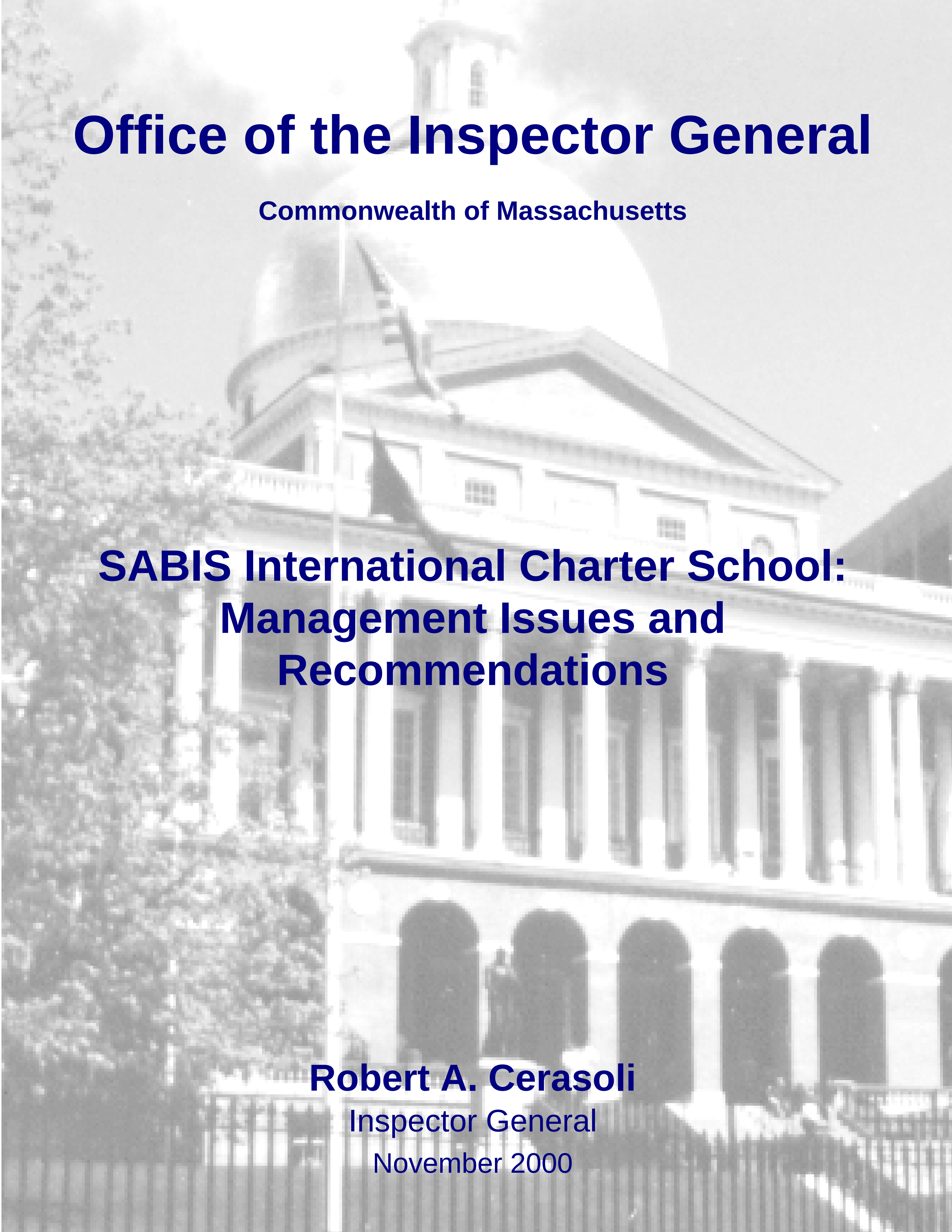

Office of the Inspector General

Commonwealth of Massachusetts

SABIS International Charter School: Management Issues and Recommendations

Robert A. Cerasoli
Inspector General

November 2000

The Commonwealth of Massachusetts

Office of the Inspector General

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November 2000

His Excellency the Governor

The Honorable President of the Senate

The Honorable Speaker of the House of Representatives

The Honorable Chairman of the Senate Ways and Means Committee

The Honorable Chairman of the House Ways and Means Committee

The Honorable Chairman of the Senate Post Audit and Oversight Committee

The Honorable Chairman of the House Post Audit and Oversight Committee

The Directors of the Legislative Post Audit and Oversight Bureaus

The Secretary of Administration and Finance

Members of the General Court

Omnibus ad quos praesentes literae pervenerint, salutem.

I am today releasing a report concerning the business operations of the SABIS International Charter School in Springfield. Under the charter school law, charter schools are public schools governed by volunteer boards of trustees. Since 1995, the SABIS International Charter School has contracted with a private company to provide comprehensive school management services.

The findings presented in this report underscore the need for strong, effective board governance. Sound business practices are fundamental to the long-term viability and effectiveness of any organization, whether public or private. Similarly, any organization that contracts out major, mission-critical functions has an obligation to provide effective contract oversight to ensure that the contract serves the organization's objectives. In the case of a public school, sound business and contract oversight practices are essential tools to enable the school to manage its funds and maximize the resources devoted to its mission of improving students' educational performance.

I am encouraged that the SABIS International Charter School Board of Trustees has recently taken steps to promote prudent Board governance of the School. The recommendations provided in this report are intended to assist the Board of Trustees in strengthening the School's capacity to serve its current and future students, to promote public accountability, and to protect the interests of the taxpayers whose dollars fund the School.

Sincerely,

Robert A. Cerasoli
Inspector General

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Executive Summary

The Massachusetts charter school law, M.G.L. c. 71, §89, authorizes the Massachusetts Board of Education to grant charters to Commonwealth charter schools and Horace Mann charter schools, both of which are public schools managed by boards of trustees. This report concerns the SABIS International Charter School (hereinafter, "the School"). The School is a Commonwealth charter school, which is a public school that is chartered by the Board of Education and operates independently of any school committee. Since it was chartered in 1995, the School has contracted with SABIS Educational Systems, Inc. (hereinafter, "SABIS Inc."), a private, for-profit company, for comprehensive educational and administrative management services.

The School, located in Springfield, was among 24 Commonwealth charter schools included in a study undertaken by the Office of the Inspector General in March 1998 pursuant to Chapter 46 of the Acts of 1997. In November 1999, the Office issued a report, *A Management Review of Commonwealth Charter Schools*, identifying weaknesses in the contracting practices, procurement procedures, and financial management of some schools. Such weaknesses could undermine the schools' ability to achieve their educational objectives and jeopardize the interests of state taxpayers whose dollars fund charter schools. The report findings regarding the School included the following:

- The School's management contract with SABIS Inc. contained no performance requirements measuring students' academic achievement, did not accurately reflect the School's actual compensation arrangement with SABIS Inc., and contained provisions that could restrict public use of educational curricula and other intellectual property developed with public funds.
- The School's substantial financial obligations to SABIS Inc. could render the School excessively dependent on SABIS Inc., reduce the School's contracting leverage, and create liabilities for the Commonwealth's taxpayers.
- The School exhibited warning signs of financial problems that, if uncorrected, could threaten the School's future viability.
- The School reportedly failed to take timely actions to correct internal control deficiencies identified by their independent auditors.

- The School's written procurement procedures did not require advertised competition for purchases of supplies, services, or equipment.

The Office initiated the review presented in this report in November 1999. This review was conducted in accordance with generally accepted government auditing standards. The purpose of this review was to conduct a more detailed examination of certain aspects of the School's operations previously identified by the Office as potential sources of risk. The Office appreciates the cooperation provided to the Office by the School's Board of Trustees and staff, SABIS Inc., and the Department of Education (hereinafter, "DOE").

Under the charter school law, charter school trustees are "public agents" with ultimate responsibility for the school. M.G.L. c. 71, §89(a) provides:

> The board of trustees of a commonwealth charter school, upon receiving a charter from the board of education, shall be deemed to be public agents authorized by the commonwealth to supervise and control the charter school.

In 1996, the former Executive Office of Education issued a legal memorandum to charter schools providing a comprehensive overview of the statutes and regulations affecting the governance structure of charter schools. This legal memorandum emphasized that a Board of Trustees is responsible and accountable for ensuring that the charter school operates in accordance with the charter school law and regulations and in accordance with the representations made in the charter school application.

Charter school trustees are also required to fulfill certain fiduciary obligations or duties that apply to members of all boards of directors, whether their organizations are private or public. These duties are generally referred to as the "duty of care" (sometimes called the duty to be informed) and the "duty of loyalty." Because the Board of Trustees has statutory and fiduciary responsibility for oversight and control of the School, the findings and recommendations provided in this report are directed to the Board.

In March 2000, the Board of Trustees signed a new contract, which contained an effective date of July 1, 2000, with a new corporation created by SABIS Inc.: "Springfield

Education Management LLC, A Delaware Limited Liability Corporation." Under M.G.L. c. 71, §89(j)(5), charter school contracts for substantially all educational services require the approval of the Board of Education. On April 10, 2000, the Board of Trustees submitted the new contract to the DOE for review and approval by the Board of Education. As of mid-November 2000, the Board of Education had not approved the new contract.

The Office's review disclosed deficiencies in the Board's governance of the School and oversight of its contract with SABIS Inc. The findings discussed in this report are summarized below:

1. **The Board of Trustees did not employ sound business and contract oversight practices in administering the School's financial relationship with SABIS Inc. during the first five years of School operations.**

   - **Although SABIS Inc. charged the School more than $950,000 in management fees between 1995 and 1999, the School paid the salaries of the on-site staff who administered the School's business operations on a daily basis during this period.**
   - **The Board of Trustees authorized more than $300,000 in reimbursements to SABIS Inc. for "corporate support" expenses that were neither specified in the 1995 contract nor substantiated with invoices.**
   - **The Board of Trustees inappropriately ceded responsibility to SABIS Inc. for selecting and engaging the services of the School's independent auditor.**

2. **The contract with SABIS Inc. executed by the Board in March 2000 would significantly increase the School's exposure to fraud, waste, and abuse.**

   - **The new contract would significantly increase SABIS Inc.'s financial control over the School while reducing Board oversight.**
   - **The new contract would significantly increase SABIS Inc.'s potential compensation while eliminating the School's ability to invest in School programs and operations.**
   - **The indefinite term of the new contract would insulate SABIS Inc. from competition in the future, thereby reducing its incentives to provide efficient, high-quality services to the School.**
   - **The new contract would allow SABIS Inc., but not the School, to terminate the contract after five years.**

- **The dispute resolution and termination provisions of the new contract would undermine the Board's ability to terminate the contract if SABIS Inc. failed to perform.**

3. The Board of Trustees did not accurately document its official actions and policies.

The Board of Trustees of the SABIS International Charter School, like other charter school boards of trustees, is comprised of unpaid members of the community who volunteer to devote time and effort to the worthy goal of improving educational opportunities for Springfield's children. The Office has no reason to doubt the Board Chairman's description of the Board members as well intentioned and committed to the School's success.

It should also be recognized that charter schools in Massachusetts and elsewhere have been evaluated primarily on the basis of the academic progress of their students. Accordingly, charter schools have been given wide latitude in establishing their internal operating procedures. While the Department of Education's small charter school office has provided assistance to charter schools, it has not provided detailed information to charter school boards of trustees concerning their statutory and fiduciary obligations. Moreover, charter applicants and charter schools applying for renewal of their charters have not been required to demonstrate that they are capable of instituting and maintaining efficient, effective business systems and practices.

Nevertheless, the Board of Trustees of the SABIS International Charter School has been entrusted with the responsibility of operating a public school serving 1,200 children. Over the past five years, the Commonwealth has invested more than $23 million in the School. The educational and financial stakes are high, not only for the students, parents, teachers, and staff in the immediate School community, but for the School's other stakeholders, such as the children and families of children on the School's waiting list and the state taxpayers whose dollars fund the School. It is essential that the Board be willing and able to devote the care, time, and expertise necessary to fulfill its statutory and fiduciary responsibility to supervise and control the School.

The Board has recently taken steps to address some deficient management controls and clarify its contracting arrangements with SABIS Inc. The Board is to be commended for initiating improvements in the governance of the School. Sound business systems and contracting practices are fundamental to the capacity of any organization, whether public or private, to sustain growth and achieve its long-term objectives. Accordingly, the Inspector General offers the following recommendations to address the issues raised in this report:

1. **The Board of Education should disapprove any contract between the School and SABIS Inc. containing the risky and unfavorable provisions discussed in Finding 2 of this report.**

2. **The Board of Trustees should evaluate alternatives to recontracting with SABIS Inc. to manage the School's business operations.**

3. **If the Board of Trustees elects to recontract with SABIS Inc. or to contract with a different management contractor for administrative services, the Board should direct its legal counsel to draft a new contract that will require and enable the Board to exercise appropriate financial oversight and control over School resources and operations.**

4. **The Board of Trustees should directly select, contract with, and oversee the School's independent auditor.**

5. **The Board of Trustees should assign responsibility for administering and monitoring the School's management contract with SABIS Inc. (or another management contractor) to a School employee with appropriate financial and managerial skills and experience.**

6. **The Board should continue to seek guidance concerning the legal requirements governing the Board and School employees.**

7. **The Board should conduct or commission a systematic analysis of the School's financial requirements before borrowing additional funds from SABIS Inc. or any other source.**

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Introduction

The Massachusetts charter school law, M.G.L. c. 71, §89, authorizes the Massachusetts Board of Education to grant charters to Commonwealth charter schools and Horace Mann charter schools, both of which are public schools managed by boards of trustees. This report concerns the SABIS International Charter School (hereinafter, "the School"). The School is a Commonwealth charter school, which is a public school that is chartered by the Board of Education and operates independently of any school committee. Since it was chartered in 1995, the School has contracted with SABIS Educational Systems, Inc. (hereinafter, "SABIS Inc."), a private, for-profit company, for comprehensive educational and administrative management services.

The School, located in Springfield, was among 24 Commonwealth charter schools included in a study undertaken by the Office of the Inspector General in March 1998 pursuant to Chapter 46 of the Acts of 1997. In November 1999, the Office issued a report, *A Management Review of Commonwealth Charter Schools*, identifying weaknesses in the contracting practices, procurement procedures, and financial management of some schools. Such weaknesses could undermine the schools' ability to achieve their educational objectives and jeopardize the interests of state taxpayers whose dollars fund charter schools. The report findings regarding the School included the following:

- The School's management contract with SABIS Inc. contained no performance requirements measuring students' academic achievement, did not accurately reflect the School's actual compensation arrangement with SABIS Inc., and contained provisions that could restrict public use of educational curricula and other intellectual property developed with public funds.
- The School's substantial financial obligations to SABIS Inc. could render the School excessively dependent on SABIS Inc., reduce the School's contracting leverage, and create liabilities for the Commonwealth's taxpayers.
- The School exhibited warning signs of financial problems that, if uncorrected, could threaten the School's future viability.
- The School reportedly failed to take timely actions to correct internal control deficiencies identified by their independent auditors.

- The School's written procurement procedures did not require advertised competition for purchases of supplies, services, or equipment.

Objectives, Scope, and Methodology

The Office initiated the review presented in this report in November 1999. This review was conducted in accordance with generally accepted government auditing standards. The purpose of this review was to conduct a more detailed examination of certain aspects of the School's operations previously identified by the Office as potential sources of risk. During the course of this review, the Office obtained documents from the School and from SABIS Inc. covering the period of January 1995 through November 1999. The Office subsequently obtained documents pertaining to the School from the Massachusetts Department of Education (hereinafter, "DOE") covering the period from February 1995, the date of the School's charter application, through April 2000. In June and July of 2000, the Office interviewed the Chairman of the School's Board of Trustees and the individual who initially served as Director of the School and later served as SABIS Inc.'s Regional Director. These individuals provided the Office with additional documents pertaining to the School's business operations. The Office appreciates the cooperation provided to the Office by the School's Board of Trustees and staff, SABIS Inc., and the DOE.

In a September 2000 letter, the attorney representing the School's Board of Trustees notified the Office that the Board had recently taken steps to clarify its financial and operational arrangements, including its arrangements with SABIS Inc. Where appropriate, this report includes an italicized summary of the updated information provided by the Board's attorney. In October 2000, the Office provided the Board of Trustees with a confidential draft of this report. The Board's full response to the confidential draft report is included in Appendix A of this report.

Under the charter school law, charter school trustees are "public agents" with ultimate responsibility for the school. The law provides:

> The board of trustees of a commonwealth charter school, upon receiving a charter from the board of education, shall be deemed to be public agents

> authorized by the commonwealth to supervise and control the charter school.[1]

In 1996, the former Executive Office of Education (EOE)[2] issued a legal memorandum to charter schools providing a comprehensive overview of the statutes and regulations affecting the governance structure of charter schools. This legal memorandum emphasized that a Board of Trustees is responsible and accountable for ensuring that the charter school operates in accordance with the charter school law and regulations and in accordance with the representations made in the charter school application.

Charter school trustees are also required to fulfill certain fiduciary obligations or duties that apply to members of all boards of directors, whether their organizations are private or public. These duties are generally referred to as the "duty of care" (sometimes called the duty to be informed) and the "duty of loyalty." A 1996 legal memorandum issued to charter schools by the former EOE provided the following explanation of the obligations of charter school trustees to fulfill the duty of care and the duty of loyalty:

> The Board of Trustees, as a public agent, is entrusted by the Commonwealth to supervise and control the charter school. Accordingly, the Board of Trustees is primarily responsible for ensuring the charter school's compliance with the charter school legislation.
>
> The Board of Trustees has two primary duties as a public agent: (1) the duty of care, and (2) the duty of loyalty. The duty of care means that each trustee must act with such care as an ordinary prudent person would employ in the trustee's position. This duty imposes on the trustee the responsibility of participating actively in the oversight of the charter school's activities. Such participation includes attending meetings, reviewing the school's code of conduct, financial reports, and other required documents, and monitoring delegated activities. The duty of loyalty means that the trustee must act in good faith and in a manner the trustee reasonably believes is in the best interest of the charter school.

[1] M.G.L. c. 71, §89(a).

[2] The former EOE was responsible for charter school oversight until 1996, when the EOE was abolished. Since 1996, the Department of Education has been responsible for charter school oversight under the supervision of the Board of Education.

Because the Board of Trustees has statutory and fiduciary responsibility for oversight and control of the School, the findings and recommendations provided in this report are directed to the Board.

Background on the SABIS International Charter School

The Board of Education awarded a charter to the School in March 1995. The School began operations in September 1995 with 450 students in kindergarten through seventh grade. Over the subsequent five years, the School expanded to 1,132 students in kindergarten through eleventh grade. The School plans to serve 1,200 students, in kindergarten through twelfth grade, in the 2000-2001 school year.

According to meeting minutes recorded by the School's Board of Trustees, the membership of the Board has fluctuated between 10 and 12 since 1995. In July 1999, the Board of Education voted to renew the School's five-year charter.

According to the School's audited financial statements,[3] the School received more than $15 million in M.G.L. c. 70 funds[4] from the state between 1995, when the School was first chartered by the state, and the end of the 1999 fiscal year. The audited financial statements also reported that the School received almost $1.5 million in other revenues, such as educational or program fees, interest income, grants, and educational entitlements, during the same period. Table 1 lists the School's annual revenues.

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[3] The charter school law requires each charter school to obtain an annual, independent audit of its accounts and file the audit each year with the DOE and the State Auditor.

[4] M.G.L. c. 70 establishes standards for state funding of public schools in Massachusetts.

Table 1. School Revenues, FY 1996 - 1999

Fiscal Year	State Revenues	Other Revenues	Total
1996	$2,568,443	$281,727	$2,850,170
1997	3,431,308	271,345	3,702,653
1998	4,484,715	296,563	4,781,278
1999	5,508,380	639,870	6,148,250
Total	**$15,992,846**	**$1,489,505**	**$17,482,351**

Source: Audited financial statements.

The School's audited financial statements for the 2000 fiscal year were unavailable for this review. However, according to information published by the DOE, the School received M.G.L. c. 70 funds totaling $8,014,616 in the 2000 fiscal year.

Background on SABIS Educational Systems, Inc.

In August 1995, the School executed a five-year contract with a private Minnesota-based company, the International School of Minnesota, Inc. – which transacted business in the Commonwealth as SABIS Educational Systems, Inc. – for comprehensive educational and administrative management services. The School's charter application to the Board of Education provided detailed information on the SABIS Inc. curriculum and teaching methods. The School profile published by the DOE contained the following summary of the SABIS Inc. approach:

> As in the other worldwide network of schools operated by Sabis Educational Systems, Inc., students in this school wear uniforms and teachers use the "point" and "prefect" system of instruction to teach. For each lesson, teachers post the key points to be discussed in each class. Once the teacher covers a point, the work of student prefects is checked. Student prefects, usually numbering five per class, are chosen because they excel in a particular subject. Once the prefects have checked with the teacher to ensure they have mastered the "point," the prefects check the understanding of an assigned group of their classmates. Student leadership is further enhanced by the "Student Life" program in which students earn points for participation in various school activities that reflect the quality and extent of their contribution to the school's learning environment.

According to the School's charter application, the SABIS Network of Schools was comprised of for-profit schools located in England, the United Arab Emirates, Lebanon, Pakistan, Egypt, and the United States. A chart included in the charter application listed 13 schools in the SABIS Network, along with their opening dates, student populations, and percentage of SABIS Inc. ownership. However, the School's application indicated that most of the 13 schools listed were not owned by SABIS Inc.: only three were 100 percent owned by SABIS Inc., including one private school in the United States. SABIS Inc.'s ownership interest in the other schools listed in the chart ranged from 0 percent to 25 percent.[5]

In March 2000, the Board of Trustees signed a new contract, which contained an effective date of July 1, 2000, with a new corporation created by SABIS Inc.: "Springfield Education Management LLC, A Delaware Limited Liability Corporation." Under the charter school law, charter school contracts for substantially all educational services require the approval of the Board of Education.[6] On April 10, 2000, the Board of Trustees submitted the new contract to the DOE for review and approval by the Board of Education. As of mid-November 2000, the Board of Education had not approved the new contract with SABIS Inc.

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[5] According to the SABIS School Network website, all schools in the SABIS Network had implemented the "SABIS Educational System," but each school was financially and administratively independent.

[6] M.G.L. c. 71, §89(j)(5).

Findings

Finding 1. The Board of Trustees did not employ sound business and contract oversight practices in administering the School's financial relationship with SABIS Inc. during the first five years of School operations.

The Office's review disclosed that during the first five years of the School's operations, the Board of Trustees did not institute appropriate administrative controls over the School's multimillion-dollar financial relationship with SABIS Inc. The Board's inadequate oversight of the School's 1995 contract with SABIS Inc. was reflected in the flawed and vulnerable arrangements discussed below.

1a. Although SABIS Inc. charged the School more than $950,000 in management fees between 1995 and 1999, the School paid the salaries of the on-site staff who administered the School's business operations on a daily basis during this period.

SABIS Inc. was responsible for administering the School's business operations under the 1995 management contract between the School and SABIS Inc. The contract stated:

> RIGHTS AND OBLIGATIONS OF [SABIS Inc.]. Consistent with the obligations of the School under the Charter, the Act, and any and all applicable laws and regulations, and in order to assist the School in carrying out the terms of the Charter, [SABIS Inc.] agrees to perform the duties and services to be performed by it under this Agreement, and [SABIS Inc.] shall have the following rights and obligations in connection with the education of the children enrolled as students in the Charter School. . . .

SABIS Inc.'s obligations under the contract were enumerated under the heading "Authority to Manage Charter School":

> 2.1 Subject to the provisions of this Agreement, and in accord with the provisions of the Act, the Charter, and all applicable laws and regulations, **[SABIS Inc.] shall be responsible for the operation of the Charter School,** including the responsibilities set forth in paragraph 1.1, above, (except those provided in Section 1.1.5,

which are reserved to the School), and **[SABIS Inc.] shall have the right and obligation to educate the children enrolled in the Charter School, including:**

2.1.1.1 The education program and program of instruction, including student admissions, bilingual education (G.L. 71A), student records, access to equal educational opportunities, school year and school day requirements, special education (G.L. c. 71B, subject to the proviso of Section 1.1.1), student testing, extra and co-curricular activities and programs, and selection and acquisition of instructional materials, equipment and supplies.

2.1.1.2 All personnel and payroll functions on behalf of the School for the teachers who are employed by the School.

2.1.1.3 Professional development for principals and instructional personnel.

2.1.1.4 The maintenance and operation of the School's facilities provided pursuant to Section 1.6.

2.1.1.5 The business administration of the School.

2.1.1.6 Food services for the students and School staff.

2.1.1.7 Transportation services for the students.

[Emphasis added.]

The contract also provided:

> **[SABIS Inc.] shall assume and be solely responsible for all tasks and functions** associated with the educational services to be provided to the children enrolled as students at the Charter School in accordance with the Charter, the Act, and any and all applicable laws and regulations. Such tasks and functions shall include, but not be limited to, contracting with public or private entities or with private persons for:
>
> 2.2.1 Its principal;
>
> 2.2.2 All administrative and support staff;
>
> 2.2.3 Transportation;

2.2.4 Custodial services, supplies and equipment;

2.2.5 Food services;

2.2.6 Improvements to the building site as [SABIS Inc.] deems necessary for the implementation of its program. . . ; and

2.2.7 Any other services deemed reasonably necessary to achieve the goals of [SABIS Inc.]

[Emphasis added.]

These provisions did not clearly assign responsibility to SABIS Inc. for funding the services themselves, although these provisions could be construed to mean that SABIS Inc. would fund all services listed under SABIS Inc.'s obligations, including transportation services, custodial services, and food services. Notwithstanding this ambiguity, however, the contract clearly required SABIS Inc. to administer and oversee the delivery of the services and functions listed in the contract provisions excerpted above.[7]

The Office's review disclosed that SABIS Inc. did not pay the salaries of any administrative staff working at the School during the first three years of the contract. According to the former Director of the School (who became SABIS Inc.'s Regional Manager in 1998),[8] the day-to-day administration of the School's business functions has been conducted by School employees since 1995. He stated that both the Director of

[7] Under the contract, the School's obligations included compliance with the charter and all applicable laws and regulations, adoption of general policies governing certain school management issues, maintenance of the charter, provision of funding, determination of the method of evaluating SABIS Inc.'s progress toward educating the School's children; provision of space for the School, and maintenance of the school's tax status.

[8] After serving as Director of the School for approximately three years, the Director resigned his School-funded position to serve as SABIS Inc.'s Regional Director beginning in August 1998. By July 2000, when the Office interviewed him, he had become a consultant to SABIS Inc., and SABIS Inc. had appointed a new Regional Director. In the interest of simplicity, this report will henceforth refer to the former Director of the School, who is also the former Regional Director, as "the former Director."

the School and the School's Business Manager were employees of the School and were paid with School funds. This was also the case for all other full-time administrative staff employed at the School.[9] He stated that since 1998, SABIS Inc.'s Regional Manager has overseen the operations of three Massachusetts charter schools contracting with SABIS Inc.: the SABIS International Charter School, the Somerville Charter School, and the SABIS Foxborough Regional Charter School.

Table 2 summarizes the fees and reimbursements charged by SABIS Inc. to the School, as reported in the School's audited financial statements. These statements reported that SABIS Inc. charged the School a management fee, a license fee, and a corporate support charge (discussed in the next subfinding) each year between 1995 and 1999. Although the 1995 contract did not specify either the compensation to be paid to SABIS Inc. or the basis upon which SABIS Inc.'s compensation would be calculated,[10] the management fee apparently constituted payment for the services specified in the contract.[11]

Table 2. Fees Charged By SABIS Inc.

Fees	FY96	FY97	FY98	FY99	Total
Management	$144,000	$217,000	$269,083	$330,503	$960,586
License*	148,958	217,000	269,083	330,503	965,544
Corporate support	155,746	89,986	5,877	73,510	325,119
Total	**$448,704**	**$523,986**	**$544,043**	**$734,516**	**$2,251,249**

Source: Audited financial statements.
*Labeled "License and Rental Fee" in the 1996 audited financial statement.

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[9] At the Office's request, SABIS Inc.'s attorney provided confirmation in July 1999 that the Director and Business Manager of the School were employees of the School and not employees of SABIS Inc.

[10] The Office's 1999 report contained a detailed discussion of the three fees charged by SABIS Inc. and the lack of provisions in the School's 1995 contract with SABIS Inc. specifying either the fees or the basis upon which they were to be calculated.

[11] A 1995 letter from SABIS Inc. to the School stated that the license fee related to the School's use of SABIS Inc.'s proprietary systems, methods, materials, and software.

As Table 2 shows, SABIS Inc. charged the School management fees totaling $960,586 between 1995 and 1999.[12] When asked to specify the services provided by SABIS Inc. in return for the management fees paid by the School, the former Director stated that these services included time devoted to the School by SABIS Inc.'s corporate employees in Minnesota, research and development of curriculum materials, "program timetabling," and quality control oversight. These services did not correspond to all of the administrative functions for which SABIS Inc. was responsible under the 1995 contract.

Given the fact that the School, and not SABIS Inc., has borne most of the costs of administering the School's business operations on a daily basis, the substantial management fees charged by SABIS Inc – more than $950,000 over the first four years of the contract – appear excessive. This situation highlights the importance of active Board participation in and oversight of the School's business dealings. Entering into a substantial service contract without instituting appropriate contract monitoring and enforcement mechanisms is an invitation to waste as well as fraud and abuse.

1b. The Board of Trustees authorized more than $300,000 in reimbursements to SABIS Inc. for "corporate support" expenses that were neither specified in the 1995 contract nor substantiated with invoices.

According to the School's annual budgets and audited financial statements, SABIS Inc.'s charges to the School between 1995 and 1999 included more than $300,000 in reimbursements for "corporate support" expenses in addition to the management and license fees discussed above. The previous Table 2 lists the corporate support expenses charged by SABIS Inc. (as reported in the School's audited financial statements) for the first four fiscal years of School operations. As Table 2 shows, these corporate support charges varied significantly from year to year.

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[12] The School's audited financial statements for the same period also reported that SABIS Inc. charged the School $164,582 in interest expenses on unpaid financial obligations and $1,180,000 in lease payments on property leased by the School from SABIS Inc.

The School's 1995 contract with SABIS Inc. contained no provision authorizing or governing expense reimbursements to SABIS Inc. There was no indication of the basis for the School's reimbursements to SABIS Inc. in the School's annual reports or the School's audited financial statements pertaining to the first four years of School operations. Moreover, the meeting minutes of the Board of Trustees provided to this Office by the school contained no discussion or votes regarding the corporate support expenses charged by SABIS Inc. (The inadequacy of the documentation reflecting the Board's business decisions is discussed in Finding 3 of this report.)

In an interview, the Board Chairman stated that SABIS Inc.'s corporate support charges to the School consisted of reimbursements to SABIS Inc. for certain expenses such as teacher training at conferences. The Board Chairman stated that he did not know how the determination was made as to whether or not specific costs incurred by SABIS Inc. were covered by SABIS Inc.'s management fee or whether they were reimbursable corporate support expenses. He stated that the Board reviewed the corporate support expenses charged by SABIS Inc. but that these reviews did not always take place before the School paid the corporate support charges specified by SABIS Inc.

According to the former Director, SABIS Inc.'s corporate support charges were "unforeseen" expenses of services that fell outside the scope of SABIS Inc.'s customary services. As examples of such unforeseen expenses, he cited the cost of school textbooks purchased by SABIS Inc. when the School first opened and the salaries of SABIS Inc. employees, such as a computer technician and a "student life officer"[13] assigned to work temporarily at the School. He stated that SABIS Inc. made the determination as to whether specific expenses should be reimbursed by the School: toward the end of each fiscal year, SABIS Inc.'s corporate treasurer informed the School's Business Manager of the dollar amount of corporate support charges owed by the School. SABIS Inc. was not required to produce receipts, invoices, timesheets, or

[13] According to the SABIS School Network website, student life advisors "train students in managing their mini-society."

other documentation of the corporate support expenses for which it requested and received reimbursement, according to the former Director.

It is not clear why administrative and educational costs such as those cited by the former Director should be considered “unforeseen” or outside the scope of SABIS Inc.’s responsibilities under its contract with the School. Even more troubling, it appears that the School paid the corporate support expenses charged by SABIS Inc. without detailed scrutiny or verification of their accuracy and reasonableness. The monthly financial reports SABIS Inc. was contractually required to provide to the School should have documented the corporate support expenses charged by SABIS Inc.; however, the Board did not enforce this contract provision. According to the Board Chairman, the Board only required SABIS Inc. to provide financial reports “on request.”

In September 2000, the Board’s attorney advised the Office that SABIS Inc. had been instructed to provide the Board’s Finance Committee with monthly income and expense statements showing budgeted to actual financial performance and monthly balance sheets.

Cost reimbursement compensation provisions are generally less advantageous than fixed-price compensation provisions because the former provide no cost-saving incentives to the contractor and require the contracting organization to provide more contract oversight to protect the organization from overcharges. If a contracting organization decides to allow payment to the contractor based on the contractor’s allowable costs, sound business practice dictates that the allowable costs be clearly spelled out in the contract and that the contracting organization closely review the invoices submitted by the contractor to ensure that the costs to be reimbursed are both allowable and reasonable. In this case, however, the Board authorized more than $300,000 in reimbursements to SABIS Inc. despite the lack of contract language specifying the allowable costs to be reimbursed and without requiring SABIS Inc. to submit invoices or other substantiation of the requested reimbursements.

The September 2000 letter from the Board's attorney to the Office stated:

> *SABIS Educational Systems is addressing the issue of separating corporate support and management fees, and should be reporting back to the Board of Trustees in the near future.*

1c. The Board of Trustees inappropriately ceded responsibility to SABIS Inc. for selecting and engaging the services of the School's independent auditor.

The charter school law requires each charter school to obtain an annual, independent audit of its accounts and file the audit each year with the DOE and the State Auditor.[14] The independent audit is the DOE's principal source of information regarding each school's financial condition. The DOE's charter school regulations require a charter school applicant to demonstrate its ability to achieve fiscal and operational viability within the five-year charter term in order to obtain charter approval.[15] The Board of Education may revoke a charter for financial insolvency.[16] Similarly, DOE regulations require a charter school seeking renewal of its charter to demonstrate its financial viability,[17] and the DOE's charter renewal application indicates that the DOE relies on the audited financial statements and other information furnished by the school's independent auditor to make this determination.

The annual audit of the School is thus an important responsibility of the Board of Trustees. However, the Board inappropriately delegated this responsibility to SABIS Inc. The Board minutes show that SABIS Inc. selected and engaged the services of an audit firm located in Minneapolis, Minnesota – near SABIS Inc.'s corporate headquarters in Eden Prairie, Minnesota – for the School's 1998 fiscal year audit.

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[14] M.G.L. c. 89, §71hh.

[15] 603 CMR 1.05.

[16] 603 CMR 1.12.

[17] 603 CMR 1.11.

According to the former Director of the School, SABIS Inc. had selected this audit firm to conduct audits of all schools operated by SABIS Inc. in the United States.[18]

The extent of the Board's detachment from the process of selecting and hiring the School's independent auditor is illustrated by the following excerpt from the Board meeting minutes for December 16, 1998, which shows that the Board was unaware that SABIS Inc. had hired a Minnesota firm months earlier to conduct the audit for the 1998 fiscal year:

> SABIS Educational Systems has contracted [the Minnesota audit firm] of Minneapolis, Minn. for the school's annual audit instead of [the Springfield audit firm that had prepared the School's audits for the 1996 and 1997 fiscal years]. The Board of Trustees requested the board be contacted prior to changes in these decisions and recommended we contract locally next year.

The Minnesota audit firm's invoices, copies of which were provided to the Office, were sent to SABIS Inc.'s corporate headquarters in Eden Prairie. However, according to the former Director, the School paid for the audit, the cost of which included transportation expenses for the Minnesota-based auditors who traveled to Springfield. Although the invoices for the audit totaled more than $10,000, the former Director stated that he never saw a written contract between the School and the audit firm.

The Board meeting minutes for February 10, 1999 show that the Board voted to send a letter to SABIS Inc. requesting that a local firm conduct the following year's audit. The School's audit for the 1999 fiscal year audit was prepared by the Springfield audit firm that had prepared the School's audits for the 1996 and 1997 fiscal years.[19]

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[18] Records reviewed by the Office showed that this same Minnesota audit firm prepared the 1997 and 1998 fiscal year audits for the Somerville Charter School, which contracted with SABIS Inc. to provide comprehensive school management services.

[19] Records reviewed by the Office showed that this same Springfield audit firm prepared the 1999 fiscal year audit for the Somerville Charter School.

In September 2000, the Board's attorney advised the Office that the Board had voted to retain the same Springfield audit firm to perform the annual audit for the 2001 fiscal year.

The tasks of selecting and hiring a charter school's independent auditor should reside with the charter school's Board of Trustees rather than being carried out by its management contractor because a properly conducted independent audit should provide the Board with information on the management contractor's performance. In this case, however, the Board allowed SABIS Inc. to hire the auditors – one of which was a Minnesota audit firm that SABIS Inc. had hired to audit other schools operated by SABIS Inc. This arrangement raises serious concerns about the independence of the School's audits. This arrangement also appears to have contributed to the Board's inaction in response to audit recommendations to correct internal control weaknesses. For example, each year for four consecutive years, the auditors criticized the School's failure to adopt a complete accounting manual. According to the Board Chairman, the Board's failure to require SABIS Inc. to prepare an accounting manual was an oversight. Such an oversight would have been less likely to occur if the Board had been actively engaged in the audit process each year.

In September 2000, the Board's attorney advised the Office that the Springfield audit firm was in the process of reviewing an accounting manual that had been prepared by SABIS Inc.

Finding 2. The contract with SABIS Inc. executed by the Board in March 2000 would significantly increase the School's exposure to fraud, waste, and abuse.

The Office's 1999 report identified numerous unfavorable provisions contained in some contracts between charter schools and their private management contractors. For example, the report disclosed that the SABIS International Charter School's 1995 contract with SABIS Inc. contained no contractor performance requirements related to students' academic achievement. The contract also lacked compensation provisions specifying SABIS Inc.'s fees and other charges to the School.

In June 2000, the School's Acting Director wrote to the Inspector General summarizing the School's achievements and action plan in response to the findings contained in the Office's 1999 report. With respect to the School's contract with SABIS Inc., the Acting Director's letter advised the Inspector General that the Board had executed a contract with SABIS Inc. that included specific performance requirements tied to students' academic achievements and that specified the School's compensation arrangements with SABIS Inc.

At the Office's request, the Board of Trustees provided the Office with a copy of the new contract, which was executed on March 16, 2000 with an effective date of July 1, 2000. The School's new contract was executed with "Springfield Education Management LLC, a Delaware Limited Liability Company," a limited liability corporation created by SABIS Inc. The Office's review of the new contract disclosed that the modifications reported by the Acting Director of the School had been made. Unlike the previous contract, the new contract would require SABIS Inc.[20] to meet or exceed specific educational outcomes reflecting students' academic achievement. The new contract also contained an explicit compensation provision guaranteeing SABIS Inc. a license fee and a management fee and reimbursement for "corporate expenses." The contract provided that the license fee and management fee would each be calculated at six percent of the total funds received by the Board pursuant to the charter school law. It also required advance Board approval, except in cases of emergency, of corporate expense reimbursements to SABIS Inc. The contract did not specify the allowable expenses to be reimbursed under this provision nor what would constitute an emergency.

However, the new contract contained other provisions that would substantially increase SABIS Inc.'s potential compensation well beyond the fees and reimbursements discussed above. These provisions would benefit SABIS Inc. while posing significant and unwarranted risks to the School.

[20] In the interests of clarity and simplicity, this report will continue to refer to this limited liability corporation created by SABIS Educational Systems, Inc. as "SABIS Inc."

The School submitted the new contract to the DOE's charter school office on April 10, 2000. As of mid-November, the Board of Education had not approved the new contract.[21]

2a. The new contract would significantly increase SABIS Inc.'s financial control over the School while reducing Board oversight.

The new contract would require the Board to transfer all School funds, except those funds budgeted for Board operations, to SABIS Inc. within seven days of receiving the funds. The contract stated:

> 1.3 Funding. As soon as possible, but in no event later than seven (7) days after receipt, **the Trustees shall forward all funds**, except those funds retained by the Trustees for operational purposes, which sum shall be based upon a written operating budget developed cooperatively by SABIS® and the Board of Trustees, **received by it pursuant to the Charter School Law to SABIS®.** Federal funds may be so allocated to the extent permissible under federal requirements. **Of the funds paid by the School to SABIS® under this section**, six (6%) percent of those funds shall be allocated as payment for a license to use SABIS'® proprietary information and systems as defined in Section 8 below, and also six (6%) percent shall be allocated as a management fee. SABIS® shall also be reimbursed for corporate expenses, which shall be approved in advance by the Trustees, except in case of emergency. [Emphasis added.]

The new contract would therefore give SABIS Inc. responsibility for managing all School funds except for those funds budgeted for Board operations. The Board's own budget has historically comprised a small fraction of the total School budget: approximately 0.3 percent.[22] Under the new contract, SABIS Inc. would "allocate" its charges to the School for management fees and license fees from the funds transferred by the Board. The

[21] Under M.G.L. c. 71, §89(j)(5), the Board of Education is required to approve the terms of any charter school contract with a private entity that will provide "substantially all educational services" to the School.

[22] In the 1999-2000 proposed budget contained in the School's 1998-1999 annual report, Board expenses were budgeted at $30,000 out of a total projected School budget of $7,983,000.

contract did not specify a procedure for reimbursing SABIS Inc. for corporate expenses or for administering the School's other financial obligations to SABIS Inc.[23]

Increasing SABIS Inc.'s control over School finances would be extremely risky and unwise as well as inappropriate. As discussed in the Office's 1999 report and in the previous Finding 1 of this report, SABIS Inc. consistently failed to institute sound business systems and practices over a four-year period despite repeated findings by the School's auditors of major internal control weaknesses in the School's business operations. Similarly, SABIS Inc. failed to correct the problems of poor or nonexistent financial documentation identified by the School's auditors each year.

SABIS Inc.'s increased financial control would also increase the risk that funds appropriated for the School's use may be shifted to other schools managed by SABIS Inc. Records reviewed by the Office showed that funds were transferred between schools managed by SABIS Inc. on several occasions. The School provided the Office with a spreadsheet of financial transactions between the School and SABIS Inc. for the 1996, 1997, 1998, and 1999 fiscal years. The spreadsheet included a $76,776.92 entry labeled "Summer 1997 – Somerville Trfr." The Office showed the former Director this spreadsheet as well as a record from the Somerville Charter School showing transfers of $30,000 and $250,000 between the two schools. The former Director provided the following written explanation to the Office:

> When the Somerville Charter School was opening, the Sabis International Charter School ordered materials and supplies from vendors (that school had no credit standing yet) in the amount of $30,000. Somerville Charter School repaid that amount. Nine days later the Somerville Charter School transferred $250,000 to the Sabis International Charter School. That amount was intended for [SABIS Inc.] in Minnesota. The $250,000 was sent transferred [*sic*] to the Somerville Charter school by the Sabis International Charter School.

[23] The issue of how SABIS Inc. would allocate the amounts owed to SABIS Inc. from the funds received from the School may be rendered largely irrelevant by another contract provision, discussed below, that would entitle SABIS to retain all of the School's surplus funds.

The former Director's letter thus confirmed that public funds were transferred on several occasions between the accounts of two independent Massachusetts public schools whose only connection was that they shared the same management contractor.[24]

Moreover, the School's spreadsheet did not list the transfers of $30,000 and $250,000 between the School and the Somerville Charter School. These fund transfers and record-keeping discrepancies are alarming indications of lax financial controls over the School's funds.

Giving a private contractor discretion to manage the assets of a public organization without safeguards such as accounting controls, sound business practices, and effective contract oversight by the contracting organization jeopardizes those assets. Under this scenario, any organization is extremely vulnerable to mismanagement, abuse, and fraud. By requiring most School funds to be transferred to SABIS Inc., the new contract would dramatically increase the School's exposure to these risks.

At the same time, the new contract would reduce the Board's ability to monitor SABIS Inc.'s management of the School's financial operations. The 1995 contract required SABIS Inc. to submit monthly financial reports to the Board. (As discussed in the previous Finding 1, the Board did not enforce this requirement.) However, the new contract would require SABIS Inc. to provide financial reports to the Board only on a quarterly basis and only upon request, thereby further reducing the Board's access to financial information. The new contract would also continue the Board's practice of delegating to SABIS Inc. the responsibility for preparing the School's annual audits. As discussed in Finding 1, this responsibility should reside with the Board.

Finally, the new contract would eliminate the principal source of leverage available to a contracting organization: control over payments to the contractor. Under any service contract, the contracting organization should verify that the contractor's performance has been satisfactory before approving each fee payment. However, the new contract

[24] The former Director's letter did not address the $76,776.92 entry labeled "Summer 1997 – Somerville Trfr." on the School's spreadsheet.

would authorize SABIS Inc. to "allocate" fees to itself from the funds transferred by the Board. Under this arrangement, the Board would not have the ability to withhold payments to SABIS Inc. even if SABIS Inc. had not fulfilled the terms of the contract.

2b. The new contract would significantly increase SABIS Inc.'s potential compensation while eliminating the School's ability to invest in School programs and operations.

Although the new contract would not change the educational or administrative functions for which SABIS Inc. has been responsible, the new contract would significantly increase SABIS Inc.'s potential compensation. The new contract provided that, in addition to the license fee, management fee, and corporate expense reimbursements, SABIS Inc.'s compensation would include all surplus School funds. The contract language regarding SABIS Inc.'s entitlement to the School's surplus funds was convoluted, as the following excerpt shows:

> **2.4 Operating Budget.** SABIS® agrees to use the amounts received under Section 1.3 solely for the purposes and obligations contained in this Management Agreement. SABIS® shall prepare and present to the Board of Trustees for its approval the annual and projected Budgets in the spring preceding each school year. Budget approval shall not be withheld by the Trustees to reduce or eliminate SABIS® profits. **SABIS® shall be allowed to recover its investment and accumulated deficits (prior year losses) net of annual surpluses by way of future surpluses during the contract period and any extension thereof,** however, surplus shall not be applied to deficits if it adversely affects providing for current student needs. **The satisfaction of any and all accumulated deficits by future surplus shall not mean SABIS® is no longer entitled to surplus.** . . . Any surplus remaining from payments received by SABIS pursuant to Section 1.3, (the six (6%) percent management fee, six (6%) percent license fee, and corporate expenses) after all expenses of the school have been paid, shall be retained by SABIS®. In the event that no surplus of funds remains from the tuition payments after all expenses of the School have been paid, SABIS® shall bear sole financial responsibility for all remaining expenses and neither the School, nor the Trustees shall have any obligation to contribute additional funds. [Emphasis added.]

This contract provision stated that SABIS Inc. would be entitled to recover its "investment and accumulated deficits," but these terms were undefined, as was the methodology for allowing SABIS Inc. to achieve this recovery "by way of future surpluses." The contract stated that SABIS Inc. would retain any surplus remaining "after all expenses of the school have been paid," but contained no explanation of how, when, or by whom the determination would be made that "all expenses of the school" had been paid. Moreover, while the final sentence of the foregoing provision suggested that SABIS Inc. would be responsible for any future operating deficits, the preceding provision allowing SABIS Inc. to recover its accumulated deficits "by way of future surpluses" suggested that the School could ultimately bear the cost of any operating deficits. In short, this contract language is so poorly drafted that it would be impossible for the School or its independent auditor to calculate with any degree of certainty the compensation to which SABIS would be entitled in a given contract year.

The contract language stating that SABIS Inc. would bear all remaining expenses in the event that there was no surplus suggests that the School would no longer have to borrow funds from SABIS Inc. to cover operating shortfalls under the new contract. However, in September 2000 the Board's attorney forwarded to the Office a draft revolving line of credit note authorizing the School to borrow $600,000 from SABIS Inc. at an interest rate of one percent per year in excess of the prime rate on the date of the loan.

The new contract language quoted above could substantially increase SABIS Inc.'s compensation. As Table 3 shows, the School has reported an increase in net assets (or surplus) every year except the 1998 fiscal year, when the School reported a decrease in net assets. The School's reported surpluses for the 1996, 1997, and 1999 fiscal years totaled $850,020 – an average surplus of $283,340 for each of the three years. Had the above-cited provision been in effect during the first four years of the School's contract with SABIS Inc., SABIS Inc. would have charged the School an additional $575,610 over and above the $2.2 million in fees and corporate support charges discussed in the previous Finding 1.

Table 3. Changes in Net Assets Reported by the School

Fiscal Year	Increase/Decrease
1996	$405,217
1997	317,858
1998	(274,410)
1999	126,945
Total	**$575,610**

Source: Audited financial statements.

More broadly, this new contract language would be highly disadvantageous to the School. As discussed in detail in the Office's 1999 report, a compensation provision that bases a management contractor's payment on the charter school's surplus revenues at the end of the fiscal year creates a disincentive for the management contractor to make or recommend certain expenditures that may be warranted, since any expenditure reduces the school's potential surplus and, thus, the contractor's compensation.

The risks are even higher if the management contractor is responsible for preparing the charter school budget, as in the case of the School. Put simply: every unspent dollar budgeted as an expenditure becomes part of the surplus retained by the management contractor, as does every dollar of actual revenue that was not included in the budget. Under this scenario, the management contractor has an incentive to overestimate budgeted expenditures or underestimate budgeted revenues.

Moreover, any unanticipated (and, therefore, unbudgeted) grants and donations that are received by the charter school during the year could increase the amount of the surplus – and, thus, the management contractor's compensation. In other words, monies given to the School for the benefit of the students could instead become part of SABIS Inc.'s compensation.

Finally, this type of compensation provision also eliminates the opportunity for a school to reinvest surplus funds in school operations and to share in the financial benefits of any efficiency measures or cost-saving strategies during the fiscal year. For example, if the Board were to restructure the School's business operations, the Board could potentially generate substantial cost savings that could then be used for programs or activities that serve the School's mission.[25] Under the new contract, however, only SABIS Inc. would reap the financial benefits of a more efficient and cost-effective business operation.

In short, the surplus provision could reward SABIS Inc. for poor budgeting and for changes in the School's finances unrelated to SABIS Inc.'s performance as the School's management contractor. In the Office's view, there is no public policy justification for an arrangement that creates these incentives.

2c. The indefinite term of the new contract would insulate SABIS Inc. from competition in the future, thereby reducing its incentives to provide efficient, high-quality services to the School.

The new contract stated that the term of the contract was "indefinite":

> This Management Agreement shall run from the date hereof for an indefinite term, subject only to the renewal of the Charter and the provisions of the Charter School law, School Policies, developed in conjunction with SABIS® and any and all other applicable federal and state laws and regulations.

Contracting with a private contractor to furnish services for an indefinite term is an unsound business practice. This type of provision binds the contracting organization to terms and conditions that may prove unfavorable over time. It also reduces the likelihood that the contracting organization will conduct a meaningful evaluation of the contractor's performance and cost of the contract, since this evaluation is most likely to take place when the contract is about to expire.

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[25] As discussed in the previous Finding 1, the School has for many years paid fees to SABIS Inc. to perform administrative functions that have in fact been performed by the School's own administrative staff.

Research shows that when government contracts with the private sector, the competitive pressures of the private marketplace can produce more efficient, cost-effective service delivery methods. Conversely, such contracts tend to be neither efficient nor cost-effective without the discipline of competition.[26] The charter school concept is premised on a similar assumption: i.e., that by creating a competitive environment, charter schools will create incentives for other public schools to institute innovative educational practices, thereby fostering improved educational outcomes throughout the public education system.[27]

The indefinite term of the School's new contract would effectively insulate SABIS Inc. from competitive pressure. This provision – like many other provisions of this contract – would be advantageous to SABIS Inc. but disadvantageous to the School.

2d. The new contract would allow SABIS Inc., but not the School, to terminate the contract after five years.

The purpose of a contract is to create binding obligations for both parties while balancing and protecting both parties' interests. However, the renewal provision contained in the new contract would allow SABIS Inc. – although not the School – to propose changes to the contract at any time after the first five years but within 10 years. Under this provision, if the School did not agree to SABIS Inc.'s proposed changes, SABIS Inc. – but not the School – would be able to terminate the contract at the end of the academic year. The precise contract language is provided below:

> At any time, after July 1, 2005, but before June 30, 2010, SABIS® may provide a written notice to the Trustees of its desire to renegotiate the Management Agreement. The written notice shall contain any proposed

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[26] See, for example, John D. Donahue, *The Privatization Decision: Public Ends, Private Means* (HarperCollins, 1989); John Goodman and Gary Loveman,, "Does Privatization Serve the Public Interest?," *Harvard Business Review*, November-December 1991; Donald F. Kettl, *Sharing Power: Public Governance and Private Markets* (Brookings Institution, 1993); and Jonas Prager, "Contracting Out Government Services: Lessons from the Private Sector*," Public Administration Review* (March/April 1994).

[27] See, for example, the DOE's 1998 report entitled *The Massachusetts Charter School Initiative: Expanding the Possibilities of Public Education*.

> changes in this Management Agreement that SABIS® believes should be made as a condition of its continued management. Within thirty (30) days of receipt by the Trustees of SABIS'® written notice to renegotiate, the Trustees shall in writing indicate whether it desires to renegotiate the Management Agreement and if so, the conditions it is willing to accept. If both parties desire to revise the terms of the Management Agreement, the parties shall endeavor in good faith to reach an agreement on the terms no later than one hundred eighty (180) days from the date of the Trustees Notice to Renegotiate. **If there is no agreement on the new terms, within the one hundred eighty (180) days, then SABIS® at its sole option shall elect to continue under the terms then in existence or terminate the Management Agreement.** In either event, the parties shall fulfill all their mutual obligations hereunder until the end of the then current academic year. [Emphasis added.]

Thus, SABIS Inc. could after the first five years propose substantial changes: for example, SABIS Inc. could propose to reduce or eliminate the educational performance requirements specified in the contract. If the Board did not agree to the changes, SABIS Inc. could terminate the contract at the end of that academic year. This provision would effectively render the educational performance requirements as well as the other contract requirements unenforceable after five years. If the Board took steps to enforce a requirement, SABIS Inc. could then propose a change to the requirement and then terminate the contract if the Board did not accept the proposed change. In the meantime, the School would be bound to the many unfavorable contract provisions (some of which have been previously discussed in this report) until the year 2010.[28]

2e. The dispute resolution and termination provisions of the new contract would undermine the Board's ability to terminate the contract if SABIS Inc. failed to perform.

The dispute resolution and termination provisions of the new contract would permit either party to terminate the contract for cause – i.e., in the event of a material breach by the other party of the terms of the charter school law, any applicable law or regulation, or the contract itself. However, disputes over contract breaches would have to be submitted to binding arbitration. The non-breaching party would be able to

[28] The apparent conflict between this provision and the previously discussed provision specifying an "indefinite term" was not addressed or resolved by the contract.

terminate the contract *only* if the arbitrator determined that the breaching party either could not remedy or refused to remedy the breach. In other words, even if the arbitrator determined that SABIS Inc. had failed to perform under the contract and that this failure constituted a material breach of the contract, the School would not have the right to terminate the contract unless the arbitrator also found that SABIS Inc. would not or could not perform in the future. This provision would thus undermine the School's capacity to hold SABIS Inc. accountable for fulfilling the educational performance requirements and providing the services required by the contract.

Finding 3. The Board of Trustees did not accurately document its official actions and policies.

Charter schools are required to operate in accordance with the state's open meeting law, M.G.L. c. 30A, §11A½. The open meeting law requires governmental bodies to maintain accurate, detailed documentation of their official actions, including those taken during executive sessions.[29] The open meeting law states, in part:

> A governmental body shall maintain accurate records of its meetings, setting forth the date, time, place, members present or absent and action taken at each meeting, including executive sessions. The records of each meeting shall become a public record and be available to the public; provided, however, that the records of any executive session may remain secret as long as publication may defeat the lawful purposes of the executive session, but no longer. All votes taken in executive session shall be recorded roll call votes and shall become a part of the record of said executive session.[30]

The School's 1998-1999 annual report contained the following description of the Board's policy-setting role:

> School governance is sound and it benefits from the direct oversight and support of the School's Board of Trustees and the SABIS Educational Management System. The administrative team manages day to day

[29] Executive sessions are not open meetings. The open meeting law specifies the procedural requirements for convening executive sessions, defines the specific purposes for which executive sessions may be convened, and restricts the circumstances under which executive session records may be kept secret.

[30] M.G.L. c. 30A, §11A½(7).

> operations of the school. The Board sets all policies for the school. **Meetings are held throughout the year in compliance with the Open Meeting Law.** [Emphasis added.]

In response to the Office's request, the School provided minutes of 27 meetings held by the Board of Trustees between June 1995 and November 1999. These meeting minutes contained no documentation of any discussion or recorded votes on the following major policy matters affecting the school's finances:

Annual school budget. The Board meeting minutes contained no documentation of any discussion or recorded votes on the school's annual budget. However, in an interview with the Office, the Board Chairman stated that each year SABIS Inc. prepared the budget and submitted it to the Board, and that the Board did vote on each budget.

Deferred fees and charges owed to SABIS Inc. The Board meeting minutes contained no documentation of any discussion or recorded votes on the School's decisions to defer payments of management fees and other financial obligations to SABIS Inc.[31] According to the Board Chairman, however, the Board did hold lengthy discussions of the deferred payments to SABIS Inc.

Corporate support expense reimbursements to SABIS Inc. The Board meeting minutes contained no documentation of any discussion or recorded votes on the School's corporate support expense reimbursements to SABIS Inc. As discussed in the previous Finding 1, however, the Board Chairman stated that the Board did review and authorize these reimbursements.

Loans from SABIS Inc. The Board meeting minutes contained no documentation of any discussion or recorded votes on SABIS Inc.'s loans to the School. According to transaction records provided to the Office by the School, SABIS Inc. transferred funds to the School on 16 occasions between October 1995 and November 1999. Table 4 lists these fund transfers.

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[31] The School's practice of repeatedly deferring payments of its financial obligations to SABIS Inc. was a focus of the Office's 1999 report.

Table 4. Fund Transfers from SABIS Inc. to the School

Transaction Date	Amount	Transaction Type
10/16/95	$100,000	wire transfer
12/6/95	120,000	wire transfer
8/29/96	100,000	wire transfer
5/8/97	100,000	wire transfer
5/23/97	100,000	wire transfer
6/10/97	100,000	wire transfer
6/20/97	100,000	wire transfer
9/4/97	270,000	check
12/10/97	178,000	check
3/25/98	100,000	check
8/28/98	100,000	check
9/10/98	200,000	check
9/23/98	50,000	check
3/26/99	100,000	check
8/25/99	70,000	unspecified
9/99	450,000	unspecified

Source: Transaction records provided by SABIS International Charter School.

Although many of the financial transactions listed in Table 4 entailed substantial amounts of money – $100,000 or more in most cases – the minutes of Board meetings held between June 1995 and November 1999 contained no documentation of any Board votes or discussion relating to these financial transactions.[32]

The Board Chairman stated in an interview that the Board has had a general understanding with SABIS Inc. that SABIS Inc. would advance funds to the School if necessary and that the Board has discussed the School's financial obligations to SABIS

[32] The Office's 1999 report raised concerns about the school's mounting financial obligations to SABIS Inc. and the absence of a written loan agreement between the school and SABIS Inc. The School's audited financial statements for the 1999 fiscal year reported that the School owed SABIS Inc. more than $900,000 as of June 30, 2000.

In September 2000, the Board's attorney advised the Office that the School's financial obligations to SABIS Inc. had been paid in full, that the Board and SABIS Inc. were close to an agreement on a revolving line of credit arrangement to address the School's future cash flow needs, and that a $600,000 revolving line of credit note had been drafted for execution in the near future.

Inc. at Board meetings. He expressed surprise that these discussions were not reflected in the Board minutes.

The open meeting law requires that executive session minutes be recorded and that these records include roll call votes taken in executive sessions. According to the School's attorney, however, the School has not recorded minutes of the Board's executive sessions.

The September 2000 letter from the Board's attorney to the Office indicated that the Board had recently sought and received legal guidance regarding the requirements of the open meeting law.

The problem of inadequate documentation also extended to the issue of student enrollment. The Board's longstanding, unwritten policy of according preference to the children of the School's Board members conflicted with the enrollment procedures mandated by the charter school law and described in the School's annual reports.

The charter school law sets out the process by which a charter school must select students when the total number of eligible applicants who reside in the city or town in which the charter school is located exceeds the number of spaces available. Under M.G.L. 71, §89(n), charter schools are required to hold an admissions lottery to determine which eligible students should be enrolled. The charter school regulations, 603 CMR 1.06, specify a process by which those eligible applicants not selected in the lottery are placed on a waiting list in the order the names were drawn and then enrolled as space becomes available. The charter school regulations state, in part:

> Charter schools shall place names of students not selected in an enrollment lottery on a waiting list in the order the names were drawn. Students on the waiting list may be enrolled as space becomes available. In cases where the enrollment of a student from the waiting list would exceed the district charter tuition cap or the total number of students for which a district was notified, the student should be skipped over but kept on the waiting list.

The SABIS International Charter School's 1998-1999 Annual Report provided the following description of its enrollment policy:

> Enrollment policies are non-selective and non-discriminatory. A list is sent to the Springfield Public School System each year stating the number of openings we have in each grade. They select the students that will be admitted to SABIS by means of a lottery. Our enrollment policy is in compliance with the state enrollment mandates. We have always maintained a waiting list that at this point has reached over 1,600 students. Priorities with consideration for race and gender balance will be made according to an accumulated point system. If an applicant has other siblings that attend SABIS, they receive two points. One point can also be accumulated for residence in the Educational Zone of our school. Another point is accumulated if SABIS is the closest available school or in walking distance.

The Board meeting minutes show, and the Chairman of the Board of Trustees confirmed in an interview, that the School has had a longstanding policy of enrolling the children of Board members before other applicants on the waiting list. None of the annual reports issued by the School have disclosed this policy.

According to the minutes of the Board meeting held on September 15, 1999 the Board decided to continue its policy of according preference to Board members' children, despite concerns about the policy expressed by the DOE's Acting Associate Commissioner. The minutes stated:

> The Board agreed to maintain the policy to admit children of SABIS Board of Trustees to the school. The students will be admitted without displacing other students on the waiting list and will be funded by SABIS Educational Systems.

In an interview, the former Director of the School explained that when the School enrolled the children of Board members, it did not include those children in the enrollment figures reported to the DOE. The M.G.L. c. 70 funds provided to the School by the DOE were computed on the basis of the School's reported enrollment, which would have been lower than the actual enrollment if any Board members' children had been newly enrolled. SABIS did not actually "fund" the tuition of the Board members' children, according to the former Director; rather, the cost of educating these additional children was simply absorbed by the School. The Board Chairman told the Office that the Board has since 1995 accorded preference in the admission process to the children of Board members, that this policy has been unwritten, and that the DOE disagreed with the policy.

The DOE's charter school regulations require charter schools to provide written notification to and obtain the approval of the Board of Education for any material changes to their programs or governance.[33] The regulations state, in part:

> If a charter school plans to change materially its program or governance, the Board of Trustees shall submit in writing to the Board of Education a request to amend its charter. Material changes requiring a charter amendment include, but are not limited to, any change in the membership of a charter school's Board of Trustees, and substantive modifications to a charter school's educational philosophy or mission, school schedule, **admissions process**, governance structure, by-laws, school management contract, code of conduct, enrollment capacity, or school location. [Emphasis added.]

Thus, the Board should have documented the change to its official enrollment policy and submitted the new policy to the Board of Education back in 1995, when the policy was first adopted.

It is understandable that Board members who assume the substantial governance responsibilities and obligations of Board membership would like to be assured that their children will be enrolled in the School. However, the Board exercised poor judgment by operating the School for five years on the basis of an unwritten enrollment policy that conflicts with the official enrollment policy set forth in the charter school law and in the School's own annual reports. This approach to governance undermines public accountability and could foster public cynicism. The Board is obligated by its charter to comply with the charter school law and the terms of the charter.

In March 1999, the DOE's Acting Associate Commissioner sent a memorandum to all charter school leaders emphasizing the importance of a "clear and fair enrollment process." Such a process is fundamental to the concept of charter schools as independent public schools.

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[33] 603 CMR 1.10(1).

Conclusion and Recommendations

Charter schools are charged with the ambitious mission of improving the educational performance of public school students. As the Commonwealth's public agents, charter school boards of trustees are responsible for providing sound, professional school governance and financial management. Since 1995, the Board of Trustees of the SABIS International Charter School has contracted with a private management contractor, SABIS Inc., to administer the School's educational programs and business operations.

The findings contained in this report show that the Board has not provided sufficient oversight of the School's business operations. Because of the Board's deficient contracting safeguards, the School has paid SABIS Inc. hundreds of thousands of dollars for questionable and unsubstantiated contract billings. At the same time, the School has paid its own staff to perform functions for which SABIS Inc. was contractually responsible. These arrangements were highly vulnerable to fraud, waste, and abuse.

The Board's new contract with SABIS Inc., which was executed in March 2000 and submitted to the DOE in April 2000, would magnify the problems detailed in this report. This indefensibly risky contract, which would require the Board to transfer to SABIS Inc. all but a fraction of the public funds it receives from the Commonwealth, would further increase SABIS Inc.'s control over the School's business operations and financial decisions while further reducing the Board's ability to hold SABIS Inc. accountable. If the new contract were approved and implemented, it appears likely that the School's financial decisions would increasingly be guided by private objectives rather than by public policy considerations in years to come.

This report has also shown that the lack of detailed records documenting major policy decisions and votes of the Board of Trustees has diminished the School's accountability to the members of the School community, local citizens, and state taxpayers whose dollars fund the School. Charter school advocates maintain that public disclosure – or "transparency" – is an essential component of charter school accountability.[34] Commonwealth charter schools, which are not subject to the jurisdiction of local school districts and are exempt from many regulations governing other public schools, have a special obligation to disclose information about their operations to interested parties in the community and elsewhere.

It is important to recognize that the Board of Trustees of the SABIS International Charter School, like other charter school boards of trustees, is comprised of unpaid members of the community who volunteer to devote time and effort to the worthy goal of improving educational opportunities for Springfield's children. The Office has no reason to doubt the Board Chairman's description of the Board members as well intentioned and committed to the School's success.

It should also be recognized that charter schools in Massachusetts and elsewhere have been evaluated primarily on the basis of the academic progress of their students. Accordingly, charter schools have been given wide latitude in establishing their internal operating procedures. While the Department of Education's small charter school office has provided assistance to charter schools, it has not provided detailed information to charter school boards of trustees concerning their statutory and fiduciary obligations. Moreover, charter applicants and charter schools applying for renewal of their charters have not been required to demonstrate that they are capable of instituting and maintaining efficient, effective business systems and practices.[35]

Nevertheless, the Board of Trustees of the SABIS International Charter School has been entrusted with the responsibility of operating a public school serving 1,200 children. Over the past five years, the Commonwealth has invested more than $23 million in the School. The educational and financial stakes are high, not only for the students, parents, teachers, and staff in the immediate School community, but for the

[34] See "Accountability Via Transparency" by Chester E. Finn, Bruno V. Manno, and Gregg Vanourek in a Heritage Foundation report entitled *School Choice 1999: What's Happening in the States*.

[35] The Office's 1999 report contained detailed recommendations for strengthening the DOE's oversight of Massachusetts charter schools.

School's other stakeholders, such as the children and families of children on the School's waiting list and the state taxpayers whose dollars fund the School. It is essential that the Board be willing and able to devote the care, time, and expertise necessary to fulfill its statutory and fiduciary responsibility to supervise and control the School.

The Board has recently taken steps to address some deficient management controls and clarify its contracting arrangements with SABIS Inc. The Board is to be commended for initiating improvements in the governance of the School. Sound business systems and contracting practices are fundamental to the capacity of any organization, whether public or private,[36] to sustain growth and achieve its long-term objectives. Accordingly, the Inspector General offers the following recommendations to address the issues raised in this report:

1. **The Board of Education should disapprove any contract between the School and SABIS Inc. containing the risky and unfavorable provisions discussed in Finding 2 of this report.**

2. **The Board of Trustees should evaluate alternatives to recontracting with SABIS Inc. to manage the School's business operations.**

   SABIS Inc.'s performance to date suggests that SABIS Inc. lacks the capacity to provide efficient, effective financial management services to the School and that these services should not be included in any future contract with SABIS Inc. Accordingly, if the Board is satisfied with the educational services provided by SABIS Inc., the Board should consider reducing the scope of the School's contract to exclude noneducational services. In view of the fact that School employees have performed most administrative functions for which SABIS Inc. has had contractual responsibility, this approach would not substantially change the School's staffing requirements, although it would require the Board to restructure the staff's reporting relationships to the Board to ensure clear lines of responsibility and accountability. If the Board elects to contract out the management of the School's business

[36] *The Balanced Scorecard* by Robert S. Kaplan and David P. Norton (Harvard Business School Press, 1996) contains a persuasive analysis of the importance of internal business processes to the long-term growth and success of private organizations.

operations, the Board should obtain the benefits of market-driven competition by seeking competitive proposals from qualified management contractors for these noneducational services.

3. **If the Board of Trustees elects to recontract with SABIS Inc. or to contract with a different management contractor for administrative services, the Board should direct its legal counsel to draft a new contract that will require and enable the Board to exercise appropriate financial oversight and control over School resources and operations.**

   The new contract should also enable the Board to hold SABIS Inc. or another management contractor fully accountable for performing the business functions required under the contract. The contract should include provisions that:

   - Clarify the contractor's functional responsibilities and specify the services the contractor is required to provide as a condition of payment of the fee or fees authorized in the contract.
   - Specify the dollar amount of the fee or basis of compensation, the payment terms, and the payment schedule.
   - Specify allowable reimbursements, if any, and require the contractor to submit invoices and written justification for all expenses submitted for reimbursement.
   - Specify the contract staffing requirements, including the number, qualifications, and time devoted to the contract of all on-site staff to be provided and funded by the contractor.
   - Require full implementation of the internal control measures recommended by the School's independent auditors.
   - Ensure appropriate restrictions on SABIS Inc.'s access to School funds.
   - Require the contractor to submit regularly scheduled reports to the Board documenting the contractor's performance and actions on behalf of the School.
   - Specify the term of the contract, which should be no longer than five years.
   - Require the Board to conduct and document a comprehensive evaluation of the contractor's performance prior to any renewal or extension of the contract.
   - Specify clear and workable termination rights to be exercised by the Board in the event that the contractor fails to perform at any time during the contract term.

4. **The Board of Trustees should directly select, contract with, and oversee the School's independent auditor.**

   The School's management contractor should have no role in procuring or managing the annual audits.

5. **The Board of Trustees should assign responsibility for administering and monitoring the School's management contract with SABIS Inc. (or another management contractor) to a School employee with appropriate financial and managerial skills and experience.**

   This contract administrator, in consultation with the Board of Trustees and the School's independent auditor, should institute sound business systems and procedures designed to provide the School with accurate, timely information and documentation regarding SABIS Inc.'s performance under the contract. The contract administrator should also review and approve all financial transactions between the School and SABIS Inc., monitor SABIS Inc.'s activities to ensure that they comply with applicable laws and sound business practices, and advise the Board on major policy decisions affecting the School's financial and administrative operations.

6. **The Board should continue to seek guidance concerning the legal requirements governing the Board and School employees.**

   The Board has recently adopted an open meeting law policy as well as a conflict of interest law policy. All other major policies should be accurately documented and, if required by the charter school regulations, submitted to the Board of Education for approval. The Board should also direct its legal counsel to prepare a comprehensive summary of the other legal requirements to which the School is subject, including but not limited to the charter school law and regulations, the public construction laws, and the public records law. The policies and the summary of legal requirements should be provided to the Board, the Director of the School, the Business Manager, the contract administrator (recommended above), all SABIS-funded contract staff assigned to the School, and other key School personnel.

7. **The Board should conduct or commission a systematic analysis of the School's financial requirements before borrowing additional funds from SABIS Inc. or any other source.**

   This analysis should also include identification of any alternatives to borrowing from SABIS Inc. Any loan agreement, including the draft revolving line of credit note currently under consideration, should require a formal vote of the Board.

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Appendix A: Response of the SABIS International Charter School Board of Trustees

The attached response[*] indicates that the Board of Trustees of the SABIS International Charter School recognizes the need for improved Board governance and has already begun to address some of the deficiencies identified this report. The Office made several changes to the draft report based on the Board's response. These changes, along with the Office's comments on the Board's responses to specific findings, are summarized below.

Finding 1. The Board's suggestion that the management fees paid to SABIS Inc. since 1995 were not intended to compensate SABIS Inc. for the management services detailed in the School's 1995 contract with SABIS Inc. reinforces the Office's position that the Board did not employ sound business and contract oversight practices in administering the School's financial relationship with SABIS Inc. The Office agrees with the Board that an excerpt from the question-and-answer section of a 1998 technical advisory issued by the DOE to charter schools was not directly on point. Accordingly, the Office omitted the excerpt from this finding.

The Board's comments regarding the School's annual audit indicate that the Board may not recognize the importance of ensuring that the Board directly selects, contracts with, and oversees the School's independent auditor. The Office stands by its position that these functions should not be delegated to the School's private management contractor.

Finding 2. The Board's response inaccurately characterizes some provisions of the contract with SABIS Inc. that was signed by the Board in March 2000 and submitted to the DOE in April 2000. For example, contrary to the Board's statements, the new contract explicitly required the Board to transfer School funds to SABIS Inc., did not require SABIS Inc. to expend funds in accordance with the budget approved by the Board, and did not require the Business Manager to approve SABIS Inc.'s expenditures.

[*] The Board's response letter has been scanned for electronic publication. The text of the letter has not been changed.

The Office stands by its position that the contract provisions cited in the report would further increase SABIS Inc.'s control over the School's business operations and financial decisions while further reducing the Board's ability to hold SABIS Inc. accountable. The draft report was corrected to state that the Board submitted the new contract to the DOE on April 10, 2000.

Finding 3. The Office commends the Board for its recent actions to address the Office's concerns regarding the Board's inadequate documentation of its major policy decisions and votes. The Office stands by its position that the Board should accurately document its unwritten student enrollment policy and submit the policy to the DOE for approval, as required by the DOE's charter school regulations.

BR&G

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November 8, 2000

VIA UPS NEXT DAY AIR

Robert Cerasoli, Inspector General
Commonwealth of Massachusetts
One Ashburton Place, 13th Floor
Boston, MA 02133

Re: SABIS International Charter School (the "School")

Dear Inspector General Cerasoli:

The Board of Trustees (the "Board") of the School has received your letter dated October 13, 2000 and enclosed draft report relative to the above matter. The Board appreciates the effort that was spent on the report and thanks you for offering it the opportunity to comment on the report prior to its publication. The Board especially appreciates your granting an extension of time within which to respond.

At the outset the Board wants to acknowledge that the report makes a number of points which will assist the Board in making further improvements to the business administration side of the School. However, in the Board's view, the report taken as a whole fails to present a balanced picture of the School.

First, while the obvious and appropriate focus of your office is on business practices, that is only a part of the focus of the Board, for which education is the most critical issue. Educationally, measured by any objective criteria, the School, through its collaboration with Springfield Education Management, LLC ("SABIS"), has been a great success. Before this was a charter school, it was one of the worst schools in Springfield in terms of facilities and student performance. Today, its diverse student body has grown fourfold, and out-performs that of almost all City schools. There are currently 1600 children on the School's waiting list, and the School has a physical plant second to none. These results are due to the cooperative efforts of the Board and SABIS.

Second, the Board was very concerned about the tone of, and overall impression left by, the draft report, which seems to say that the School has been mismanaged. As referenced above, the School's management has allowed it to achieve great educational success and, therefore, has been extremely effective by that critical measure. The business administration aspect of School management has been a work in progress. When the School was first awarded a charter by the Board of Education in March of 1995, there was no history and no official guidance to assist the Trustees in their operation of the School. As you noted in your report, in 1996 the predecessor to the Department of Education first issued a legal memorandum providing an overview of the laws affecting the governance structure of charter schools. In 1998, the Department of Education ("Department") promulgated guidance relative to sound business practices, but as you state elsewhere in your report, the Department of Education's assistance to charter schools has not included detailed information concerning their statutory and fiduciary obligations. In fact, the report prepared by your office issued in November of 1999 indicated that whatever systemic weaknesses may have existed in the management and administration of charter schools generally, were attributable at least in part to the lack of comprehensive official guidance.

Finally, for the Board, the crux of the matter is stated on page 36 of your draft report where you note: "It is important to recognize that the Board of Trustees of the SABIS International Charter School, like other charter school Boards of Trustees, is comprised of unpaid members of the community who volunteer to devote time and effort to the worthy goal of improving educational opportunities for Springfield's children. The office has no reason to doubt . . . that the Board is well intentioned and committed to the School's success." The Board believes that the record is clear that when specific recommendations have been presented, or where specific shortcomings have been identified, the Board has followed such recommendations and corrected such shortcomings. Yet, the Board's recent efforts to improve the management and administration of the School (which began in the Spring of this year) are not presented in the draft report in a positive manner. It notes in italicized form that in September 2000 your office received certain information from us, as attorneys for the Board, relative to what are essentially characterized as purported improvements. In fact, these improvements have been made and additional improvements have been made or are in the process of being made as set forth below. These improvements are significant and they ought to be acknowledged directly.

<u>Finding No. 1</u>

The first finding set forth in the draft report, namely that the Board did not employ sound business practices during the first five years of the School's operations, is unwarranted. The statement in the draft report is based on the three subsidiary findings, relating to discrete issues, which do not support such a broad conclusion.

"Although SABIS, Inc. charged the School more than $950,000 in management fees between 1995 and 1999, the School paid the salaries of the on-site staff who administered the School's business operations on a daily basis during this period." (page 7)

This subsidiary finding is not directly related to any of the "three essential elements of sound business practices" cited in the report. Rather, this finding seems to be a criticism of the School's 1995 management contract with SABIS. The report implies that the School either did not receive value for the management fees paid or paid twice for the same service. In fact, the management fee charged by SABIS, as is noted in the report, was intended to compensate SABIS for many activities not specifically related to management, including "research and development of curriculum materials, program time tabling, and quality control oversight." While the use of the term "management fee" may therefore have been less than completely descriptive, the extent of overlap between services provided by SABIS and those performed by School employees was apparently fairly limited and not necessarily inappropriate.

In addition, the business administration of the School changed during the first five years of the School's operation. While the Director of the School and the School's Business Manager were employees of the School paid by School funds throughout this period, since 1998 SABIS has provided substantial oversight through a Regional Manager employed, at least in part, by it.

"The Board of Trustees authorized more than $300,000 in reimbursement to SABIS, Inc. for 'corporate support' expenses that were neither specified in the 1995 contract nor substantiated with invoices." (page l2)

As to this secondary subsidiary finding, the Board acknowledges that the previous management contract could have been clearer on the types of expenses intended to be reimbursed for "corporate support." The Board did review these expenses but the timing and method of review and the record keeping related to such expenses could have been better. As was reported to your office in prior correspondence, however, the Board has taken action to address these issues. After extensive consideration of the issue, the Board has decided to propose to SABIS that the new management contract should provide for reimbursement to SABIS for corporate support only with the prior written approval of the Board based upon a showing both of the need for such support and an explanation of why the cost of the support is not included in the management fee. In addition, the Finance Committee took steps in July 2000 to assure proper monthly review of all income and expense items.

"The Board of Trustees inappropriately ceded responsibility to SABIS, Inc. for selecting and engaging the services of the School's independent auditor." (page 15)

The Board does not agree with this finding. The Board does understand its statutory responsibility with regard to engagement of an independent auditor. However, the Board does not agree that its actions with regard to the annual audit have evidenced a failure to employ sound business practices. In each year except 1998, the local firm of Moriarty & Primack, LLC, was engaged to perform the audit. In 1998, a Minnesota firm was engaged. This firm, like Moriarty & Primack, was an independent audit firm and not "SABIS, Inc.'s own Minnesota audit firm." The report contains no indication that this firm's audit or Moriarty & Primack's audits were other than complete and accurate. In fact, no annual audit has ever disclosed any material weakness and all recommendations relative to reportable conditions contained in audit reports have been addressed by the Board. It is unclear to the Board why your office feels that their actions in this regard "raise[] serious concern about the independence of the School's audits."

The Board also feels that your report understates its efforts recently (again, beginning last Spring) with respect to auditing procedures and policies. At its meeting in July, 2000, the Board requested and received a presentation detailing its responsibilities with regard to the annual audit, including the engagement of the auditor, the scope of the audit, and appropriate follow-up of any audit findings or recommendations. Also at that meeting, the Board instructed SABIS to work with Moriarty & Primack to develop a complete accounting procedures manual.

Finding No. 2

This finding criticizes various provisions of the new management contract between SABIS and the Board. Some of the information presented in this section is incorrect and the paragraph summarizing the background of the issue on page 6 is misleading and incorrectly implies that the Board has been deceptive or irresponsible. On page 18, the report indicates that the Board had not submitted the new management contract to the Department of Education by August of 2000. In fact, pursuant to G.L. c. 71, §89(j)(5), the Board submitted a draft to the Department on April 10, 2000 for its review and approval. The Board was told that the document had to be signed in order to be reviewed by the Department, but the Board always anticipated that that review would result in changes. The Department did not respond until the School contacted it in August of 2000, at which point the Board was told by the Department to operate under the unapproved contract and that the Department's comments and proposed revisions would be sent at a later date. The Department's comments were not received by the Board until October 20, 2000. Clearly, this document has been a work in progress, and the Board has been working with the Department to incorporate suggested changes since that time. The lack of Department approval should not be reported to imply any failure on the part of the Board to meet its procedural responsibilities.

With regard to substantive issues, the Board has addressed all of the concerns raised by your office relative to the new management contract and intends to modify the contract in those areas the Board deems appropriate.

"The new contract would significantly increase SABIS Inc.'s financial control over the School while reducing Board oversight." (page 19)

The Board does not agree with this finding. All funds are and will be deposited initially in an account in the name of the Board. Quarterly, as funds for the School's operations are received, they will be transferred to an operations account (not to SABIS). Funds will be expended from the operations account only in accordance with the budget approved by the Board and only with the approval of the Business Manager employed by the School (not by SABIS) and responsible to the Board.

As mentioned above, the Board's Finance Committee already has directed SABIS to provide monthly financial information which will be reviewed timely to improve financial control.

"The new contract would significantly increase SABIS Inc.'s potential compensation while eliminating the School's ability to invest in School programs and operations." (page 21)

The Board also disagrees with this finding. The Board does understand the need to modify the new contract to clarify the issue of surpluses and deficits and is working with SABIS to do so. The conceptual agreement between the parties is that meeting educational goals will continue to be paramount and that the Board will have control through the budget approval process. SABIS's ability to recoup deficits will be limited by the need to provide adequate and appropriate funding for education. Since all funds (other than SABIS fees and the Board's expenses) will be allocated in the Budget to specific education related expenses on an annual, line-item basis, surpluses will result only from efficiencies implemented in the current operating year and will be carefully managed and controlled by the Board.

"The indefinite term of the new contract would insulate SABIS, Inc. From competition in the future, thereby reducing its incentives to provide efficient, high quality services to the School." (page 25)

The Board believes the new management contract should be for a five-year term. The expectation of both parties is that the relationship will continue thereafter. All issues, however, would be open for negotiations at the end of the term although SABIS's percentage fees seem to be fixed. In the Board's view, all termination provisions in the new contract should be reciprocal.

"The dispute resolution and termination provisions of the new contract would undermine the Board's ability to terminate the contract if SABIS Inc. failed to perform." (page 27)

The Board is working with SABIS to modify this provision in the new contract to address the concern raised by your office.

After developing revisions to the contract substantially in accordance with the discussion above, the Board will need to hear back from the Department as well as SABIS, and thus further discussion in this letter of substantive issues is premature at this time.

Finding No. 3

The third finding of your report, relating to accurate documentation of official actions and policies, is another area where the Board's recent actions have received inadequate recognition. At its July meeting, the Board received not only "legal guidance regarding the requirements of the open meeting law" (as reported on page 31 of the report) but a comprehensive presentation relative to the responsibilities of Board members as public employees, the conduct of meetings including executive sessions, and help with appropriate record keeping procedures. All of this was documented to your office in materials which accompanied the letter from us, as counsel to the Board, to your office in September.

The enrollment of the children of Board members has been the source of an honest difference of opinion with respect to the interpretation of charter school regulations. The Board voted to continue to allow enrollment of their children in the School as long as the Department of Education, which was aware of the policy, did not forbid it. The Board will continue to reconsider this policy over time.

Conclusion

In the Board's view, the educational performance of the School has been consistently superior. With regard to business administration, the Board recognizes that it is always possible to do better and is committed to doing so. The Board has been assisted by input from the Department and from your office in this regard. In fact, your office clearly has been the impetus for many of the recent improvements in this area. The Board hopes to continue to make such improvements and trusts that your office will continue to play a supportive role in that process.

Very truly yours,

Peter H. Barry

PHB/rw