon its current 4% rate of interest.

Finally, the "Current Ratio" (current assets/current liabilities) provides an indication of a school's ability to meet its cash obligations in the near future by demonstrating the extent to which a school's current liabilities are covered by its current assets when converted to cash. The higher the current ratio, the more able the organization is to meet its short-term liabilities or obligations. On June 15, 2004 the OSA issued Audit Report No. 2004-5110-17C entitled "Independent State Auditor's Review of Certain Aspects of Charter School Financial Results and Financial Reporting Fiscal Years 2002 and 2003." This statewide report identified that during fiscal year 2003, the 48 charter schools tested had an average current ratio of 7.1. For fiscal years 2003 and 2004, RMH had a current ratio of 1.66 and 1.07, respectively. Clearly, RMH may have significant problems meeting its cash obligations in the near future.

RMH Operating Losses

During fiscal years 2003 and 2004, RMH incurred operating losses totaling $199,304 and $164,934, respectively. In contrast, our aforementioned review that assessed the financial condition of charter schools throughout the Commonwealth revealed that for fiscal year 2003, 38 of the 48 charter

schools statewide reported net income that ranged from $4,159 to $1,037,779, with the average of $254,239. Moreover, only nine of the 48 charter schools statewide reported net losses, which ranged from $1,785 to $307,442, with an average of $116,394. RMH's operating loss for fiscal year 2003 totaled $199,304, which was the third highest among all Commonwealth charter schools.

Our tests of RMH expenses identified several financial transactions that contributed to the charter school's fiscal year 2003 and 2004 operating losses. While the examples provided below offer some insight into RMH's troubled financial operations, by no means do they encompass the major factors contributing to the charter school's financial problems. These major factors are reported as separate audit issues within this report.

- During fiscal years 2002 and 2003, RMH paid property taxes totaling $28,495 on property that it leases from School Street Properties, Inc. (SSPI), a related party. RMH could have avoided these tax payments had SSPI filed timely for its tax-exempt charitable organization status under Section 501(c)(3), of the Internal Revenue Code.

- On August 31, 2001, RMH signed a three-year lease agreement with American Express Business Finance for a closed-circuit television security system. Under the lease terms, RMH was required to make 36 monthly payments of approximately $1,030. However, from August 1, 2002 through April 30, 2004, RMH's monthly remittances were late 13 times, resulting in unnecessary late payment charges totaling approximately $1,862.

- During fiscal years 2003 and 2004, RMH had meals and refreshments catered for trustees and staff totaling approximately $12,064. RMH could have used these funds more prudently given its struggling financial situation.

RMH's Deteriorating Financial Health

A charter school's net assets (the difference between its assets and liabilities) represents one way to measure RMH's financial health or financial position. Over time, increases and decreases in a charter school's net assets indicate whether RMH's financial health is improving or declining. Over the past two fiscal years, RMH's net assets have decreased from $715,340 to $351,102, or 51%.

In addition, RMH has a significant portion of its net assets invested in fixed assets. Consequently, these amounts are not available for use by RMH. By reducing RMH's June 30, 2004 net assets by these amounts, the net assets balance available for use by RMH is only $140,807 ($351,102 - $210,295).

Non-Financial Factors

As part of our review of RMH's overall financial health, we also considered non-financial factors, including RMH's (a) control environment, (b) administrative staffing levels and segregation of duties, (c) communication systems, and (d) facility conditions. Our audit found weaknesses in each of these areas, which are described below.

a. Control Environment: The control environment, which represents management's overall attitude about internal controls within the organization, deals with management's integrity and ethical values, commitment to competence, and philosophy and operating style. In this regard, a strong control environment would include evidence of a code of conduct, established policies and procedures covering financial accountability, and required weekly staff meetings with the entity's Chief Executive Officer. Our review found that RMH's control environment is inadequate to safeguard its assets and that the inadequate control environment contributed significantly to RMH's current financial problems. As noted throughout this report, we found that RMH's Board of Trustees members:

- Authorized questionable related-party transactions;
- Withheld audit information relative to these related-party transactions;
- Engaged in potential conflicts of interest;
- Did not implement policies and procedures covering financial accountability, such as authorizing, documenting, and recording expenses, inventory control, and payroll;
- Utilized restrictive procurement practices;
- Violated RMH's organizational bylaws relative to term limits;
- Did not file required financial disclosure forms with the Commonwealth; and
- Did not prepare meeting minutes that detail the board's discussions and votes on major issues.

b. Administrative Staffing Levels and Segregation of Duties: Segregation of accounting functions is a basic internal control activity that helps entities safeguard assets and ensure proper accounting of financial transactions. However, we found that RMH had not maintained adequate staffing levels to segregate duties within its business office. In fact, over the past four years, RMH's Business Manager handled all of the charter school's day-to-day financial activities. At times, RMH did employ a temporary accounting clerk to assist the Business Manager. However, the added help was not nearly sufficient to ensure adequate segregation of duties within the business office. Moreover, the staff shortage prevented RMH from performing numerous routine financial activities, such as preparing purchase orders, obtaining price quotes and soliciting competitive bids, ensuring proper authorization of expenses, maintaining supporting documentation for expenses, depositing cash receipts timely, maintaining inventory control records, preparing bank reconciliations timely, updating operating budgets, preparing and updating monthly cash flow projections, and developing detailed consultant contracts.

In addition, RMH has experienced significant turnover in the Business Manager position over the past five years. Specifically, from November 5, 1999 through December 31, 2004, the position has turned over five times. Although RMH's first three Business Managers were permanent employees of RMH, its last two Business Managers were employed through a personnel agency. As of January 1, 2005, RMH was operating without the benefit of a Business Manager.

Clearly, continuity in the Business Manager position is critical to developing, implementing, and maintaining control procedures that ensure financial accountability. In addition, employing a qualified Business Manager is essential to identifying and correcting control weaknesses, developing and implementing control procedures, monitoring staff activities, and communicating financial results with management. However, as was noted in RMH's fiscal year 2004 Independent Auditor's Report, "Most of the people hired for this position were either not qualified or did not carry the due diligence spirit that is necessary."

c. Communication Systems: Communication within a charter school may take place in many variations, such as informal communication between the Principal and the staff, or through more formal lines of communication between the Board of Trustees and the school's

management officials. In addition, charter schools routinely communicate with regulatory bodies and other interested people.

RMH's lines of communication are clearly delineated within its bylaws and charter. Regarding the Principal, RMH's bylaws state, in part:

> *The Principal shall be the chief executive officer of the school and, subject to the direction and control of the Board of Trustees, shall have general charge of the affairs of the School. The Principal shall have such other powers and duties as are usually incident to the office and as may be vested in that office by these By-Laws or by the Trustees.*

RMH's charter further addresses the Principal's authority, duties, and lines of communication with the trustees. Specifically, RMH's charter states:

> *The Principal will function as the Chief Executive Officer of the RMHACS, reporting to the Board of Trustees. The senior management team will also include the Educational Director and the Business Manager, who will report to the Principal.*
>
> *The Principal's duties include developing strategic plans, goals and objectives of the school; … supervising senior staff; overseeing all financial systems, fiscal management, fund-raising, development; …*

Although RMH's bylaws and charter clearly describe the Principal as the Chief Executive Officer whose responsibilities include supervising the Business Manager and overseeing RMH's financial activities, we found that a lingering conflict over this authority existed at RMH.

First, RMH's organizational chart (see Appendix IV) indicates that the Business Manager reports directly to the Board of Trustees. However, RMH's former Principal, whose tenure lasted from May 14, 2001 through January 22, 2004, indicated that a conflict existed over her lines of authority within RMH. In this regard, she stated that trustees required the Business Manager to report directly to them, which, at times, created friction between the Business Manager, Board of Trustees, and herself.

We also found that trustees, at times, were unwilling to accept input from school officials. For example, the former Principal attempted to share competitive bid information with the board regarding a major purchase of computer equipment. Despite her concerted efforts to identify the best qualified provider, the board disregarded her input, which resulted in RMH procuring inferior and defective computer equipment (see Audit Result No. 5).

On January 21, 2004, the former Principal tendered a letter of resignation to the Board of Trustees, effectively making her the fifth principal to depart RMH since it opened in September 1999. Within the letter, the former Principal provided the following reason for resigning from her position at RMH:

> *It has become apparent to me that the Trustees and I have reached a point where our philosophies regarding the oversight of the school differ greatly; therefore, I feel it is necessary for me to tender my resignation.*

d. Facility Conditions: RMH is presently experiencing significant structural problems with its front entryway. Specifically, the front stairs and landing area, which are made from poured, reinforced concrete, are crumbling and deteriorating and present a serious safety hazard. Consequently, students, faculty, and visitors are denied access to RMH through the front doors.

RMH's Facility Manager stated that the damage started during the winter of 2003 due to excessive salt being applied to the area, and over time the extent of damage has increased and has resulted in a hazardous situation. Consequently, as of January 2005, RMH still had not received a permanent Certificate of Occupancy from the City of Springfield, and based upon correspondence between RMH and the city's Code Enforcement Department, RMH will not receive a Permanent Certificate of Occupancy until all work has been completed on the front landing and exterior hand railings (see Audit Result No. 2).

Recommendation

In order to address our concerns relative to this matter, RMH should adopt internal control measures that better ensure the effective and efficient management of RMH. At a minimum, these should include the following:

- Closely monitoring financial operations, paying particular attention to budgeted versus actual revenues and expenditures on an ongoing basis, so that potential problems can be identified and decisions made to prevent further financial shortfalls.

- Adopting a policy relative to managing its line of credit. This policy should prevent RMH from incurring unnecessary interest charges. Prior to accessing its line of credit, RMH should discuss this matter at an open board meeting and obtain board approval for the drawdown of any funds.

- Eliminating all unnecessary expenses, paying its operating expenses in a timely manner, and using funds prudently to help ensure the financial viability of RMH.

- Adhering to DOE's Administrative and Governance Guide and implementing its Recommended Fiscal Policies and Procedures Guide to ensure greater financial accountability in such areas as authorizing, documenting, and recording expenses; inventory control; and payroll.

- Hiring a qualified Business Manager to oversee the day-to-day fiscal operations of RMH. The Business Manager should also implement RMH's fiscal policies and procedures manual to ensure that all RMH financial transactions are supported with proper documentation.

- Taking steps to improve its communication system, including having the Business Manager report to the Chief Executive Officer of RMH and reflecting this change in RMH's organization chart.

- Adopting a policy of cooperation with government agencies whereby information is made available at reasonable times upon request.

Auditee's Response

In response to this audit result, RMH officials provided the following comments:

> *The Audit Report makes much of the alleged mismanagement of financial resources and operations. The report points abstractly to the Board of Trustees, giving rise to the inference that the Trustees are making the day-to-day decisions on the expenditure of RMH's financial resources. However, the Audit Report makes no mention of the role that Principal Swan played as the Chief Executive Officer. During the tenure of the former Principal/CEO, all of the non-financial factors that were mentioned in the Audit Report, such as control environment, staffing patterns, lines of communications and facilities were under her control. Without mentioning this fact, the OSA unduly relied on the former Principal and the former Chairman of the Board of Trustees as the sources of information to support the charges of mismanagement. Plainly, the OSA missed the opportunity to focus on the former Principal/CEO's conduct in managing the RMH's financial resources. At all times pertinent to the alleged mismanagement, the former Principal/CEO was at the helm of the School; therefore, the alleged mismanagement was committed by her staff and under her management. It is worrisome that the Audit Report fails to mention this fact.*
>
> *The OSA is correct in stating that the school was operating with a surplus and did not experience deficits until 2003 and 2004. The audit failed to highlight the bases of the deficit or the acts, omissions or commissions that resulted in the deficit. Further, the OSA did not interview members of the RMH Board to gain a balanced perspective of the operation of the School during the period when the deficit was incurred. Such an interview would have given the OSA a more balanced perspective as to the circumstances that gave rise to the deficit. If the OSA took a balanced approach to its mission, it would have learned that the former Principal/CEO removed herself from the supervision of the RMH Board and used the Associate Commissioner as a heavy blunt instrument to bludgeon the RMH Board into taking a hands-off position in overseeing her performance and attempting to assert its duty to manage the business affairs of the School. For example, OSA would have learned that the former Principal/CEO refused to provide the Board with timely financial information, and that RMH suffered a 20 percent reduction in tuition income* in mid-year *due to a reduction in funding by the DOE.*

The OSA's awareness of these circumstances might have tempered, or possibly, contributed to a more balanced report. Indeed, providing a balanced report is mandated by the OSA's enabling legislation. In this instance, the OSA failed in its mission because it naively permitted itself to be manipulated by a clever, vindictive, former employee of the School who continues to grind her axe even though she unceremoniously walked away from the School at a very critical point in its development....

The current Principal/CEO has worked cooperatively with the Board of Trustees to significantly improve RMH's financial condition; thus leading to a favorable FY05 year to date surplus, improved cash flow position, and increased reserves. The following financial indicators show that RMH's financial position has improved significantly:

a. *Net Assets (i.e., Excess of Revenues and Support over Expenses) increased by $187,906 ($539,009 - $351,103) or 54% for the period 7/1/04 – 11/30/04.*

b. *Net Asset Available for Use (i.e., Unrestricted Net Assets) increased by $182,460 ($323,267 - $140,807) or 130% for the period 7/1/04 – 11/30/04.*

c. *Current Ratio has increased from 1.07 as of June 30, 2004 to 2.95 as of November 30, 2004, reflecting an increase of 176%.*

d. *As of November 30, 2004, the line of credit had a zero balance.*

In addition, RMH's most recent unaudited Financial Statements as of March 31, 2005 indicate that RMH's financial position has improved significantly based on the following financial indicators:

a. *Net Assets (i.e., Excess of Revenues and Support over Expenses) increased by $226,018 ($577,121 - $351,103) or 64% for the period 7/1/04 – 3/31/05.*

b. *Net Asset Available for Use (i.e., Unrestricted Net Assets) increased by $220,572 ($361,379 - $140,807) or 157% for the period 7/1/04 – 3/31/05.*

c. *Current Ratio has increased from 1.07 as of June 30, 2004 to 2.08 as of March 31, 2005, reflecting an increase of 94%.*

The current financial results indicate that RMH has improved the management of its finances and has restored its cash flow position. It expects to show a surplus for fiscal year 2005.

Auditor's Reply

First, as noted in the Audit Scope, Objectives, and Methodology section of this report, our audit was conducted in accordance with applicable generally accepted government auditing standards (GAGAS) for performance audits issued by the Comptroller General of the United States. The fieldwork standards related to evidence and audit documentation for performance audits in accordance with GAGAS require respectively:

Sufficient, competent, and relative evidence is to be obtained to provide a reasonable basis for the auditor's findings and conclusions.

> *Auditors should prepare and maintain audit documentation. Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor, who has had no previous connection with the audit, to ascertain from the audit documentation the evidence that supports the auditor's significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their reports.*

The reporting standard related to the contents of the report for performance audits conducted in accordance with GAGAS require:

> *The audit report should include the objectives, scope, and methodology; the audit results, including findings, conclusions, and recommendations, as appropriate; a reference to compliance with generally accepted government auditing standards; the views of responsible officials; and, if applicable, the nature of any privileged and confidential information omitted.*

In completing our audit of RMH, the OSA complied with the field work and reporting standards promulgated by the Comptroller General of the United States. As such, the OSA thoroughly analyzed RMH's financial and operational activities and maintained documentation to support its conclusions and recommendations. This documentation includes, among other things, RMH's (a) Board of Trustees' meeting minutes, (b) operating policies and procedures, (c) audited financial statements, (d) related-party agreements and consultant contracts, (e) payroll records, (f) bank reconciliations, and (g) other accounting records and supporting documents. As a result, all the findings and conclusions detailed within the audit report reflect the actual financial and operational conditions that existed at RMH during the audit period. By no means has the OSA described alleged mismanagement at RMH. Rather, as stated in our report, RMH clearly mismanaged its financial operations during the audit period resulting in significant cash-flow problems and questions about its current and long-term financial health.

Second, RMH's Board of Trustees points blame at the former Principal for most of the deficiencies identified by the audit staff. The OSA has not attempted to point such blame in any one direction, since both the Board of Trustees and the Principal/CEO have responsibility for governing the school's operations. In this regard, the Charter School Administrative and Governance Guide published by the Massachusetts DOE states:

> *As public agents authorized by the state, the members of Boards of Trustees of charter schools are responsible for governing those schools. A strong Board of Trustees defines the mission of the school, develops school policies and changes them when appropriate, hires qualified personnel to manage the school's day-to-day operations, and formulates a long-range plan that will ensure the school's continued stability. In addition to its many*

> *other responsibilities, the Board must ensure that the school is complying with all of the state and federal laws that apply to the school and that the Board itself is operating in accordance with the rules set out by the applicable Massachusetts laws and regulations. Finally, the Board is responsible for operating the school in accordance with its charter and with any approved amendments to its charter.*

Consequently, our report appropriately attributes most of the audit findings to the RMH Charter School in general, and only directs attention to specific trustees or school administrators when they directly benefited from a questionable action or failed to comply with reporting requirements mandated by Massachusetts General Laws and Regulations.

Third, the Board of Trustees asserts that the Audit Report makes no mention of the role played by the former Principal as Chief Executive Officer. The OSA takes exception to this statement since the responsibilities of the former Principal as Chief Executive Officer are clearly delineated within RMH's bylaws and charter, which we cite within our report. In addition, we reported that the former Principal's actual role in overseeing RMH's financial operations was a point of contention among trustees and school administrators. In this regard, we held discussions with current and former RMH officials and concluded that an acrimonious relationship existed between the trustees and the former Principal, which culminated with her resigning on January 21, 2004. The former Principal's resignation reflected the fifth Principal to depart RMH since it opened in September 1999.

Fourth, the Board of Trustees points blame at the former Principal for the deficiencies identified in RMH's control environment, staffing patterns, lines of communication, and facilities. However, based upon our audit work, the Board of Trustees had a direct involvement in these areas and certainly shares some responsibility for the school's problems. For example, the Board of Trustees is certainly responsible for denying the audit team access to certain audit related information. The Board's unwillingness to share relevant audit information reflects a significant deficiency in RMH's control environment. Similarly, the Board of Trustees is partially responsible for the school's inability to obtain a Certificate of Occupancy. Documents maintained by RMH's Facility Manager reflect the Board's full knowledge of electrical, plumbing, and structural issues at the school, which directly impeded certification of the school building. Consequently, for the Trustees to point blame at the former Principal in these matters is disingenuous and counter-productive to the audit process.

Fifth, RMH's operating deficits for fiscal years 2003 and 2004 did not result from a single act, omission, or commission. Rather, the basis for the deficits was RMH's failure to implement adequate internal controls over its financial operations. This lack of control led to various problems, including unallowable and questionable expenditures, contracting and procurement deficiencies, inventory control weaknesses, cash flow problems, undocumented expenses, etc. We identified these deficiencies by thoroughly examining RMH's control structure, sample testing transactions, and interviewing RMH officials. Moreover, we conducted a mid-point conference with RMH's Board of Trustees to discuss these matters in detail and to obtain a complete understanding of the circumstances surrounding the school's fiscal problems. This mid-point conference served little benefit to the audit process, since some trustees in attendance preferred critiquing the audit process to discussing the audit issues.

Sixth, as previously stated, GAGAS requires that sufficient, competent, and relative evidence be obtained to provide a reasonable basis for the auditor's findings and conclusions. The OSA has met this fieldwork standard by gathering, analyzing, and concluding on the financial books and records maintained by RMH. In some instances, RMH could not provide the audit staff with documents necessary to support its expenditure of Commonwealth funds. This, in and of itself, represented a serious deficiency within RMH's control structure, and, accordingly, our audit report discloses the matter. In addition, as a general rule, the OSA defers to the State Ethics Commission for final rulings on potential violations of the state's conflict-of-interest law. Consequently, Audit Result No. 4 of our report identifies that RMH's Chairperson and Treasurer ***may*** have violated Chapter 268A of the General Laws. This wording, however, does not diminish the OSA's responsibility to comply with the fieldwork and reporting standards of GAGAS.

Seventh, based upon RMH's response, it appears that the trustees have taken steps to begin improving the charter school's financial condition. However, the OSA cannot attest to the financial data offered by the trustees without first reviewing the school's books and records. In addition, it should be noted that the Trustees indicated that as of November 30, 2004, the school's line of credit had a zero balance, but they neglected to share its line of credit balance as of March 31, 2005. Most likely, RMH's line of credit increased over the four-month period, since its current ratio declined from 2.95 to 2.08 over the period.

2. RMH MADE UNALLOWABLE AND QUESTIONABLE LEASE PAYMENTS TOTALING $279,055 TO A RELATED PARTY THAT DID NOT SATISFACTORILY COMPLETE RENOVATIONS NECESSARY FOR RMH TO OBTAIN A CERTIFICATE OF OCCUPANCY

During our audit period, RMH leased a building located at 91 School Street, Springfield that it uses to operate its school from School Street Properties, Inc., (SSPI), a related-party organization. RMH's lease agreement with SSPI requires it to make rent payments based upon a percentage of SSPI's loan obligations on the property. However, our audit found that RMH's rent payments had been inflated by SSPI, which resulted in RMH's making excessive rent payments totaling $55,886 during the period September 1, 2001 to June 30, 2004. In addition, contrary to DOE's Recommended Policies and Procedures Guide, RMH did not maintain documentation to support the reasonableness of its monthly rent payments to SSPI, which totaled $279,055 (including the $55,886 discussed above) over this period. During the audit, we attempted to obtain documentation from SSPI necessary to substantiate the reasonableness of these lease payments. However, despite our efforts, SSPI was unwilling to share any documents with us relative to this matter. Consequently, the Commonwealth cannot be assured that all of the rent payments RMH made to SSPI, its related party, during the period covered by our audit were reasonable and allowable.

We also found that RMH experienced significant problems with the General Contractor hired by SSPI to initially renovate this property. Specifically, the General Contractor's electrical and plumbing work did not pass inspection by local building code officials. Under state law and regulations, charter schools are required to obtain a Certificate of Occupancy from the local building inspector prior to opening the charter school facility. However, as of June 30 2004, RMH had been unable to obtain a Certificate of Occupancy from the City of Springfield, and according to local code enforcement officials, RMH has illegally occupied the 91 School Street property since September 1, 2001.

Related-Party Relationship

During our audit period, RMH maintained a related-party relationship with SSPI. The Financial Accounting Standards Board (FASB) Statement No. 57, Related Party Disclosures, defines a related party as follows:

> *Affiliates of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise and its management, members of the immediate families of*

> *principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to the extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.*
>
> *Another party is also related if it can significantly influence the management or operating policies of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.*

In July 2001, several RMH trustees formed SSPI as a not-for-profit corporation under Chapter 180 of the Massachusetts General Laws. According to its calendar year 2002 Return of Organizations Exempt from Income Tax (federal Form 990), SSPI was organized for the purpose of acquiring, holding, managing, rehabilitating, reconstructing, and operating real estate for use by schools and/or other educational or charitable purposes. Although SSPI was created as an independent not-for-profit agency, it shares a common Board of Trustees with RMH, and its real estate transactions to date have been conducted exclusively for RMH's benefit. Based upon FASB 57, such common management, common control, and exclusiveness of purpose constitute a related-party relationship.

Unallowable Lease Payments Totaling $55,886

On August 7, 2001, RMH entered into a 50-year lease agreement with SSPI to lease the 91 School Street property for the operation of its Commonwealth charter school and related activities. Under the terms of this agreement, RMH agreed to pay monthly rent to SSPI equal to 1.1 times SSPI's monthly loan obligations on this property. Based upon the loan documents we reviewed, SSPI's annual loan payments on this property through June 30, 2004 totaled $202,881, as detailed in the following table.

Total Annual Loan Payments				
Lender Institution	Fisacl Year 2002	Fiscal Year 2003	Fiscal Year 2004	Total
Hampden Savings Bank	$ 25,805	$ 32,404	$ 32,404	$ 90,613
MassDevelopment	18,597	37,777	29,557	85,931
Western Mass. Enterprise Fund	7,183	9,577	9,577	26,337
Total	$ 51,585	$ 79,758	$ 71,538	$ 202,881

Our review of RMH's financial records identified that it paid SSPI $279,055 in lease payments from September 1, 2001 through June 30, 2004. These payments, which were based upon monthly

invoices submitted by SSPI to RMH, exceeded the amounts RMH was required to pay under its lease agreement with SSPI by $55,886 ($279,055 – [1.1 x $202,881 = $223,169]).

According to Section 202, Subsection (B) of DOE's Guide, charter schools are prohibited from making payments based upon false or fictitious invoices such as the ones submitted by SSPI to RMH. Specifically, Section 202, Subsection (b) of the Guide states:

> *Receipts and disbursements must be fully and accurately described in the books and records;*
>
> *No false entries may be made on the books or records nor any false or misleading reports issued, and*
>
> *Payments may be made only to the contracting party and only for the actual services rendered or products delivered. No false or fictitious invoices may be paid.*

Questionable Lease Payments

Under Section (7) of the lease agreement, SSPI was required to complete certain work necessary to prepare the 91 School Street facility for RMH's charter school operations. Specifically, SSPI was required to make repairs to the facility's roof and heating and air conditioning systems. Also, SSPI was required to make various interior renovations, including constructing 10 classrooms, a cafeteria and dining area, a computer lab, a nurse's station, a library and conference room, and an administrative area. Lastly, SSPI was responsible for improving the facility's exterior areas, including the parking lot and playground.

The estimated cost of these improvements was $470,000, which SSPI initially funded through loans it obtained from both private and quasi-state lenders. In all, SSPI obtained loans totaling $840,000 for the project. These loans helped cover the renovations as well as the $400,000 purchase price of the building and other costs (e.g., legal expenses, architectural fees, appraisal costs) totaling $95,000. Finally, SSPI was required to provide cash equity totaling $175,000 toward the project, of which SSPI obtained $125,000 directly from RMH. The table below details the financing that SSPI obtained to finance the 91 School Street property project.

Lending Institution		Loan Amount	
MassDevelopment Finance Agency		$ 407,500	
Hampden Savings Bank		382,500	
Western MA Enterprise Fund		50,000	
Total Loans		$ 840,000	
SSPI Cash Equity		$ 175,000	
Total Project Costs		$ 1,015,000	

Through its lease payments, RMH will ultimately pay for all the costs associated with the purchase, renovation, and upkeep of the 91 School Street property with state tuition reimbursements and state facility grant funds. In this regard, RMH's lease with SSPI requires RMH to pay monthly rent equal to 1.1 times the monthly loan payment obligations of SSPI on this property. In addition, the terms of the lease specify that RMH, at its own expense, is responsible for all repairs necessary to maintain the building in good working condition.

Chapter 71, Section 89, of the General Laws, which governs charter schools, states, in part:

> *Said auditor [the State Auditor] may investigate the budget and finances of charter schools and their financial dealings, transactions and relationships, and shall have the power to examine the records of charter schools and to prescribe methods of accounting and the rendering of periodic reports.*

In addition, DOE's Recommended Fiscal Policies and Procedures Guide (DOE Guide), requires charter schools to maintain books, records, and supporting documents applicable to all their financial activities. Specifically, Section 202, Subsection B; and Section 1100, Subsection (B); state respectively:

> *To provide an accurate auditable record of all financial transactions the School's books, records, and accounts are maintained in conformity with generally accepted accounting principles as required by the Commonwealth's statutes, applicable to Charter Schools.*
>
> *All entries are supported by adequate documentation that clearly shows the justification and authorization for the transaction.*

Because Chapter 71, Section 89, of the General Laws provides for the OSA to investigate the financial activities of charter schools, including relationships (e.g., related-party transactions), we requested that RMH and SSPI provide documentation to us to ensure that RMH's lease payments were reasonable and allowable. As previously noted, RMH's lease payments constitute a 110%

repayment of SSPI's loan obligations for the purchase and renovation of the 91 School Street property. Accordingly, we requested all documents relative to these matters (e.g., purchase and sale agreements, closing documents, request for bids, contract agreements, and contractor invoices). However, contrary to the DOE Guide, RMH did not maintain any documents supporting the reasonableness of its lease payments to SSPI. Moreover, despite our legal authority to investigate this related-party transaction, SSPI refused to provide any information to help resolve this matter. Consequently, the Commonwealth cannot be assured that RMH's lease payments, which totaled $279,055 through June 30, 2004, represent reasonable, allowable, and allocable charter school costs.

RMH Site Inspection

During our review, we tried to substantiate the building renovations made to the 91 School Street property in order to further evaluate the reasonableness of RMH's lease payments to SSPI. As part of this effort, we obtained the pertinent architect design plans, which were on file with the City of Springfield Building Department, specifying all required work necessary to bring RMH building up to code. Also, with the assistance of RMH's Facility Manager, we conducted an inspection of the interior and exterior of the leased premises. Our site inspection revealed the following issues:

- The architect's design plans recommended completely removing the existing built-up roofing and providing a new rubber membrane roofing system. However, during our site inspection, the Facility Manager stated that a new roof had not been installed. Moreover, he stated that roof leaks have routinely plagued the building and that the General Contractor responsible for the building's renovations, as well as SSPI, had not done anything to address this problem.

- The architect's plans recommended removing and replacing the safety hand railings along all stairways and protected areas. However, during our site inspection, we found that all of RMH's safety railings were broken and rusted, creating a potentially hazardous situation.

- Our site inspection of RMH's seventh- and eighth-grade classrooms identified improperly positioned ceiling tiles. The Facility Manager informed us that the City of Springfield Building Inspector had noted certain wiring deficiencies above the ceiling tiles and that the tiles were repositioned in order for the General Contractor to correct the electrical problems.

- Our site inspection noted miscellaneous structural issues, including rusted and defective door casings, loose and uneven floor tiles, water-stained and cracked ceiling tiles, inoperable windows, and crumbling stairwell steps.

As described above, we found during our inspection that the General Contractor did not address all recommendations made by the architect. However, because neither RMH nor SSPI would provide

us with the information we requested relative to these renovations, it can not be determined what leasehold improvements the General Contractor was required to complete or whether payments that he received represent reasonable, allowable, and allocable costs to the Commonwealth.

Occupancy Permit

DOE's Charter School Administrative and Governance Guide requires charter schools to obtain a Certificate of Occupancy prior to occupying a facility. Specifically, Section II, Subsection D, of the Governance Guide states, in part:

> *Prior to its occupation of a facility, a charter school must obtain a Certificate of Occupancy from the local building inspector…*

However, contrary to DOE's guidelines, RMH did not receive a Certificate of Occupancy prior to opening its charter school on September 1, 2001. In addition, because of ongoing electrical, plumbing, and structural problems, as of June 30, 2004, the charter school was still operating without a Certificate of Occupancy.

According to the Springfield Code Enforcement Commissioner, as of July 26, 2004, the City of Springfield had not issued a Certificate of Occupancy for the 91 School Street property, and technically the building is illegally occupied by RMH. In this regard, the Commissioner stated that renovations to the property resulted in lingering electrical and plumbing problems, including open electrical panels and exposed electrical wires that, at one point, created a life-threatening situation for children and adults at RMH. Moreover, the Commissioner stated that an Occupancy Permit could not be issued for the property until RMH rectifies these problems, which as of July 26, 2004 RMH's General Contractor had not totally completed. Finally, the Commissioner stated that despite these unresolved issues, the city's prior administration allowed RMH to open and remain open without ensuring RMH's full compliance with applicable building code requirements.

During our audit, RMH's Chairperson and Treasurer stated that the Board of Trustees had been unaware of the Occupancy Permit issue. However, our review found that these officials had been fully apprised of the issue by the Facility Manager, yet they did not take all the steps necessary to secure an Occupancy Permit for the building. In this regard, the Facility Manager maintained a correspondence file that contained many of his memorandums to Board of Trustee members dating back to March 8, 2002. These memorandums specified problems RMH was having with the

General Contractor's work; the negative impact the poor work quality had upon RMH's students, teachers, and administrators; and the difficulty that RMH had securing an Occupancy Permit for the building. Moreover, some of the memorandums expressed the Facility Manager's complete dissatisfaction with the General Contactor's performance and untimely completion of renovations necessary for RMH to obtain a Certificate of Occupancy. Provided below are examples of the concerns that the Facility Manager shared with RMH's Trustees.

- A March 8, 2002 memorandum to RMH's Treasurer and the General Contractor states that upon entering the building the Facility Manager found water leaking from the ceiling onto the hallway floor next to the computer room. He also noticed a ceiling tile saturated with water and partially broken. Upon further inspection of the building, he found water stains on ceiling tiles in the kitchen.

- A March 11, 2002 memorandum to RMH's Board Treasurer refers to work the General Contractor completed as "shabby and incomplete." Specifically, the Facility Manager noted, "There are open holes with electrical wires hanging out behind the door in the conference room, the lower bathroom and the Education Director's office. Also, the pipes in the nurse's office were to be covered and were never done."

  The memorandum further states, "There is some painting that was never completed. Ductwork in the Administrative area has not been completed. The handicap bathroom in the upper grade level cannot be used because of poor workmanship. The toilet is unusable because of the way it tilts from the floor not being even, there is also a problem with the lock."

  Finally, regarding the General Contractor's response time to these issues, the Facility Manager wrote, "As you can see the [General Contractor's secretary] contacted me in November of last year and the work has yet to be completed. I made calls to [the General Contractor's secretary] only to receive no response."

- A March 27, 2002 memorandum to RMH's Board Treasurer states, "Since our meeting on March 11th [the General Contractor] has completed only three of the items on the punch list that we went over. As you may recall they stated that within two weeks the punch list would be resolved. To date it has not been done. Please be advised that their neglect in these matters is creating other matters of concern to develop."

- A June 18, 2002 letter to RMH's Board Chairperson states, "Since our last meeting on May 5, 2002, with [the General Contractor] the work that was agreed upon to be done (bathroom floor, cafeteria door lock, outside fence, fifth grade door, windows to be fixed, and closures to be fixed or replaced), none of this work has even been attempted to be addressed. Also, the air conditioner is still not operational. It was said that this work would be completed within the week ….I think it's absolutely disgraceful that the children had to be subjected to some unbearable conditions because these concerns were not addressed as agreed upon."

- An August 20, 2002 letter to the General Contractor refers to a punch list of items that the General Contractor agreed to complete but did not address. Moreover, the Facility Manager states, "I find that the level of professional attention that RMH has received from you is inexcusable. For almost a year you have consistently neglected and refused to meet your responsibilities here at Robert M. Hughes Academy Charter School."

- An October 27, 2003 memorandum to RMH's former Principal refers to the Springfield Code Enforcement Department's inspection of the electrical wiring throughout the school building. The inspection was prompted by the Facility Manager in an effort to secure a Certificate of Occupancy. Regarding the inspector's findings the Facility Manager states, "He communicated to me that he believed that much of the work that had been done was unsatisfactory and of the poorest quality. He also identified some safety issues of concern….He could have made a decision to close RMH down as a result of the findings during the inspection."

- A January 14, 2004 memorandum to RMH's Chairperson references the Facility Manager's earlier "Summer 2003" conversations with board members regarding RMH's inability to obtain a Certificate of Occupancy. Regarding RMH's ongoing electrical problems, the Facility Manager states, "The [building inspector] would not be able to issue our regular building inspection certificate nor the certificate of occupancy until this matter is resolved. He also indicated because of the seriousness of the matter that he "could shut the school down."

Lastly, RMH is presently experiencing significant structural problems with its front entryway. Specifically, the front stairs and landing area, which are made from poured, reinforced concrete, are crumbling and deteriorating and present a serious safety hazard. Consequently, students, faculty, and visitors are denied access to RMH through the front doors. RMH's Facility Manager stated the damage started during the winter of 2003 due to excessive salt being applied to the area, and over time the extent of damage has increased and created a hazardous situation.

On October 27, 2003, the Springfield Code Enforcement Department performed an unscheduled building inspection at RMH. Following the inspection, code enforcement officials informed RMH's Facility Manager that RMH needed to show evidence that repair for the front landing had gone out to bid and that the landing would be useable in the near future.

As of the completion of our audit fieldwork, RMH had not started repairs to its front landing. Access to this area continues to be denied to everyone, and entry to RMH is primarily permitted through the building's rear entryway. Consequently, as of January 2005, RMH still had not received a permanent Certificate of Occupancy from the City of Springfield, and based upon correspondence between RMH and the city's Code Enforcement Department, RMH will not receive a Permanent

Certificate of Occupancy until all work has been completed on the front landing and exterior hand railings.

Recommendation

In order to address our concerns relative to this mater, DOE should:

- Require RMH to recover the $55,886 in unallowable payments it made to its related party, SSPI.

- Require SSPI to provide documentation to substantiate its $279,055 in monthly lease charges. If SSPI should fail to provide documentation, DOE should consider requiring RMH to recover $279,055 from SSPI and remit these funds to the Commonwealth. If SSPI provides this documentation, DOE should conduct a review of this information and determine what additional funds, if any, RMH should recover and remit to the Commonwealth.

- Require that RMH take the steps necessary to secure a permanent Certificate of Occupancy for the building, including resolving all electrical and plumbing issues necessary to bring the 91 School Street property up to code. RMH should also initiate repairs to its front entryway. RMH should issue a Request for Proposals and have all proposals evaluated at a public meeting of the Board of Trustees.

Auditee's Response

RMH is grateful to the OSA for pointing out the possible overpayment of rent to its landlord, School Street Properties, Inc. ("SSPI"), an alleged related party[1]. OSA reported that the alleged overpayment was $55,886. RMH's Business Manager review suggests that the correct figure is approximately $39,000. This error was not apparent to neither the RMH Board or to its outside auditors. The Board of Trustees relied on the former Principal/CEO to properly examine and determine the accurate amounts to pay all of its vendors. The overpayment confirms that the Principal/CEO failed to fulfill her duties to properly manage the finances of the School.

Once again, the OSA was quick to point an accusatory finger at the Board for the alleged mismanagement of the School's finances. While the RMH Board takes responsibility for the overall management of the School finances, it is a contradiction for the OSA to base its conclusions on the representations of the former Principal/CEO under whose watch the alleged mismanagement occurred. At a minimum, the OSA should have acknowledged in its report that the alleged mismanagement took place under the watch of the former Principal/CEO.

RMH will work with SSPI to verify and resolve any and all overpayment issues by June 30, 2005.

[1] The OSA repeatedly refers to SSPI as a related party, but it does not define the term "related party" in the Audit Report. The fact that both SSPI and RMH share one or more directors does not make them related parties by any definition of that term.

Reasonableness of the Rent Payments.

The OSA suggested that RMH failed to keep records as to the reasonableness of the lease payments made to SSPI. RMH is confused as to the OSA's interpretation of its obligation to pay reasonable rent for its space. The OSA suggests that RMH should make such a determination annually during the term of a long-term lease. This is impossible. Here, RMH entered into a lease with SSPI after surveying the market to determine the reasonableness of the lease terms. Once this determination was made, RMH believed that it had fulfilled its obligations, and that the OSA's use of hindsight to measure the reasonableness of the terms by applying annual measurements is unrealistic and invites RMH to breach its lease by reevaluating the lease terms annually. This begs the question as to whether the OSA would apply the same standards in the environment of a rising real estate market.

The Certificate of Occupancy.

The OSA noted that RMH placed the health and safety of its students at risk by failing to get a certificate of occupancy for the building situated at 91 School Street, Springfield, MA. RMH takes issue with the OSA on this point. Throughout the period in question, the property had a temporary certificate of occupancy. RMH received a Temporary Certificate of Occupancy Permit # 74520 issued July 31, 2001. In addition, a Building Inspection Certificate was issued on January 28, 2002, which has been renewed annually to date. These two documents led School leaders to believe that RMH was occupying the building legally.

At the time that RMH learned of the discrepancy with the Certificate of Occupancy, the School's leaders aggressively sought to address all applicable building code issues and obtained a Partial Certificate of Occupancy on September 13, 2004. RMH currently occupies the building under a current Partial Certificate of Occupancy as well as a current Building Inspection Certificate.

In April of 2003, after occupying the building for approximately 18 months, RMH became aware that the concrete in the front entrance area had deteriorated due to the harsh weather conditions of the previous winter. According to the lease agreement, RMH is responsible for all necessary structural repairs to the property during the term of the lease.

To repair the defects, RMH, under its current Principal/CEO, launched a competitive bidding process to solicit proposals to repair the front entrance to the building under the guidance of the architectural firm of Dore and Whittier Architects, Inc. After planning announcements in the required publications, RMH received a single bid from the Wall Construction Company, which proposed to make the repairs for $19,500.00. The bid was accepted and a contract was awarded to Wall Construction Company. The repairs began on April 18, 2005, with a targeted completion date of May 30, 2005. On completion, RMH will apply for a Certificate of Occupancy and upon issuance; RMH will forward a copy to the Charter School Office of the DOE.

Auditor's Reply

First, the Trustees contend that RMH's rent overpayment to School Street Properties, Inc. (SSPI), a related-party organization, totaled approximately $39,000, or $16,886 less than the amount reported by the OSA. However, the Trustees have not provided the OSA with an

explanation or documentation to support the reduced amount. Consequently, the OSA cannot adjust the reported overpayment from $55,886 to $39,000.

During the audit, we requested that RMH and SSPI provide complete information relative to RMH's rental payments to SSPI. At the time, RMH claimed that the requested financial records were unavailable within the school's files. In addition, SSPI refused to respond to any of our requests relative to this matter. Consequently, we calculated RMH's rent overpayment amount based upon the best information available to us at the time, which included the 50-year lease agreement between RMH and SSPI, the rental payments recorded within RMH's accounting ledgers, and SSPI's loan repayment schedules, which the audit staff obtained from applicable lender institutions.

Contrary to RMH's response, our report clearly defines the term related party within the audit report and details why the lease entered into between RMH and SSPI constitutes a related party transaction. Specifically, our report sites the Financial Accounting Standards Board (FASB) Statement No. 57, which defines the term related party. Based upon FASB No. 57, a related party relationship exists between RMH and SSPI since they share common management, common control, and SSPI's real estate transactions have been conducted exclusively for RMH's benefit.

Second, contrary to RMH's response, our report does not state or even imply that RMH should make an annual determination of the reasonableness of the rent it is paying SSPI under its lease agreement. As stated in our report, our concern is that neither RMH nor SSPI was able to provide us with documentation to substantiate the reasonableness of these lease payments. As noted in our report, under the terms and conditions of this lease agreement, RMH was obligated to pay monthly rent to SSPI in an amount equal to 1.1 times SSPI's monthly loan obligations on this property. However, our initial review identified that during fiscal years 2002 through 2004, RMH made rental payments to SSPI that exceeded by $55,886 what it was legally obligated to pay under this leased agreement. Based on this fact, and the fact that a related party relationship existed between RMH and SSPI, the audit team wanted to make a determination as to whether or not all of the loan obligations that were being used by SSPI to calculate its monthly rental billings to RMH were in fact related to the property being rented by RMH. This is a prudent and necessary audit step in order to determine if in fact the monthly rental invoices being submitted

by SSPI to RMH are accurate and reasonable. However, as noted in our report, neither RMH nor SSPI was willing or able to provide us with the information we need to make this determination. Consequently, it was necessary for us to refer this matter to DOE for its review and resolution.

Third, the Trustees contend that the RMH property had a temporary certificate of occupancy throughout the period in question. However, permit #74520, issued on July 31, 2001 to RMH by the City of Springfield Code Enforcement Department, was not a temporary occupancy permit as suggested by RMH. Rather, based upon information provided by the Code Enforcement Department, permit # 74520 was a building permit that allowed RMH to make renovations to the school building. In addition, the Building Inspection Certificate issued to RMH on January 28, 2002 was not a temporary occupancy permit either. The Code Enforcement Department explained to us that this certificate established RMH's building capacity of 160 persons, and that the egress and means of escape from the building in case of fire are sufficient. Consequently, these two certificates did not provide RMH with the legal authority to occupy the school building.

Finally, contrary to RMH's response, RMH leaders did not aggressively seek to address all applicable building code issues at the charter school. As noted in our report, the Facility Manager maintained a correspondence file that contained many memorandums he sent to the Board of Trustee members dating back to March 8, 2002. These memorandums specified problems the school was having with the general contractor's work, as well as the difficulty that RMH had securing an Occupancy Permit for the building. Despite being fully apprised of the issue by the Facility Manager, RMH leaders failed to take appropriate steps necessary to secure either a Temporary or Permanent Occupancy Permit in an expeditious manner.

3. RMH TRANSFERRED $125,000 TO A RELATED PARTY WITHOUT MAINTAINING DOCUMENTATION TO SUPPORT THE PURPOSE, AUTHORIZATION, AND USE OF THESE STATE FUNDS

During fiscal year 2002, RMH transferred $125,000 in state funds to its related party, SSPI. Although RMH's accounting records reflect the cash transfer of these funds, it could not provide us with any documentation detailing the reason for the transfer of these funds or SSPI's specific use of these funds. Also, the meeting minutes of RMH's Board of Trustees did not indicate that the board was made aware of this transfer and did not contain information regarding the authorization,

intended use, or repayment of these funds. During our audit, we requested that SSPI provide us with the documentation it was maintaining relative to the use of these funds. However, as of the end of our audit fieldwork, SSPI had not provided us with the requested information. Consequently, the Commonwealth cannot be assured that the transfer of the $125,000 in funds by RMH to SSPI was appropriate or that these funds were used for their intended purposes.

According to state law, charter schools are required to maintain complete and accurate records of all their activities. Specifically, Chapter 71, Section 89, Subsection (hh), states, in part:

> *Each charter school shall keep an accurate account of all its activities and all its receipts and expenditures and shall annually cause an independent audit to be made of its account.*

In an effort to support this requirement, DOE provided all charter schools with the Commonwealth of Massachusetts Charter School Recommended Fiscal Policies and Procedures Guide (Guide) dated March 2001. Under Section 1200 of the Guide, DOE details cash management procedures that charter schools should follow when disbursing state funds. Among other things, DOE recommends the following procedures to help ensure proper authorization, recording, and documentation of cash disbursements.

- When the transaction is complete and payment is due, a pre-numbered check is prepared by the Business Manager who attaches all supporting documentation: (e.g., vendor invoice, purchase order, purchase requisition, etc.) and submits the package to the Charter Leader for approval.
- All invoices are submitted for signature and will include approvals for payment, charged expense account, check number and date of payment.
- All supporting documents are canceled (i.e., stamped *PAID*) by the signatory and filed by the Business Manager.
- Books, records, documents, and other supporting evidence including paid, cancelled or voided checks, accounts payable records, vendors' invoices, payroll sheets and registers of salaries and wages, tax withholding statements, employees' timesheets, and other public documents are retained for seven years after the original date.

During our audit, we requested that RMH provide documentation to support the transfer of $125,000 of state funds to SSPI, its related party. Among other things, we requested Board of Trustee minutes detailing the purpose and authorization of the cash transfer; agreements between RMH and SSPI detailing the disbursement, repayment, and intended uses of the funds; and copies of the related cancelled checks. In addition, we requested RMH to provide documents relative to

the actual expenditure of these funds. Since RMH's general ledger indicated that the $125,000 was utilized for leasehold improvements, we requested contractor agreements, request for proposals, billing invoices, expense authorizations, and cancelled checks. However, RMH provided us with only two cancelled checks in the amounts of $100,000 and $25,000, which were dated July 31, 2001 and August 31, 2001 respectively; two unauthorized expense request forms totaling $100,000; and a $25,000 purchase requisition form approved by RMH's Chairman, who also served as an officer of SSPI.

Because RMH did not maintain adequate documentation to support the transfer and use of the $125,000 in state funds, we attempted to obtain the needed information directly from SSPI. However, as of the completion of our fieldwork, SSPI had not responded in any manner to our requests.

In addition, during the audit, RMH's former Chairperson provided conflicting information regarding the use of these funds. Specifically, the former Chairman stated that the $125,000 was not used for leasehold improvements, but rather to purchase equipment for RMH, including desks, chairs, fencing, and playground equipment. Records maintained by RMH, however, could not support the former Chairman's comments.

Clearly, RMH has been unable to substantiate the purpose of this related-party transaction. The school did not maintain documents detailing the transfer and use of the funds involved; Board of Trustee meeting minutes provide no indication that the transaction was discussed and approved by the board; and RMH's accounting records conflict with comments made by a former RMH official. Consequently, the Commonwealth cannot be assured that RMH used the $125,000 in state funds for reasonable, allowable, and allocable purposes, and there is a strong indication that state funds may have been misappropriated.

Recommendation

Given the highly questionable nature of this transaction, DOE should require RMH and SSPI to provide it with documentation to substantiate the reason and use of this $125,000 payment. If such documentation is provided, DOE should review this information and determine the reasonableness of this expenditure. If RMH and SSPI are unable to provide adequate and complete documentation, RMH should recover this $125,000 from SSPI and remit these funds to the Commonwealth. In

addition, if DOE cannot obtain sufficient information to resolve this matter, it should refer to the appropriate oversight and/or law enforcement agencies for their review and resolution. In the future, RMH should take appropriate measures to ensure that all transactions are properly authorized and documented in RMH's financial records.

Auditee's Response

The OSA criticizes RMH for not documenting a transfer of $125,000 from RMH to SSPI. Here, again, the OSA relies on the representations made by the former Principal/CEO and the former Board Chairman, both of whom were responsible for overseeing the renovation of the Property. It appears that OSA had extensive meetings with the former Chair and the former Principal/CEO, and both of them should be able to explain the circumstances surrounding the transfer of the funds.

The lack of documentation in the minutes of the Board of Trustees is attributed to the loss of the minutes for several meetings of the Board of Trustees. These minutes were in the possession and control of the former Principal/CEO.

RMH will request that SSPI provide a listing with supporting documentation as to how the initial investment of $125,000 provided by RMH, per the lease agreement, was spent in the purchase of equipment and fixtures necessary for the operation of the school.

Auditor's Reply

Our report accurately and clearly denotes the fact that RMH transferred $125,000 to SSPI in state monies without maintaining adequate documentation to support this transaction. Moreover, we correctly state that RMH could not provide the audit staff with documentation detailing SSPI's specific use of these funds. Consequently, the Commonwealth cannot be assured that the funds were used for their intended purposes. Our conclusions relative to this matter were not solely based on representations made by former RMH officials, but rather were based on detailed audit work that included interviews with both former and current RMH officials, as well as a review of all the documentation that was made available to us by agency officials relative to this matter. As stated in our report, MGL Chapter 71, Section 89, requires charter schools such as RMH, to keep an accurate account and sufficient documentation of all of its activities. Because RMH failed to comply with this statutory requirement, it was not possible for the audit team to assess the reasonableness and propriety of the transfer of these funds.

The lack of Board minutes is only one of the documentation problems the audit team encountered in its efforts to assess this transaction. As noted in our report, we asked RMH officials to provide us with documentation to support the transfer of $125,000 to SSPI. Among

other things, we requested Board of Trustee minutes detailing the purpose and authorization of the cash transfer; agreements between RMH and SSPI detailing the disbursement, repayment, and intended uses of the funds; and copies of the related cancelled checks. In addition, we requested RMH to provide documents relative to the actual expenditure of these funds. Since RMH's general ledger indicated that the $125,000 was utilized for leasehold improvements, we requested, among other things, requests for proposals, contractor agreements, billing invoices, expense authorizations, and cancelled checks. However, RMH officials were able to provide us with only a minimal amount of documentation relative to this transaction.

In its response, RMH states that it is now, several months after the conclusion of our audit field work, going to request SSPI to provide us with documentation as to how this $125,000 was spent. Clearly, this information should have been provided during the conduct of our audit fieldwork when it was requested, so that it could be fully analyzed and tested.

4. RMH'S CHAIRPERSON AND TREASURER MAY HAVE VIOLATED THE STATE'S CONFLICT OF INTEREST LAW IN THE INVESTMENT OF $150,000 OF RMH'S FUNDS

Our audit found that RMH's Chairperson and Treasurer may have violated Chapter 268A of the General Laws, (the state's Conflict of Interest Law), as a result of a financial transaction between RMH and the D. Edward Wells Federal Credit Union (DEW). Specifically, on July 10, 2002, RMH purchased a $150,000 certificate of deposit from DEW. At this time, RMH's Chairperson served as DEW's Chief Executive Officer (CEO), and RMH's Board Treasurer served on DEW's Board of Directors. Moreover, DEW was apparently experiencing financial difficulties at the time, as evidenced by the National Credit Union Association (NCUA) placing DEW into conservatorship on February 21, 2003. Since Chapter 268 prohibits board members from taking advantage of their position to gain improper benefits for themselves, their relatives, their associates, or their friends, the propriety of this transaction is questionable.

DOE's Charter School Administrative and Governance Guide (Guide) states that the actions of individual board members are governed by a legal principle, duty of loyalty. Specifically, the DOE Guide prohibits board members from doing anything that would allow them to profit personally or indirectly because of their position. According to the Guide, to comply with the duty of loyalty, trustees must:

- Not knowingly do anything that would harm the school; and
- Not vote on any matter in which they have a personal interest.

Additionally, Chapter 268A of the General Laws prohibits board members from taking advantage of their position to gain improper benefits for themselves, their relatives, their associates, or their friends. The law restricts board members from voting on matters affecting their financial interest and limits the circumstances under which they can receive anything of value because of their official position. Under the financial interest restriction of Chapter 268A, Section 6, trustees cannot take any action, such as vote on, or even enter into a discussion regarding, an issue when one of the groups below will receive a financial benefit:

- The trustee, his/her immediate family, or his/her business partner;
- A business organization in which the trustee is serving as officer, director, trustee, partner, or employee; or
- Any person or organization with whom the trustee is negotiating or has any arrangement concerning prospective employment.

Despite these requirements, we found that on July 10, 2002, RMH purchased a $150,000 certificate of deposit from DEW. At this time, RMH's Chairperson served as DEW's CEO, and RMH's Board Treasurer also served on DEW's Board of Directors. Moreover, DEW was apparently experiencing financial difficulties, as evidenced by the National Credit Union Association (NCUA) placing DEW into conservatorship on February 21, 2003. RMH's account balance with DEW totaled $151,489 as of September 30, 2002. This amount included the $150,000 certificate of deposit in question, interest, as well as other deposits that RMH made to the DEW dating back to June 30, 2000. As of August 29, 2004, RMH had been reimbursed all but $1,095 in principal and interest payments it was due under this agreement.

According to RMH's Business Manager, the $150,000 certificate of deposit was purchased from DEW because RMH's Independent Auditor's Report for fiscal years 2001 and 2002 identified that RMH's operating account maintained federally uninsured cash balances. However, we learned during the audit that RMH's operating account balances were in fact fully protected against loss even though they exceeded the federal insurance threshold of $100,000. In this regard, RMH's operating account was maintained in a financial institution that offered both federal and state insurance

protection, whereby the state portion covers amounts over the $100,000 federal limit. Thus, RMH's account balances were never in jeopardy of loss.

As previously noted, the DOE Guide prohibits individual board members from knowingly doing anything that would harm their school. Clearly, as a CEO of a financial institution, RMH's Chairperson and the Treasurer of its board should have recognized the potential risk of loss by depositing the $150,000 into this credit union, which only had insurance to cover deposits of up to $100,000. Moreover, based upon her training, experience, and background as a CEO, the Chairperson should have advised RMH against transferring its funds from a fully insured institution to an institution with limited federal coverage.

During the audit, we spoke with the Board of Trustees regarding this matter. Several trustees indicated that the board fully discussed RMH's uninsured bank balances and subsequently voted to deposit $150,000 into a certificate of deposit at the DEW to alleviate the problem. Moreover, the trustees stated that the board's meeting minutes would fully detail their discussions and vote. However, our review of board minutes found no indication that the trustees ever considered this matter.

During this same meeting, RMH's Chairperson stated that she was present at the time of these discussions. However, the Chairperson stated that she neither participated in the discussions nor voted on the matter. In contrast, the Board Treasurer made no comment relative to her involvement in the $150,000 investment with the DEW.

As noted above, Chapter 268A prohibits trustees from taking any actions, such as a vote, or even entering into a discussion regarding an issue involving a business organization in which the trustee is serving as officer, director, trustee, partner, or employee. Given the fact that RMH's Chairperson and Treasurer were also on DEW's board, we question the propriety of this transaction.

Lastly, Chapter 71, Section 89(v), of the General Laws requires board members to annually file a financial disclosure with the State Ethics Commission, the Department of Education, and the city or town clerk where the charter school is located. The purpose of this filing is for board members to inform the Commonwealth if they or a member of their family have a financial interest in the operations of any charter school or with any person doing business with a charter school. Although the Chairman and Treasurer filed a financial interest disclosure form for calendar year 2002, they did

not disclose the potential conflict of interest to the Commonwealth. Consequently, the State Ethics Commission did not determine whether this transaction was appropriate.

Recommendation

Given the seriousness of this transaction, RMH's Board of Trustees should ensure that the board's Chairperson and Treasurer report this transaction to the State Ethics Commission. If the State Ethics Commission determines that a violation of the state's conflict of interest law has occurred, RMH's Board of Trustees should take measures necessary to address this problem. RMH should also adopt a policy to ensure that all future potential conflict of interest transactions are disclosed to the State Ethics Commission. Additionally, the RMH Board of Trustees should adopt a formal conflict-of-interest policy and ensure that all potential conflict-of-interest matters are fully disclosed in board minutes and votes.

Auditee's Response

The OSA suggests that RMH's Board Chairperson and Treasurer may have violated conflict of interest laws as a result of a deposit in D. E. Wells Federal Credit Union. Clearly, this is a speculative legal conclusion by the OSA. The OSA's comment on the DEW matter distorts its mission from purely fact finding to mudslinging that insinuates the possible benefits that might have accrued to the RMH Board Chairperson and Treasurer. It would have been sufficient for the DOE to note the fact of the deposit, the absence of records surrounding the decision to make the deposit, and to have made recommendations in this matter.

In response to the DOE's comment on the DEW deposit, Trustees Carol Aranjo and Norma Baker sought the advice from Holland & Knight LLP as to the appropriateness of obtaining an ethics opinion regarding the relationship between them and the D. Edward Wells Federal Credit Union. Attorney Steven Wright, Esq. on behalf of Holland & Knight informed Trustees Aranjo and Baker that the Ethics Commission only provides written advisory opinions on prospective conduct as opposed to past conduct. In the absence of the ability to secure a ruling by the State Ethics Commission, Atty. Wright provided an analysis regarding potential state ethics and conflict of interest violations based on the RMH Board's decision to invest $150,000 with the D. Edward Wells Credit Union. In summary, Atty. Wright's analysis suggests that no violations occurred.

RMH should not be implicated with the DEW matter, which is a matter between an individual volunteer board member and the credit union regulators. The funds in question have been returned to RMH and the Board will be more attentive to possible conflicts of interest in handling future financial matters.

Auditor's Reply

As stated in our report, we believe that RMH's Chairperson and Treasurer may have violated certain provisions of MGL Chapter 268A, the state's conflict-of-interest law, in this matter.

Contrary to what RMH contends in its response, our belief is not speculative, but rather is based on our analysis of the facts and documents relative to this transaction and our analysis of the specific requirements of MGL Chapter 268A. Further, since this transaction involved RMH officials, who at the time this transaction took place, also had an interest in DEW, it was appropriate for us to disclose these facts in our audit report.

In its response, RMH asserts that the agency's attorney suggested that no violations of Chapter 268A occurred relative to this transaction. However, the agency did not give us a copy of its legal counsel's opinion relative to this matter. Moreover, it is the responsibility of the SEC to make a determination on each government employee's compliance with the terms and conditions of MGL 268A.

As noted in our report, Chapter 71, Section 89(v), of the General Laws requires board members to annually file a financial disclosure with the State Ethics Commission, the Department of Education, and the city or town clerk where the charter school is located. The purpose of this filing is for Board members to inform the Commonwealth if they or a member of their family have a financial interest in the operations of any charter school or with any person doing business with a charter school. Although the Chairman and Treasurer filed a financial interest disclosure form for calendar year 2002, they did not disclose the potential conflict of interest to the Commonwealth. Consequently, the State Ethics Commission could not determine if this transaction was appropriate.

In its response, RMH contends that it should not be implicated in this matter and points out that the funds have been returned to the agency. However, clearly RMH officials needed to authorize and approve this transaction in order for it to be processed. Further, the fact that most of the $150,000 in funds has been recouped by RMH does not mitigate the fact that the agency and certain board members elected to conduct such a questionable transaction.

5. RMH PURCHASED COMPUTER EQUIPMENT TOTALING $116,357 WITHOUT THE BENEFIT OF COMPETITIVE BID PROCEDURES

During our audit period, RMH did not use competitive bid procedures while purchasing computer equipment totaling $116,357. RMH's actions, which were controlled by the Board of Trustees, directly violated procurement guidelines provided by DOE to all charter schools. Specifically, RMH repeatedly used the same vendor for the majority of its computer-related needs. RMH did so

without due consideration of other vendors and without regard for the best interest of RMH and its funding source. Of particular concern is that, based on comments made by several current and former school officials as well as our review of RMH's internal records and its computer request and complaint log, the computer equipment supplied by this vendor was of inferior quality, required frequent repairs, and adversely affected RMH's administrative and educational operational activities. Moreover, RMH's Board of Trustees dismissed efforts made by RMH's former Principal to improve the school's procurement process.

On July 1, 1998, the DOE issued Charter School Technical Advisory 98-1 to clarify the processes and procedures that commonwealth charter schools must employ in the procurement of goods and services. According to Technical Advisory 98-1, Commonwealth charter schools are required to follow sound business practices and generally accepted government auditing standards as conditions of their charter. Sound business practices consist of those activities that a prudent purchaser would consider to be reasonable under the circumstances. According to Technical Advisory 98-1, sound business practices and reasonable procurement policies, at a minimum, include documentation of the following:

- A system of internal controls, including generally accepted accounting principles that ensure that funds are appropriately received, expended and accounted for.
- A procurement process that provides for the greatest amount of competition, gives potential bidders sufficient information upon which to base their bid or quote, and employs a process of evaluating a bidders' responses which enables the charter school to determine the best value proposal.
- Policies and procedures that ensure the procurement process is consistent with and based upon the internal control system of the organization, and which provide documentation for audit purposes.

In addition, DOE issued its Recommended Fiscal Policies and Procedures Guide to all charter schools during March 2001. This guide requires charter schools to employ sound business practices for purchases of less than $1,000; obtain three written quotes and select the best value for items valued greater than $1,000 and less than $5,000; and use a formal competitive bid process for items valued greater than $5,000, in which three bids will be received and evaluated using a formal evaluation process. Moreover, the guide states that charter schools should adhere to the following objectives when conducting a procurement of goods and services:

- Procurements will be completely impartial based strictly on the merits of supplier and contractor proposals and applicable related considerations such as delivery, quantity, etc.
- Make all purchases in the best interests of the school and its funding sources.
- Obtain quality supplies/services needed for delivery at the time and place required.
- Buy from responsible sources of supply.
- Obtain maximum value for all expenditures.
- Deal fairly and impartially with all vendors.
- Maintain dependable sources of supply.
- Be above suspicion of unethical behavior at all times; avoid any conflict of interest, related parties, or even the appearance of a conflict of interest in the charter school supplier relationships.

During the audit, we reviewed RMH's procurement procedures to ensure that RMH complied with DOE's Technical Advisory 98-1 and Recommended Fiscal Policies and Procedures Guide. Our review included a sample test of seven computer equipment purchases totaling $116,357 that RMH made during the four-year period ended June 30, 2004. The items tested represented 91% of the computer and computer-related items purchased by RMH during the period. The table below provides further details regarding the seven items selected for our review.

Payment Date	Payment Amount	Vendor Name
August 2, 2000	$ 31,840	ACP Business Services/Strother Group
October 1, 2000	14,024	ACP Business Services/Strother Group
November 9, 2000	16,300	ACP Business Services/Strother Group
December 13, 2000	1,283	PJ Computers
January 18, 2001	6,990	ACP Business Services/Strother Group
March 11, 2002	34,440	ACP Business Services/Strother Group
June 5, 2002	11,480	ACP Business Services/Strother Group
	$ 116,357	

As detailed in the table above, six of the seven procurements reviewed involved payments totaling more than $5,000. Based upon DOE's guidelines, RMH should have utilized a formal competitive bid process in each of the three years that these purchases were made. For the remaining procurement tested, which involved a payment of only $1,283, RMH should have obtained three written quotes from interested vendors based upon DOE's guidelines. However, we found that, contrary to DOE's procurement guidelines, RMH did not utilize a formal competitive-bid process or solicit price quotes for the seven items selected for our review. In fact, the procurement files for

these items were void of all required documents, including requests for bids, vendor selection criteria, vendor contact lists, vendor bids and price quotes, and bid award letters.

As can be seen in the table above, RMH used the same vendor, ACP Business Services, for all its computer equipment and computer consulting needs. However, RMH officials could not explain why this vendor, which is based in Hartford, Connecticut, was noncompetitively awarded these contracts. In addition, our review of Board of Trustees' meeting minutes provided no insight into the selection of this company or its relationship with the charter school.

RMH's former Principal stated that during her tenure as RMH's Principal, she attempted to purchase 10 desktop computers for RMH utilizing a competitive procurement process because she was dissatisfied with the quality of equipment and service provided by ACP Business Services. A technical request and complaint log maintained within RMH's computer lab supports the former Principal's concerns with ACP Business Services. This log reveals that teachers, students, and administrative staff had constant problems with the computer equipment, software, and service provided by ACP Business Services. Excerpts from RMH's computer log are provided below, which highlight typical problems experienced by the staff and the impact these problems had upon RMH's administrative and educational activities.

- *7/01/04 - "Computer will not access internet, does not have S-drive anymore and cannot access gradequick, I cannot print from this computer anymore either.*
- *5/14/04 - "The floppy drives need to be repaired or replaced at Station 4 and 9."*
- *5/05/04 - "Computer does not work. Monitor made a noise and the screen went blank."*
- *4/29/04 - "I am not able to use the server or internet connections. I am unable to print to the copy room."*
- *8/21/03 "Computer did not turn on in which the screen read "Check Signal" then suddenly the CPU blew out making a loud noise like when a balloon pop followed by smoke."*
- *6/23/03 "File-Save As- feature shuts down the entire program and document is lost. This has been an ongoing problem all year."*
- *5/27/03 "Mrs. Bys fan is going out on her computer and my mapping on Quickbook is still not working."*
- *3/18/03 " The computer doesn't turn on."*
- *3/11/03 "A" drive is broken. Can't load up data. Can't save data."*

- *2/11/03 " We need to talk regarding your email and web site. We need to pay them asap so they don't turn the email off again."*
- *1/28/03 " Cannot get on net word, cannot access admi. Driver."*
- *11/07/02 "I cannot receive my E-mails, and my Microsoft word is not functioning right as you can see. This is the way it prints on normal settings. This was previously brought to the attention of Mr. S. about three weeks ago and nothing was done about it."*
- *8/09/02 " …The computer problems we are having are negatively impacting the daily operations of Robert M. Hughes Academy Charter School…"*

According to the former Principal, five vendors had submitted proposals to her relative to RMH's planned computer purchase. After reviewing each vendor proposal, the former Principal recommended to the Board of Trustees that the 10 computer systems be purchased from a vendor that had a proven track record at another school with computer networking. The vendor recommended by the former Principal was not RMH's primary provider at the time, ACP Business Services. However, according to the former Principal, despite her efforts to conduct this procurement in accordance with DOE's guidelines, RMH's Board of Trustees dismissed her recommendation and purchased the equipment that they wanted from ACP Business Services.

RMH's former Chairman of its Board of Trustees concurred that RMH encountered several problems with ACP Business Services. In this regard, he stated that teachers voiced several complaints about the computers not being networked and that ACP Business Services did not honor its scheduled service dates.

Because RMH has not followed the procurement requirements of DOE's Technical Advisory 98-1 and the Fiscal Policies and Procedures Guide, the Commonwealth has inadequate assurance that RMH makes purchases in the best interest of RMH and its funding source.

Recommendation

In order to address our concerns relative to this issue, RMH should:

- Follow the procurement requirements of DOE Technical Advisory 98-1 and DOE's Recommended Fiscal Policies and Procedures Guide.
- RMH should also maintain procurement files that contain documentation such as requests for proposals, vendor bids, price quotes, and bid award letters.

In addition, RMH's Board of Trustees should adopt a policy whereby it reviews all open competitive bids received from vendors and awards all contracts to the lowest responsible bidder.

Auditee's Response

Although Commonwealth charter schools are not subject to the requirements of the Uniform Procurement Act, G.L.c. 30B, the Department strongly encourages all schools to follow the requirements of F.L. c. 30B, and many Commonwealth charter schools do so. The Charter School Administrative and Governance Guide allow RMH to pick and choose vendors using sound business practices.

The audit makes reference to a violation of procurement guidelines provided by DOE when discussing RMH's computer purchases. Section 5 of the Audit Report begins by stating that "RMH did not use competitive bid procedures while purchasing computer equipment totaling $116,357." This is not an accurate statement and it appears to intentionally exacerbate the damage to RMH's reputation. Nowhere does the OSA mention that the guidelines are not mandatory. Further the OSA fails to mention that RMH received three proposals from computer vendors and selected one of the vendors to receive the contract award. The former Principal/CEO recommended another vendor, but the Trustees rejected her recommendation and informed her of the reasons for their decision to select another vendor.

The Board of Trustees has requested the current Principal/CEO to make a thorough review of the School's procurement policy and to make recommendations to bring the School's policies and practices into conformance with the DOE's guideline. In conjunction with the review, the School has hired a Business Manager who will also serve the Procurement Officer. The Business Manager is required to become certified under the Massachusetts Certified Purchasing Official (MCCPO) program conducted by the Office of the Inspector General.

Auditor's Reply

Contrary to RMH's response, DOE requires charter schools to follow a competitive procurement process when purchasing goods and services. As detailed in the audit report, DOE issued Charter Schools Technical Advisory 98-1 as well as its Recommended Fiscal Policies and Procedures Guide to all charter schools. Both of these documents mandate that charter schools employ sound business practices when procuring goods and services. According to Technical Advisory 98-1 sound business practices include, "A procurement process that provides for the greatest amount of competition, gives potential bidders sufficient information upon which to base their bid or quote, and employs a process of evaluating a bidders' responses which enables the charter school to determine the best value proposal." DOE's Recommended Fiscal Policies and Procedures Guide, which RMH adopted as its fiscal operating procedures manual, requires charter schools to employ sound business practices for purchases less than $1,000; obtain three written quotes and select the best value for items greater than $1,000 and less than $5,000; and

use a formal competitive bid process for items greater than $5,000, in which three bids will be received and evaluated using a formal evaluation process.

However, as detailed in our report, RMH routinely acquired its computer equipment from a single service provider without the benefit of a competitive procurement process. In this regard, RMH's procurement files were void of all required documents including requests for bids, vendor selection criteria, vendor contact lists, vendor bids and price quotes, bid award letters, etc. Consequently, the OSA's statement that RMH did not comply with DOE's procurement guidelines is an accurate assessment of the school's procurement practices during the audit period.

In addition, contrary to the Trustees' response, the OSA did report that RMH, in one instance, attempted to procure 10 computers based upon a competitive proposal process. However, as we reported, the process, which the former Principal attempted to conduct in accordance with DOE's procurement guidelines, proved pointless since the Trustees dismissed her recommendation and purchased the equipment from the school's primary provider, ACP Business Services. Neither RMH's procurement files nor its Board of Trustees' meeting minutes provided an explanation for the Trustees' decision to select ACP Business Services, which other school officials and instructors found to be problematic and non-responsive to the school's needs. Moreover, the Trustees' response to our audit report provides no further clarification on the matter.

While the Board of Trustees has begun taking appropriate steps to improve RMH's procurement procedures, the Board of Trustees must become mindful of its responsibility to provide oversight necessary to ensure that the Business Manager/Procurement Officer performs all of his/her job related responsibilities in a manner consistent with DOE's guidance.

6. RMH AWARDED QUESTIONABLE CONSULTANT CONTRACTS TOTALING AS MUCH AS $240,187

Our audit found that RMH awarded consultant contracts that resulted in questionable payments totaling as much as $240,187. Contrary to guidance provided by DOE to all charter schools, RMH did not award consultants contracts based upon competitive-bid procedures; develop detailed agreements specifying required consultant services, maximum obligations, service delivery periods, and authorizing signatures; maintain documentation to support consultant charges; limit consultant

charges to agreed-upon maximum obligations, and ensure the delivery of consultant services and products. Consequently, there is inadequate assurance that the state funds RMH expended on consultant services represent reasonable, allowable, and allocable costs.

In addition, the Internal Revenue Service Code specifies that taxpayers must file information Form 1099-MISC for each person to whom they have paid at least $600 in a year. However, for fiscal year 2002, RMH did not file this required information form for two consultants to whom it paid $5,450 and $4,104, respectively. By not filing Form 1099-MISC for these two consultants, RMH did not comply with federal law, and penalties could be assessed against RMH and the individual consultants who possibly filed incorrect federal and state tax returns.

DOE's Charter School Administrative and Governance Guide requires Commonwealth charter schools to follow sound business practices and generally accepted government auditing standards as conditions of their charters. Sound business practices advocate that entities such as RMH establish and implement effective internal controls over their operations, including the award and administration of contracts. Such controls serve to ensure that not only contract terms and conditions are met, but also that contracting entities receive the highest quality services at the lowest cost. Moreover, such controls serve to maintain the integrity of the contracting process and ensure that charter school funds are safeguarded against loss, waste, or misuse.

Additionally, DOE's Recommended Fiscal Policies and Procedures Guide provides all Commonwealth charter schools with a resource of recommended procedures to follow when procuring consultant services. Specifically, Section 1000, entitled Consultants and Contractors, requires charter schools to ensure that the utilization of all consultant and contractor personnel is sufficiently evidenced by the following:

- Details of all agreements (e.g., work requirements, rate of compensation, and nature and amount of other expenses, if any) with the individuals or organizations providing the services and details of actual services performed.

- Invoices or billings submitted by consultants, including sufficient detail as to the time expended and nature of the actual services performed.

- The use of a management contract for educational and administrative services will clearly identify the contractor's performance requirements, including students' academic achievement, contractor's compensation, and the charter school's right to educational curricula and intellectual property developed. If the contract provides substantially all

educational services, then the contract will be approved by the Board of Education prior to signature by the charter school.

During the four-year period ended June 30, 2004, RMH procured consultant services totaling $292,521. Of this amount, we reviewed 13 consultant contracts totaling $240,187, or 82%. Based on our sample test, we found that RMH had neither utilized sound business practices nor implemented DOE's recommended policies and procedures when procuring consultant services. Specifically, RMH selected consultants based upon factors other than open and fair competition; did not utilize formal agreements to document the terms and conditions of procured services; did not maintain documentation authorizing and supporting consultant payments; and did not issue required federal Form 1099-MISC. The table below quantifies the deficiencies noted during our sample test of consultant contracts.

Fiscal Year	Total Consultant Payments	Bid Process Utilized	Consultant Payments Supported by Contract		Consultant Payments Authorized		Consultant Invoices Maintained		Form 1099-MISC Issued	
2001	$ 73,831	No	$ 17,273	23%	$ 25,371	34%	$ 32,038	43%	$ 73,831	100%
2002	85,990	No	6,065	7%	62,873	73%	68,913	80%	76,436	89%
2003	43,998	No	26,100	59%	23,685	54%	36,098	82%	43,998	100%
2004	36,368	No	19,486	54%	17,499	48%	30,128	83%	36,368	100%
Total	$ 240,187		$ 68,924	29%	$ 129,428	54%	$ 167,177	70%	$ 230,633	96%

Provided below are specific examples of deficiencies that our test sample found relative to RMH's procurement of consultant services.

- From July 1, 2000 to June 30, 2004, RMH paid a consultant $24,778 without the benefit of a formal written consultant agreement. Of this amount, RMH did not maintain consultant invoices to support payments totaling $3,891; improperly recorded fiscal year 2002 consultant payments totaling $8,865 as fiscal year 2001 expenses; and did not issue the consultant federal Form 1099-MISC for fiscal year 2002 payments totaling $4,104.

- During fiscal years 2003 and 2004, RMH paid a consultant $24,691 to analyze student standardized test results and help improve classroom instruction at RMH. Of this amount, however, RMH did not authorize payments totaling $13,977 and did not maintain consultant invoices totaling $8,964. Moreover, the consultant's contract for fiscal year 2004 stated, in part, "Total fees and expenses are not to exceed $10,000," yet, RMH paid the consultant $16,791, or $6,791 above the agreed-upon maximum contract obligation without amending the terms and conditions of the consultant agreement. In addition, for calendar year 2002, RMH did not issue this consultant a federal Form 1099-MISC totaling $5,450 for the services she provided during the period.

- During fiscal year 2002 and 2003, RMH paid a consultant $19,590 to provide students in kindergarten through fourth grade with art instruction. However, an authorized RMH official did not sign the consultant's fiscal year 2002 contract. In addition, although the consultant's fiscal year 2003 contract limited the consultant's total fees and expenses to $12,700, RMH paid the consultant $13,220, or $520 above the maximum contract amount, without amending the contract.

- During fiscal years 2001, 2002, and 2004, RMH paid consulting fees totaling $31,884 to the husband of a Board of Trustees member. Of this amount, RMH did not have a formal consultant agreement for payments totaling $16,179, and provided him with unauthorized and undocumented payments totaling $17,964 and $6,504, respectively. Moreover, a fiscal year 2001 invoice submitted by the consultant stated, in part, "A report on my progress will be submitted soon." However, RMH officials were unable to provide us a copy of consultant's progress report. Although the trustee disclosed her financial interest in RMH to the State Ethics Commission for calendar 2002, she did not provide the same required disclosure to the state for fiscal years 2001 and 2004. In addition, Chapter 268A, Section 6, of the General Laws states that trustees of a charter school, as special state employees, may not have a financial interest in contracts of the charter school absent an exemption from the Governor. However, RMH's consultant files contained no evidence that the consultant ever requested such an exemption.

Regarding this matter, RMH's Business Manager stated that RMH had adopted DOE's Recommended Fiscal Policies and Procedures as its own fiscal operating manual. However, RMH officials could not explain their reasons for awarding consultant contracts and making consultant payments in a manner contrary to RMH's established policies and procedures.

Recommendation

In order to address our concerns relative to this matter, RMH should take measures to ensure that it fully implements DOE's Recommended Fiscal Policies and Procedures Guide Section 1000 regarding the use of Consultants and Contractors. It should also ensure that each individual receiving $600 or more in a calendar year receives an Internal Revenue Service Form 1099-MISC. Finally, RMH should ensure that any actions involving compensation or other benefits it provides to its trustees are properly disclosed to the State Ethics Commission.

Auditee's Response

RMH's Board of Trustees relied on the former Principal/CEO to award consultant contracts. The use of consultants was determined by the Principal/CEO. The Trustees only participated in selecting 2 or 3 consultants. It is evident that the prior process was problematic; therefore, RMH trustees have advised the CEO to review procedures and DOE guidelines when obtaining consultant services.

Auditor's Reply

As noted in our report, we found that RMH awarded consultant contracts that resulted in questionable payments totaling as much as $240,187. Further, RMH failed to award consultants contracts based upon competitive bid procedures; develop detailed agreements specifying required consultant services, maximum obligations, service delivery periods, and authorizing signatures; maintain documentation to support consultant charges; limit consultant charges to agreed upon maximum obligations, and ensure the delivery of consultant services and products. We also found that contrary to IRS regulations, for fiscal year 2002, RMH had not filed the required Form 1099-MISC for two consultants to whom it paid $5,450 and $4,104, respectively.

While we agree with RMH's contention that the procurement process being utilized by the agency during the period covered by our audit was problematic, we do not believe it is prudent or accurate to attribute these problems to a single individual. Clearly, all of the agency's administrative staff and its Board of Trustees are responsible for the efficient and effective operation of the agency. While it is management's responsibility to establish controls and processes to be followed that will, among other things, ensure compliance with applicable laws and regulations, it is the responsibility of the agency's Board to provide the oversight necessary to ensure that the agency's Executive Director is performing all of his/her job-related responsibilities in an appropriate manner.

Based on its response, RMH is taking certain measures to address our concerns relative to this manner.

7. INADEQUATE INTERNAL CONTROLS OVER ADMINISTRATIVE, ACCOUNTING, AND OPERATIONAL FUNCTIONS

We found that RMH has not implemented adequate internal controls over its administrative, accounting, and operational functions. Specifically, although RMH stated that it has adopted DOE's Recommended Fiscal Policies and Procedures Guide, we found this not to be the case. Consequently, from July 1, 2000 to June 30, 2004, RMH did not (a) ensure that Board of Trustees members filed their annual financial interest disclosure forms with the Commonwealth; (b) maintain inventory records that supported purchases, transfers, and the disposal of furniture and equipment totaling $237,858; (c) maintain time and attendance records that support employee salaries, wages,

and fringe benefits totaling $3,998,257; and (d) maintain purchase requisitions, purchase orders, vendor invoices, and other documents to ensure that general operating expenses were reasonable, allowable, and allocable.

According to standards published by the American Institute of Certified Public Accountants (AICPA), it is the responsibility of management to establish and maintain an effective internal control structure. Sound internal controls are essential in maintaining full accountability for resources and achieving management objectives in the most effective and efficient manner. Sound internal controls include putting into effect a formal written policies and procedures manual that details the specific procedures to be followed regarding an entity's various accounting, administrative, and operational activities. Such documentation ensures the continuity of the accounting system in case of staff turnover and establishes accountability for various operational activities.

Chapter 71, Section 89, of the General Laws states, in part: "Each charter school shall keep an accurate account of all its activities and all its receipts and expenditures…" In addition, the DOE promulgated The Charter School Administrative and Governance Guide (Governance Guide) to give Boards of Trustees, leaders, and administrators of charter schools guidance regarding their legal responsibilities. Under Section III, Subsection A, of the Governance Guide, DOE specifies the need for charter schools to establish internal controls as well as the benefits derived from a sound internal control system by stating;

> *Schools must establish adequate internal controls over all aspects of the school's financial operations. Internal financial control policies provide the charter school with the foundation to properly safeguard its assets, implement management's internal policies, comply with state and federal laws and regulations, and produce timely and accurate financial statements.*

During our audit, RMH officials stated that RMH has adopted DOE's Recommended Fiscal Policies and Procedures Guide; however, we found this not to be case. As a result, we found a number of problems relative to certain administrative and operational activates conducted by RMH during our audit period, as detailed in the sections below:

a. RMH Board Members Did Not Annually File a Financial Interest Disclosure Form with the Commonwealth

Chapter 71, Section 89(v), of the General Laws requires Board members to annually file a financial interest disclosure form with the state. The purpose of the filing is for Board members to inform the state if they or a family member have a financial interest in the operations of any charter school or with any person doing business with a charter school. To help ensure that all Board members comply with this law, the DOE promulgated Section I, Subsection A (5), of the Governance Guide, which states, in part:

> *Every year, charter school board members must complete and file a disclosure form to inform the state if they or a family member have a financial interest in any charter school in the Commonwealth or any other state or with any person doing business with any charter school.*

Closely related to these financial disclosure requirements is the state's conflict-of-interest law, Chapter 268A, of the General Laws. This law prohibits board members from taking advantage of their position to gain improper benefits for themselves, their relatives, their associates, or their friends.

DOE requires board members to file their disclosure form before September 1 each year for their service in the prior calendar year. DOE helps to facilitate this process by mailing the required disclosure forms with instructions to each charter school annually. Board members must complete and sign their financial disclosure under the pains and penalties of perjury and return the completed form to DOE, the State Ethics Commission, and their city or county clerk.

Our audit disclosed that certain RMH board members did not file their financial disclosure forms with the DOE. Specifically, seven of 12 trustees (58%), five of 12 trustees (42%), and nine of 10 trustees (90%) did not complete their disclosure form for calendar years 2001, 2002, and 2003 respectively. Moreover, as highlighted below, two trustees withheld critical financial information from the state, which, if disclosed, would have revealed potential conflict-of-interest situations.

- As noted in Audit Result No. 4, on July 10, 2002, RMH purchased a $150,000 certificate of deposit from DEW. At the time of purchase, RMH's Board Chairperson also served as DEW's Chief Executive Officer. In addition, RMH's Board Treasurer also served on DEW's Board of Directors. The Chairman and Treasurer both filed a financial interest disclosure form for calendar year 2002, however, within their disclosure statements, neither

individual informed the Commonwealth about the $150,000 investment made by RMH with DEW.

- As noted in Audit Result No. 6, during fiscal years 2001, 2002, and 2004, RMH paid consulting fees totaling $31,884 to a trustee's family member. The trustee appropriately disclosed her family's fiscal year 2002 financial transaction to the Commonwealth. However, the trustee did not make a similar financial disclosure for fiscal years 2001 and 2003.

RMH's Administrative Clerk explained that each year trustees are provided with the instructions and financial disclosure forms necessary for them to fulfill the filing requirements of the Commonwealth. However, our audit found that RMH has not established follow-up procedures to ensure that Trustees satisfy the state's financial disclosure law.

b. RMH Had Not Implemented a System of Internal Control over Property and Equipment Totaling $237,858

Chapter 46 of the Acts of 1997 required charter schools to keep an accurate account of all its activities, including the purchase, transfer, and disposal of property and equipment. To help charter schools comply with this law, the DOE promulgated Section 700 within its Recommended Fiscal Policies and Procedure Guide entitled, "Property Management Policies." DOE's property management policies provided a clear, concise, and specific set of instructions for charter schools to follow when they purchase and receive property; conduct physical inventories; and dispose of assets. Among other things, DOE recommended that charter schools perform the following:

- Maintain detailed records of all government-furnished property and equipment, with an identification and segregation of property and equipment acquired through government contracts.

- Tag all property upon receipt and record assigned numbers on all applicable documents and the property control system log.

- Maintain records for every item of property in its possession, as follows:

  a. Name and description

  b. Serial number, model number, or other identification

  c. Whether title vests with the charter school or a government entity

  d. Vendor name, acquisition date, and cost

  e. Location and condition of equipment

f. Ultimate disposition date, sales price, and method of disposal

- Perform a physical inventory of all property in its possession or control on an annual basis, and reconcile the physical inventory to the detailed fixed asset subsidiary ledger

- Adopt standard disposition procedures for charter school staff to follow including an Asset Disposal Form, which identifies the asset's book value and condition, the reason for disposition, signature of the requester, and supervisor's approval or denial.

Contrary to DOE's guidelines, RMH has only performed one physical inventory of its property and equipment, which was conducted in April 2003. At that time, RMH prepared an inventory list, which identified each item observed by name, location, serial number, and identification number. In addition, RMH had not developed a detailed fixed asset subsidiary log or maintained basic inventory records (e.g., purchase requisitions, purchase orders, vendor invoice, and shipping receipts). Consequently, RMH could not reconcile its April 2003 physical inventory to actual inventory control records. Without such reconciliation, RMH cannot ensure that the $237,858 of furniture and equipment it purchased with state funds is adequately safeguarded.

During the audit, we sampled 30 items from RMH's April 2003 inventory list. We selected primarily high tech items, including laptop computers, monitors, keyboards, CPUs, and printers. The problems we found are detailed below.

- Thirty of the 30 items, or 100%, did not have its purchase price, acquisition date, or vendor name included on the inventory list. Moreover, as previously noted, RMH did not maintain a fixed asset subsidiary log for these items.

- Eleven of the 30 items, or 37%, including computer monitors, keyboards, and CPUs were not found in the areas designated on RMH's inventory list. Moreover, RMH officials could not locate the missing items when we provided them an opportunity to do so.

- Six of the 30 items, or 20%, were missing the inventory control tag designated on RMH's inventory list.

- One of the 30 items was unknowingly removed from RMH. The removal was not noted on RMH's inventory list, and an authorized asset transfer form was not completed.

Additionally, we selected 16 items, which we physically observed on the RMH premises, to trace them back to the RMH's inventory list. For this test, we selected high-tech items that were primarily located within RMH's computer lab. Our sample testing revealed that seven of the 16 items, or 44% were neither identified on the inventory list nor had an inventory control tag attached to its surface.

Moreover, similar to our original test sample, RMH did not have a fixed asset subsidiary log or other records available detailing the purchase price, acquisition date or supplier of these 16 items.

The Interim Principal stated that RMH is in the process of developing policies and procedures to control property and equipment. Moreover, he indicated that the policies and procedures should be completed in the near future and would require maintaining delivery receipts, applying identification tags to all property, maintaining a perpetual inventory control list, conducting an annual physical inventory, recording the disposal of equipment, and reporting stolen or missing property. The Interim Principal explained that, prior to June 2002, RMH staff did not have the experience necessary to develop adequate control procedures. He added that, since that time, a human resource clerk was hired who reviewed RMH's inventory practices, identified various inventory deficiencies, and presently, is developing policies and procedures to correct the noted problems.

Finally, RMH's temporary business manager explained that the accounting software utilized by RMH does not offer an integrated inventory control application. Consequently, he said RMH's computer system does not generate a fixed asset subsidiary ledger detailing the specifics about individual purchases. Lastly, the temporary business manager stated that he is manually preparing an inventory register, which he expects to have completed in the near future.

c. RMH Needs to Improve Controls over Payroll

Our audit identified that RMH needs to improve controls over its payroll recordkeeping system. Specifically, RMH has not: required teachers and administrative staff to submit time sheets on a biweekly basis; ensured the mathematical accuracy of time and attendance data reported by hourly wage employees; required employees to adequately account for vacation, sick, personal, and other leave time; or reviewed and approved employee timesheets prior to paying salaries, wages and fringe benefits. Consequently, RMH is operating a payroll system that conflicts with DOE's Recommended Fiscal Policies and Procedures Guide. Moreover, until RMH improves controls over its payroll system, the charter school cannot assure the Commonwealth that state funding spent for salaries, wages, and fringe benefits represents reasonable, allowable and allocable costs.

During fiscal years 2001 through 2004, RMH provided its employees with salaries, wages, and fringe benefits totaling $3,998,257. However, while making these payments, RMH did not implement DOE's recommended payroll control objectives and control procedures. Specifically, Section 1400 of DOE's Fiscal Policies and Procedures Guide details payroll control objectives for charter schools to meet, including calculating and recording payroll data accurately for all employees, ensuring that the payment of salaries and wages is made in accordance with documented time records, and ensuring that the hours reported on time sheets reconcile to the hours recorded on the payroll register. To help charter schools meet these control objectives, DOE recommended specific payroll procedures to abide by, as follows:

- *Hourly and salary employees prepare time sheets on a bi-weekly basis; enter hours in ink and sign the completed time keeping record; and make all corrections in ink by crossing out the error and initialing the change.*
- *Each employee's time sheet is forwarded to the Administrative Assistant or Receptionist on a bi-weekly basis, which ensures all time sheets are submitted in a timely manner. Once collected, the time sheets are forwarded to the Charter Leader who reviews and approves them.*
- *Before vacation time is paid, a Vacation Authorization Request is to be prepared by the employee, which is reviewed and approved by the Business Manager.*
- *Authorized timesheets are forwarded to the Business office for processing. Hours shown on time sheets are reconciled to the hours recorded on the payroll register by the Business Manager for each time sheet period.*

During the audit, we test sampled RMH's payroll records for the weeks ended March 8, 2002; March 15, 2002; October 4, 2003; and October 11, 2003. Our review found that RMH had not implemented control procedures similar to those prescribed by DOE. In fact, we found that RMH did not require its classroom teachers to prepare and submit individual time sheets. Instead, RMH relied upon a consolidated "Teacher's Sign-In Sheet" to account for time and attendance. Although RMH's sign-in sheet provided adequate space for teachers to record their arrival and departure time, we found that teachers did not consistently sign the document or disclose the hours they worked, RMH's administrator did not review or approve the sign-in sheet, and the sign-in-sheet did not provide adequate space for teachers to report vacation time, sick leave, and personal time taken.

RMH required its administrative staff to complete individual time sheets on a weekly basis. However, our sample test of time sheets found that administrative staff did not consistently report their work hours and leave time usage, supervisors did not review and approve time sheets

submitted by administrative staff, time sheets contained mathematical errors, and administrative staff did not summarize their hours in accordance with school instructions.

During the audit, RMH's business manager stated that the primary purpose of the Teacher's Sign-In-Sheet is to ensure that classrooms have appropriate teacher coverage and that RMH's Principal does not routinely review and approve the document. Regarding undocumented absences, the business manager could not locate supporting documentation for the items we noted, but she stated that the Principal might have verbally approved the undocumented employee absences. Lastly, the business manager stated that RMH is developing new control procedures, which should correct the deficiencies noted by our audit.

d. RMH Needs To Improve Internal Controls Over General Operating Expenses

As previously noted, DOE's fiscal policies and procedures guide was intended to help charter schools develop effective internal controls, keep an accurate account of their activities, and provide for an annual independent audit of their financial statements. Although DOE does not mandate that charter schools completely implement the guide, RMH officials stated that RMH has adopted the guide as its operating policies and procedures manual. The guide covers all routine fiscal activities including general accounting, cash management, procurement, accounts payable, etc. Regarding general operating expenses, the guide provides charter schools with control objectives and detailed control procedures that include the following:

- Recordkeeping - Receipts and disbursements must be fully and accurately described in the books and records.

- General Accounting Procedures - All entries are supported by adequate documentation that clearly shows the justification and authorization for the transaction.

- Purchasing - Purchase requisitions include a description of items ordered, a cost estimate, the required delivery information, and a statement of the nature and purpose of the procurement.

- Accounts Payable - Invoices are compared to the purchase order and the packing list. The invoice is reviewed for: the nature, quality and quantity of goods ordered and the related price, accuracy of all arithmetic calculations, and extensions.

- Cash Disbursements - When the transaction is complete and payment is due, a pre-numbered check is prepared by the Business Manager who attaches all supporting

documentation; (e.g., vendor invoice, purchase order, purchase requisition, etc.) and submits the package to the Charter Leader or the Treasurer for approval.

- Travel Expense Reimbursements - Soon after traveling, but not exceeding 30 days, an employee who seeks reimbursement for authorized expenses completes a travel report detailing the expense incurred, attaching originals of supporting documentation.

Despite the assertions made by RMH officials, during our audit we reviewed the documentation RMH was maintaining relative to 56 financial transactions totaling $86,235 and found that RMH had not effectively implemented the guide's policies and procedures. In fact, based upon our sample test results, RMH conducted its fiscal activities without consistency, direction, or oversight.

Our sample of RMH expenses covered the four-year period ended June 30, 2004. Included within our sample were vendor payments totaling $61,737; travel expenses totaling $11,007; marketing and development costs totaling $10,776; and cash advances totaling $2,715.

Of the 23 vendor payments reviewed, we found deficiencies with 22 payments, or 96%, totaling $59,327. Specifically, RMH did not use purchase requisitions, purchase orders, price quotes, or competitive bids for services and supplies it purchased with state funds. In addition, RMH could not provide billing invoices detailing the specific services, supplies, and cost of items purchased from local vendors. For example, on September 4, 2002, RMH paid a vendor $4,100. However, RMH did not have a purchase requisition, purchase order, or vendor invoice on file to substantiate the payment. Consequently, RMH cannot assure the Commonwealth that the payment represented a reasonable, allowable, and allocable cost.

Similarly, of the 13 travel expenses reviewed, we found problems with 11 expenses, or 85%, totaling $7,396. Specifically, we found that RMH did not maintain supporting documentation, reimbursed unauthorized travel expenses, and misclassified non-travel-related expenses as travel costs. For example, during fiscal year 2001, RMH made three payments to hotels totaling $704, $805, and $2,055, respectively. However, RMH did not have records on file authorizing and detailing the expenses.

Our test of RMH's marketing and developmental costs revealed problems with five of the seven items sampled, or 71%, totaling $5,578. Again, we found that RMH had not implemented controls to ensure that expenses were properly authorized, documented, and recorded within RMH's financial records. For example, during August and September 2002, RMH paid a local caterer

$1,219 to provide luncheon services on four separate occasions. Although RMH maintained a copy of the caterer's billing invoice, it could not provide any documentation relative to the purpose, authorization, and attendees of the luncheons.

Finally, our sample of cash advances found problems with 10 of the 13 advances reviewed, or 77%, totaling $1,955. Specifically, in seven instances, RMH had not maintained any documentation to support cash advances to trustees (e.g., travel itineraries, travel authorizations, travel advance requests, travel receipts, travel vouchers). For the remaining three advances reviewed, RMH did maintain travel itineraries, travel authorizations, and travel advance requests. However, upon completing their travel, the three trustees were not required to submit travel receipts or prepare travel vouchers. Consequently, RMH could neither account for these travel advances nor recover any unspent travel funds.

Recommendation

Although RMH officials indicated that RMH has adopted DOE's Recommended Fiscal Policies and Procedures Guide, our audit testing has determined that this was not the case. Therefore, we recommend that RMH establish a system of effective internal controls over all of its administrative, accounting and operational functions, which should include implementing DOE's Recommended Fiscal Policies and Procedures Guide. In addition, RMH should monitor agency transactions and activities to ensure that the policies and procedures it establishes in this area are consistently adhered to.

Auditee's Response

The OSA alleges *shortcomings in RMH's adoption and implementation of DOE's Recommended Fiscal Policies and Procedures Guide Section 1000. To ensure that it is fully compliant, RMH has hired, via the competitive bid process, Alexander, Aronson, Finning & Co., P.C. ("AAF") to review and recommend ways to strengthen fiscal policies, procedures and internal controls for the School. AAF is a leading CPA and business advisory firm working with Massachusetts charter schools to establish procedures and formats that comply with the latest Department of Education guidelines. AAF began the engagement at RMH in mid-May 2005. Tentative target date for project implementation and completion is set for the end of August 2005. Upon completion of the project, a copy of the board-approved RMH fiscal policies, procedures and internal control manual will be forwarded to DOE's Charter School Office (CSO).*

a. Financial Interests Disclosure Statements*.*

RMH Board of Trustees has always filed their financial disclosure statement with the former Principal/CEO. The statements were completed and mailed from the School. The

former Principal/CEO collected the statements and assured the Trustees that they would be mailed. The OSA found deficiencies in the filings that were presumably made by the former Principal/CEO. To correct the filing problems, RMH has adopted new procedures to ensure that it will be fully compliant with the disclosure obligations of its Trustees.

Auditor's Reply

The OSA's audit report reflects actual deficiencies within RMH's financial operations. The audit staff identified the financial deficiencies by, among other methods, reviewing applicable charter school laws, rules, regulations, and guidelines; analyzing RMH's financial statements and records, evaluating RMH's system of internal control; sample testing RMH's financial transactions; and interviewing current and former school administrators. Moreover, as previously noted, the OSA developed and reported on RMH's deficiencies in accordance with the fieldwork and reporting standards of GAGAS.

The Trustees' response indicates that a consultant has been hired to review and recommend ways to strengthen RMH's fiscal policies, procedures, and internal controls. Certainly, RMH will benefit from this step if the Trustees and administrative staff remain committed to improving the school's financial operations. We only make this point since DOE had already provided directives, guidelines, policies, and procedures to all charter schools which, if implemented by RMH, would have prevented the majority of issues detailed in this report.

The Trustees contend that they completed and submitted all their financial disclosure forms to the former Principal, but she failed to mail them. However, the trustees need to realize that the filings are their personal responsibility, and as such, each trustee is individually responsible for completing and signing his/her financial disclosure form under the pains and penalties of perjury and returning it to the appropriate state agencies.

In addition, our audit report detailed that for calendar years 2001, 2002, and 2003, seven of 12 trustees (58%), five of twelve trustees (42%) and nine of 10 trustees (90%) respectively did not complete their disclosure forms. These figures indicated to the audit staff that some trustees met their disclosure responsibilities, while others failed to do so. Based upon the trustees' response, it seems improbable that the former Principal mailed some of the filings but declined to mail others.

8. RMH'S BOARD OF TRUSTEES NEEDS TO IMPROVE OVERSIGHT OF RMH'S FINANCIAL OPERATIONS

We found that during our audit period, RMH's Board of Trustees did not provide adequate oversight over RMH's financial operations. Specifically, the Board of Trustees did not maintain adequate documentation in the form of meeting minutes detailing discussions, votes, and other actions taken by the board, and functioned without the benefit of current financial statements from RMH's Business Manager. In addition, several board members were frequently absent from scheduled board meetings, and the majority of board members served terms beyond the maximum allowable limits set by RMH's corporate bylaws. These conditions prevented the board, at times, from achieving a quorum, exercising proper oversight over RMH's fiscal operations, and effectively carrying out their duties as board members.

The Board of Trustees of a charter school is the primary organizational body that ensures that RMH meets its operational objectives in the most effective and efficient manner. Although charter schools are public entities rather than private, nonprofit organizations, board members should be guided in part by the same principles that guide board members of private nonprofit organizations. The Charter School Administrative and Governance Guide published by the DOE defines the duties and responsibilities of charter school board members. Like board members of nonprofit organizations, members of Boards of Trustees of charter schools have a duty of care, which requires that each board member be diligent about fulfilling their board responsibilities while making decisions carefully based upon full and complete information, and a duty of loyalty, which prohibits them from doing anything that would allow them to profit personally or indirectly because of their position. To comply with the duties of care and loyalty, trustees must:

- Attend Board meetings and participate actively.
- Carefully consider every vote made as a board member, using informed judgment and common sense.
- Review on a regular basis the school's charter accountability plan, budget, code of conduct, financial reports, contracts with outside management organizations (if any), leases for facilities, loan agreements, curriculum, and other significant documents.
- Delegate responsibility to qualified staff while making sure the staff implements the board's decisions as intended.

- Ensure that the school is in compliance with the law and raise relevant questions and discuss issues fully before deciding upon them.
- Not knowingly do anything that would harm the school.
- Not vote on any matter in which they have a personal interest.

In addition, DOE's Recommended Fiscal Policies and Procedures Guide (Guide) further details responsibilities of the Board of Trustees. Among other things, the Guide states the following:

> *The Board of Trustees will meet monthly to ensure its fiduciary duty is maintained. The Board will review the following: prior meeting minutes, business items, subcommittee reports, Charter Leader report, new business and other items.*
>
> *Originals of the following corporate documents are maintained and their presence is verified on a periodic basis: charter and all related amendments, minutes of the Board of Trustees and subcommittees....*

Contrary to the guidelines published by DOE, RMH's Board of Trustees did not consistently maintain meeting minutes detailing its discussions, votes, and other actions. Specifically, for the four-year period ending June 30, 2004, minutes were unavailable at the charter school for eight meetings held by the Board of Trustees. Moreover, board minutes that were available frequently did not detail the significant events discussed and voted upon by the board. For example, as noted in Audit Result No. 4, RMH invested $150,000 into a financial institution whose CEO at the time was RMH's Chairperson. Although trustee members stated that this transaction was approved by the full Board of Trustees, we found no evidence of such a vote within the board minutes. Similarly, as noted in Audit Results No. 3, RMH transferred $125,000 to its related party, SSPI, yet this transaction was not documented within the board minutes.

In addition, the Board of Trustees did not require RMH's principal or business manager to provide financial reports in a consistent and timely manner. During fiscal years 2003 and 2004, the board convened 10 times without the benefit of income statements, balance sheets, or expense reports.

As previously noted, DOE's Administrative and Governance Guide requires that board members attend meetings and participate actively. However, our review of RMH's board meeting minutes found that several members were frequently absent from monthly meetings. Specifically, our review of RMH's fiscal years 2001 through 2004 board minutes identified the following deficiencies relative to board member attendance:

- Fiscal Year 2001: Our review of 22 sets of board meeting minutes identified that six of the 11 members had absences ranging from six to 21 meetings. On average, these six individuals missed 13, or 59%, of the meetings held during fiscal year 2001.

- Fiscal Year 2002: Our review of 16 sets of board minutes identified that five of the 12 members had absences ranging from four to 16 meetings. On average, these five individuals missed seven, or 44%, of the meetings held during fiscal year 2002.

- Fiscal Year 2003: Our review of 11 sets of board minutes identified that five of the 10 members had absences ranging from four to 10 meetings. On average, these five individuals missed six, or 54%, of the meetings held during fiscal year 2003.

- Fiscal Year 2004: Our review of 12 sets of board minutes identified that four of the 12 members had absences ranging from six to 11 meetings. On average, these five individuals missed eight, or 66%, of the meetings held during fiscal year 2004.

The most egregious situation involved a board member who missed almost every scheduled board meeting since RMH was founded. RMH's corporate bylaws state that any trustee may be removed from office with cause by an affirmative vote of the trustees in office. However, the board minutes did not indicate that the trustees were considering removing this individual from office due to his excessive absenteeism.

In addition, RMH's bylaws state, "All Board members will be elected for two year-terms with an option to be elected for an additional two-year term." However, as of June 30, 2004 RMH's Board of Trustees included seven of RMH's founding members whose services started during December 1998. Consequently, the seven trustees have violated RMH's bylaws by extending their term of service by one and one half years as of June 30, 2004.

Finally, on January 29, 2004, DOE's Associate Commissioner for Charter Schools sent correspondence to RMH's Chairperson, requesting her to provide clarification of this matter. Specifically, the Associate Commissioner wrote, "Please provide the action plan of the Board of Trustees to address the findings in the school's fourth-year site visit report and the renewal inspection report that the Board of Trustees has members serving beyond the limits of their terms as specified in the school's bylaws."

In a letter to DOE dated February 6, 2004, RMH's Board Chairperson responded as follows:

> *The Board acknowledges that, ideally, term limits should be followed to limit the number of years to be served by members of the Board. The Board also believes, however, that the school is still in its early stages and significant turnover on the Board at this point could cause substantial*

disruption in School governance. In light of these competing concerns, the Board has scheduled a Board retreat in late February 2004 at which the Board will consider this issue and the By-Laws as a whole.

However, our review of board meeting minutes and discussions held with school officials revealed that the Board of Trustees did not take its planned February 2004 retreat. Therefore, to ensure that RMH remedied this matter, we requested RMH's Chairperson to provide a copy of the action plan required by DOE. However, as of our audit completion date, RMH's Chairperson had not supplied us with the requested document.

Recommendation

In order to ensure that the Board of Trustees provides adequate oversight of RMH's operations, we recommend that the board:

- Maintain board meeting minutes for each meeting held by the board. These minutes should include sufficient detail on all pertinent discussions and votes taken regarding all financial and personnel issues.
- Adopt a formal policy requiring the Business Manager to provide monthly financial statements to the board in a consistent and timely manner.
- Attend board meetings on a consistent basis. Members that have not attended meetings consistently should resign their position on the Board of Trustees. Although RMH's corporate by-laws state that any trustee may be removed from office with cause, they do not specifically address this issue. RMH should amend their bylaws to address this concern.
- Should comply with its corporate by-laws with respect to term limits. In this regard, RMH should form a search committee comprised of three board members to seek out individuals within the community interested in serving on the RMH Board of Trustees.

Auditee's Response

The OSA penchant for making broad sweeping statements is evident from its report on the record-keeping practices of the Board of Trustees. RMH's staff provided the OSA with minutes for a 4-year period. The staff also advised the RMH Board of Trustees that the minutes for 6 to 8 meetings *were misplaced or missing. Those minutes were in the possession and the control of the former Principal/CEO. Since the former Principal/CEO is not currently in contact with RMH, it is not possible to ascertain what happened to the missing minutes. In response to the missing minutes, RMH's Board of Trustees has revised the procedures for taking and maintaining the minutes of its proceeding, and to protect against the loss of minutes in the future, the Clerk will keep a duplicate copy on the minutes off site.*

As of July 2004, the School's Office Manager attends monthly scheduled Board meetings and takes notes. The Office Manager prepares the meeting minutes, including the date of the meeting, the time and location of the meeting, the members present or absent,

and all action taken at the meeting including a list of issues discussed and a record of the formal votes taken. The minutes are submitted for review to Board of Trustees members at the following month's meeting. Following Board approval, the Board Clerk signs off on a signature sheet. Copies of the minutes are retained within the School building by the Office Manager, and a copy is maintained by the Clerk offsite. This procedure should ensure that there are two complete sets of minutes available at all times.

As of February 2005, RMH has hired a highly qualified Business Manager who is responsible for developing, implementing and maintaining procedures that ensure financial accountability. In addition, a competent Accounting Clerk was hired in April 2005 to assist in daily operations and ensure segregation of duties in the business office. Currently, the Business Manager and Accounting Clerk reconcile all balance sheet accounts on a monthly basis with the exception of both the operating cash account and payroll cash account, both of which are reconciled by the Office Manager. The Business Manager facilitates the month-end close via a procedural checklist which was developed to ensure accurate and timely financial reporting. Furthermore, the Business Manager generates monthly financial statements by the 15th of the following month, upon which reports are furnished, and such reports are then made available for presentation at scheduled monthly meetings of the Trustees. The following financial reports are included in the Board of Trustees' monthly meeting package:

1. *Balance Sheet;*
2. *Cash Flow Projections; and*
3. *Current Month and Fiscal YTD Actual vs. Budget Statement of Revenues and Expenses and accompanying variance analysis narrative identifying and explaining major variances to ensure that corrective measures are made in a timely manner.*

In addition, cash flow projections have facilitated the management of RMH's line of credit under the guidance of the Treasurer and the Board of Trustees. As a result, RMH's financial condition has improved significantly, thus leading to a favorable FY05 YTD surplus, improved cash flow position, and increased reserves.

The Trustees' Term of Office.

With regards to the Trustees' term limits, RMH, on July 15, 2004, through its counsel sent amendments to its bylaws to DOE and requested review and approval to implement the Amended and Restated Bylaws. The Resolutions adopted by the Board of Trustees approving the Amended Bylaws were also included in that mailing. To date, the DOE has not responded to RMH's request. In any case, RMH has implemented the provisions of the Amended and Restated Bylaws as to the Trustees' term limits. The amendment lifts the limitations on the term of office of the Trustees and staggers the Board to ensure that one-third of the members come up for re-election each year.

Auditor's Reply

Contrary to the trustee's response, the OSA did not make a broad sweeping statement relative to the recordkeeping practices of the Board of Trustees. Rather, the audit report detailed the Board's responsibilities relative to recordkeeping, and identified the specific deficiencies found in

this area. Specifically, for the four-year period ending June 30, 2004, board minutes were unavailable at the school for eight meetings held by the trustees. Moreover, minutes that were available frequently did not detail the significant events discussed and voted upon by the Board. The OSA did not attempt to list every event that the board failed to disclose within its meeting minutes. Rather, the OSA provided two significant examples of incomplete meeting minutes in order to support its reported conclusions and recommendations in this area.

The fact that the Board of Trustees places the blame with the former Principal for the missing board minutes is unfortunate since these minutes, if actually in existence, could have easily been copied and provided to the audit staff. In this regard, during our mid-point conference with the Board of Trustees we were informed that all trustees receive a copy of meeting minutes. Based upon this assertion, we provided the Chairperson with a list of the missing meeting minutes and expected that copies of the missing documents would be provided. However, the Chairperson neither produced the missing documents nor provided an explanation for her non-response.

Based upon its response, RMH has taken corrective action to help ensure that board meeting minutes are prepared in detail and maintained in accordance with DOE's Recommended Fiscal Policies and Procedures Guide.

RMH's response indicates that a highly qualified Business Manager has been hired to develop, implement, and maintain procedures that ensure financial accountability. We believe that RMH has taken a positive step to ensure that the Board of Trustees will have up-to-date and accurate financial information available in a consistent and timely manner.

Our report noted that seven of RMH's founding members extended their term of service on the Board of Trustees by one and one half years beyond the limits set forth in RMH's by-laws. We also detailed that that several board members were frequently absent from board meetings and, at times, the board failed to achieve a quorum. RMH's response indicates that it has amended its by-laws whereby the term limitation for each individual board member has been lifted and one-third of the board members come up for reelection each year. Although RMH has addressed the issue of board members serving beyond their term of service, RMH did not provide a response to help address the frequent absenteeism of several board members and the inability at times for the board to achieve a quorum.

9. RMH DID NOT TRANSFER WITHHOLDINGS TO THE MASSACHUSETTS TEACHERS' RETIREMENT SYSTEM ON A TIMELY BASIS, RESULTING IN A LOSS OF POTENTIAL INTEREST INCOME TO THE RETIREMENT SYSTEM AND IN THE UNAUTHORIZED USE OF EMPLOYEE CONTRIBUTIONS

During our audit, we found that RMH did not transfer to the Massachusetts Teachers' Retirement System (MTRS), on a monthly basis as required by law, funds that it withheld from its teachers' and other eligible staffs' earnings. In fact, rather than remitting these funds on a timely basis, RMH used these employee payroll withholdings to improve its cash flow and pay for various operational expenses of RMH. As a result, the MTRS lost the opportunity to invest these funds in a way that maximizes the returns on the state retirees' pensions. In addition, RMH risked the loss of these employee retirement contributions.

According to Chapter 71, Section 89, of the General Laws and subsequent guidance issued by DOE, certain employees of charter schools are required to participate in the MTRS. Specifically, Chapter 71, Section 89, of the General Laws states, in part:

> *Teachers employed by a charter school shall be subject to the state teachers' retirement system under chapter 32 and service in a charter school shall be "creditable service" within the meaning thereof.*

As an employer of staff who are participants in the MTRS, RMH has the fiduciary responsibility of withholding the appropriate amount of pension contribution from each employee's paycheck and remitting those funds in a timely manner to the MTRS on behalf of the employee. In this regard, Chapter 32, Section 22, of the General Laws establishes the following requirements for remittance of these funds to the MTRS by employers such as RMH:

> *In the case of teachers who are members of the teachers' retirement system, the various amounts withheld for any month for deposit in the annuity savings fund of such system shall, together with proper vouchers therefore, be transmitted by the disbursing authorities to the secretary of the teachers' retirement board on or before the tenth day of the next succeeding month.*

The MTRS has also issued guidelines on monthly deduction transmittal and reporting that restate the statutory requirements.

We found that RMH was not routinely remitting in a timely manner the retirement funds that it was withholding from its teachers and other eligible staff in accordance with Chapter 32, of the General Laws. Specifically, based on our review of RMH's monthly cash reconciliation records for the 12-month period July 2003 through June 2004, we determined that in four of the 12 months reviewed,

RMH did not transfer its Massachusetts teachers' retirement withholdings to the MTRS on a timely basis. Specifically, withholdings for the four-month period (February 1, 2004 through May 30, 2004) totaling $32,307 were held and not submitted until after June 30, 2004.

Of particular concern is that these pension funds are not the property of RMH, but rather are the property of the individual employees making their contributions. RMH has the responsibility to act only as a transferring agent of these funds, but does not have the legal authority to use these funds for its own purposes. Despite this fact, RMH utilized these pension withholdings to pay for operational expenses during the additional time it held them. In this regard, since RMH maintains only one bank account for all of its funds, the contributions held beyond the statutory time were likely used to pay for RMH's operational expenses.

RMH does not have the authority to use the pension funds that it withholds from its staff in any manner it deems necessary. Clearly, RMH has a fiduciary responsibility to safeguard these funds and ensure that they are withheld and deposited in a manner consistent with state statutes. By not doing so, RMH has deprived the MTRS of the ability to fully invest these funds and maximize the returns that could be used to pay for retirement benefits of RMH employees.

According to RMH's temporary business manager, the four late payments took place during fiscal year 2004, when RMH was experiencing serious cash-flow problems.

Recommendation

RMH should take appropriate measures to ensure that all employee pension withholdings are remitted to the MTRS in accordance with Chapter 32 of the General Laws. Additionally, RMH should not use any pension funds that it withholds from its staff to fund any school-related expenses. Such actions constitute an unauthorized loan and are a violation of state law and RMH's fiduciary responsibility.

Auditee's Response

RMH's Board of Trustees authorized its Principal/CEO to hire a temporary accountant to manage the affairs of the business office while the School recruited a permanent Business Manager. During this period, the OSA began the audit of the School. The temporary business manager was unable to supply the myriad of documents requested by the OSA each day while learning the School's business policies and procedures as well. As a result, some of the tasks that he should have performed were neglected.

The Temporary Business Manager should have made timely payments to the MTRS (MA Teachers Retirement System) because the School had ample financial resources on hand to cover the remittances. At the time, the School's line of credit had more than enough capacity to cover cash needs during the gap between receiving services provided by contractors and receiving payments from the state. At no time during the stated time frame of the audit or the actual time frame, did the School overdraw its line of credit.

RMH's Business Office currently submits monthly withholding checks, MTRB retirement deduction submittal forms, and payroll deduction reports to the Massachusetts Teachers' Retirement System by the 10th of the month being reported on.

Auditor's Reply

The OSA's request for documents from RMH's business office had no bearing upon the school's ability to transfer withholdings to the Massachusetts Teachers' Retirement System (MTRS) on a timely basis. In fact, for each month in question, RMH's temporary accountant prepared a payroll withholdings remittance check for the MTRS and recorded the payment with RMH's financial records. However, because RMH was experiencing significant financial difficulties at the time, the temporary accountant did not mail the payments to the MTRS. This problem was not rectified until RMH received its June 30, 2004 quarterly tuition payment from DOE. A review of RMH's general ledger showed that just prior to receiving this tuition payment, RMH had a negative cash position of $44,739.36. Consequently, RMH's deficiencies in this area accurately reflect the school's cash flow problems at the time.

APPENDIX I

Conditional Renewal of RMH's School Charter, February 24, 2004

On a motion duly made and seconded, it was:

VOTED: that the Board of Education, in accordance with General Laws chapter 71, section 89, and 603 CMR 1.00, and subject to the conditions set forth below, hereby grant a renewal of a public school charter to the following school for the five-year period from July 1, 2004 through June 30, 2009, as recommended by the Commissioner:

Commonwealth Charter School:

Robert M. Hughes Academy Charter School
Location: Springfield
Number of students: 180
Grade levels: K-8

This renewal is explicitly conditioned upon conditions that follow. Failure to meet any of these conditions may result in placing the Robert M. Hughes Academy Charter School on probation or revoking its charter.

1. The Robert M. Hughes Academy Charter School ("School") will make Adequate Yearly Progress in the aggregate as determined by the Department of Education based upon the results of the spring 2004 and spring 2005 administration of the Massachusetts Comprehensive Assessment System.

2. Members of the Board of Trustees who also served as members of the board of directors, officers, executives, advisors, consultants, and in any other capacity for the D. Edward Wells Federal Credit Union must immediately request an opinion from the State Ethics Commission regarding their failure to disclose this interest on their financial disclosure forms and their participation in any decisions made regarding deposits of the funds of the School with the D. Edward Wells Federal Credit Union, including deposits made in excess of the "maximum insured sum" as noted in the school's auditor's report for FY03 on page 14 in number 14 of the Notes to Financial Statements. If the State Ethics Commission determines that any members of the Board of Trustees violated either the Commonwealth's conflict of interest or financial disclosure laws, those members must immediately resign from the Board of Trustees.

3. **The Board of Trustees must hire a consultant by April 15, 2004 with experience working with boards of trustees of charter schools regarding board practice and governance. Such consultant must be acceptable to the Department of Education and must not have any personal relationships with any members of the Board of Trustees. The consultant shall perform an evaluation of the Board of Trustees' performance of its governance and oversight duties and submit a written report to the Department of Education by June 30, 2004. The Board of Trustees shall submit an action plan based upon this report by September 13, 2004 to the Department of Education for approval and for use in the ongoing evaluation of the school.**

4. **The Board of Trustees must comply with, or revise in a manner acceptable to the Department of Education, the bylaws for the School regarding terms of members by June 30, 2004.**

5. **Members of the Board of Trustees must cooperate with the Department of Education and the Office of the State Auditor to fully address the questions and issues raised by the Department.**

Said charter school shall be operated in accordance with the provisions of General Laws chapter 71, section 89, and 603 CMR 1.00 and all other applicable state and federal laws and regulations and such additional conditions as the Commissioner may from time to time establish, all of which shall be deemed conditions of the charter.

The vote was unanimous.

APPENDIX II

DOE Request for RMH Documents and Information, January 29, 2004

The Commonwealth of Massachusetts
Department of Education

350 Main Street, Malden, Massachusetts 02148-5023 Telephone: (781) 338-3000

January 29, 2004

By Telecopier and Mail

Carol Aranjo, Chairperson
Board of Trustees
Robert M. Hughes Charter School
91 School Street
Springfield, MA 01105

RE: Renewal of Charter for Robert M. Hughes Charter School

Dear Chairperson Aranjo:

At the meeting of the Board of Education on January 27, 2004, Commissioner Driscoll presented for discussion and initial recommendation that the Board renew the charter for Robert M. Hughes Charter School ("RMH"). Enclosed with the copy of this letter sent by mail is a copy of the Commissioner's recommendation. At the January 27th meeting, the Commissioner noted that the Board would not vote on the charter renewal until its next monthly meeting on February 24th. He stated that the Department just recently received notice that the principal for the school, O'Rita Swan, had resigned. The Commissioner said he would consider this new information in making his final recommendation to the Board in February.

You also addressed the Board at the January 27th meeting. You indicated that the resignation of Ms. Swan occurred after the Board of Trustees of RMH had requested that she account for two hundred thousand dollars of the school's funds.

In the course of the Board of Education's discussion of this matter, members of the Board of Education had a number of questions and requested the Charter School Office to investigate and gather additional information. Listed below are documents and information that the Charter School Office must receive no later than 5 p.m. on Friday, February 6th from the RMH Board of Trustees, submitted under the penalties of perjury.

1. Please provide a detailed explanation of the school's decrease in revenues and increase in instructional costs experienced during FY03. Please also provide the action plan of the Board of Trustees to address these issues during FY04 and future years. Please provide copies of all documents relating to this response.

2. Please detail the specific circumstances leading to the resignation of the school's principal, O'Rita Swan, on or about January 22, 2004, including but not limited to the allegations regarding unaccounted for expenses and issues regarding the payment of contractors providing services to the school. Please provide copies of all documents relating to this response.

3. Please explain in detail the allegations of a missing two hundred thousand dollars made at the meeting of the Board of Education on January 27, 2004. Please provide: (a) the action plan of the Board of Trustees to recoup these funds and take any necessary further action; (b) copies of the accounting journal containing entries reflecting the allegations made at the Board of Education meeting; and (c) copies of all other documents relating to this response.

4. We note finding 03-1 on page 18 of the school's independent audit for FY03 regarding bank reconciliations. Please provide us with a detailed status report regarding the steps taken to correct this finding and the action plan of the Board of Trustees in connection with this finding. Please also provide copies of any and all management letters from the school's auditor reflecting any other findings.

5. Please provide the action plan of the Board of Trustees to address the findings in the school's fourth year site visit report and the renewal inspection report that the Board of Trustees has members serving beyond the limits of their terms as specified in the school's bylaws.

6. Please provide a copy of the "formal document explicating the relationship between D. Edward Wells Federal Credit Union and the RMH Academy Charter School to include any bookkeeping disparities" as referred to in the school's response to its second year site visit report. Please provide copies of all documents relating to this response.

7. Please detail which members of the Board of Trustees of RMH also served as members of the board of directors, officers, executives, advisors, consultants, and in any other capacity for the D. Edward Wells Federal Credit Union, including but not limited to, their roles by time periods at D. Edward Wells Federal Credit Union, their compensation from D. Edward Wells Federal Credit Union, and the years they served at D. Edward Wells Federal Credit Union. Please provide copies of all documents relating to this response.

8. Please indicate which members of the Board of Trustees who served in any capacity for the D. Edward Wells Federal Credit Union disclosed this to the Commonwealth on their financial disclosure forms. If they did not do so, please explain in detail the reasons for not doing so, including all contact with and opinions from the State Ethics Commission regarding serving with the D. Edward Wells Federal Credit Union and on the Board of Trustees for RMH. Please provide copies of all documents relating to this response.

9. Please provide a detailed explanation and history of deposits made by RMH with the D. Edward Wells Federal Credit Union and other relationships between RMH and the D. Edward Wells Federal Credit Union, including but not limited to minutes of Board of Trustees meetings at which this was discussed and voted and decisions made regarding deposits, including deposits made in excess of the "maximum insured sum" as noted in the school's auditor's report for FY03 on page 14 in number 14 of the Notes to Financial Statements. Please provide copies of all documents relating to this response.

10. Please identify the name and address of the auditing firm for the D. Edward Wells Federal Credit Union.

11. Please describe in detail and provide all documents relating to communications between or among members of the Board of Trustees of RMH regarding the D. Edward Wells Federal Credit Union.

We look forward to the school's response. Please note that, as provided in 603 CMR 1.09(9), the school's response will be deemed to be under the penalties of perjury even if not explicitly stated in the response. Please feel free to contact me at 781-338-3227 should you require any additional information.

Very truly yours,

Kristin E. McIntosh

Kristin E. McIntosh
Associate Commissioner for Charter Schools (Acting)

Enclosure

C: Commissioner David p. Driscoll (w/o enc.)
Douglas Greer
Rebecca Wolf (w/o enc.)

APPENDIX III

RMH Response to DOE's Request for Documents and Information, February 6, 2004

ROBERT M. HUGHES ACADEMY CHARTER SCHOOL
91 School Street
Springfield, Massachusetts 01105

February 6, 2004

Charter School Office
Department of Education
Commonwealth of Massachusetts
350 Main Street
Malden, MA 02148-5023

Re: Renewal of Charter for The Robert M. Hughes Academy Charter School (the "School")
Response to Request for Information Dated January 29, 2004

Ladies and Gentlemen:

On behalf of the Board of Trustees of the School (the "Board"), I am delivering this letter and the enclosed materials in response to the January 29, 2004 letter addressed to me from Kristin E. McIntosh, Associate Commissioner for Charter Schools. Set forth below is the response from the Board to each of paragraphs 1 through 11 in Ms. McIntosh's letter.

1. **Please provide a detailed explanation of the school's decrease in revenues and increase in instructional costs experienced during FY03. Please also provide the action plan of the Board of Trustees to address these issues during FY04 and future years. Please provide copies of all documents relating to this response.**

Response:

I have enclosed with this letter as Exhibit A, a report from the School's accountants, Benton & Krusz, dated February 3, 2004. This report addresses most of Request No. 1 in the January 29 letter. The Board looks forward to discussing this issue further with the Board of Education.

2. **Please detail the specific circumstances leading to the resignation of the school's principal, O'Rita Swan, on or about January 22, 2004, including but not limited to the allegations regarding unaccounted for expenses and issues regarding the payment of contractors providing services to the school. Please provide copies of all documents relating to this response.**

Response:

The Board wishes to emphasize to the Board of Education that neither the Board nor any individuals comprising the Board have ever made any allegations that Ms. Swan failed to account for School funds or otherwise misplaced School funds or any similar allegations regarding "unaccounted for expenses". The Board appreciates Ms. Swan's dedicated service to the School and the Board maintains that Ms. Swan was important to the positive improvement of the School and its students to date.

Ms. Swan notified the Board that she resigned from her position with the School due to philosophical differences with the Board. The Board has not yet discussed the specifics of Ms. Swan's resignation with her and, accordingly, does not possess specific information regarding the philosophical differences cited by Ms. Swan.

The Board is aware of no allegations regarding payment of contractors providing services to the School. The Board requests clarification from the Board of Education regarding this specific issue so that it can respond further if necessary.

3. **Please explain in detail the allegations of a missing two hundred thousand dollars made at the meeting of the Board of Education on January 27, 2004. Please provide: (a) the action plan of the Board of Trustees to recoup these funds and take necessary further action; (b) copies of the accounting journal containing entries reflecting the allegations made at the Board of Education meeting; and (c) copies of all other documents relating to this response.**

Response:

As stated above, the Board has made no allegations that two hundred thousand dollars is "missing". The Board maintains that no one present at the January 27, 2004 meeting of the Board of Education made such an allegation. All of the funds received by the School and spent by the School have been accounted for. Accordingly, in light of the fact that there have been no allegations of missing funds, we have not enclosed any additional documentation on this point.

4. **We note findings 03-1 on page 18 of the school's independent audit for FY03 regarding bank reconciliations. Please provide us with a detailed status report regarding the steps taken to correct this finding and the action plan of the Board of Trustees in connection with this finding. Please also provide copies of any and all management letters from the school's auditor reflecting any other findings.**

Response:

A temporary fiscal clerk has been retained to perform the bank reconciliation. The bank accounts have been carefully reconciled through December, 2003.

The Finance Committee of the Board of Trustees will meet with the Business Manager monthly and review the bank reconciliations to ensure that they have been completed. The Finance Committee will date and sign the reconciliations. The Finance Committee will ask the School's accountants to confirm the accuracy of the reconciliations quarterly.

The Board has not received any management letter from the School's accountants reflecting any other findings.

5. **Please provide the action plan of the Board of Trustees to address the findings in the school's fourth year site visit report and the renewal inspection report that the Board of Trustees has members serving beyond the limits of their terms as specified in the school's bylaws.**

Response:

The Board acknowledges that, ideally, term limits should be followed to limit the number of years to be served by members of the Board. The Board also believes, however, that the School is still in its early stages and significant turnover on the Board at this point could cause substantial disruption in School governance. In light of these competing concerns, the Board has scheduled a Board retreat in late February, 2004 at which the Board will consider this issue and the By-Laws as a whole.

6. **Please provide a copy of the "formal document explicating the relationship between D. Edward Wells Federal Credit Union and the RMH Academy Charter School to include any bookkeeping disparities" as referred to in the school's response to its second year site visit report. Please provide copies of all documents relating to this response.**

Response:

Attached as Exhibit B is a statement confirming an account balance as of June 30, 2000 of $258.66 together with a copy of the management letter from the School's accountants for the year ended June 30, 2001, which management letter addresses the bank reconciliation. This management letter is attached as Exhibit C. To the extent that the Board of Education has further questions regarding this specific issue, the School's accountant could provide further explanation.

7. **Please detail which members of the Board of Trustees of RMH also served as members of the board of directors, officers, executives, advisors, consultants, and in any other capacity for the D. Edward Wells Federal Credit Union, including but not limited to, their roles by time periods at D. Edward Wells Federal Credit Union, their compensation from D. Edward Wells Federal Credit Union, and the years they served at D. Edward Wells Federal Credit Union. Please provide copies of all documents relating to this response.**

Response:

The D. Edward Wells Federal Credit Union (the "Credit Union") terminated all operations in 2003. Prior to that time, Carol Aranjo, the current chairperson of the Board, also served as the Chief Executive Officer of the Credit Union and as a member of the Board of Directors of the Credit Union. In addition, Norma Baker, the current Treasurer of the Board, served on the Board of Directors of the Credit Union. Mary Ann Lane, a member of the Board, represented the Credit Union as its attorney. At various times, other members of the Board were "members" of the Credit Union, a status that is obtained by virtue of owning an account with the Credit Union.

Neither Ms. Aranjo, Ms. Baker nor Ms. Lane disclosed these positions on their disclosure forms because they did not receive any benefit personally or to the Credit Union as a result of their service on the Board. The School did not pay any fees to the Credit Union. There was no deliberate attempt to deceive and the individuals or the Board will request an opinion from the State Ethics Committee regarding this matter. Ms. Baker never received any salary or other benefits from the Credit Union. Ms. Aranjo respectfully maintains that the compensation that she received from the Credit Union has no relevance to the issue of the renewal of the charter for the School.

It is important to note, however, that all School Annual Reports submitted to the Board of Education clearly identified Ms. Aranjo as the Chief Executive Officer of the Credit Union.

8. **Please indicate which members of the Board of Trustees who served in any capacity for the D. Edward Wells Federal Credit Union disclosed this to the Commonwealth on their financial disclosure forms. If they did not do so, please explain in detail the reasons for not doing so, including all contact with and opinions from the State Ethics Commission regarding serving with the D. Edward Wells Federal Credit Union and on the Board of Trustees for RMH. Please provide copies of all documents relating to this response.**

Response:

Please refer to our response to Request No. 7 above.

9. **Please provide a detailed explanation and history of deposits made by the RMH with the D. Edward Wells Federal Credit Union and other relationships between RMH and the D. Edward Wells Federal Credit Union, including but not limited to minutes of Board of Trustees meetings at which this was discussed and voted and decisions made regarding deposits, including deposits made in excess of the "maximum insured sum" as noted in the school's auditor's report for FY03 on page 14 in number 14 of the Notes to Financial Statements. Please provide copies of all documents relating to this response.**

Response:

The School made no deposits with the Credit Union since January, 2000 except for the purchase of one certificate of deposit in the amount of $150,000 in July, 2002. The members of the Board were fully aware of the positions held by certain members of the Board with the Credit Union and all banking activities with the Credit Union were authorized by the Board.

10. Please identify the name and address of the auditing firm for the D. Edward Wells Federal Credit Union.

Response:

The Credit Union's Supervisory Committee was responsible for its yearly audit and was assisted by Alex Perry, a public accountant. An outside audit was not required. Benton & Krusz did perform an audit of the Credit Union in 2003 at the request of the National Credit Union Administration ("NCUA") and was approved by the NCUA.

11. Please describe in detail and provide all documents relating to communications between or among members of the Board of Trustees of RMH regarding the D. Edward Wells Federal Credit Union.

Response:

The Board respectfully requests that the Board of Education provide some clarification regarding this request for information. The Board is happy to comply with a more specific request.

In closing, the Board acknowledges that the growing process for the School has not been perfect. The Board recognizes that it needs to control spending to ensure that the School maintains its current positive trend in performance without running an operating deficit.

At the same time, the Board is extremely proud of the progress made by the students of the School and the School itself. The Board is especially proud that, after receiving several comments from the Charter School Office of the Department of Education regarding test scores, this year's test scores were higher for all grades than the average scores for the City of Springfield and the fourth grade math scores were higher than the state average.

The Board understands that it is the responsibility of the Board of Education to ask questions and probe into certain matters that are the subject of this letter. The Board hopes, however, that the Board of Education recognizes the benefit that the School is providing to the children and families it serves and votes to renew the School's charter.

The Board respectfully requests a meeting with Mr. David P. Driscoll, Commissioner, and Kristen E. McIntosh, Associate Commissioner for Charter Schools to review the matters addressed in this letter prior to the next scheduled meeting with the Board of Education.

Thank you for your consideration.

Signed under the pains and penalties of perjury.

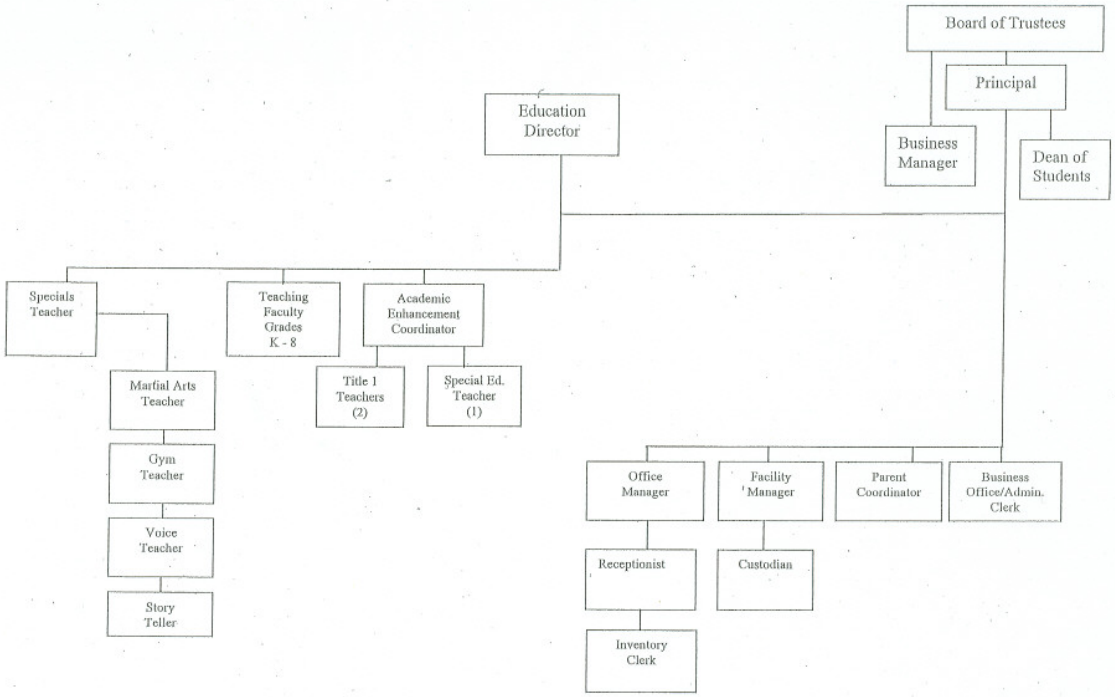
Carol Aranjo

Carol Aranjo

Dated: February 6, 2004

APPENDIX IV

Robert M. Hughes Academy Charter School Organizational Chart



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