



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report – Issued August 31, 2011

READS Collaborative

For the period July 1, 2008 through June 30, 2010



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INTRODUCTION**1**

READS Collaborative (READS) was established in 1989 as a governmental organization under Chapter 40, Section 4E, of the Massachusetts General Laws, which allows school districts, with the approval of the Commonwealth's Department of Elementary and Secondary Education (DESE), to enter into intergovernmental agreements establishing cooperative public entities referred to as education collaboratives. READS operates under the control of a Board of Directors composed of superintendents from each of its 14 member districts. Although READS's primary purpose is to provide services to its member districts, under its Collaborative Agreement with DESE, it is also allowed to provide program services to other districts, as long as there is available capacity in the program. In addition to its own operations, READS is also affiliated with a not-for-profit organization called READS, Inc. (the Corporation). The Corporation is a nonprofit corporation established in 1974 that provides diagnostic and evaluations services to school districts served by READS. During the audit period, the Corporation employed approximately 13 individuals to perform its services, which include Medicaid-reimbursed diagnostic testing and evaluation services for school districts. Although READS and the Corporation are separate legal entities, they are housed in the same building and share a common Board of Directors and some staff members, including READS's Executive Director.

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor (OSA) has conducted an audit of certain activities of READS for the period July 1, 2008 through June 30, 2010. The scope of the audit included a review and examination of certain aspects of READS's fiscal and program operations during fiscal years 2009 and 2010. However, in some instances it was necessary to expand the audit period. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit objectives consisted of a determination of whether READS implemented effective internal controls over all aspects of its operations and an assessment of READS's business practices and its compliance with applicable laws, rules, and regulations, as well as the various fiscal and programmatic requirements of its state contracts.

Our audit identified as much as \$118,072 in excessive compensation provided to READS's Executive Director, as much as \$1,287,411 in questionable allocations of administration costs, a questionable loan totaling \$944,000 from READS to its related-party corporation, payment for which READS charged non-member school districts hundreds of thousands of dollars in additional fees, and accrued questionable surpluses in excess of \$3.4 million. In addition, as discussed in the Other Matters section of the report, the audit found that non-member school districts that are receiving services from READS lost the opportunity to save \$1,053,720 during the audit period by not joining the collaborative and that necessary improvements were being taken in DESE's oversight and monitoring of collaborative activities.

AUDIT RESULTS

6**1. AS MUCH AS \$118,072 IN EXCESSIVE COMPENSATION PROVIDED TO READS'S EXECUTIVE DIRECTOR IN VIOLATION OF THE STATE'S PENSION LAW**

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Chapter 32, Section 91, of the General Laws limits the amount of compensation a retired teacher or administrator can receive from a public sector employer such as an education collaborative. The audit revealed that since 2004, one individual has simultaneously functioned as the full-time Executive Director of both READS and the Corporation. This individual is a retired superintendent of the Carver public school system and, as such, must comply with the applicable requirements of Chapter 32. Prior to fiscal year 2008, the Executive Director was administering both agencies, but the majority of his compensation (88%) was paid by READS. However, the Executive Director told us that during fiscal year 2008, the Massachusetts Teachers Retirement System (MTRS) informed him that some of the compensation he was receiving from READS was in violation of the limits imposed by Chapter 32. Consequently, the Executive Director told us that he had reached a settlement agreement with the MTRS; however, he would not disclose to us the terms of this agreement. Subsequent to reaching this settlement agreement, beginning in fiscal year 2009, this individual took measures to have 100% of his compensation provided by the Corporation rather than by READS even though he continued to function as READS's Executive Director. Since the Corporation is a separate nonprofit entity, the Executive Director appears to have believed that this compensation arrangement would not represent a violation of Chapter 32. However, even though he charged all of his compensation expenses to the Corporation, these charges were inappropriate, since he also simultaneously administered READS. Moreover, because this individual continued to function as READS's Executive Director, his decision to have all of his compensation provided to him by the Corporation was clearly an attempt to circumvent the statutory limitations relative to this compensation established by Chapter 32. We estimate that the Executive Director received as much as \$118,072 in compensation that exceeded the amount allowed by statute during the audit period.

2. READS'S USE OF AN UNACCEPTABLE METHODOLOGY TO ALLOCATE \$1,287,411 IN ADMINISTRATIVE COSTS RESULTED IN INACCURATE FINANCIAL REPORTING AND QUESTIONABLE PENSION CONTRIBUTIONS

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Although READS and the Corporation are two legally separate entities, they share common staff and other operating expenses. In order to comply with generally accepted accounting principles and properly account for their organizational activities, each entity should have established adequate controls, including developing and utilizing an acceptable cost allocation plan to properly allocate their shared costs so that these costs are accurately reported in each organization's financial statements. The audit found, however, that during the audit period, READS did not use an acceptable method to allocate the cost of shared expenses between the two entities. Rather, 100% of the compensation provided to the Executive Director was charged to the Corporation, and 100% of all other shared administrative expenses were charged to READS. As a result of these issues, there is inadequate assurance that the financial statements issued by both entities during the period covered by the audit were accurate or that the percentage of shared expenses charged to READS and paid for by school districts that purchased

services from READS was reasonable and appropriate. In addition, the effect of this allocation methodology is that the state's pension liability for READS's shared staff could be inflated. Specifically, although at least six members of READS's administrative staff are working for the Corporation, their salaries are being paid by READS. Accordingly, these employees are receiving credit for 100% of their compensation for state retirement purposes.

3. QUESTIONABLE LOAN TOTALING \$944,000 FROM READS TO ITS RELATED-PARTY CORPORATION AND HUNDREDS OF THOUSANDS OF DOLLARS IN INAPPROPRIATE CHARGES TO NON-MEMBER SCHOOL DISTRICTS TO PAY FOR THIS LOAN

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As an educational collaborative, READS operates as a governmental entity and must ensure that all funds it receives are expended in accordance with applicable laws, rules, and regulations and for the purposes for which it was organized. During fiscal year 2000, READS provided its related party, the Corporation, with \$944,000 in funding to purchase a building that would house READS's Academy Program. The OSA's review of this transaction revealed several issues. First, there was no loan agreement executed between the two entities that detailed the specific terms of the loaned funds. As such, READS failed to establish adequate controls to ensure that these funds were properly safeguarded from loss, theft, or misuse. Second, during fiscal years 2001 through 2010, READS assessed non-member communities that received services from it additional fees totaling \$488,400 to help pay down the debt that the Corporation owed READS. These additional fees were not only unnecessary but represent an inappropriate use of tuition funds, since they only served to benefit the Corporation and did not provide any additional benefits to the non-member school districts. Finally, using public funds to provide a loan to a nonprofit charitable organization such as the Corporation appears to be contrary to the requirements of the "anti-aid" amendment (Article 46, as amended by Article 103 of the Articles of Amendment) of the Massachusetts Constitution, which prohibits the loan of public funds to nonprofit charitable organizations such as the Corporation for this purpose.

4. READS HAS ACCRUED EXCESSIVE SURPLUSES TOTALING OVER \$3.4 MILLION

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The Massachusetts Department of Revenue's Division of Local Services (DLS) and the state's Office of the Attorney General (OAG) have issued guidance relative to the amount of fees that governmental agencies such as READS can charge for their services. This guidance effectively states that the amount of fees that a governmental agency charges for services should not exceed the actual cost of providing these services. The audit found, however, that during the period covered by the audit READS was not following this guidance. Specifically, the method that READS uses in pricing its program services includes charging fees to non-member districts for services in excess of its actual costs of providing these services and in excess of the amount it agreed to charge non-member communities in its Collaborative Agreement with DESE. Further, the audit noted that READS does not follow an effective policy for reimbursing school districts for any excess revenues it accumulates. As a result, over a multi-year period, READS has accumulated a total fund balance of \$3,465,567 as of the end of fiscal year-end June 30, 2009, contrary to DLS and OAG guidance.

OTHER MATTERS

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1. NON-MEMBER SCHOOL DISTRICTS THAT ARE RECEIVING SERVICES FROM READS LOST THE OPPORTUNITY TO SAVE AT LEAST \$1,053,720 BY NOT BECOMING MEMBERS OF THE COLLABORATIVE

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According to READS’s Collaborative Agreement with DESE, one reason for the agency’s establishment was to provide programs and services that “maximize cost efficiency and program effectiveness through a collaborative effort.” However, according to READS’s Executive Director, no communities have joined the collaborative since 1994. Moreover, officials from several of the non-member school districts that send students to READS told us that they were unaware how to join the collaborative. In one instance, the Director of Pupil and Personnel Services of one non-member school district stated that several years ago his district inquired about joining the collaborative but was informed by READS’s Executive Director that there was a possible “equity buy-in fee” of approximately \$100,000 to join, which his district could not afford. READS charges non-member communities a higher rate (up to 23% more) for its program services than it does its members. Because of this, during the audit period READS provided services to 34 non-member communities that paid \$1,053,720 more for their services than they would have paid had they been members of READS. These funds could have been used by these non-member districts to fund additional educational services. Consequently, READS should consider conducting more formal outreach to non-member school districts, especially those that are currently purchasing services from the collaborative, to provide information on how to join the collaborative and the benefits that can be realized by districts through this membership.

2. DESE IS TAKING MEASURES TO IMPROVE ITS OVERSIGHT OF COLLABORATIVE ACTIVITIES

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The Department of Elementary and Secondary Education (DESE), the Commonwealth’s oversight agency for public primary and secondary education, has broad authority over and responsibility for activities of education collaboratives such as READS. On April 13, 2010, the Office of the State Auditor (OSA) issued Audit Report No. 2009-4515-3C, Independent State Auditor’s Report on Certain Activities of the Education Cooperative. This audit, which covered the period July 1, 2006 through February 28, 2010, found that DESE has not established policies and procedures to effectively monitor the activities of education collaboratives such as READS. Specifically, this audit identified that although DESE has been statutorily assigned certain oversight responsibilities relative to collaborative activities, it has not updated the Education Collaborative Policy that it developed for this purpose since 1988. As a result, this policy is significantly outdated, and many of the oversight provisions detailed in the policy are no longer being implemented. Consequently, DESE does not have effective monitoring, financial reporting, and auditing systems for education collaboratives; does not ensure that a representative from DESE attends or participates in each collaborative’s board meetings in an advisory capacity as required by state law; and has not adequately addressed issues regarding the applicability of various public school state laws and regulations to collaboratives. This condition has resulted in education collaboratives not being held to the same performance standards that apply to public school districts and charter schools within the Commonwealth. As part of the audit of READS, the OSA asked DESE

officials to provide information relative to any measures it had taken to address the concerns the OSA had previously raised relative to its monitoring of education collaboratives. In response to the request, DESE's Commissioner provided comments indicating that DESE is taking measures to address the OSA's concerns in this area. In this regard, DESE should continue to fully implement the recommendations made in audit report No. 2009-4515-3C, including making policy changes to implement effective monitoring, financial reporting, and auditing systems over education collaboratives and amending Chapter 40, Section 4E, of the General Laws to resolve existing uncertainties regarding DESE's authority to appropriately regulate and oversee the activities of education collaboratives.

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INTRODUCTION

Background

READS Collaborative (READS) was established in 1989 as a governmental organization under Chapter 40, Section 4E, of the Massachusetts General Laws, which allows school districts, with the approval of the Commonwealth's Department of Elementary and Secondary Education (DESE), to enter into intergovernmental agreements establishing cooperative public entities referred to as education collaboratives by stating, in part:

Two or more school committees of cities, towns and regional school districts may enter into a written agreement to conduct education programs and services which shall complement and strengthen the school programs of member school committees and increase educational opportunities for children.

READS operates under the control of a Board of Directors composed of superintendents from each of its 14 member districts (see Appendix A). Although READS's primary purpose is to provide services to its member districts, its Collaborative Agreement (Agreement) with DESE allows it to provide services to other districts as long as there is available capacity in the program. According to its Agreement, the purpose of READS is to provide the following services:

The Collaborative shall conduct and/or provide programs and/or services for, but not limited to, special needs children, needs assessment and recommendations, and in-service education.

In addition, the Collaborative shall provide diagnostic testing, evaluation, and recommendation in a variety of areas, including, but not limited to, medical, psychological, educational, audiological, ophthalmological, speech and language, and physical and occupational therapy.

Such programs and/or services shall maximize cost efficiency and program effectiveness through a collaborative effort.

During the period covered by the audit, READS specialized in the development of regional programs for school-age children with low-incidence handicapping conditions. A detailed description of the services offered to children by READS during the audit period appears in Appendix B. READS also conducts workshops and training programs through its Professional Development Program and offers several summer programs.

During the audit period, READS employed approximately 100 individuals, including part-time employees, during the regular school year and another approximately 100 temporary individuals during the summer. READS's revenue primarily comes from tuition payments charged to both

member and non-member school districts based upon a per-student, per-program basis. Certain services such as professional development may be directly charged by READS to individual educators. READS also receives funding from state and federal grants for specific purposes. A summary of the funding that READS received during the period covered by the audit appears in the table below:

Revenue Source	Fiscal Year 2009	Fiscal Year 2010¹
Tuition	\$5,213,822	\$5,461,470
Ancillary Income	468,325	579,470
Professional Development Income	46,879	26,851
Academy Assessment and Consultation Income	23,900	33,643
Governmental Revenue	88,579	0
Grants	14,747	181,525
Other Income	0	8,206
Interest Income	<u>60,046</u>	<u>36,926</u>
Total Revenue	5,916,298	6,328,091
Less - Credits Paid to Members ²	<u>(382,840)</u>	<u>(151,390)</u>
Revenue after Credits	<u>\$5,533,458</u>	<u>\$6,176,701</u>

In addition to its own operations, READS is also affiliated with a not-for-profit organization called READS, Inc. (the Corporation). The Corporation is a nonprofit corporation, established in 1974, that provides a variety of services, including diagnostic and evaluation services (see Appendix B) to communities served by READS. According to its Articles of Organization, the purpose of the Corporation is as follows:

To identify school age children who have special needs, diagnose and evaluate the needs of such children, and propose a special education program to meet those needs

During the audit period, the Corporation employed approximately 13 individuals to perform Medicaid-reimbursed diagnostic testing and evaluation services. In addition, the Corporation utilized the business office staff of READS to perform all of its administrative activities. According to its financial statements, during fiscal years 2008 and 2009, the Corporation realized revenues and profits as indicated in the table below:

¹ As fiscal year 2010 financial statements were not available during the time of our audit field work, this information is derived from READS's general ledger and is unaudited.

² Credits are surplus revenue from operations that can be remitted to member districts per board vote.

Revenue Source³	Fiscal Year 2008	Fiscal Year 2009
Program Service Fees	\$1,903,824	\$1,929,548
Clinic Credits Issued	(145,065)	(193,815)
Interest Income	13,560	3,140
Rental Income	<u>115,050</u>	<u>114,400</u>
Total Revenue	1,887,369	1,853,273
Total Expenses	<u>1,737,551</u>	<u>1,799,447</u>
Change in Net Assets	<u>\$149,818</u>	<u>\$53,826</u>
Total Net Assets ⁴	\$1,754,303	\$1,808,131

The Corporation is in the same building as READS's administrative office, which is at 105 East Grove Street, in Middleboro, and its Board of Directors consists of the same superintendents from the same school districts as READS.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor (OSA) has conducted an audit of certain activities of READS for the period July 1, 2008 through June 30, 2010. The scope of the audit included a review and examination of certain aspects of READS's fiscal and program operations during fiscal years 2009 and 2010. However, in some instances it was necessary to expand the audit period. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit objectives consisted of the following:

- Determine whether READS implemented effective internal controls over all aspects of its operations.
- Assess READS's business practices and its compliance with applicable laws, rules, and regulations, as well as the various fiscal and programmatic requirements of its state contracts.

³ This information was derived from the Corporation's fiscal year 2008 and 2009 Financial Statements – Statement of Activities.

⁴ Total Net Assets is equivalent to cumulative profits of the Corporation.

In order to achieve our objectives, we first assessed the internal controls established and implemented by READS over its operations. The purpose of this assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through READS's accounting system. We used this assessment in planning and performing audit tests. We then held discussions with READS officials and reviewed organization charts; internal policies and procedures; and all applicable laws, rules, and regulations. We also examined READS's financial statements, invoices, and other pertinent financial records to determine whether expenses incurred were reasonable; allowable; allocable; properly authorized and recorded; and in compliance with applicable laws, rules, and regulations.

During the audit, the scope of the OSA's review was limited by the refusal of READS and its related-party organization, the Corporation, to provide the audit team with certain requested documents. A scope limitation occurs when an auditee places restrictions on the scope of the auditor's work. These restrictions resulted in the inability to apply all the audit procedures considered necessary by the auditor in the circumstances of this engagement. The OSA is authorized by its enabling legislation, Chapter 11, Section 12, of the General Laws, to perform audits of governmental entities such as READS and the Corporation to "determine compliance with the provisions and requirements of the contract or agreement, the grant, and the laws of the commonwealth." This statute further mandates that "the state auditor shall have access to such accounts at reasonable times and said department [OSA] may require the production of books, documents, vouchers, and other records relating to any matter within the scope of such audit." Additionally, the Office of the Attorney General (OAG) determined in a letter dated January 14, 2005, that "since READS Inc. [the Corporation] is under common control with READS Collaborative, which is a public entity under chapter 40, section 4E, we must deem READS Inc. exempt from filing requirements as an arm of a state agency." However, within this letter exempting READS, Inc. from filing with the OAG's Public Charity Division, it was specifically noted that its "accounts are subject to audit by the State Auditor's Office."

Despite these statutory requirements and the aforementioned determination made by the OAG, during the conduct of the audit fieldwork, READS refused to make some of the records requested available to the audit staff. Specifically, READS would not provide the OSA with any documentation relative to the compensation provided to an individual who was simultaneously serving as the Executive Director of both READS and the Corporation. Therefore, the ability to

perform sufficient audit testing in this area was impaired, and the audit results and opinions expressed in this report are based solely on the information that the OSA was able to obtain from READS.

The audit was not made for the purposes of forming an opinion on READS's financial statements. The audit also did not assess the quality and appropriateness of all program services provided by READS. Rather, the report is intended to report findings and conclusions on the extent of READS's compliance with applicable laws, rules, regulations, and contractual agreements, and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

At the conclusion of the audit, a draft copy of the entire report was provided to READS and a draft copy of the "Other Matters" section of the report was provided to DESE officials for their review and comments. The report was modified as necessary based on the comments provided by both of these entities.

On September 23, 2010, READS's Board of Directors unanimously voted to dissolve the Corporation.

Our audit identified as much as \$118,072 in excessive compensation provided to READS's Executive Director, as much as \$1,287,411 in questionable allocations of administration costs, a questionable loan totaling \$944,000 from READS to its related-party corporation, payment for which READS charged non-member school districts hundreds of thousands of dollars in additional fees, and accrued questionable surpluses in excess of \$3.4 million. In addition, as discussed in the Other Matters section of the report, the audit found that non-member school districts that are receiving services from READS lost the opportunity to save \$1,053,720 during the audit period by not joining the collaborative and that necessary improvements were being taken in DESE's oversight and monitoring of collaborative activities.

AUDIT RESULTS

1. AS MUCH AS \$118,072 IN EXCESSIVE COMPENSATION PROVIDED TO READS'S EXECUTIVE DIRECTOR IN VIOLATION OF THE STATE'S PENSION LAW

Chapter 32, Section 91, of the Massachusetts General Laws limits the amount of compensation a retired teacher or administrator can receive from a public sector employer such as an education collaborative. The audit revealed that since 2004, one individual has simultaneously functioned as the full-time Executive Director of both the READS Collaborative (READS) and its affiliated not-for-profit organization, READS, Inc. (the Corporation). This individual is a retired superintendent of the Carver public school system and, as such, must comply with the applicable requirements of Chapter 32. Prior to fiscal year 2008, the Executive Director was administering both agencies, but the majority of his compensation (88%) was paid by READS. However, the Executive Director told us that during fiscal year 2008, the Massachusetts Teachers Retirement System (MTRS) informed him that some of the compensation he was receiving from READS was in violation of the limits imposed by Chapter 32. Consequently, the Executive Director told us that he had reached a settlement agreement with the MTRS, but would not disclose to us the terms of this agreement. Subsequent to reaching this settlement agreement, beginning in fiscal year 2009, he took measures to have 100% of his compensation provided to him by the Corporation rather than by READS even though he continued to function as READS's Executive Director. Since the Corporation is a separate nonprofit entity, the Executive Director appears to have believed that this compensation arrangement would not represent a violation of Chapter 32. However, even though he charged all of his compensation expenses to the Corporation, these charges were inappropriate since he also simultaneously administered READS. Moreover, because this individual continued to function as READS's Executive Director, his decision to have all of his compensation provided to him by the Corporation was, in the OSA's opinion, clearly an attempt to circumvent the statutory limitations relative to this compensation established by Chapter 32. The OSA estimates that the Executive Director received as much as \$118,072 in compensation that exceeded the amount allowed by this statute during the audit period.

According to Chapter 32, Section 91, of the General Laws, a teacher or administrator who is receiving a retirement allowance is limited to a maximum of 960 hours of employment in the public sector in any calendar year. In addition, according to this statute, the salary that the

person receives from this position, when added to his or her retirement allowance, cannot exceed the salary that is currently being paid for the position from which he or she retired. Further, on January 12, 2004, the Public Employee Retirement Administration Commission (PERAC) issued the following guidance to all retirement boards that specifically states that retirees may not avoid the state's salary limitations by forming a company to make the salary payments:

[Chapter 32, Section] 91 applies to any public employment regardless of whether or not it occurs in the same governmental unit from which the employee retired A retiree may not avoid the limitations in [Chapter 32, Section] 91 by forming a company if the primary reason for the formation is to avoid the limitations.

As noted in the Background section of this report, READS and the Corporation share common administrative staff, including the same Executive Director, who has been employed by both organizations since September 2004. According to the Executive Director, he and the other business office personnel are responsible for all of READS's and the Corporation's administrative functions. Further, the Executive Director's written job description states, "the Executive Director is the chief administrative officer of the Board of Directors for READS Collaborative and R.E.A.D.S., Inc. [the Corporation]." The audit also found that the Executive Director is a retired superintendent of the Carver Public School System who, beginning on June 30, 2003, has been collecting a retirement pension of approximately \$89,000 per year from the Massachusetts Teachers Retirement System (MTRS). Because the Executive Director is collecting a retirement pension from the MTRS, he is subject to the limitations on the compensation he can receive from either READS or the Corporation by Chapter 32, Section 91, of the General Laws.

During the audit, the OSA attempted to determine the allowable amount of compensation the Executive Director could be paid by READS and/or the Corporation in order to comply with the requirements of Chapter 32. In order to do this, the OSA first contacted the Chief Operations and Financial Officer of the Carver public school system, who stated that the compensation of the district's superintendent was \$138,553 and \$131,626 in fiscal years 2009 and 2010, respectively. As previously noted, neither READS nor the Corporation would provide us with documentation (e.g., IRS W-2 Forms) that substantiated the amount of compensation that the Executive Director received from the Corporation during the audit period. However, the OSA's examination of the budgets approved by READS's Board of

Directors revealed that the budgeted salary for the Executive Director that was to be paid by the Corporation was at least \$103,572 and \$106,679 for fiscal years 2009 and 2010, respectively. In addition, because the Executive Director did not maintain records (e.g., timesheets) that indicated the amount of time he spent working for each entity, it was not possible to determine the amount of time, if any, that the Executive Director spent performing services related to the Corporation. Consequently, our analysis of the allowable maximum compensation that the Executive Director should have been paid as detailed below is limited and is based solely on the information obtained from MTRS and READS records and from the information provided verbally by the official from the Carver public school system.

	School Year	
	2009	2010
Salary of Carver Superintendent	\$138,553	\$131,626
Retirement Funds Received	\$89,000	\$89,000
Maximum Compensation Allowed per Statute	\$49,553	\$42,626
Estimated Actual Salary Received	\$103,572	\$106,679
Estimated Unallowable Compensation	\$54,019	\$64,053

Prior to fiscal year 2009, READS's and the Corporation's common administrative expenses were charged to each entity based on an allocation plan in which 88% of the common staff payroll expenses, including those of the Executive Director, were charged to READS. However, beginning in fiscal year 2009, the Executive Director's compensation was charged solely to the Corporation, even though he continued to function as both READS's and the Corporation's Executive Director. According to the Executive Director, this change occurred because during fiscal year 2009, the MTRS reviewed his compensation from READS and found that it was in violation of Chapter 32, Section 91, of the General Laws. According to the Executive Director, he reached an agreement with the MTRS regarding this matter. Consequently, subsequent to this date, the Executive Director charged all of his compensation expenses to the Corporation rather than READS, apparently believing that this was appropriate. During the audit, the OSA attempted to verify the Executive Director's assertion of the agreement he claims to have made with the MTRS, but he would not provide us with a copy of his settlement agreement.

However, even after the Executive Director was found to be in violation of the requirements of Chapter 32, he continued to receive compensation that exceeded the limitations imposed by law, since the primary reason that READS began paying all of his compensation through the Corporation was to avoid the limit imposed by the statute.

Recommendation

In order to address the OSA's concerns relative to this matter, MTRS should review the compensation provided to the Executive Director by READS and the Corporation during and subsequent to the period covered by the audit and determine what portion of this compensation was not allowable in accordance with Chapter 32, Section 91, of the General Laws. Based on this review, READS, in conjunction with the MTRS and the Executive Director, should take the necessary measures to resolve this matter. In the future, READS should ensure that it fully complies with the requirements of this statute.

Auditee's Response

In response to this issue, a representative from a law firm representing READS and the Corporation provided the following comments, which are excerpted below:

As you are aware, this matter of excess compensation was reviewed extensively by MTRS. They reviewed calendar years 2003 thru 2009 (7 calendar years) which covered over \$634,000 in compensation to the Executive Director. The MTRS concluded, according to the statutory framework, that only \$28,570 in excess compensation was paid to [the Executive Director] over that 7 year period of time. It was determined that there was an excess because MTRS decided 50% of [the Executive Director's] salary was attributable to work undertaken for the Collaborative, whereas [the Executive Director] maintained only 35% of his time, energy and, consequently, salary was properly allocated. . . .

Your audit only covered two years and included ½ of 2010 which was not reviewed by MTRS. The audit conclusion of \$118,072 is incorrect.

The representative from the law firm also provided a table that showed his calculations and concluded that the collaborative's Executive Director does not owe any repayments to the MTRS for the period of time covered by the audit. In regard to this table, the representative from the law firm stated, in part:

This information is derived from . . . W-2s, 1099-R's, a printout from the MTRS showing retirement disbursements, and an email from the Payroll Administrative Assistant relative to the Carver Superintendent's Fiscal Year Contract. . . . It should also be noted, pursuant to the decision of the MTRS, that only a MAXIMUM of 50% of [the Executive

Director's] Fiscal Year salary at the Collaborative should be taken into account when calculating excess benefit as the non-profit Corporation was deemed wholly private and not subject to the earnings restrictions in Chapter 32. It was also determined by MTRS that [the Executive Director] did not spend more than 50% of his time on work for the Collaborative. Thus . . . there was no excess benefit during this period. . . .

The figures show that since half of the Executive Director's time was spent working for the private Corporation, there was no excess benefit.

Auditor's Reply

The report acknowledges that the MTRS appeared to have reviewed the compensation provided to the Executive Director during a period of time prior to that covered by the audit. However, we found that there was still an issue with the compensation that the Executive Director was receiving during the audit period. As previously noted, the Executive Director's assertion that he had reached a settlement agreement with the MTRS could not be verified because, despite repeated requests, he would not provide the OSA with any information regarding this purported settlement. Further, as previously noted, despite the determination made by the OAG that the OSA has the authority to audit the records of the Corporation, during the conduct of the audit fieldwork, READS refused to provide the OSA with any documentation relative to the compensation provided to the Executive Director by the Corporation. Therefore, the ability to perform sufficient audit testing in this area was impaired, and the audit results and opinions expressed in this report are based solely on the information that the OSA was able to obtain from READS. Since the information provided by the representative from the law firm on behalf of READS was not provided to us during the audit, the OSA cannot comment on it since there was no opportunity to review and assess the accuracy of this information during the conduct of audit field work.

The OSA disagrees with the assertion made by the representative from the law firm representing READS that it was incorrect for us to state that as much as \$118,072 in compensation provided to the Executive Director was in violation of the state's pension laws. This assertion is based on the representative's claim that the Executive Director spent 50% of his time working at each agency. However, for us to assume such a division of labor is reasonable would be contrary to all the information that the OSA was able to obtain during the audit. Specifically, prior to 2009, the allocation of the Executive Director's salary as approved by READS's board was 88% for READS and 12% for the Corporation. According to the minutes of READS's board meetings, this calculation was based upon a methodology approved by the board in what they thought

accurately reflected “personnel needs, student population, related payroll expenses, and other expenses.”⁵ Accordingly, the allocation of the Executive Director’s time in this manner seems more reasonable than the 50% suggested by the representative of the law firm given that READS received over three times the revenue that was received by the Corporation and employed almost eight times the number of staff. Moreover, as noted in this report, READS’s administrative staff, including the Executive Director, do not maintain any time and attendance records that document the time they worked for each entity. Therefore, any assertion that the Executive Director spent 50% of his time working for the Corporation is unfounded and unsupported. Of particular concern is that beginning in fiscal year 2009, the Executive Director took measures to have 100% of his compensation provided to him by the Corporation rather than by READS even though he continued to function as READS’s Executive Director. As noted in the report, the Corporation, although a separate legal entity, is under the control of READS through the same board members and Executive Director. Because this individual continued to function as READS Executive Director, his decision to have all of his compensation provided to him by the Corporation, over which he had control, was clearly an attempt to circumvent the statutory limitations relative to this compensation established by Chapter 32 and is a matter that should be reviewed by the MTRS. Therefore, the OSA again strongly recommends that the MTRS review the compensation provided to the Executive Director by READS and the Corporation during and subsequent to the period covered by the audit and determine what portion of this compensation was not allowable in accordance with Chapter 32, Section 91, of the General Laws.

2. READS’S USE OF AN UNACCEPTABLE METHODOLOGY TO ALLOCATE \$1,287,411 IN ADMINISTRATIVE COSTS RESULTED IN INACCURATE FINANCIAL REPORTING AND QUESTIONABLE PENSION CONTRIBUTIONS

Although READS and the Corporation are two legally separate entities, they share common staff and other operating expenses. In order to comply with generally accepted accounting principles (GAAP) and properly account for their organizational activities, each entity should have established adequate controls, including developing and utilizing an acceptable cost allocation plan to properly allocate their shared costs so that these costs are accurately reported in each organization’s financial statements. However, during the audit period READS did not

⁵ Quote is derived from READS Collaborative Board Approved Operating Budget Administrative Allocation section, which states, in full: “the administrative budget is allocated to programs based on a complex formula which is based on the program’s personnel needs, student population, related payroll expenses, and other expenses.”

use an acceptable method to allocate the cost of the shared expenses between the two entities. Rather, 100% of the compensation provided to the Executive Director was charged to the Corporation, and 100% of all other shared administrative expenses was charged to READS. As a result of these issues, there is inadequate assurance that the financial statements issued by both entities during the period covered by the audit were accurate or that the percentage of shared expenses charged to READS and paid for by school districts that purchased services from READS was reasonable and appropriate. In addition, the effect of this allocation methodology is that the state's pension liability for READS's shared staff could be inflated. Specifically, although at least six members of READS's administrative staff are working for the Corporation, their salaries are being paid by READS. Accordingly, these employees are receiving credit for 100% of their compensation for state retirement purposes.

As noted in the Background section of this report, although READS and the Corporation are two separate entities, they share common expenses including staff expenses. Because of this, in accordance with GAAP, each entity should establish controls to ensure that all shared expenses are properly identified, recorded, and reported. In order to meet this requirement, READS and the Corporation should have developed an acceptable cost allocation methodology to determine how to allocate the costs of their shared expenses. Such a methodology should be documented and reasonable, based on studies of the actual usage of the shared resources. An effective cost allocation methodology is necessary to ensure that all costs are appropriately recognized in READS's budgeting and pricing processes and reported accurately and completely in each organization's financial statements. According to READS's records, during the period of the audit, the common or shared expenses that were incurred with the Corporation are as follows:

Description	Fiscal Year 2009	Fiscal Year 2010
Payroll and Related Expenses	\$ 475,331	\$ 457,436
Liability Insurance	37,998	43,164
Other Expenses	<u>134,868</u>	<u>138,614</u>
Total	<u>\$648,197</u>	<u>\$639,214</u>

According to information maintained by READS, administrative expenses that are shared between itself and the Corporation are to be allocated to each entity based on an established cost allocation plan. According to this plan, these expenses are to be allocated between the two

entities as follows: payroll and related expenses by the number of employees working at each entity, liability insurance by the number of students being served by each entity, and all other expenses by the percentage of each entity's budgeted expenses versus the total budgeted expenses for both organizations for the fiscal year. However, READS did not follow this cost allocation methodology during the audit period. Rather, READS simply allocated 100% of the cost of the compensation provided to the Executive Director to the Corporation, while 100% of all other shared administrative expenses were paid for by READS. According to READS officials, this was done as a result of the MTRS ruling that the compensation that the Executive Director was receiving from READS was in violation of Chapter 32, Section 91, of the General Laws (see Audit Result No. 1). Therefore, in an effort to match the amounts that would have been charged to the two entities if the plan was followed, READS charged all of the shared non-payroll administrative expenses to READS.

It should be noted that even if READS followed its established cost allocation methodology, which it did prior to the period covered by the audit, the allocation of shared expenses would have been flawed, as follows:

- The allocation of expenses for shared administrative staff should have been based upon actual services rendered as derived from documents such as time sheets that document the actual time each staff person worked for each entity. However, the audit found that READS's administrative staff does not maintain any time and attendance records that document the time they worked for each entity. As a result, there is inadequate assurance that the amount of shared administrative staff compensation expenses that would have been allocated to each organization using this methodology would have been appropriate.
- The non-payroll expenditures shared between the two entities was to be allocated to each organization based on the percentage of each entity's budgeted expenses to the total budgeted expenses for both organizations. However, this method of allocation is flawed in that it is not based on any study of actual consumption of these resources and could result in READS paying for a disproportionate amount of these expenses. For example, during the two years covered by the audit, the Corporation only budgeted expenses of \$856,668, which would have resulted in it only paying for 14% of the non-payroll shared expenses. However, according to the Corporation's financial statements, it actually incurred expenses totaling \$1,799,447 in fiscal year 2009 and \$1,737,551 in fiscal year 2008. If these entities used actual expenses as a basis for the allocation of these expenses, the Corporation would have paid for approximately 25% of these expenses rather than the 14% that it would have been allocated using this methodology.

In addition to the financial results of each entity's activities being misstated, the effect of this allocation methodology is that the state's pension liability for READS's shared staff may be inflated. Specifically, although at least six members of READS's administrative staff are working for the Corporation, their salaries are being paid by READS. Accordingly, these employees are receiving credit for 100% of their compensation for state retirement purposes. As previously noted, READS's administrative staff do not maintain time and attendance records that identify when and where they worked. Consequently, it was not possible to accurately calculate the amount of compensation provided to these six staff members during the audit period that should not have been included in their retirement calculations.

Recommendation

READS should take the necessary measures to ensure that all shared expenses between itself and the Corporation are properly identified, classified, recorded, and reported in an accurate manner in accordance with GAAP. Further, in the future READS should take measures to ensure that the pension contributions of any shared staff are accurately calculated and provided to the MTRS.

Auditee's Response

In response to this issue, READS provided comments, which are excerpted below:

The administrative cost of the executive director's salary was found by MTRS Hearing officer . . . , MTRS Deputy Counsel, to be equally shared at fifty percent for the Collaborative and fifty percent for the Corporation. The MTRS hearing decision did not occur until after the fiscal year's budget had been determined. The fifty percent amount was not initially reflected in the Collaborative budget. That has been corrected, and the Collaborative budget identifies fifty percent of the executive director's salary as determined by MTRS. The review of [the Executive Director's] salaries by MTRS covered years 2003 through 2009. It should be noted that MTRS does not use fiscal years but an annual January through December year frame to identify salary. The salary of [the Executive Director] follows the decision rendered by MTRS and is within the salary guidelines identified by MTRS, with NO EXCESS SALARY EARNED for the 2010 year and within the earning limits for 2011. Any issues identified in this area have been addressed by MTRS and have been adjusted to fall within the allowable earning guidelines. . . .

For fiscal year 2011, READS has taken the necessary measures to ensure that all shared expenses between itself and the Corporation are properly identified, classified, recorded, and reported in accordance with GAAP. On September 23, 2011 the R.E.A.D.S., Incorporated Board of Directors voted to dissolve the Corporation as of June 30, 2011, thus making this a non issue after fiscal year 2011. The Board Attorney . . . has taken the legal steps to ensure the dissolution will take place as of July 1, 2011.

The initial organization of the two entities, READS Collaborative and R.E.A.D.S., Inc. in 1989 and how to handle employees who worked for the original R.E.A.D.S., Inc. was determined by legal counsel

Every year since the Collaborative was formed, to date, each employee has been appointed annually by the Board of Directors of READS Collaborative.

Auditor's Reply

As noted in the report, contrary to the requirements of GAAP, during the audit period, READS did not use an acceptable method to allocate the cost of the shared expenses between the two entities. Rather, 100% of the compensation provided to the Executive Director was charged to the Corporation, and 100% of all other shared administrative expenses were charged to READS. As a result of these issues, there is inadequate assurance that the financial statements issued by both entities during the period covered by the audit are accurate and complete or that the percentage of shared expenses charged to READS and paid for by school districts that purchased services from READS was reasonable and appropriate.

In its response, READS implies that the allocation methodology in question was used because the MTRS's hearing decision regarding how the Executive Director's salary was to be allocated did not occur until after the fiscal year's budget had been determined. However, this assertion is without merit, since the MTRS's decision was relative to the Executive Director's pension and has no bearing on READS's responsibility to develop appropriate accounting methods, including an acceptable cost allocation methodology, in order to ensure that its financial records are maintained in accordance with GAAP. In this regard, READS is clearly responsible for establishing and maintaining an acceptable cost allocation plan relative to its operations. Such a methodology should be documented, reasonable, and based on studies of the actual usage of the shared resources. An effective cost allocation methodology is necessary to ensure that all costs are appropriately recognized in READS's budgeting and pricing processes and are reported accurately and completely in each organization's financial statements. Further, as previously noted, during the audit period READS changed its cost allocation methodology in what appears to be an attempt to circumvent the requirements of Chapter 32, Section 91, of the General Laws. Consequently, the OSA disagrees with READS's assertion that no excess salary was paid to the Executive Director.

In its response, READS does not comment on the audit's concern that the state's pension liability for READS's shared staff could be inflated. Specifically, although at least six members of READS administrative staff were working for the Corporation, their salaries were being paid by READS. Accordingly, the OSA reiterates that these employees inappropriately received credit for 100% of their compensation for state retirement purposes.

The OSA agrees with READS's assertion that the allocation of costs between the two entities will no longer be an issue once the Corporation is dissolved, as planned. However, this point does not mitigate the fact that during the period covered by the audit the financial statements of the two entities may have been misstated and that the state's pension liability for READS's shared staff may be inflated. Clearly, READS should take the measures necessary to ensure both that its financial statements are correctly reported and that its state pension liabilities are correctly calculated and reported for the period covered by the audit.

3. QUESTIONABLE LOAN TOTALING \$944,000 FROM READS TO ITS RELATED-PARTY CORPORATION AND HUNDREDS OF THOUSANDS OF DOLLARS IN INAPPROPRIATE CHARGES TO NON-MEMBER SCHOOL DISTRICTS TO PAY FOR THIS LOAN

As an educational collaborative, READS operates as a governmental entity and must ensure that all funds it receives are expended in accordance with applicable laws, rules, and regulations and for the purposes for which it was organized. During fiscal year 2000, READS provided its related party, the Corporation, with \$944,000 in funding to purchase a building that would house READS's Academy Program. The OSA's review of this transaction revealed several problems. First, there was no loan agreement executed between the two entities that detailed the specific terms of the loaned funds. As such, READS failed to establish adequate controls to ensure that these funds were properly safeguarded from loss, theft, or misuse. Second, during fiscal years 2001 through 2010, READS assessed non-member communities that received services from it additional fees totaling \$488,400 to help pay down the debt that the Corporation owed READS. These additional fees were not only unnecessary but represented an inappropriate use of tuition funds, since they only served to benefit the Corporation and did not provide any additional benefits to these non-member school districts. Finally, using public funds to provide a loan to a non-profit charitable organization such as the Corporation appears to be contrary to the requirements of the "anti-aid" amendment (Article 46, as amended by Article 103 of the Articles

of Amendment) of the Massachusetts Constitution, which prohibits the loan of public funds to non-profit charitable organizations such as the Corporation for this purpose.

On July 29, 1999, the Corporation's Board of Directors elected to purchase a property located at 101 East Grove Street in Middleboro for \$725,000.⁶ Listed below are excerpts from the Corporation's board meeting on this date relative to this transaction.

The Executive Director recommends the purchase of the property located at 101 East Grove Street, Middleboro for the amount of \$725,000. Motion was made by [name of board member] and Seconded by [name of board member] to approve the purchase of this property for the amount of \$725,000.

The Executive Director recommends that READS, Inc. [the Corporation] accept the amount of \$420,000 from READS Collaborative as rent. A Motion was made by [name of board members] and seconded by [name of board member] to approve this recommendation.

Even though this property was being purchased by the Corporation, it was going to be used to house READS's Academy Program. On this same date, READS's Board of Directors voted to loan funds to the Corporation so that it could purchase this property. The specific board minutes relative to this transaction follow:

The Executive Director recommends restricting \$420,000 from the fund balance to pay READS Inc. for future rent. A Motion was made by [name of board member], Seconded by [name of board member], to approve the recommendation of the Executive Director to restrict \$420,000 for the fund balance to pay READS Inc. for future rent.

In addition, the Executive Director requests authorization to transfer funds to READS Inc. on an as-needed basis, not to exceed \$475,000, as rent. A Motion was made by [name of board member], Seconded by [name of board member], to authorize the Executive Director to transfer funds to READS Inc. on an as-needed basis, not to exceed \$475,000, as rent.

The audit reviewed the documentation READS was maintaining relative to this transaction and noted a number of issues. First, READS never entered into any type of formal written loan agreement with the Corporation relative to these funds that specifically established the terms and conditions of the loan including charging any interest on the loaned funds. Consequently, READS failed to properly ensure that the public funds that were used to purchase this building were properly safeguarded against lost, theft, or misuse.

⁶ This amount was verified by the records maintained at the Registry of Deeds.

Second, the Corporation's debt to READS was paid by allowing READS to operate its Academy Program in this facility for an annual rental fee that was not actually paid by READS but rather was credited against the outstanding balance that the Corporation owed READS for this loan. The written lease agreement between the two entities established an annual rent of \$60,250. However, the audit identified that there were also additional amounts being reduced from the loan obligation of the Corporation. When asked to explain the nature of these additional payments, READS officials stated that a \$1,200 annual increase in tuition per non-member student was decided upon and approved by the Board of Directors on April 13, 2000. According to the minutes of this Board of Directors meeting, the purpose of the higher rate was "to help fund the cost of the newly purchased building at 101 East Grove St." The information relative to this loan and the additional fees that READS assessed to non-member districts that was provided to us by READS's Business Manager is summarized below:

Fiscal Year	Loaned to Corporation*	Rent Credit*	Additional Non-Member Assessment*
2000	\$800,300	-	-
2001	143,700	\$30,412	\$23,100
2002	-	69,526	26,400
2003	-	60,250	32,100
2004	-	30,000	49,200
2005	-	30,000	55,800
2006	-	30,000	55,800
2007	-	30,000	84,000
2008	-	60,250	76,200
2009	-	60,250	45,300
2010	-	<u>60,250</u>	<u>40,500</u>
Totals	<u>\$944,000</u>	<u>\$460,938</u>	<u>\$488,400</u>
Total Loaned to Corporation	\$944,000		
Total Repaid to Corporation	\$949,338		

* The information in this table was provided to us by READS's Business Manager and is unaudited.

Since the rental amount READS was to credit against the loan it had made to the Corporation had already been contractually agreed to in a formal lease agreement, clearly the additional

charges that READS assessed to its non-member communities were unnecessary and also represented an inappropriate use of tuition fees, since they only served to benefit the Corporation and did not provide any additional benefits to these non-member school districts.

Finally, READS was established under Chapter 40, Section 4E, of the General Laws as an education collaborative “to conduct education programs and services which shall complement and strengthen the school programs of member school committees and increase educational opportunities for children.” In addition to state finance laws, as a governmental entity, READS is also required to comply with the requirements of the Massachusetts Constitution. In this regard, the “anti-aid” amendment to the Massachusetts Constitution (Article 46, as amended by Article 103 of the Articles of Amendment) prohibits the use of public funds or property “for the purpose of founding, maintaining or aiding any infirmary, hospital, institution, primary or secondary school, or charitable or religious undertaking” that is not publicly owned and controlled, by stating as follows:

No grant, appropriation or use of public money or property or loan of credit shall be made or authorized by the Commonwealth or any political subdivision thereof for the purpose of founding, maintaining or aiding any infirmary, hospital, institution, primary or secondary school, or charitable or religious undertaking which is not publicly owned and under the exclusive control, order and supervision of public officers or public agents authorized by the Commonwealth or federal authority or both.

Since READS used public funds to make this loan to the Corporation, which is a nonprofit charitable organization, this transaction may not have been consistent with the requirements of this section of the Massachusetts Constitution.

The OSA discussed this matter with READS’s Executive Director and Business Manager, who stated that the Corporation, rather than READS, purchased the building because READS officials believed that at the time the building was purchased, collaboratives may not have been allowed to own property. The Executive Director also stated that purchasing the building through the Corporation allowed READS to avoid the public bidding process that it would have been required to complete if it were purchased by the collaborative. It should be noted that on August 10, 1995, well before the Corporation purchased this building during fiscal year 2000, Chapter 40, Section 4E, was amended to allow collaboratives such as READS to own land, buildings, and equipment.

Recommendation

In order to address the OSA's concerns relative to this matter, the Corporation should immediately transfer at no cost to READS the property in question. Further, READS should return to the non-member communities the additional fees totaling \$488,400 that were assessed to them that READS used to help the Corporation pay for this property. In the future, READS should take measures to ensure that all agreements that it enters into are formally documented in writing and approved by its Board of Directors and that it does not assess any fees that are not consistent with its Collaborative Agreement with DESE.

Auditee's Response

In response to this issue, READS provided comments, which are excerpted below:

The audit report repeatedly identifies that nonmembers were charged to pay for the loan; however, it does not clarify that member districts also were charged, in order to pay for the loan, by the use of credits that would have gone back to them. There is nothing illegal or inappropriate for the Collaborative to charge non members a fee for purchasing a structure that would benefit them by ensuring lower tuition fees, which is what owning our own building has done. As a matter of fact, we could have simply raised the tuition permanently to assist in paying the cost of the building but did not, and after the building was paid for, we actually have reduced the cost of tuition to non members.

The additional amount charged non members during the period of time the building loan was being paid was consistent with the Collaborative Agreement. The audit report only refers to the first section of non member surcharge (Article VI of the Collaborative Agreement) by stating it is identified as 15%; however, it also states, "...said surcharge to be reviewed annually by the Board." . . .The Board of Directors, at its publicly posted board meeting, reviewed the surcharge and voted to change the amount during the period of the building loan. . . . This was totally consistent with the Collaborative Agreement.

There is nothing to indicate that there is a need to return funds to non members since the vote of the Board of Directors was legal and beneficial to the non members as stated above.

Since the corporation will cease to exist after June 30, 2011, the property it currently owns, along with all assets, will be transferred to the Collaborative. Although a formal loan agreement was not executed between the two entities, adequate internal controls ensured that the funds at all times were properly safeguarded from loss, theft, and misuse. READS Collaborative as well as R.E.A.D.S., Inc. have independent Audits on an annual basis.

Auditor's Reply

The OSA acknowledges that members of READS were also charged for the cost of the purchase of the building in question. This was done through READS's budgetary process, whereby READS would include the cost of the rent it was going to credit against what the Corporation owed it on its loan in its budget and use this budget to establish the fees it would charge for its program services. However, the OSA's concern is that in addition to the fees that READS charged to its members and non-members, which already included sufficient funds to pay for the rental costs associated with the building, READS charged non-member communities additional fees to help pay for the cost of this building. In fact, during fiscal years 2001 through 2010, READS assessed non-member communities additional fees totaling \$488,400 to help pay down the debt that the Corporation owed READS. Since READS's established fees already included enough funds to pay for the rental expense associated with this building, these additional fees were unnecessary and represented an inappropriate use of tuition funds that only served to benefit the Corporation and did not provide any additional benefits to these non-member school districts. Clearly, the additional charges that READS only assessed to its non-member communities were not representative of costs of providing services as mandated by the regulations cited in this audit result. Since the Corporation, and not READS, owns the building for which READS provided the funding, the only benefit to these additional fees paid by non-members was to the Corporation.

READS's assertion that in addition to paying fees for its services, its members also paid for the cost of this building by forgoing credits that they would have received at the end of each year is misleading. READS's use of the term "credits" refers to the net income or profits that is available at the end of each year that it can distribute to its members. However, what READS fails to point out is that this net income is largely derived from the higher fees paid by its non-members, which it then redistributes to its members. Regardless of whether READS's board approved these fees, as noted in Audit Result No. 4 this pricing methodology for non-member districts is clearly not consistent with the terms of READS's Collaborative Agreement with DESE or with guidelines established by the Massachusetts Department of Revenue's Division of Local Services (DLS) or the OAG, since it is not based on the actual costs of providing these services. In practice, if READS were following DLS and OAG guidelines in terms of its fees, there would be no so-called "credits" available. Consequently, the OSA disagrees with READS

and reaffirms that the additional fees charged by READS to its non-member communities to pay for this building were excessive and should be refunded to the communities.

In its response, READS states “although a formal loan agreement was not executed between the two entities, adequate internal controls ensured that the funds at all times were properly safeguarded from loss, theft, and misuse.” However, this is not an accurate statement, given that there is no formal, written agreement between the two entities that clearly identifies and establishes the legal duties and responsibilities of both parties relative to the repayment of this debt. Since READS is a public agency, it has a fiduciary responsibility to the citizens of the Commonwealth to take all appropriate measures to ensure that public funds are properly safeguarded. By not establishing a legal loan agreement ensuring the repayment of over \$900,000 in public funds, READS did not fully meet this fiduciary responsibility. Moreover, entering a loan agreement that established a rate of interest to be paid by the Corporation on the loaned funds would have reduced the amount of fees that READS would have to have charged its member and non-member districts.

Finally, READS does not comment on the fact that this transaction may not have been consistent with the anti-aid amendment of the Massachusetts Constitution because public funds were used to make this loan to the Corporation, which is a nonprofit charitable organization. This matter should be investigated by DESE and other oversight agencies, as appropriate. If the transaction in question is found to represent a violation of this amendment, DESE should take the measures it deems necessary to resolve this matter, including issuing guidance to all collaboratives regarding the prohibition on these types of activities.

4. READS HAS ACCRUED EXCESSIVE SURPLUSES TOTALING OVER \$3.4 MILLION

DLS and the OAG have issued guidance relative to the amount of fees that governmental agencies such as READS can charge for their services. This guidance effectively states that the amount of fees that a governmental agency charges for services should not exceed its actual cost of providing the services. The audit found, however, that READS was not following this guidance during the audit period. Specifically, the method that READS uses in pricing its program services includes charging fees to non-member districts for services in excess of its actual costs of providing these services and in excess of the amount it agreed to charge non-member communities in its Collaborative Agreement with DESE. Further, the OSA noted that

READS does not follow an effective policy for reimbursing school districts for any excess revenues it accumulates. As a result, over a multi-year period, READS has accumulated a total fund balance of \$3,465,567 as of the end of fiscal year 2009, contrary to DLS and OAG guidance.

Municipal government agencies in Massachusetts have been advised on different occasions by DLS and the OAG that service fees may be used to offset the costs of providing services but may not be used to produce a surplus or profit in excess of the costs of the program, since to do so would constitute a constitutionally prohibited exaction. For example, on December 24, 2003, the then Massachusetts Attorney General responded to an inquiry from the Town Clerk of Bridgewater regarding the implementation of a fee by the town by stating, in part:

In approving the fees established in Article XXXXIII, we remind the town that fees cannot exceed the limits imposed on local government by the Constitution and the statutes of the Commonwealth. Valid fees are distinguishable from invalid taxes by three criteria: (i) the fee is assessed for a particular government service benefiting the party paying the fee in a manner not shared by other persons; (ii) the person assessed has the option to decline the service and thus avoid the charge; and (iii) the amounts paid compensate the town for its costs and expenses of providing the services rather than raising revenues. Emerson College v. Boston, 391 Mass. 415, 427-28 (1984). Moreover, a lawful fee is one that covers only the permit granting authority's reasonably anticipated costs of providing the services for which the fee is assessed. Southview Cooperative Housing Corp. v. Rent Control Board of Cambridge, 396 Mass. 395, 402 (1985)

Similar guidance has also been promulgated by the Commonwealth's Executive Office for Administration and Finance (EOAF) for use by state agencies. Specifically, EOAF Bulletin No. 6 states, in part:

Fees may not be used purely as a tool to raise revenue, but should reflect the government's expense in providing the service associated with the fee. Expenses may be defined as the reasonable costs imposed on an agency for providing a service or regulating an activity, including administrative and enforcement costs.

As noted in the Background section of this report, READS generates revenues through tuition charges paid by both member and non-member districts and, in some cases, by educators and parents. In addition, READS receives miscellaneous income through grants, contracts, and interest income generated by bank accounts and investments. During the audit, the OSA reviewed the process that READS used to establish the rates for its program services in its two largest programs, its Deaf and Hard of Hearing Program and its Academy Program. In these two programs, READS establishes its rates based upon budgeted expenditures, which are

calculated on a per-pupil basis for the anticipated usage by both members and non-member students. This rate calculation methodology appears to be consistent with DLS and OAG guidelines and is done through an established policy in READS's Collaborative Agreement that states, in part:

The assessment of cost to Members for Collaborative programs and services shall be determined on a per-pupil basis annually. Any programs, and/or services funded through Federal, State, or other non-member funding sources need not be assessed on a per-pupil basis.

Non-member school districts are also allowed to purchase READS's services in these two programs, and non-member tuitions totaled \$5,028,774 in these two programs during the audit period. However, non-member school districts are required to pay a surcharge over and above the member school district tuition, as authorized by READS's Collaborative Agreement with DESE, which states, in part:

There will be a fifteen (15) percent surcharge on a per-pupil basis for programs/services provided to non-member municipalities or districts, said surcharge to be reviewed annually by the Board.

During the audit, the OSA analyzed READS's charges for services rendered to both its member and non-member districts. The analysis revealed that READS was not complying with its Collaborative Agreement to charge a 15% flat rate surcharge for non-member districts but was instead charging its non-member school districts between 10.6% to 23.4% more than its member districts for its services, as shown in the following table:

<u>Annual Tuition Per Student</u>				
<u>Program</u>	<u>Non-Member</u>	<u>Member</u>	<u>Premium</u>	<u>Premium %</u>
Deaf and Hard of Hearing – 180 Day				
Level #1	\$33,660	\$28,080	\$5,580	19.9%
Level #2	\$38,520	\$32,940	\$5,580	16.9%
Level #1 BP ⁷	\$45,720	\$40,860	\$4,860	11.9%
Level #2 BP	\$50,580	\$45,720	\$4,860	10.6%
Level #3	\$67,320	\$58,680	\$8,640	14.7%
Academy – 180 Day				
Tuition	\$28,440	\$23,040	\$5,400	23.4%

⁷ These services are provided out of Bristol Plymouth (BP) Technical High School.

During the audit, the OSA discussed the discrepancy in rates with READS's Executive Director and Business Manager. These individuals stated that the 15% surcharge was only a guideline for determining the rates for non-member school districts and that the collaborative also takes into consideration such other factors as the amounts that other collaboratives are charging for these services. This pricing methodology for non-member districts is clearly not consistent with the terms of READS's Collaborative Agreement with DESE or with DLS or OAG guidelines, since it is not based on the actual costs of providing these services.

As a result of these questionable pricing arrangements, by the end of fiscal year 2009, READS had accumulated a total fund balance of \$3,465,567. According to READS officials, there is no formal written policy on the actual amount of profit that can be retained by the collaborative. However, these officials stated that during the November 1, 1994 meeting of its Board of Directors, the board approved maintaining a fund balance at a level equal to 60 days' worth of READS's operating expenses. READS officials stated that the collaborative has been following this policy since it was established by the board. However, the OSA's analysis of READS's fund balance revealed that the agency has actually not followed this policy, since it had accrued over \$2.5 million in excess of 60 days' worth of its operating expenses as of the end of fiscal year 2009, as shown in the following table:

Total Expenditures	\$5,620,094
Operating Expenses - 60 days	\$923,851
Fund Balance	\$3,465,567
Excessive Fund Balance	\$2,541,716

In addition, READS officials provided us with a memorandum from the agency's Executive Director to the collaborative's Business Manager dated September 15, 2006 that indicated READS would be allocating some of its excess revenues as a tuition credit to its member districts, which they indicated was a standing policy of the agency. The audit did note that during fiscal year 2009, READS issued tuition credits totaling \$382,840 to its member districts. However, it issued no such tuition credits to its non-member districts. Further, as indicated in the table above, this distribution which has already been subtracted from the amounts shown in the table, is clearly not consistent with the collaborative's stated policy to retain only 60 days' worth of operating expenses.

The OSA discussed this matter with READS's Executive Director and Business Manager, who acknowledged that the fund balance was currently well over the 60-day operating threshold set forth by READS's policy and agreed that the collaborative would take measures to address this issue.

Recommendation

READS should seek guidance from DLS and OAG in developing and implementing an acceptable revenue retention policy that is consistent with established guidelines. Further, READS, in conjunction with OAG and DLS, should develop procedures to make sure that member and non-member districts receive reimbursements from READS's fund balance in an equitable manner.

Auditee's Response

In response to this issue, READS provided comments, which are excerpted below:

READS has already taken the necessary steps to ensure current policy is followed.

On November 19, 2010 the Board of Directors voted:

- *To increase the monies retained (fund balance) to cover operating expenses of 120 days. (Approximately \$2.45 million)*
- *To return \$170,502 to member districts*
- *To return \$665,377 to member districts as tuition credits held from FY99, FY00, and FY01 to fund the purchase of READS Academy 101 East Grove Street, Middleboro, MA*
- *To retain \$185,000 to reduce the FY12 tuition increase for member districts*

The idea that non members should receive some type of reimbursement is not consistent with Board policy and lacks rationality. What benefit does a member have if non members receive all of the same benefits? The members of READS provide significant time and input into the operation of the Collaborative and have responsibilities that non members do not have.

Auditor's Reply

In its response, READS details measures it is taking to address the OSA's concerns relative to this matter. However, on several occasions during the audit, the OSA specifically recommended to READS officials that they seek guidance from DLS and OAG in developing and implementing an acceptable revenue retention policy that is consistent with established

guidelines. Since READS chose to address this matter on its own without seeking such guidance, the OSA cannot comment on whether the actions taken by READS to resolve this matter are appropriate. Further, the OSA disagrees with READS's assertion that it is not rational to recommend that member and non-member districts receive reimbursements from READS's fund balance in an equitable manner. In this case, "equitable" means in a process that is fair to all parties, not, as READS's response seems to indicate, in equal amounts. For example, as noted in the report, non-member school districts are required to pay READS a surcharge over and above the member school district tuition, as detailed in READS's Collaborative Agreement with DESE, which states, in part:

There will be a fifteen (15) percent surcharge on a per-pupil basis for programs/services provided to non-member municipalities or districts, said surcharge to be reviewed annually by the Board.

However, during the audit, the OSA analyzed READS's charges for services rendered to both its member and non-member districts. The OSA's analysis revealed that READS was not complying with its Collaborative Agreement to charge a 15% flat rate surcharge for non-member districts but was instead charging its non-member school districts 10.6% to 23.4% more than its member districts for its services. So one example of an equitable distribution to non-member districts would be to reimburse them for any amounts they were charged over and above this 15%. Since this is the amount established in READS's Collaborative agreement, which has been adopted by its board, it would be consistent with board policy. Moreover, it is important to point out that, notwithstanding any distribution of profits, READS members still clearly benefit from paying lower fees for services than non-members.

OTHER MATTERS

1. **NON-MEMBER SCHOOL DISTRICTS THAT ARE RECEIVING SERVICES FROM READS LOST THE OPPORTUNITY TO SAVE AT LEAST \$1,053,720 BY NOT BECOMING MEMBERS OF THE COLLABORATIVE**

According to READS's Collaborative Agreement with DESE, one reason for the agency's establishment was to provide programs and services that "maximize cost efficiency and program effectiveness through a collaborative effort." However, according to READS's Executive Director, no communities have joined the collaborative since 1994. Moreover, officials from several of the non-member school districts that send students to READS told us that they were unaware how to join the collaborative. In one instance, the Director of Pupil and Personnel Services of one non-member school district stated that several years ago his district inquired about joining the collaborative but was informed by READS's Executive Director that there was a possible "equity buy-in fee" of approximately \$100,000 to join, which his district could not afford. READS charges communities that are non-members of the collaborative a higher rate (up to 23% more) for its program services than it does its member districts. Because of this, during the audit period READS provided services to 34 non-member communities that paid \$1,053,720 more for their services than they would have paid had they been members of READS. These funds could have been used by these non-member districts to fund additional educational services. Consequently, READS should consider conducting more formal outreach to non-member school districts, especially those that are currently purchasing services from the collaborative, to provide information on how to join the collaborative and the benefits that can be realized by districts through this membership.

Chapter 40, Section 4E, of the General Laws requires collaborative such as READS to establish how communities can become members of collaborative, by stating, in part:

The written agreement which shall form the basis of the education collaborative shall set forth...the procedure for admitting new members.

In order to comply with this requirement, READS's Collaborative Agreement with DESE states the following:

Any school committee of any area city, town, or regional school district may apply for membership to the Collaborative by giving written notice of such request to join to the attention of the Chairman of the Board. Such written request shall be brought before the Board for discussion and action. The request will be reviewed, and a decision will be rendered within approximately

sixty (60) days of the receipt of the written request to become a member. A new member may be accepted only by the unanimous vote of the entire Board, subject to the approval of the Member school committees and by acceptance of this Agreement by the new member. New memberships shall take effect only at the beginning of a fiscal year. Notice of the admission of a new member will be provided to the Commissioner of Education through the appropriate regional education center thirty (30) days prior to the effective date of the admission of the new member.

According to READS's Executive Director, no school district has either requested or been accepted by READS for membership into the collaborative since Carver was granted membership in 1994. As previously noted, READS charges its non-member school districts higher fees (up to 23% higher) for its services. As a result, the OSA determined that the non-member districts being served by READS could have saved over \$1 million during the audit period alone if they had been members of the collaborative, as detailed in the table below:

Non-Member District Total Student Enrollment and Potential Savings

School District	Fiscal Year 2009		Fiscal Year 2010		Total	
	Students	Potential Savings	Students	Potential Savings	Students	Potential Savings
Plymouth	11	\$60,120	14	\$76,500	25	\$136,620
Fall River	10	54,360	13	70,920	23	125,280
Acushnet	7	37,980	9	48,780	16	86,760
Norton	9	49,140	6	32,940	15	82,080
Brockton	6	32,760	6	32,760	12	65,520
Kingston	6	32,760	5	27,360	11	60,120
Wareham	6	32,580	4	21,780	10	54,360
Weymouth	4	21,960	3	16,560	7	38,520
Somerset	3	16,740	3	16,740	6	33,480
Whitman Hanson	4	22,140	2	11,160	6	33,300
New Bedford	2	10,800	4	21,600	6	32,400
Fairhaven	3	16,200	2	10,800	5	27,000
Dennis Yarmouth	2	11,160	2	11,160	4	22,320
Falmouth	2	11,160	2	11,160	4	22,320
Boston	1	5,400	3	16,200	4	21,600
Randolph	1	5,400	3	16,200	4	21,600
Sandwich	2	10,800	2	10,800	4	21,600
Barnstable	2	10,980	1	5,580	3	16,560
Halifax	1	5,400	2	10,980	3	16,380
Dartmouth	2	10,800	1	5,400	3	16,200
Holbrook	1	5,400	2	10,800	3	16,200
Canton	1	5,580	1	5,580	2	11,160

Tiverton, RI	1	5,580	1	5,580	2	11,160
Easton	1	5,400	1	5,400	2	10,800
Hingham	2	10,800	0	-	2	10,800
North Attleboro	1	5,400	1	5,400	2	10,800
Quincy	1	5,400	1	5,400	2	10,800
Swansea	0	-	1	5,580	1	5,580
Duxbury	1	5,400	0	-	1	5,400
Mansfield	0	-	1	5,400	1	5,400
Marshfield	0	-	1	5,400	1	5,400
Rockland	0	-	1	5,400	1	5,400
Sharon	0	-	1	5,400	1	5,400
Worcester	<u>1</u>	<u>5,400</u>	0	-	<u>1</u>	<u>5,400</u>
Total	<u>94</u>	<u>\$513,000</u>	<u>99</u>	<u>\$540,720</u>	<u>193</u>	<u>\$1,053,720</u>

During the audit, the OSA contacted several of the non-member school districts that sent students to READS to determine why they had not sought membership into the collaborative. The majority of officials from each of these school districts informed the OSA that they were unaware how to join the collaborative. In one instance, the Director of Pupil and Personnel Services for the Plymouth School District informed the OSA that, approximately five years ago, his district had inquired about joining the collaborative. However, he stated that he had been informed by the Executive Director of READS that there was an up-front fee of \$100,000 to join and that the district's budget did not allow for this expenditure. However, as previously detailed, READS's Collaborative Agreement with DESE clearly does not state that there is a fee for becoming a member of the collaborative. When asked about this incident, READS's Executive Director provided the following written comments:

At this time READS Collaborative does not have a formal policy in place to charge a fee to become a member of the collaborative.

However, in 1994 the Carver Public Schools applied for membership and was accepted into the collaborative. Carver Public Schools was charged an amount that was based on an equity buy-in formula to become a member of the collaborative. Carver Public Schools was the last school district to formally apply for membership.

As of this date, READS Collaborative has received one informal inquiry from Plymouth Public Schools, a non-member district, to become a member of the collaborative. Based on past history of charging by the equity buy-in formula, the district was told there would be a possible equity buy-in of approximately \$100,000; however, Plymouth Public Schools never formally applied for membership. It should be noted that this inquiry came from the Director of Special Education, not the Superintendent of Schools. If the

Superintendent of Schools in Plymouth had sent a formal letter of application for membership to the collaborative a discussion regarding the equity payment would have ensued by the Board of Directors and a new process for membership that did not include any equity payment may have resulted.

As of this date, READS Collaborative has discussed a formal application with the Superintendent of Schools in Acushnet, a non-member district, to join the collaborative. Using the equity buy-in formula would be cost-prohibitive to the school district. The Superintendent of Schools in Acushnet has not sent a formal letter of application for membership to date; however, when he does the issue of equity payment will be fully discussed and the result will be a formal policy on requesting membership and an updated process.

If READS is going to charge an “equity buy-in” fee for districts to join the collaborative, this should be done through a formal, written policy that has been adopted by READS’s Board of Directors and approved by DESE through an amendment of READS’s Collaborative Agreement. Additionally, READS should consider conducting more formal outreach activities to non-member school districts, especially those that are currently purchasing services from the collaborative, to provide information on how to join the collaborative and the benefits that can be realized by districts through this membership. This would ensure compliance with its Collaborative Agreement with DESE to provide programs and services that “maximize cost efficiency and program effectiveness through a collaborative effort.”

Auditee’s Response

In response to this issue, READS provided comments, which are excerpted below:

To begin with the \$1,053,720 number is arbitrary and purely irrational. All of the non members that READS has done some business with were listed, and then a monetary figure was identified to add in the legal and correct 15% charge for non members. To assume that 34 school districts, some as far away as Worcester and one in Rhode Island, would want to be members is absurd. That being said the issue of an equity buy-in is being addressed by the Board of Directors and will be voted on at the June 2, 2011 Board of Directors meeting. A footnote is several of the districts listed in the thirty four that could have saved money were members at one time and withdrew from the Collaborative.

Auditor’s Reply

Contrary to READS’s assertion, the \$1,053,720 in potential savings figure cited in the report is neither arbitrary nor irrational. To the contrary, this figure is based solely on READS’s records of the number of non-member students actually sent to READS by school districts during the period in question and the amounts over and above the member fees that these districts paid for these students’ services. Further, the report correctly and accurately states that this amount

represents the savings that these districts could have realized if they were members of the READS collaborative.

The OSA does not agree with READS's claim that it would be "absurd" to assume that a school district, no matter where it is located, that is already sending students to READS, would want to join the collaborative if it had the opportunity to save tens of thousands of dollars annually. Regardless, it is not READS's responsibility to speculate on which school districts may or may not join the collaborative but rather to make the districts aware of the benefits of joining the collaborative and encourage their membership. Moreover, what could be considered absurd is for an education collaborative, which is a public agency established for the purposes of providing programs and services that "maximize cost efficiency and program effectiveness through a collaborative effort," to inhibit school districts from actually realizing improvements in the effectiveness and efficiency of their programming by establishing an "equity buy-in amount" that clearly can serve as an impediment to a school district's decision to join the collaborative. If READS is concerned about the distribution of its assets, it should consider establishing a policy that distributes any remaining assets to communities in a fair and equitable manner upon its dissolution rather than creating barriers that discourage school districts from becoming members. The OSA therefore again stresses that READS should consider conducting more formal outreach to non-member school districts, especially those that are currently purchasing services from the collaborative, to provide information on how to join the collaborative and the benefits that can be realized by districts through this membership.

Finally, READS's comment that some of the districts that the audit stated could have saved money by joining the collaborative were members at one time but withdrew is irrelevant to this matter. Clearly, there are many reasons why a district may withdraw from a collaborative. For example, at some point, a school district may withdraw because it has the resources necessary to provide services to its student with special needs in-house rather than because it feels there is little benefit to collaborative membership.

2. DESE IS TAKING MEASURES TO IMPROVE ITS OVERSIGHT OF COLLABORATIVE ACTIVITIES

The Department of Elementary and Secondary Education (DESE), the Commonwealth's oversight agency for public primary and secondary education, has broad authority over and

responsibility for activities of education collaboratives such as READS. On April 13, 2010, the OSA issued Audit Report No. 2009-4515-3C, Independent State Auditor's Report on Certain Activities of the Education Cooperative. During this audit, which covered the period July 1, 2006 through February 28, 2009, the OSA found that DESE had not established policies and procedures to effectively monitor the activities of education collaboratives such as READS. Specifically, this audit identified that although DESE has been statutorily assigned certain oversight responsibilities relative to collaborative activities, it has not updated the Education Collaborative Policy that it developed for this purpose since 1988. As a result, this policy is significantly outdated, and many of the oversight provisions detailed in the policy are no longer being implemented. Consequently, DESE does not have effective monitoring, financial reporting, and auditing systems for education collaboratives; does not ensure that a representative from DESE attends or participates in each collaborative's board meetings in an advisory capacity as required by state law; and has not adequately addressed issues regarding the applicability of various state laws and regulations to public schools and to collaboratives. This condition has resulted in education collaboratives not being held to the same performance standards that apply to public school districts and charter schools within the Commonwealth.

As part of the audit of READS, the OSA asked DESE officials to provide information relative to any measures it had taken to address the concerns the OSA had previously raised relative to its monitoring of education collaboratives. In response to the request, DESE's Commissioner provided comments indicating that DESE is taking measures to address the OSA's concerns in this area. In this regard, DESE should continue to fully implement the recommendations made in audit report No. 2009-4515-3C, including making policy changes to implement effective monitoring, financial reporting, and auditing systems over education collaboratives and amending Chapter 40, Section 4E, of the General Laws to resolve existing uncertainties regarding DESE's authority to appropriately regulate and oversee the activities of education collaboratives.

Chapter 40, Section 4E, of the Massachusetts General Laws also gives DESE express control over the provisions of all education collaborative agreements by stating, in part:

The written agreement which shall form the basis of the education collaborative shall set forth the purposes of the program or service, the financial terms and conditions of membership of the education collaborative, the method of termination of the education

collaborative and of the withdrawal of member school committees, the procedure for admitting new members and for amending the collaborative agreement, the powers and duties of the board of directors of the education collaborative to operate and manage the education collaborative and any other matter not incompatible with law which the member committees deem advisable. The agreement shall be subject to the approval of the member school committees and the commissioner of education.

In addition, this statute requires that DESE appoint a representative to serve in an advisory (non-voting) capacity to the education collaborative board. Pursuant to its general oversight responsibilities, DESE (then the Department of Education) promulgated an Education Collaborative Policy (Policy) document in 1977, which was amended in 1988 to reflect provisions of various statutory changes relevant to the operation of education collaboratives.⁸

As previously noted, OSA Audit Report No. 2009-4515-3C found that DESE had not established policies and procedures to effectively monitor the activities of education collaboratives such as READS, which has resulted in education collaboratives not being held to the same performance standards that apply to public school districts and charter schools within the Commonwealth. In response to the concerns raised in this prior report, DESE's Commissioner provided the following comments:

I concur with the recommendation that the Department needs to update its twenty-two year old policy on collaboratives and, as part of that update, we need to address the frequently-asked questions on what provisions of state education law do, and what provisions do not, apply to these organizations. As noted in your report, our existing policy pre-dates the Commonwealth's 1993 education reform law. Much has changed in the intervening years, including the roles of collaboratives themselves, and so a fresh review of these issues is indeed overdue. I intend to carry out this review during the coming calendar year and have asked . . . our school governance office to lead this effort.

She will coordinate our internal review as well as manage outreach to the educational collaboratives and other constituent agencies.

As part of this review, we will address the appropriate mechanisms for ongoing state oversight of collaboratives. In so doing, we will need to find a workable framework that will safeguard the public interest and that can be accomplished within the limited resources available to us.

As you suggest, we may determine during the course of this review that statutory changes are required to provide needed clarity on certain issues. Also, we will consider the option of issuing regulations in addition to an updated policy. During the course of our review, we intend to consult with local officials, including those from school districts and from the

⁸ These included Chapter 188 of 1985 (the School Improvement Act), Chapter 727 of 1987 (An Act Enhancing the Teaching Profession and Recognizing Educational Achievement), and Chapter 631 of the Acts of 1985 (An Act Relative to the Authority of Educational Collaboratives).

collaboratives themselves, as well as the various state oversight agencies that may have some role to play. I hope you will allow us to seek advice from your office on key issues...

Auditee's Response

As part of the audit, the OSA asked DESE officials to provide information regarding any measures it had taken relative to the concerns that had been previously raised concerning its monitoring of education collaboratives. In response, on March 18, 2011, DESE's Commissioner provided written comments that are excerpted below:

The Department agreed with the original findings in the Auditor's Report on TEC [The Education Collaborative] that we should update the twenty-two year old policy on educational collaboratives, and address the frequently asked questions on what provisions of state education law are applicable to these organizations. In April 2010, I asked [name of individual] of our school governance office to lead this effort by coordinating our internal review and managing outreach efforts to the educational collaboratives and other constituent agencies. [Name of individual] has been appointed as the Department's liaison to the Massachusetts Organization of Educational Collaboratives (MOEC) as well as the designee to all educational collaboratives across the state. As noted in our response to the TEC report, the 1988 policy document, not the statute, states that the Department would appoint a representative to serve on the board of each educational collaborative in a non-voting advisory capacity. The statute requires only that the Department appoint an individual to serve in an advisory capacity to the education collaborative board. [Name of individual] is now that appointee.

Special legislative commission Section 72 of Chapter 188 of the Acts of 2010, the Municipal Relief Act of 2010... established a special legislative commission to examine efficient and effective strategies to implement school district collaboration and regionalization. As the Commissioner's representative, [name of individual] has been meeting with the commission on a regular basis. The commission's report deadline has been extended from March 30 to May 30, 2011. In deference to the legislative commission's work, we would like to take into consideration the recommendations that may be forthcoming from the commission's report, as well as the findings and recommendations from the OSA reports before issuing a new policy or making recommendations for legislative changes to the statute governing educational collaboratives. We intend to bring policy recommendations to the Board of Elementary and Secondary Education after the commission issues its findings in May. In the meantime, the OSA may want to consider contacting the co-chairs of the legislative commission and attending one or more of the upcoming commission meetings. We expect that the commission would find the State Auditor's reports on educational collaboratives valuable, just as we do.

Accountability, outreach and program/fiscal monitoring: We continue to include educational collaboratives in all Department notifications to public schools. A recent example is DESE's initiative to collect bullying prevention and intervention plans from all public entities providing services to school-aged students. All educational collaboratives were required to submit a plan and all met the submission deadline. We have also added several informational documents to the Department's website, www.doe.mass.edu, including a listing of approved educational collaboratives, the authorizing legislation and a document designed to assist districts, charter schools and educational collaboratives with the process for forming or amending an educational collaborative agreement.

As part of the policy review effort, a subcommittee of MOEC has been assigned to work with the Department on updating the 1988 Board Policy on Educational Collaboratives. The group has met on a regular basis to discuss policy, financial and legislative issues as well as to share information and best practices on current operations. The DESE/MOEC policy review committee has also identified and discussed several issues requiring clarification and direction, including applicability of certain state laws and a collaborative's eligibility for state and federal grants.

In addition, DESE has adapted our program, civil rights and fiscal monitoring documents and will use them to pilot two on-site reviews of collaborative programming in May 2011. Educational collaboratives have been notified that at the end of this year's pilot, all educational collaboratives will be included routinely in the Department's program and fiscal monitoring cycle.

I believe our Department is making significant progress toward implementing the recommendations that the OSA outlined in the TEC audit and clarifying the role of educational collaboratives in the Massachusetts public educational system. As you might expect, if there is to be an expanded role for the Department with respect to educational collaboratives, there is a corresponding need to secure resources to support that role.

Auditor's Reply

Based on its comments, DESE is taking measures to address the OSA's concerns in this area. In this regard, the OSA encourages DESE to fully implement the recommendations made in audit report No. 2009-4515-3C relative to making policy changes to implement effective monitoring, financial reporting, and auditing systems over education collaboratives and amending Chapter 40, Section 4E, of the General Laws to resolve existing uncertainties regarding DESE's authority to appropriately regulate and oversee the activities of education collaboratives.

APPENDIX A

READS Member Districts

Abington
Berkley
Bridgewater-Raynham Regional
Carver
Dighton/Rehoboth Regional
East Bridgewater
Freetown
Lakeville
Marion
Mattapoisett
Middleboro
Rochester
Taunton
West Bridgewater

APPENDIX B

Programs Operated by READS and the Corporation

During the audit period, the programs offered by READS included the following:

Program for Deaf and Hard of Hearing (DHH): This program provides educational services within a public school setting for hearing-impaired students ranging from pre-kindergarten through high school. The program tailors its services to each type of hearing loss and communication needs while keeping the student's intellectual and academic goals as the priority. Some of the services in the DHH program include small group and individual instruction; speech therapy; school-to-work programming at the high school level; occupational, physical, and adaptive physical education; and sign language instruction.

READS Academy: The Academy is a therapeutic day school serving children and adolescents between the ages of five and 22 experiencing behavioral and emotional difficulties. Its mission is to facilitate a student's personal growth on an emotional and psychological level and to provide a structure for developing basic interpersonal and social skills through academics and counseling. The Academy runs for 10 months following the school calendar and offers an optional six-week summer component. Some of the services offered in the Academy include individual and small group instruction, behavior management and support, social skills development, and work-study programs.

Summer Programs: In addition to its DHH and Academy programs, READS offers three additional summer programs for those who are not generally enrolled in the collaborative during the regular school year. These six-week summer components are as follows:

- **Summer Academic Maintenance Program (SAM):** This program is for six- to 12-year-olds and provides academics during the summer months in order to prevent regression in reading, language development, and math.
- **Summer Early Enrichment Program (SEEP):** This program is designed for children aged three to five years and provides age-appropriate summer enrichment activities.
- **Summer Pervasive Development Delays Program (PDD):** This program is for three- to seven-year-olds that provides academic support to prevent regression and short-term inclusion options.

During our audit period, the programs offered by the Corporation included the following:

Clinic: The purpose of the Clinic, which is located at 105 East Grove Street in Middleboro, is to evaluate children to determine the possible reasons for difficulties that relate to learning and behavioral problems. Services at the Clinic involve psycho-educational and ancillary evaluations, including audiological, central auditory processing, ophthalmological, speech and language, neuropsychological, classroom, and specialized assessments for servicing the evaluation needs of hearing-impaired students.

District Services: Services include consultation, evaluation, and direct services to students in occupational and physical therapy, vision evaluation and consultation, sensory integration evaluation and consultation, speech and language therapy, and adaptive physical education and behavior.

Early Intervention Services: This program is designed for children from birth to age three and consists of speech therapy, linguistic, and early childhood services. Support and education for parents is an integral aspect of this service, and the program coordinates with early intervention agencies to maximize each child's potential and to assist the family in developing communication skills.