



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

Making government work better

Official Audit Report-Issued October 7, 2013

Gloucester Community Arts Charter School

For the period July 1, 2010 through January 9, 2013





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Making government work better

October 7, 2013

Maura O. Banta, Chair
Massachusetts Board of Elementary and Secondary Education
75 Pleasant Street
Malden, MA 02148

Mitchell D. Chester, Commissioner
Massachusetts Department of Elementary and Secondary Education
75 Pleasant Street
Malden, MA 02148

Dear Chairwoman Banta and Commissioner Chester:

I am pleased to provide this performance audit of the Gloucester Community Arts Charter School (GCACS). This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2010 through January 9, 2013 (the date the school ceased operations). I am providing this report to you in your capacity as the responsible oversight entities for the charter school, since GCACS is no longer legally in existence. My audit staff discussed the contents of this report with management and the chairperson of GCACS's Board of Trustees before the June 30, 2013 expiration of the charter. The chairperson subsequently provided comments that were the basis for the Auditee Response content appearing in the report.

I also would like to express my appreciation to the Department of Elementary and Secondary Education for the cooperation and assistance provided to my staff during the audit of GCACS.

Sincerely,

A handwritten signature in blue ink, appearing to read "SMBump".

Suzanne M. Bump
Auditor of the Commonwealth

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EXECUTIVE SUMMARY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor (OSA) has conducted a performance audit of certain activities of the Gloucester Community Arts Charter School (GCACS) for the period July 1, 2010 through January 9, 2013. Our audit objectives were to (1) determine whether GCACS had instituted adequate internal controls over its financial and management activities and was complying with applicable laws, rules, regulations, and charter provisions and (2) obtain information regarding the oversight of GCACS performed by the state's Department of Elementary and Secondary Education (DESE).

On February 24, 2009, the Commonwealth's Board of Elementary and Secondary Education approved a charter for GCACS, authorizing it to operate a school that included kindergarten through eighth grade for up to 240 Gloucester-area students beginning September 2010. At the time that OSA initiated its audit, GCACS had completed its second year of operation with a final enrollment of 127 students and had begun its third year of operation with a starting enrollment of 132 students. However, deficiencies in the operation of GCACS resulted in a DESE proposal to revoke the school's charter in December 2012 and, combined with an escalating financial crisis at the school, led to a decision by the GCACS's Board of Trustees (Board) to abruptly close the school on January 9, 2013. Although the school was closed, GCACS remained a legal entity through June 30, 2013 to complete closeout activities required by state law and DESE regulations.

Summary of Findings

We found that deficiencies in Board governance, management, and financial practices, combined with low enrollment, rendered GCACS insolvent and, together with what DESE determined to be inadequate educational performance, resulted in the abrupt closure of the school. The specific issues we identified are as follows:

- GCACS did not adequately address numerous deficiencies related to procurement, accounting, internal control, recordkeeping, management, education, governance, and compliance with the state's Open Meeting Law (Chapter 30A, Sections 18 – 25, of the General Laws) that had been identified in external reviews conducted by the Commonwealth's Office of the Inspector General (OIG), the Attorney General's Office, a private certified public accounting firm, DESE's Charter School Office, and a private charter-school management consultant.

- GCACS did not accurately estimate its student enrollment; as a result, its actual enrollment figures were, on average, only approximately 65% of the enrollment estimates that it used to establish its budgets during its years of operation.
- GCACS spent more to rent its facilities than was planned for in its approved charter proposal. Specifically, it leased a building that cost approximately \$55,000 more per year than its charter proposal said it would spend on all of its occupancy costs (including lease payments, utilities, and other expenses) and also indebted the school for lease payments for ten years longer than its charter proposal permitted.
- GCACS did not effectively manage its administrative staffing costs. Specifically, OSA estimated GCACS's likely management costs at the start of fiscal year 2013 to be equal to 19.2% of its actual tuition revenue for 2012. This is significantly higher than the 11.5% that OSA calculated from planned amounts appearing in the school's charter application. It also exceeded the 10.8% statewide average percentage that OSA calculated from financial data gathered by DESE from 54 reporting charter schools for fiscal year 2009 (the most recent data available).
- Rather than verifying student enrollment before deciding how many educators to hire, or adjusting its planned staffing level to account for its history of lower-than-expected enrollment, GCACS hired enough educational personnel for the 2012-2013 school year to serve significantly more students than were actually enrolled.
- GCACS did not expeditiously make adjustments to its expenses to address the lower-than-anticipated enrollment and corresponding revenue. Neither GCACS's Executive Director nor the Board initiated appropriate corrective budget measures before the start of the school year to address the budget implications of under-enrollment.
- According to unaudited information covering GCACS's financial activity through January 2013, GCACS could have an accumulated net asset deficit in excess of \$308,000 and substantial financial obligations could remain unmet, including approximately \$5.8 million in outstanding facility lease obligations not included in the net asset deficit.

Recommendation

Under normal circumstances, OSA would provide our recommendations to GCACS to address any deficiencies identified during our audit. However, given that GCACS has ceased operating, OSA recommends that GCACS complete all required charter-school record preservation and financial closeout activity, as specified by DESE, pursuant to 603 Code of Massachusetts Regulations 1.13. In light of the potential for continued litigation or other legal or federal grant compliance activity related to the school, we also recommend that all school documentation be retained by an independent government agency—such as DESE, a local public school district, or a city auditor—for a retention period to be specified by DESE.

Post-Audit Action

According to the chairman of GCACS's Board, the following has occurred since the end of our audit field work:

- The Gloucester Public School District has been designated the trustee responsible for future maintenance of GCACS's records, and all records have been turned over to the district's Director of Finance and Operations.
- GCACS's outstanding financial obligations are being documented through a formal claim-filing process.
- With DESE approval, GCACS has sold some of its remaining physical assets, such as equipment and furnishings, generating approximately \$50,000 to be used to partially offset its financial obligations.
- As part of the charter-school closeout process, DESE is in the process of examining GCACS's compliance with federal grant funding requirements.

Conclusion

GCACS was just one of 19 Massachusetts charter schools that closed between 1994 and June 2013, many with adverse consequences for students and the Commonwealth. To minimize the risk of such problems in the future, DESE should ensure that charter schools are financially viable; follow best business practices; adhere to procurement practices expected of government entities as recommended by OIG; and comply with all applicable laws, rules, and regulations, including restrictions on incurring debt beyond the charter period.

OVERVIEW OF AUDITED AGENCY

Background

Commonwealth charter schools are public schools that are administratively and financially independent of the conventional school-district structure, pursuant to Chapter 71, Section 89, of the Massachusetts General Laws. Instead of a local school committee, a Board of Trustees is responsible for overseeing the school during the five-year renewable charter period.¹ The Department of Elementary and Secondary Education (DESE) gives these schools significant operational freedom but requires them to adhere to the terms of their charters, demonstrate academic success, and operate as financially viable organizations. If these requirements are not met, the charter may be subject to nonrenewal or, in extreme circumstances, revocation before the expiration of the five-year charter period. As of June 2013, DESE data indicated that, out of 94 Commonwealth and Horace Mann charters granted since 1994, excluding 8 charters for recently approved schools that have not yet opened, there have been 19 charter-school closures. Five shut down after charter approval without ever opening. Of the 13 that closed after opening, 5—including the Gloucester Community Arts Charter School (GCACS)—had their charters revoked, the Commonwealth’s Board of Elementary and Secondary Education (BESE) declined to renew the charters of 2, and 7 closed after opening but without formal revocation or nonrenewal action.

At the recommendation of the DESE Commissioner, BESE approved GCACS’s charter on February 24, 2009, authorizing it to operate a school that included kindergarten through eighth grade for up to 240 Gloucester-area students, with the school opening to occur by no later than September 24, 2010. The school’s charter had been approved despite an adverse recommendation from the DESE Charter School Office (which was responsible for the review of GCACS’s charter application), resulting in criticism by the Office of the Inspector General (OIG) and litigation regarding the validity of the charter approval.² The Attorney General’s Office (AGO) and OIG were also investigating GCACS procurement practices, including the procurement of school facility space, at the time the school opened.

¹ The statute also authorizes creation of Horace Mann charter schools operated by local school districts; however, GCACS was authorized as a Commonwealth charter school.

² Available at <http://www.mass.gov/ig/publications/reports-and-recommendations/2010/gloucester-cs-rpt.pdf>.

Problems with completing renovations to the leased facility, and the resignation of a newly hired Head of School,³ delayed opening of the school, which, though chartered at a capacity of 240 students, initially enrolled only approximately 64 students.⁴ Because of these circumstances and issues identified by the OIG and AGO investigations, DESE urged the GCACS Board of Trustees (Board) not to proceed with the opening of the school. GCACS disregarded that advice, opening the school in temporary modular classroom space at 2 Blackburn Circle in Gloucester on September 23, 2010, pending completion of renovations to its leased school facility. The opening occurred on the last day before the deadline established by DESE regulations.⁵

As stated by the DESE Commissioner in a September 29, 2010 memorandum to BESE:⁶

GCACS failed to plan adequately for construction related delays, experienced repeated delays in opening and opened over three weeks late, violated state laws regarding procurement and construction of its facilities, is without a head of school, has a significantly decreased enrollment from what it projected in its application, and will face substantial financial challenges as a result of that drop in enrollment. It is clear to me that the school's board of trustees has not managed GCACS effectively.

In response, BESE placed the school in a three-month initial probationary status and imposed special conditions, such as requirements that GCACS comply with all orders issued by AGO and comply with the state's Open Meeting Law (Chapter 30A, Sections 18 – 25, of the General Laws) and that it report all significant matters to DESE, including complaints, investigations, and any GCACS staff changes, within 48 hours. The school's opening and subsequent operations were also associated with public controversy described in the local media regarding potential adverse effects on Gloucester public schools, allegations that GCACS had repeatedly violated Open Meeting Law and public-records-law requirements, reports of high turnover for both educators and Board members, and parent/guardian complaints about educational performance.

When the Office of the State Auditor began its audit, GCACS had completed its second year of operations with a final enrollment of 127 students and had begun its third year with a starting enrollment of 132 students. As described in this report, deficiencies at GCACS resulted in a DESE

³ The position, comparable to that of a school principal, was distinct from the separate Executive Director position. For the 2012-2013 school year, the Head of School position was renamed and redefined as Director of Education.

⁴ Enrollment increased to approximately 85 students later in the 2010-2011 school year.

⁵ The deadline is established by DESE regulation 603 Code of Massachusetts Regulations 1.04(6)(b), which gives schools 19 months from the date the charter is granted to the date the school opens: "If no students are attending a charter school within 19 months from the date the charter was granted, the charter will be null and void, unless an extension is granted by the Commissioner."

⁶ Available at <http://www.doe.mass.edu/boe/docs/1010/recommendation.html>.

proposal to revoke the school's charter in December 2012, and an escalating financial crisis led to a Board decision to abruptly close the school on January 9, 2013, forcing local school districts to absorb the remaining GCACS students on an emergency basis.

Although the school was closed, under the provisions of the charter and charter surrender terms agreed to by the GCACS Board and the Commonwealth, GCACS remained a legal entity through June 30, 2013 to complete closeout activities required by law and regulation. GCACS records must be retained after that date by a DESE-approved trustee.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of the Gloucester Community Arts Charter School (GCACS) for the period July 1, 2010 through January 9, 2013.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit objectives were to (1) determine whether GCACS had instituted adequate internal controls over its financial and management activities and was complying with applicable laws, rules, regulations, and charter provisions and (2) obtain information regarding the oversight of GCACS performed by the Department of Elementary and Secondary Education (DESE). Because our initial audit work at GCACS identified the existence of an ongoing, rapidly evolving financial crisis, the audit period, which was originally planned to extend through September 4, 2012 (the start of GCACS's 2012-2013 school year), was extended through January 9, 2013 in order to assess the financial viability of GCACS, the details and causes of the financial problems GCACS was experiencing and the effectiveness of any actions taken by GCACS to address these matters. Audit work was complicated by missing and disorganized records at GCACS and numerous delays ranging from several days to over four weeks in responding to audit information requests.

To accomplish our objectives, we reviewed the significant controls GCACS had established over its revenue and expenditures; the oversight activities of GCACS's Board of Trustees (Board); GCACS's compliance with the state's Open Meeting Law and related public-records laws; adherence to GCACS charter provisions; various reports issued by oversight agencies and other external reviewers (see Appendix) and the related corrective actions taken by GCACS to address the deficiencies raised in these reports that related to our audit objectives; school admission policies and procedures; pre-enrollment and enrollment reports submitted to DESE; staff turnover; and educator qualifications, such as licensure status. Our audit included a review of documents; interviews with individuals such as GCACS managers, employees of GCACS's contracted business-management service company, and the Board chair; review of unofficial videos of Board and committee meetings; a mail survey of

93 families of students who had been recorded by GCACS as pre-enrolled for the 2012-2013 school year but who had not attended; and various financial analytical procedures, including an analysis of GCACS's cash-flow projections.

To perform our analysis and audit testing, we primarily used GCACS's source documents rather than electronic data that would require analysis of GCACS's electronic data reliability. However, we also performed comparative analysis using state accounting records derived from the Commonwealth's Massachusetts Management Accounting and Reporting System as well as statewide charter-school system data maintained by DESE on its public website. In both instances, the electronic data are widely accepted as accurate. We concluded that the data were of sufficient reliability for the limited purposes of our audit and could appropriately be used without our performing a comprehensive assessment of the data's reliability. Comparison of source documentation to summary records also revealed that GCACS's accounting system information was in some respects unreliable because of incomplete accounts-payable information, which effectively understated the amount of the school's outstanding obligations. We therefore made only limited use of that information in this report's presentation of GCACS's reported operating results and financial position.

Although most of our audit was based on an examination of all available documentation, such as Board and personnel records, our conclusions rely, in part, on analysis and testing that used judgmental samples for non-payroll-expenditure transactions. That sample selection was based on expenditure amount; the applicability of various procurement standards; and identified risks for noncompliance, waste, or abuse. Although use of the selected sampling approach does not permit extrapolation of testing results to the full population of transactions, the approach decreases the risk that significant problematic transactions will go undetected. As presented in our detailed audit results and findings, expenditure testing involved 87 invoices, totaling \$450,315, that represent 38% of payments to 21 sampled vendors and 22% of just over \$2 million in GCACS's non-payroll disbursements to approximately 300 vendors.

At the conclusion of our audit fieldwork, although GCACS had closed, we provided a copy of our draft report to the chair of GCACS's Board for his review and comments. We considered all the chair's comments when drafting our final report.

DETAILED AUDIT RESULTS AND FINDINGS WITH AUDITEE'S RESPONSE

1. Inadequate Administration and Oversight Coupled with Low Enrollment and Poor Educational Performance Resulted in the School Having to Cease Operations

We found deficient governance, management, and financial practices; inadequate educational performance as determined by the Commonwealth's Department of Elementary and Secondary Education (DESE); and low student enrollment at the Gloucester Community Arts Charter School (GCACS). Further, GCACS's management and its Board of Trustees (Board) did not adhere to statutory and regulatory requirements, correct deficiencies identified by various oversight agencies and other external reviewers, or appropriately address the school's cash-flow problems. As a result, GCACS was unable to continue operating and the school closed on January 9, 2013, forcing Gloucester and other local public school districts to absorb transferring students on an emergency basis. The specific problems we identified during our audit include the following.

a. GCACS Did Not Appropriately Address Numerous Governance, Management, and Educational Issues Identified by External Reviews

GCACS did not adequately address numerous deficiencies related to procurement; compliance with the state's Open Meeting Law (Chapter 30A, Sections 18 – 25, of the Massachusetts General Laws); accounting; internal control; recordkeeping; management; education; and governance. These deficiencies were identified in external reviews conducted by the Commonwealth's Office of the Inspector General (OIG), the Attorney General's Office (AGO), a certified public accounting (CPA) firm, DESE's Charter School Office, and a charter-school management consultant.

GCACS Did Not Fully Address Procurement Deficiencies Identified in OIG and AGO Reports

In their reports, OIG and AGO stated that GCACS's procurement of school facility space violated applicable facility construction procurement laws and that other procurements, while not in violation of law, had been conducted in a nontransparent, noncompetitive, and wasteful manner.⁷ In fact, OIG identified over \$226,000 in questionable non-bid

⁷ OIG reports are available at <http://www.mass.gov/ig/publications/reports-and-recommendations/2010/gloucester-cs-contracts.pdf> and <http://www.mass.gov/ig/publications/reports-and-recommendations/2011/dese-charter-school-oversight-revised.pdf>. AGO procurement review documentation and the resulting Final Judgment by Consent settlement agreement are not available on the Internet.

procurements by GCACS during fall 2010 and also reported that GCACS had been “recalcitrant in the face of our numerous requests for specific information about methods used for individual purchases of goods and services and the identification of individuals who conducted the purchases.” In response to OIG’s findings, AGO ordered various corrective measures, including OIG procurement training sessions as required by Chapter 46 of the Acts of 1997, prior consultation with AGO and qualified outside legal counsel on future projects, establishment of whistleblowing policies and procedures, and submission of periodic reports to AGO, as well as GCACS’s Board attending meetings with legal counsel. While DESE has issued procurement and financial-management guidelines for charter schools,⁸ it has not mandated adherence to the practices specified in those guidelines as OIG had recommended in conjunction with its review of GCACS. According to the OIG report, GCACS had disregarded the DESE guide’s recommendations and “replaced DESE’s recommended language with weak policy provisions that permit discretion to forgo any procurement process when expending taxpayer money.”

Our audit found that GCACS’s Executive Director did attend the required training session. However, despite the completion of the required training, extensive procurement and recordkeeping deficiencies continued. When we asked the Executive Director why deficiencies had not been addressed in response to recommendations made in prior reviews, he said that the applicability of various standards to charter schools was not clear; that GCACS had complied with minimum requirements mandated by law; and that guidance such as that provided by DESE was optional rather than mandatory.

We tested 87 invoices, totaling \$450,315 of the school’s approximately \$2 million in non-payroll expenditures during the audit period, and found little evidence that GCACS had used any competitive, transparent procurement process designed to obtain best value for goods and services. Further, in the few cases where signed contracts with service providers were on file, we found that, contrary to sound business practices, the contracts were open ended and did not state a maximum dollar ceiling that would limit GCACS’s financial obligation. Our testing in this area also identified inadequate accounting procedures and practices. For example, GCACS was not using purchase orders, as required by its fiscal policies and

⁸ Massachusetts Charter School Recommended Fiscal Policies & Procedures Guide, available at http://www.doe.mass.edu/charter/finance/auditing/fpp_05guide.pdf.

procedures manual, or following procedures such as documenting the business purpose of expenditures. Consequently, GCACS cannot be sure that its purchases of goods and services during our audit period were conducted in the most effective and efficient manner in accordance with applicable state laws and regulations and DESE suggested guidelines.

GCACS Did Not Comply with Certain Requirements of the State's Open Meeting Law and Public Recordkeeping Standards

AGO determined in both its 2010⁹ and 2011¹⁰ reports that GCACS had not complied with Open Meeting Law requirements. Violations included improper use of executive session and emergency meetings, apparent deliberation outside meetings, executive session minutes not being released in a timely manner, inadequate recordkeeping, and apparent disregard for Open Meeting Law requirements applicable to subcommittee meetings. AGO ordered corrective action—including the training of all Board members—in both 2010 and 2011. The 2011 determination included a warning that any further Open Meeting Law noncompliance might be treated as intentional violation of law.

Our audit determined that the required Board training requirements had not been met in 2011, that additional complaints against GCACS had been filed and were under investigation by AGO during our audit period, and that Open Meeting Law violations continued throughout the audit period. These violations included the Board's not documenting and retaining the records it used in its decisions; often not fully documenting attendance at Board meetings; and, in some instances, not complying with requirements to publicly post meetings and their agendas before meetings of the Board and its committees, all resulting in adverse effects on transparency and accountability.

GCACS had also been the subject of a complaint to the Public Records Division of the Commonwealth's Secretary of State's Office. According to the complaint, GCACS did not publicly provide documentation of its communications with DESE regarding compliance with charter-approval conditions, such as a requirement that staffing changes be reported to DESE within 48 hours. The Public Records Division's review of that complaint was pending

⁹ Open Meeting Law 2010-6, available at <http://www.oml.ago.state.ma.us/Default.aspx?sectionYear=3&year=2010>.

¹⁰ Open Meeting Law 2011-45, available at <http://www.oml.ago.state.ma.us/Default.aspx?sectionYear=2&year=2011>.

at the time of our audit work. Regarding this matter, GCACS Executive Director told us that production of records, such as e-mail communications, would require hiring an outside contractor at a cost of several thousand dollars, which would have to be borne by the individual making the records request. The Executive Director believed that the hiring would be necessary because GCACS's hardcopy and electronic records were not sufficiently organized to permit GCACS to find the requested information without outside assistance. However, Public Records Division guidance¹¹ summarizes the public recordkeeping responsibilities created by Massachusetts's public-records laws as follows:

It is the responsibility of government employees who create, receive and maintain public records to ensure their safekeeping and availability to the public. . . . A records custodian's obligations include not only responding to public records requests but also ensuring that records will be available for review when requested.

During our audit, the Office of the State Auditor (OSA) also made a records request in order to determine GCACS's compliance with DESE's charter-approval conditions. Although GCACS did not produce the requested documentation in a timely manner, it was eventually able to produce a large collection of over 8,700 electronic document files covering all aspects of GCACS operations rather than the specific documentation we requested pertaining to GCACS communications with DESE. The Executive Director asserted that the files were electronic copies of all GCACS's electronic records, including e-mails and word-processing, database, and spreadsheet files. Our review of GCACS's public recordkeeping practices determined that GCACS had not established adequate internal controls over the receipt and retention of electronic media as called for by the Public Records Division's Electronic Records Management Guidelines, which advise government offices to adopt and implement a formal record-management program to help ensure the appropriate management of electronic records. Specifically, the electronic records that GCACS provided were not appropriately organized, indexed, or accompanied by information needed to distinguish between draft and final versions of documents as needed to ensure that official public records regarding specific matters could readily be made available upon request. Consequently, OSA could not analyze these electronic files to draw audit conclusions

¹¹ "A Guide to the Massachusetts Public Records Law." As detailed in the guide, which is available at <http://www.sec.state.ma.us/pre/prepdf/guide.pdf>, Massachusetts public records law consists of provisions in multiple chapters and sections of the General Laws and certain session acts. The Massachusetts Secretary of State has also issued related regulations at 950 Code of Massachusetts Regulations 32.00.

regarding GCACS's compliance with the DESE requirements. However, our audit testing of GCACS's hardcopy documents indicated that GCACS had not complied with DESE notification requirements, and during our audit, DESE separately confirmed in a report to the Board of Elementary and Secondary Education (BESE) that GCACS was not compliant.

In addition, the Commonwealth's Fair Information Practices Law (Chapter 66A, Section 2[[, of the General Laws) states that government entity data holders may "not collect or maintain more personal data than are reasonably necessary for the performance of the holder's statutory functions." However, approximately 2,000 of the above-described electronic document files maintained in the custody of GCACS did not pertain to GCACS operations. Instead, they were documents from a private school where the Executive Director had previously been employed. These documents were of a sensitive nature, including employee information, records of student expulsion, and disciplinary communications that should not have been in GCACS's possession. The Executive Director explained the presence of these files in the GCACS computer system by stating that upon being hired by GCACS, he had taken his assigned laptop from the private school to a computer store and had the entire contents of the computer transferred to the laptop that GCACS had issued to him.

In our opinion, this documentation problem was the result of GCACS's failure to establish formal policies and internal controls and could have exposed GCACS to liability and exposed the private school employees and students to further loss of privacy had the documents been misused, inadvertently released by GCACS, or stolen.

GCACS Did Not Adequately Correct Accounting and Internal Control Deficiencies Identified by Its Private Independent Auditing Firm

As required for all charter schools, the GCACS Board hired a CPA firm to conduct annual independent audits of the school. The CPA firm performed three audits, issuing separate audit reports and associated management letters in February 2011, October 2011, and October 2012 for fiscal years 2010, 2011, and 2012, respectively. These audits all identified significant deficiencies within GCACS, including the inconsistent maintenance of financial records, failure to establish fraud-mitigation control systems and whistleblower protections, inaccurate calculation and late submission of Massachusetts Teachers' Retirement System (MTRS) employee withholdings, missing invoices for certain transactions, and significant

outstanding debts. The CPA firm recommended that the Board improve its financial oversight, and the 2012 audit also determined that GCACS lacked the controls necessary to ensure compliance with requirements applicable to certain federal grant funding received by GCACS through DESE. The CPA firm's reports showed that some of these deficiencies had persisted over multiple years.

During our audit, we found little evidence that GCACS had implemented appropriate corrective measures to address the deficiencies identified by the CPA firm. In some instances, the CPA firm reported GCACS management's response that deficiencies or instances of noncompliance had subsequently been corrected; however, even in those instances, our audit often found that corrective measures had not actually been completed or that deficient or noncompliant practices reported to have been corrected as of June 30, 2012 (the end date of the last fiscal year for which an audit report had been issued) had been resumed by GCACS after that date. For example, GCACS had not implemented recommended measures, such as the submission of monthly cash-flow statements and other regular financial reports to the Board. GCACS's expense documentation was often inadequate; the school continued to allow its Executive Director to use its debit card during fiscal year 2013, despite the CPA firm's report that GCACS had discontinued use of the card at the end of fiscal year 2012. GCACS also continued to send inaccurate and untimely submissions to MTRS, in violation of Chapter 32, Section 22(1)(i), of the General Laws. In some instances, retirement contributions withheld from teachers, which this statute requires to be turned over to the Commonwealth on the 10th day of each month, were deposited as much as 254 days late. Although the CPA firm reported that GCACS had come into compliance with MTRS submission requirements during fiscal year 2012, we determined that 8 of 12 payments during that fiscal year had been late, including the payment for June 2012, which was not made until June 30, 2013. GCACS's MTRS payment noncompliance continued every month thereafter, through the January 9, 2013 closing of the school and termination of all employees.

GCACS Did Not Adequately Address Governance, Management, and Educational Deficiencies Identified by DESE's Site Visits and a Charter-School Management Consultant

During fiscal year 2011, GCACS's Board hired a private charter-school management consultant, Small Schools Consulting, to review the school's first year of operations. On June 29, 2011, Small Schools Consulting issued its 28-page report, which identified numerous management and governance issues. Specifically, the report¹² noted that the Board did not adhere to best governance practices and had not made governance training a priority. The report indicated that the Board did not set goals for the school, the Executive Director, or itself, and that it did not establish and monitor performance indicators; conduct regular budgetary reviews; recruit Board members with necessary public-sector management expertise; or develop clarity regarding organizational structure and Board and employee roles. The lack of clarity regarding structure and roles resulted in what the consultant characterized as a "strained relationship" between the Executive Director and the individual who was then the Board chair (who subsequently resigned). The consultants identified numerous additional problems at the management staffing and consultant operational levels, including insufficient senior-management expertise in charter-school management, financial management, and the educational director roles; a lack of consistent expectations and instructional quality; and inadequate systems to support students with diverse learning needs. The report also stated that "the inconsistent use of standard fiscal operating procedures and oversight practices may have compromised the school's financial health and academic program."

The consultant made extensive recommendations for improvements, including, but not limited to, enhancing teacher involvement in curriculum development; better communicating school expectations and norms; ensuring regular budget and financial reviews by the Board; improving Board membership, transparency, and communications; and clarifying Board and management roles and responsibilities.

In addition to the deficiencies identified by the private charter-school management consultant, three annual site visits conducted by DESE during our audit period identified deviations from GCACS's charter provisions, underperformance in its academic program,

¹² Year One Formative School Review, June 29, 2011, prepared by Jennifer Feller and John Tarvin, d.b.a. Small Schools Consulting.

and a lack of organizational viability. DESE's final (November 2012) report strongly criticized GCACS for not fully addressing previously identified deficiencies and charter-approval conditions, citing continued low enrollment; academic issues, including poor scores on Massachusetts Comprehensive Assessment System (MCAS) standards-based student educational achievement tests for mathematics; lack of a documented curriculum; disorder and a lack of student engagement in the classrooms; significant staff turnover; and worsening financial conditions.¹³ Pursuant to these site visit results, DESE's Commissioner recommended to BESE that it revoke GCACS's charter.

As detailed in the Audit Objectives, Scope, and Methodology section of this report, our audit objectives did not include performing an independent assessment of GCACS's educational performance. However, our audit work corroborated certain of DESE's reported findings and confirmed that GCACS had not resolved many of the reported issues to DESE's satisfaction. For example, we determined that enrollment at the start of the school year in September 2012 was 132 students, only 62% of the 212 pre-enrollment estimate GCACS had provided to DESE the prior spring; however, as described further below, GCACS did not take appropriate budget measures in response even though enrollment continued to decline through the date of the school's closing. In addition, in terms of high turnover, we found that GCACS had a total of 62 employees during the 30-month period covered by our audit; only 21 remained as of October 31, 2012. Of the 21 employees, only 3 teachers and 2 other employees worked at GCACS for more than a year. These turnover problems affected key educational management positions, including those responsible for special education services and the senior educational position of "Head of School" (changed to "Director of Education" for the 2012-2013 school year). That position had been held by three separate educators, the first of whom resigned before the school opened in September 2010 and left a vacancy that was not filled until the following summer; this may have contributed to poor financial control over operations. The second Head of School left less than a year later, in June 2012. High turnover rates also existed for non-employee contracted consultants. Two different business-management service consultants effectively functioned as GCACS's Business Manager and Chief Fiscal Officer during the audit period.

¹³ A November 16, 2012 summary of the DESE site visit findings is available at <http://www.doe.mass.edu/boe/docs/2012-11/item6.html>.

The Board also experienced a high turnover rate during our audit period. GCACS's charter and bylaws provide for a board of 7 to 15 members. Excluding the Executive Director, who also serves as a trustee, the Board never had more than nine members at one time. Of the people who served on the Board, nine were in place for only a two-month period, and only three members have been on the Board continuously since the startup phase before the September 2010 opening of the school.

In addition to the concerns expressed by OIG, AGO, and the charter-school management consultant, DESE raised concerns regarding an inadequate range of expertise on the part of Board members and managers, which were never adequately addressed. DESE cited the need for increased expertise in public-sector management, criticized the Board's apparent inability to develop formal systems for the assessment of the school's academic progress, and ordered supplemental Board and management training regarding state ethics, the state's Open Meeting Law, and public record requirements.

b. Low Enrollment and Questionable Management and Budget Practices Made the School Insolvent, Resulting in Its Closure

Low Enrollment and Over-Projection of Enrollment

To remain financially solvent, charter schools such as GCACS must be able to operate within their financial resources. This requires limiting their costs to levels that can be supported by their revenue. Charter-school tuition rates are not based on the charter school's projected or actual costs. Instead, the Commonwealth sets each charter school's tuition rates at an amount equal to the average per-pupil spending for the local school districts where the charter school's students reside. The average per-pupil spending amount is then used to pay the charter school on the basis of actual student enrollment. Unless a charter school has significant grant or donation funding to supplement public tuition revenue, which GCACS did not,¹⁴ the charter school must budget and control costs so that it can successfully operate within the limits created by available tuition revenue. Although charter-school tuition is ultimately derived from reductions in local-aid funding to the communities where students reside, payments are calculated and processed through DESE,

¹⁴ Like other charter schools, GCACS received limited supplemental funding such as nutritional ("school lunch") reimbursement and federal Title I grant support passed through DESE. However, GCACS did not receive significant private grants or contributions and was primarily dependent on tuition revenue.

which issues quarterly charter-school tuition payments, starting at the end of September, on the basis of the school's daily enrolled student attendance. The initial payment is based on pre-enrollment counts submitted in March of the prior school year. Subsequent quarterly payments are based on actual enrolled attendance and reduced, if necessary, to offset any initial overpayment resulting from first-quarter enrollment that is lower than pre-enrollment estimates.

DESE data show that most charter schools pre-enroll and enroll students at their full approved capacities and place additional students on waiting lists. Actual enrollment typically exceeds 90% of pre-enrollment estimates for charter schools, even during their initial years of operation. In its application for charter approval, GCACS had estimated that for the 2012-2013 school year, actual enrollment would run at approximately 216, or 90% of the total charter capacity of 240 students. However, pre-enrollment at GCACS never reached the school's capacity, and GCACS's actual enrollment has always been far below 90% of its pre-enrollment estimates, as indicated below:

School Year	Pre-Enrollment Estimate	Actual Starting Enrollment*	Actual as Percentage of Pre-Enrollment
2010-2011	95	64	67.4%
2011-2012	202**	135	66.8%
2012-2013	212	132	62.3%

* This is the count stated by GCACS on the first day of school. DESE instead uses the actual enrollment reported as of the end of September to calculate tuition. For example, for September 2012, DESE counted enrollment as 122 instead of 132 because enrollment dropped to 122 during the month.

** DESE adjusted GCACS's original pre-enrollment estimate of 202 to 196 after an April 2011 visit to the school to verify enrollment.

In March 2012, GCACS reported to DESE that it had pre-enrolled 212 students for the 2012-2013 school year, as shown in the above table. Despite an established pattern of actual enrollment running at approximately 67% of estimated pre-enrollment over the prior two years, GCACS approved a fiscal year 2013 budget in June 2012 based on an 85% enrollment rate (180 students, 85% of the pre-enrolled 212). GCACS's Executive Director acknowledged to us that GCACS had not adequately followed up with pre-enrolled families over the summer to verify the accuracy of the 180-student estimate. Had GCACS accurately estimated enrollment at 132, it could have projected a tuition-revenue shortfall of more than

\$571,000 less than the \$2.1 million that would be generated by enrolling its estimated 180 students. As discussed below, GCACS never adequately adjusted its budgets to address low enrollment and associated revenue reductions.

Our analysis also noted an indirect effect of this issue on the Gloucester public school system. Specifically, since initial September tuition payments to charter schools are offset by local-aid reductions to the local communities where pre-enrolled students reside, local school districts suffer adverse planning, budget, and cash-flow consequences when pre-enrollment reported by charter schools significantly exceeds actual enrollment. In such cases, the local communities must wait for the Commonwealth to make year-end adjustments to restore any local aid due them. The City of Gloucester and its school committee publicly expressed concern regarding this problem, and members of the public also expressed concern that pre-enrollment data reported by GCACS might have been improperly inflated.

During our audit, we also sent questionnaires to parents/guardians of 93 children; these 93 constituted almost all of the children whom GCACS listed as being pre-enrolled for the 2012-2013 school year but who had not been listed as enrolled at the start of the school year. The 33 questionnaire responses we received indicated some problems with the information being obtained by GCACS through its pre-enrollment process. For example, in some cases, parents/guardians indicated that they had made pre-enrollment requests to obtain general information regarding the school but had not actually enrolled their child. For four children, parents/guardians reported that they had withdrawn their requests, but GCACS had not documented the withdrawals. In 13 cases, it was not clear from GCACS's records or the questionnaire responses whether pre-enrollment had occurred before the March deadline established by DESE for pre-enrollment processing for the school year starting in September 2012. One respondent stated:

While I was never pressured, it was "requested" that lottery applications be filled out by friends even if they had no intention of attending. I do know several families who did this, but do not know the names of the applicants.

Sixteen of the responses also included assertions by the child's parent/guardian that the child had attended GCACS in fall 2012, although the child's name had not appeared on enrollment records. Since these 16 students did not appear in GCACS's enrollment records, it was unclear whether those records were inaccurate or parents/guardians had

misunderstood the questionnaire. During our audit, we presented the information we obtained through our questionnaire to GCACS's Executive Director, who stated that he did not believe that the survey responses were accurate. However, the results of our audit testing in this area indicated that GCACS's inadequate controls and documentation practices for pre-enrollment and enrollment contributed to the financial crisis leading to the school's closure.

Questionable Management and Budget Practices

Facility Costs Were Higher Than Authorized

In August 2009, during GCACS's startup phase, GCACS's founders entered into a no-bid 15-year school facility lease with Cape Ann Medical Office Building, LLC.¹⁵ The lease obligated GCACS to make a total of \$6,811,345 in lease payments, averaging approximately \$454,090 per year, though GCACS's approved charter proposal provided for total occupancy costs (including lease payments and additional costs for utilities and maintenance) of approximately \$398,580 for fiscal year 2013. GCACS's proposal predicted that enrollment and associated revenues and expenses would be stabilized by fiscal year 2013, with an enrollment of approximately 216 (90% of approved charter capacity) and associated tuition revenue of approximately \$2.2 million. Under the approved charter proposal, the equivalent of approximately 18.2% of projected tuition revenue would have been required to meet GCACS's occupancy costs. However, the lease obligation increased the occupancy costs by more than 23%, while GCACS's low enrollment had reduced actual tuition revenue to approximately \$1.6 million for fiscal year 2012. GCACS attempted to address these high facility costs by negotiating a one-time \$120,000 rent reduction related to facility renovations for fiscal year 2012. GCACS also delayed the cash-flow effect of the lease obligation by negotiating a deferral of payment on \$156,524 and \$154,660 of lease payments for fiscal years 2011 and 2012, respectively. Despite these measures, the lease obligation for the facility continued to place severe stress on GCACS's annual budget and financial operations.

The lease also improperly exceeded the five-year duration of GCACS's charter. While Chapter 71, Section 89(k)(6), of the General Laws allows charter schools to incur

¹⁵ This facility lease was the subject of OIG and AGO reviews. GCACS entered into a settlement agreement with AGO regarding GCACS's noncompliance with public facility procurement laws.

temporary debt, such as facility lease obligations, in anticipation of receipt of funds, it prohibits charter schools from incurring debts that will not be satisfied within the five-year charter period without BESE's approval. No documentation existed to verify that GCACS had ever received the required approval. GCACS owed approximately \$5.8 million on this improperly created long-term lease at the time the school closed.

Costly and Inadequate Management Structure

When GCACS opened, its Board established a management structure composed of both a full-time Executive Director and a full-time Head of School. Business activities were managed through a contract with an individual consultant for part-time services at \$225 per hour¹⁶ for an indefinite period. The consultant contractor effectively functioned as GCACS's Chief Fiscal Officer. At the start of fiscal year 2013, GCACS was paying approximately \$300,000 per year for senior-management costs (excluding tax and fringe benefits). While the combined total of \$300,000 was consistent with the total planned amounts appearing in GCACS's charter application, its actual enrollment and associated tuition revenue were, as previously mentioned, far below initially planned levels. In addition, actual costs for other administrative items such as office supplies, insurance, and legal and audit fees far exceeded planned amounts. As a result, OSA estimated that GCACS's management costs at the start of fiscal year 2013 would total approximately 19.2% of its fiscal year 2012 actual tuition revenue. That percentage was far higher than the corresponding percentage of 11.5% we calculated from planned amounts appearing in its charter application. It also exceeded the 10.8% statewide average percentage we calculated from financial data gathered by DESE from 54 reporting charter schools for fiscal year 2009 (the most recent data available).

Additionally, available biographical information for GCACS's staff indicates that none of GCACS's initial senior managers had prior experience in charter-school management. Had they possessed such experience, GCACS might have avoided the numerous issues identified by both OSA and external reviewers regarding noncompliance with laws and regulations applicable to charter and other public schools. In July 2011, a business-

¹⁶ This consulting arrangement had been criticized in the previously mentioned OIG review of GCACS's procurement practices. Subsequently, the consultant retroactively reduced the rate to \$125.00 per hour and reportedly donated \$10,000 in in-kind consulting services to GCACS.

management services consultant with extensive charter-school experience was retained on a part-time basis at a cost averaging approximately \$4,400 per month for approximately two days of service per week. However, the owner of the consultant company acknowledged to us that, in her opinion, these management arrangements were inadequate and GCACS needed its own full-time Chief Fiscal Officer.

Educator Staffing in Excess of Levels Warranted by Enrollment

Despite a history of actual student enrollment falling significantly below estimated pre-enrollment levels, GCACS did not take appropriate measures to verify student enrollment plans over the summer before determining the educational-staff level required for the 2012-2013 school year. Instead, GCACS hired educational staff at a level that the business-management services consultant described as sufficient to serve approximately 165 students, far above GCACS's actual starting enrollment of 132 for 2012-2013, which gradually declined thereafter. The consultant stated that, given GCACS's financial condition, she was "shocked that the school had hired four more teachers" for the 2012-2013 school year (excluding the hiring of a Director of Education). She remarked that GCACS needed to make cuts; that the school was still staffing for 165 students as of the December 2012 date of her remarks; and that she could not understand why GCACS still had made no staffing cuts even with enrollment running below 135 for the first half of the school year. Since GCACS only acknowledged that it was hoping that enrollment would increase significantly and did not provide OSA with documentation of what would be an appropriate educator staffing level for its actual enrollment, we were unable to estimate the financial effect of the overstaffing cited by the business-management services consultant.

Failure to Adjust Budgets in a Timely Manner Led to Insolvency

As described above, GCACS did not promptly initiate appropriate corrective budget measures before the start of the school year to address the budget implications of under-enrollment when actual enrollment fell significantly below projected levels, as it did for each of the school's years of operation. The financial position of the school deteriorated accordingly, and at the start of the 2011-2012 school year, GCACS experienced a cash-flow crisis due in part to an operating loss in excess of \$132,000 during its initial year of

operation. As a result, GCACS did not have enough cash to meet its fiscal year 2012 payroll requirements. GCACS attempted to obtain a line of credit from local banks, but was not successful. The contracted business-management services consultant, who was effectively functioning as GCACS's Chief Fiscal Officer, responded by arranging a private loan from the Executive Director of one of several Massachusetts charter schools that were using the consultant company's services. That individual made a three-week, \$75,000 personal loan to GCACS and charged a loan fee of \$2,500.¹⁷ GCACS continued to operate only by resorting to extreme expenditure and cash-flow control measures, such as delaying payment on statutorily mandated financial obligations, like MTRS deposits; not filling key positions; and imposing across-the-board midyear 5% pay cuts, which appeared to contribute to the high educator turnover documented by our audit. These emergency measures allowed GCACS to retain sufficient cash to meet payroll needs and to report break-even financial operating results for that year; however, after two years of operation, GCACS began its 2013 fiscal year, commencing on July 1, 2012, with a significant accrued net asset deficit of \$154,805.

Although GCACS had not been able to significantly offset prior losses, it was able to obtain a \$200,000 line of credit from a local bank in August 2012 that was subject to multiple conditions, including maintenance of required financial ratios, generation of a \$25,000 financial surplus for the coming year, and a requirement that the loan principal be paid to a zero balance for at least 30 consecutive days during each calendar year. As described above, over the summer GCACS did not develop a reliable estimate of actual enrollment for the upcoming school year. Neither the GCACS Executive Director nor the Board initiated appropriate corrective budget measures before the start of the 2012-2013 school year to address the budget implications of under-enrollment should it continue. The only significant budgetary action occurred in late September 2012, when GCACS announced that the Executive Director had resigned effective October 20, 2012 as a cost-saving measure and that, rather than hiring a successor, Board members would

¹⁷ Thirteen months later, the executive director making the loan served on the team designated by DESE to perform an October 18, 2012 site visit to GCACS. At a November 27, 2012 BESE meeting, DESE managers reported that they had learned of the connection only approximately 48 hours before the meeting and stated that had they known of it at the time they were planning the site visit, they would not have asked the individual to participate. Although it was their opinion that this conflict likely did not interfere with the accuracy or objectivity of the GCACS review, DESE's managers acknowledged that its site-visit process could fairly be criticized for not soliciting such disclosures during team selection.

assume his management responsibilities without pay. However, the short-term reduction in expenses arising from the Executive Director's severance agreement was not significant in the context of the financial crisis facing the school. Under the agreement, he continued to receive full salary through January 2013, though he had only been required to work 10 hours per month since October 20, 2012.¹⁸ The severance arrangement would have provided only approximately \$55,000 in expense reductions for the second half of fiscal year 2013 and deferred approximately \$17,600 of the severance payment to the following fiscal year. This arrangement provided limited current-year cash-flow benefits with offsetting adverse cash-flow consequences for the following year.

During September 2012, GCACS had already used its entire \$200,000 line of credit; was again resorting to extreme cash-flow management strategies, such as not paying its August and September lease payments, MTRS deposits, or other financial obligations on time; and was entering a financial crisis. The business-management services consultant developed possible budget revisions to generate additional savings beyond those associated with the Executive Director's resignation. In consultation with the outgoing Executive Director, she prepared proposals calling for various cost-control measures, including consultant service reductions, staff layoffs, and further employee pay cuts. However, GCACS instead focused on what proved to be inadequate efforts to recruit additional students and to generate donations from sources such as the landlord and Board members.

Because of multiple performance concerns identified by the previously mentioned DESE review reports, the DESE Commissioner stated at a November 27, 2012 BESE meeting that he was considering recommending that BESE revoke the GCACS charter at an upcoming December 18, 2012 BESE meeting. In response, GCACS represented itself to DESE, BESE, and the public as successful and financially viable and said it would appeal any revocation action. However, those claims of financial viability were unrealistic. As a result, on December 7, 2012 the DESE Commissioner formally recommended that the charter be revoked at the upcoming meeting,¹⁹ and on December

¹⁸ The Executive Director also agreed to remain a member of the Board through March 2013.

¹⁹ Memorandum available at <http://www.doe.mass.edu/boe/docs/2012-12/item4.html>.

12, 2012, the bank froze GCACS's line of credit. On December 17, 2012—just four days before the start of the school's scheduled holiday break—GCACS received written confirmation of DESE's willingness to work collaboratively to keep the school open for the remainder of the school year, and the Board voted to unconditionally surrender its charter effective June 30, 2013. The Board also reported that it developed and approved a revised budget based on an enrollment of 110 students, the minimum enrollment level at which DESE and BESE believed that operations could successfully continue through the remainder of the school year.

However, enrollment continued to decline, reaching the 110-student minimum viability threshold on December 20, 2012. With BESE's authorization, DESE accelerated tuition and related payments to GCACS to cover the December 31, 2012 payroll. However, the continuing decline in enrollment meant that DESE had already overpaid GCACS for tuition and thus could not issue a quarterly tuition payment in February 2013. This made it unlikely that the school would be able to continue operations through the end of the school year. Parents/guardians continued to withdraw their children, reducing attendance to 50 students by January 9, 2013, when GCACS announced an abrupt midday closure and terminated all employees.

After confirming that GCACS had received closeout instructions from DESE, OSA completed all remaining audit procedures to the extent possible, including final interviews with the Board chair and the outgoing Executive Director. OSA concluded that as of the January 9, 2013 closing of the school, without unanticipated major donations or debt forgiveness, it was probable that GCACS's liabilities would substantially exceed its assets and that the school would not be able to meet its outstanding financial obligations. Subsequently, OSA reviewed the school's unaudited records covering activity through January 2013. These records indicated that GCACS's fiscal year 2013 losses through that month exceeded \$154,000, presenting the possibility that at fiscal year-end (June 30, 2013), GCACS could have an accumulated net asset deficit in excess of \$308,000 and that substantial financial obligations could remain unmet, including approximately \$5.8 million in outstanding facility lease obligations not included in the net asset deficit.

Recommendation

Under normal circumstances, OSA would provide recommendations to GCACS to address any deficiencies identified during our audit. However, given that GCACS has ceased operating, OSA recommends that GCACS complete all required charter-school record preservation and financial closeout activity, as specified by DESE, pursuant to 603 Code of Massachusetts Regulations 1.13. In light of the potential for continued litigation or other legal or federal grant compliance activity related to the school, we also recommend that all school documentation be retained by an independent government agency—such as DESE, a local public school district, or a city auditor—acting as receiver for a retention period to be specified by DESE.

Auditee's Response

In response to this report, the Board chair provided updated information regarding GCACS's activity after the January 9, 2013 end of our audit period:

- The Gloucester Public School District has been designated the trustee responsible for future maintenance of GCACS's records, and all records have been turned over to the district's Director of Finance and Operations.
- GCACS's outstanding financial obligations are being documented through a formal claim-filing process.
- With DESE approval, GCACS has sold some of its remaining physical assets, such as equipment and furnishings, generating approximately \$50,000 to be used to partially offset the above-mentioned financial obligations.
- As part of the charter-school closeout process, DESE is in the process of examining GCACS's compliance with federal grant funding requirements.

The Board chair also provided additional comments responding to our audit findings and the findings of various external reviews referred to in our report, "to provide constructive comments with the hope that it will improve the outcomes for charter schools by offering meaningful recommendations to the various departments involved in charter school oversight." Response content germane to our audit results is excerpted below.

Close-out activity ... has been on-going since January as the school has been working the entire 28 point check list with [DESE].

[R]egarding the "deficient governance, management and financial practices" the school made every practical effort to develop good governance and to provide for best financial practices. . . .

In retrospect, these steps, which the school believed would insure best financial management practices, were not enough to prevent the school's insolvency. . . .

What might have improved the school's chance for success would have been to have greater oversight from the inception by hiring a full time administrator with experience in public school finance. As the auditor's report makes clear, none of the administration had direct experience in public school administration. To avoid this problem in the future, the DESE might require a person with this qualification to be part of the charter administration before approving new charters. This would also be a necessary resource to offer schools that have already opened but are experiencing financial difficulties.

[R]egarding weak internal controls in complying with applicable laws and regulations it should be noted that the school did make ongoing efforts to acquire the skills needed to comply. The school also did act promptly to remedy situations when the school was made aware of potential regulatory or compliance problems. There are however, distinct examples where guidance from the state was either not sufficient or where the various authorities contradict each other. . . .

Where training is essential for board members in matters like Open Meeting Laws, there needs to be one definitive authority for reference in order to avoid running afoul of compliance.

The GCACS board members, like any other people new to public body oversight, did not have a strong background in compliance or administration of public bodies but the board was responsive to any new compliance, legal or regulatory matters. . . .

When the state auditors raised a concern about the use of data found that contained information concerning personnel from another school, the board immediately approached legal counsel . . . that data was immediately erased following that finding. . . .

At the final collection of the laptops from faculty and administration, the data on each computer was securely deleted. . . .

Given the priority placed upon secure personal information by state and federal guidelines, training in data security should be required just as it is procurement, open meeting laws, public document requests and other areas where public policy is a high priority. . . .

[L]ow enrollment . . . adversely and chronically affected the Gloucester Community Arts Charter School since its inception. At the time the school was first slated to open in 2010, there were approximately 90 students who had submitted forms for enrollment. Following an announcement by the Commissioner of Education that the school may not be viable, the number dropped to approximately 60 students as concerned parents understandably withdrew their children from the school. . . .

If the commissioner makes a determination the school is not viable, there should be a process whereby the school is allowed to work with the DESE on a remediation plan. If a plan can be successfully agreed upon, then the school might be granted an extension to open a year later. That way, the message to the parents and stakeholders in the community would be that the school has the full approval by the Commissioner and the DESE which would in turn have a positive impact upon enrollment and the school's financial health.

If a plan cannot be worked out, the DESE should exercise its full authority to close the school. With the critical importance of enrollment to charter school finance, and the effect that the opinion of highest executive of the public school office has upon it, the matter of a school's viability must be decided with clear and unambiguous guidelines. Recommending that school not

open, but then allowing it to open, as happened with GCACS, resulted in a severe, negative impact that did a disservice to all of the educational stakeholders in the community.

Secondly, the auditors found that questionable management and budget arrangements and "excessively high facility costs" contributed to the school's insolvency. In October, the board did begin earnest negotiations with the landlord to substantially reduce rent to improve cash flow for the remainder of the school year which would have helped both to improve cash flow for the year and also reduce the long term accrued deficit created by the rent schedule of payments. The agreement called for a forgiveness of rent starting in January in 2013 and ending in July 2013. The agreement would eliminate most of the \$308,000 in deficit that the auditors projected.

The negotiation to reduce rent changed substantially when the Commissioner of education stated at the November DESE board meeting that he would "entertain a motion" to revoke the charter." At that point, the landlord would only make the rent concessions contingent upon the school charter being renewed. As a result, the possible budget adjustment become a "contingency" and not considered under accounting terminology "proven." . . .

At the time of the late November meeting, the bank had notified the school it would no longer make any advances under the line of credit. The DESE stated it would work with the bank and give assurances that the quarterly tuition reimbursements would be paid.

At a meeting two days later, the DESE said that it had made an overpayment in the first quarterly tuition reimbursement, and therefore would not make any tuition reimbursement in the second quarter. This remedy for overpayment does not appear anywhere in MGL Chapter 70 or Chapter 76 which both govern public charter school finance. This interpretation was a surprise to the school which was negotiating in good faith to keep the school open for the rest of the year. Without the bank line of credit and without the upcoming tuition reimbursement, the school became immediately insolvent.

The authority for the proposition that overpayments made be remedied by no payments whatsoever needs to be clarified. Any charter school that receives an overpayment typically expects to make adjustments to the budget in anticipation of a lower tuition reimbursement payment the next quarter. To receive no payment at all, however, deprives the school of the ability to work with the budget it has created.

[Regarding GCACS 2012 English Language Arts MCAS results:] The GCACS did provide strong academic performance which should have been noted by the DESE in a review of the school. Where the DESE has wide powers to revoke a charter, including charging schools with poor academic performance, a decision to revoke should include factual evidence of each or all reasons cited.

CONCLUSION

The deficiencies in Board governance, management, and financial practices detailed in this report resulted in GCACS's insolvency and abrupt closure. This adversely affected GCACS's students and their families and local school districts that had to deal with the unexpected need to relocate these students. It should be noted that prior audits and reviews of charter schools in both Massachusetts and other states have frequently identified issues similar to those at GCACS. DESE data indicate that, out of 94 charters granted since 1994, excluding 8 charters for recently approved schools that have not yet opened, there have been 19 charter-school closures. To minimize the risk of such problems in the future, DESE should ensure that charter schools are financially viable; follow best business practices; adhere to procurement practices expected of government entities as recommended by OIG; and comply with all applicable laws, rules, and regulations, including restrictions on incurring debt beyond the charter period.

APPENDIX

REPORTS ISSUED BY OVERSIGHT AGENCIES AND OTHER EXTERNAL REVIEWERS REGARDING GLOUCESTER COMMUNITY ARTS CHARTER SCHOOL (GCACS)

Issuer	Document Title	Date Issued
Office of the Inspector General	Letter Report on GCACS to Governor RE: 1-5-10 letter	January 2, 2010
Office of the Inspector General	Letter Report on GCACS to State Senator and Representative	January 5, 2010
Office of the Inspector General	Review of GCACS Facility Lease Procurement	September 17, 2010
Office of the Inspector General	Review of GCACS Procurement Practices	October 3, 2011
Attorney General's Office	Letter Report to Foley Hoag, GCACS Attorney	September 22, 2010
Attorney General's Office	Final Consent Decree Regarding Procurement	November 24, 2010
Attorney General's Office	Open Meeting Law Complaint Decision #2010-6	December 17, 2010
Attorney General's Office	Open Meeting Law Complaint Decision #2011-45	November 1, 2011
Alexander, Aronson, and Finning, CPA	Annual Financial Statement Audit Report #0448-10	February 21, 2011
Alexander, Aronson, and Finning, CPA	Comments, Observations, and Recommendations on Internal Controls, Procedures and Other Matters, a part of Financial Statement Audit Report #0448-11	October 25, 2011
Alexander, Aronson, and Finning, CPA	Financial Statement Audit Report #0448-12	October 23, 2012
Small Schools Consulting	Year One Formative School Review	June 29, 2011
Department of Elementary and Secondary Education	Letter to GCACS Board from DESE Commissioner Chester	September 22, 2010
Department of Elementary and Secondary Education	DESE Year 1 Site Visit	April 8, 2011
Department of Elementary and Secondary Education	DESE Year 2 Site Visit	November 1, 2011
Department of Elementary and Secondary Education	DESE Year 3 Site Visit	November 1, 2012
Board of Elementary and Secondary Education	Commissioner's Report on GCACS	December 17, 2012
Board of Elementary and Secondary Education	Minutes of Dec. 18, 2012 BESE Meeting	December 18, 2012