Making Government Work Better

Commonwealth of Massachusetts

Office of the State Auditor

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Audit Highlights

Education Collaboratives:

Merrimack, READS and Southeastern Massachusetts

Fall 2011

THREE COLLABORATIVE AUDITS POINT TO SYSTEMIC PROBLEMS WITH OVERSIGHT

AUDIT FINDINGS

Audits on Merrimack Special Education Collaborative (MSEC), Southeastern Massachusetts Education Collaborative (SMEC) and Regional Educational Assessment and Diagnostic Services (READS) Collaborative, taken with the results of two past collaborative audits, revealed serious systemic issues across collaboratives and the Department of Early and Secondary Education (DESE), including:

- Problems with governance, including collaborative board members sitting on boards of related organizations, no requirements to document time worked and noncompliance with the Open Meeting Law
- A lack of clarity surrounding collaboratives' missions and legal status
- Noncompliance with teacher certification and evaluation requirements
- Inappropriate related-party transactions
- Illegal fiscal conduit payments and the use of collaboratives as "slush funds"
- Excessive and unauthorized compensation for executive directors and other collaborative staff and questionable credit toward a public pension
- Millions of dollars in questionable, undocumented and unallowable expenses
- Failure to return millions of dollars in surplus funds to member districts
- Improper cost allocations and accounting methods
- Lack of proper procurement
- Little review of collaboratives at both the state and local levels.

RECOMMENDATIONS

The pervasiveness of the deficiencies the OSA has found in audits of five of the 30 different collaboratives leads us to conclude that this is a broken system which puts at risk the interests of taxpayers and special needs students, both of whom were to be the beneficiaries of collaboratives.

With regard to state oversight, the OSA recommends clearly defining the services that

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Audits Lead to Action

- At the OSA's call for receivership, the Department of Elementary and Secondary Education (DESE) and the Merrimack (MSEC) board have entered into a Memorandum of Understanding which calls for DESE to oversee corrective action and to approve day-to-day activities for one year.
- The OSA is working with DESE, the Attorney General, State Treasurer, Inspector General, PERAC, the Operational Services Division, the Ethics Commission and federal authorities to hold parties accountable and take corrective action.
- The House of Representatives passed an OSA-authored bill expanding the OSA's access to records of vendors and subvendors.
- MSEC has stopped making payments on two questionable arrangements the OSA cited, overhauled its credit card use, began severing ties with its related non-profit, initiated steps to address licensing issues and reviewed compliance with state bidding laws.
- During OSA audit work, the READS board voted to dissolve its related-party non-profit effective June 30, 2011 as well as to return some of its surplus to member districts.
- SMEC responded that it will maintain its records in accordance with Generally Accepted Accounting Principles.

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MERRIMACK SPECIAL EDUCATION COLLABORATIVE

Improper Related-Party Issues

As a result of inadequate documentation and the awarding of no-bid contracts, there is little assurance that $21.3 million in goods and services that MSEC paid to its affiliated non-profit, Merrimack Education Center (MEC), during Fiscal Years 2008-2010 was reasonable, proper, or allowable by state laws and regulations. Additionally, contrary to state regulations and accounting principles, MSEC did not properly disclose $12,557,435 of these related-party transactions in financial statements.

Questionable Settlement

During fiscal year 2006, MSEC entered into a Settlement Agreement under which MSEC agreed to pay MEC $5.5 million for various services and facilities use during the prior five fiscal years. This $5.5 million was in addition to an estimated $16 million that MSEC had already provided to MEC for the same services during this period. Due to a lack of documentation for these services it could not be determined whether expenses associated with this transaction were proper and allowable.

Governance and Administrative Deficiencies

- Historically, the MSEC and MEC boards were almost identical and in effect each had the same executive director.
- Without a quorum, MSEC board members voted to approve a $5.5 million settlement to its related party, MEC.
- Three MSEC board members subsequently took jobs with MEC.
- The MSEC board, with approval of member districts, voted to amend the collaborative agreement to remove the requirement of member approval from future collaborative agreement changes.
- MSEC had an unallowable $2.6 million surplus.
- The MSEC board did not comply with open meeting laws.

Undocumented, Unallowable and Questionable Expenses

The audit uncovered $3 million in questionable administrative, program and credit card expenses. MSEC did not provide documentation for $2.5 million of these expenses, making it impossible to determine if they were appropriate. The remaining expenses either lacked adequate documentation to prove their legitimacy or were clearly questionable since they were non-program related. Specific charges included:

- $1,255 for alcohol, in violation of state law;
- $18,284 for meals and other entertainment;
- $4,576 for vehicle charges, primarily gasoline, by an employee who received a monthly $500 travel allowance; and
- 37 purchases totaling $5,735 for golf-related charges.

On credit cards used primarily by the co-executive directors, $103,765 in charges had inadequate documentation.

MSEC functioned as a fiscal conduit and processed $1.3 million in expenditures incurred by three school districts, in violation of state law. MSEC charged Westford and Chelmsford a total of $59,000 in processing fees. With Billerica, MSEC paid $23,000 due to the town to a "custodial" account for use at the direction of the Superintendent.

Salary and Pension Issues

MSEC failed to properly keep time and attendance records, resulting in its inability to ensure proper staffing levels, salary expense charges and reporting to public retirement boards. According to available documentation, MSEC did not maintain required staffing levels in at least two of its state-funded programs, and 10 MSEC employees may have received improper credit toward a public pension.

Professional Standards

Only 30% of MSEC educators were fully licensed during the audit period; 42% worked under waivers, the conditions of which were not always adhered to. Some educators worked despite waivers that were denied or never submitted; in some cases personnel were reclassified to a position exempt from licensure that lacked clear qualifications. MSEC failed to conduct both required teacher evaluations and a new teacher mentoring program. Additionally, the Board has not established employee performance measures.

District	FY10 Revenue	People Served*
Merrimack	$19.8M	498 students / 250 adults
SMEC	$5.3M	140 students / 111 adults
READS	$6.3M	379 students
State^	$305M	8,500

*Some people are counted twice if in multiple programs.

^2009 data for Massachusetts Organization of Education Collaboratives' 28 members.

READS COLLABORATIVE

Salary & Pension Issues

READS' Executive Director received as much as $118,072 in excessive compensation, violating state pension law. The Executive Director, a retired school superintendent, was serving as Executive Director of both READS and its affiliated non-profit organization, READS, Inc. (the Corporation). Despite serving both READS and the Corporation, a majority of the Executive Director's salary (88%) was paid by READS, and according to the Massachusetts Teachers Retirement Board, in violation of the state's pension law limits. In an attempt to circumvent state pension laws, the Executive Director made arrangements to have 100% of his salary paid by the Corporation while he continued to perform duties for READS. Meanwhile, 100% of other shared administrative expenses were charged to READS. This resulted in at least six employees, who worked for both READS and the Corporation, improperly receiving the full value of their salary and service time toward a public pension.

As a result of READS non-compliance with Generally Accepted Accounting Principles, $1.3 million in costs were not properly allocated between the two organizations. Thus, it cannot be determined if the percentage of shared expenses charged to READS, and paid for by school districts that purchased READS' services, were reasonable and appropriate.

Improper Related-Party Issues

In fiscal year 2000, READS provided the Corporation with a $944,000 loan to purchase a building for READS' use. Several issues are associated with this action, including:

- There was no formal loan agreement to detail the specific terms, which made it an interest-free loan;
- To pay down the Corporation's debt, READS assessed non-member communities additional fees totaling $488,400, an inappropriate use of tuition funds that did not provide additional benefits to the communities;
- The use of public funds to provide a loan to a non-profit organization appears to be contrary to the "anti-aid" amendment of the Massachusetts Constitution; and
- The property purchase by the Corporation was executed because READS officials believed that collaboratives were not allowed to own property. A statutory change five years earlier had granted collaboratives that authority.

Governance & Administrative Issues

READS and its affiliated non-profit shared the same board members and executive director. READS accumulated a surplus of $3.4 million in violation of policies set by the Department of Revenue's Division of Local Services and the Attorney General on the amount of fees a governmental agency can charge for services.

What are education collaboratives?

Authorized by M.G.L. Chapter 40, Section 4E, education collaboratives are groups of two or more school districts sanctioned by the Department of Elementary and Secondary Education with the objective of providing cost-effective education services. The state's 30 collaboratives consist of 331 school districts, according to the Massachusetts Organization of Educational Collaboratives.

SOUTHEASTERN MASSACHUSETTS EDUCATIONAL COLLABORATIVE

Unallowable Expenses

SMEC billed for unnecessary and inappropriate payments totaling $53,063. SMEC entered into contracts with the Department of Developmental Services called Limited Unit Rate Service Agreements (LUSA), which according to DDS policies were to be used by SMEC to purchase unanticipated, as-needed services for developmentally disabled people. None of the money was used for the LUSA's intended purpose.

Governance & Administrative Issues

SMEC is using a majority of its funding to provide various human services to adults rather than children in SMEC's member districts, which may not be consistent with the purposes of an educational collaborative. SMEC's provision of these services added 95 people to the pension system. If the services were provided as usual by a private vendor, such employees are not members of the pension system.

Contrary to state regulations, SMEC has not filed an annual audited financial statement with the Commonwealth and is not in compliance with Generally Accepted Accounting Principles. Because of this, it cannot be determined if SMEC is properly charging or billing for services.

RECOMMENDATIONS

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collaboratives may provide, since some are also functioning as human services contractors. DESE also needs increased authority to monitor collaboratives' finances and programs.

In terms of local accountability, the OSA recommends changing collaborative board composition and standards to ensure members possess the skills, objectivity and time necessary to ensure proper governance. The amount of surplus revenue which may be retained by collaboratives needs to be limited. The OSA also supports requiring financial reporting and auditing for collaboratives like that for charter schools.

The OSA will work with the Legislature to pass "follow-the-money" legislation, House Bill 5, in order that this office has the authority to audit spending by related parties and subcontractors. The OSA also recommends that the Legislature clarify the state's authority to effectively oversee and sanction collaboratives as well as ensuring that existing state rules regulating related party transactions apply to collaboratives.

Other OSA recommendations include:

- creating a standard collaborative agreement that requires collaboratives to provide sufficient detail on all key aspects of their operations;
- establishing periodic reviews and a periodic collaborative agreement renewal process; and
- improving transparency by posting all collaborative agreements, all collaborative required reports, the memberships of individual boards and their meeting minutes on the appropriate websites of DESE, collaboratives and their member districts.

Other immediate audit recommendations involve the cancellation of payments on contracts and settlements cited as questionable by the OSA, the separation of collaboratives from their intertwined related-parties, the termination of fiscal conduit transactions, the documentation of work time, activities and leave time, the institution of proper accounting systems and the initiation of full compliance with all laws and regulations.

The OSA has also called on DESE, the state and teachers' retirement boards, the Ethics Commission and municipalities to conduct reviews of teacher licensure, pension issues, salaries and benefits, related-party relationships and conflicts of interest. Many of these reviews are ongoing.

Collaborative	Districts Served
Merrimack (Chelmsford)	Billerica, Chelmsford, Dracut, Groton-Dunstable, Nashoba Valley Technical, North Middlesex, Tewksbury, Tyngsborough, Westford, Whittier Vocational Technical
SMEC (Middleboro)	Acushnet, Dartmouth, Fairhaven, Marion, Mattapoisett, New Bedford, Rochester, Old Rochester
READS (New Bedford)	Abington, Berkley, Bridgewater-Raynham, Carver, Dighton-Rehoboth, East Bridgewater, Freetown, Lakeville, Marion, Mattapoisett, Middleboro, Rochester, Taunton, West Bridgewater

OTHER AUDITS

Two prior OSA audits of collaboratives, a 2005 report on EDCO and a 2010 report on The Education Cooperative (TEC) had similar findings to the three current collaborative audits. A third audit, of Everett Public Schools in 2005, touched on its use of Shore Educational Collaborative and found it was used as a fiscal conduit for Everett expenses. The OSA also found that a fiscal conduit was used in relation to EDCO with $57,000 in improper processing fees associated with the transactions.

Other past findings included:

- Vendors used as a fiscal conduit to pay EDCO $435,000 for program costs;
- EDCO and TEC had a combined $2.4 million unallowable surplus;
- TEC had licensing issues for more than half of the 52 educators reviewed, including non-adherence to waiver stipulations. TEC also lacked established standards for license-exempt positions;
- Inconsistent with other public-sector benefits, the TEC board changed the requirement from 10 years of service to one year to qualify for retiree health coverage; and,
- Nearly $60,000 on alcohol and entertainment expenses was reported at TEC.

For a full copy of these reports, or for more information about the Office of the State Auditor Suzanne Bump, please visit www.mass.gov/auditor or call 617-727-2075