LESC Charter Schools Subcommittee
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CHARTER SCHOOL RISK REVIEW FINDINGS

Pursuant to the provisions of the *Audit Act* allowing the state auditor to audit the financial affairs and transactions of an agency to be audited in whole or in part, the Office of the State Auditor (OSA) conducted a risk review of the Southwest Secondary Learning Center (SSLC) and the Southwest Aeronautics, Mathematics and Science Academy (SAWS). The results of this risk review, sent on August 5, 2014 to respective presidents of the governing councils for each school, have been attached for reference.

This informational handout includes:

- a summary of the risk review findings by the OSA; and
- potential policy implications for charter school governance.

Summary of the Risk Review Findings by the OSA:

According to the letter, the OSA examined the following issues:

- risks associated with the charter schools' aviation programs;
- the leasing of real property to the charter schools by Southwest Educational Consultants, LLC (SEC), a business co-owned by the school's head administrator and another school employee; and
- other risks related to internal control issues and expenditures, including:
  - charter school governance;
  - travel reimbursements; and
  - employee salaries and contracts.

Risks Associated with the Charter Schools' Aviation Programs

The OSA letter highlights the following risks associated with the charter schools' aviation programs:

- procurement of aircraft from a business co-owned by the school's head administrator and another school employee, where:
  - it does not appear that the provisions of the *Procurement Code* were followed with respect to seeking competitive bids;
  - it appears that, in at least one instance, conflicts of interest arising from the schools' head administrator co-owning the company, from which aircraft were leased, were not disclosed; and
  - in other instances, prohibitions against conflicts of interest in the *Procurement Code* were waived only after the contract had already been bid, negotiated, and awarded.

- improper use of a statewide price agreement, which would otherwise allow the schools to bypass a competitive bid process, as a basis for procuring goods or services from a specific company; and
- lack of internal controls for the flight programs, where:

  - goods and services procured and paid for by one school were used by both schools without an appropriate apportionment of costs amongst the schools;
  - the OSA was unable to obtain sufficient documentation to indicate that the schools monitor or maintain adequate reporting on aircraft instruction to students, thus making it impossible to verify whether the costs charged by contractors are reasonable and necessary; and
  - modifications to contracts discussed and voted on by the governing council were apparently made without discussion of the amount of additional expenditures.

Leasing of Real Property to the Charter Schools

The risk review details that, between SSLC's founding in 2001 and August 2004, SSLC leased a building on Montgomery Blvd. (the Montgomery Complex) in Albuquerque from SEC, which had signed a lease with the lessor of the building. Although the charter school now resides at a different location, SSLC continues to lease space at the Montgomery Complex from SEC.

The OSA notes that SSLC does not seek lease assistance from the Public School Capital Outlay Council for the Montgomery Complex, which would require a conflict of interest disclosure in its application, and pays for the lease through operational funds, primarily the State Equalization Guarantee (SEG). In addition, the OSA has found that SSLC may be improperly coding this expenditure as instruction, rather than operation of buildings, which could artificially inflate the instruction function in its financial statements.

With respect to this specific risk, the OSA recommended:

- SSLC's and SAMS's governing authorities and the Public Education Department (PED) evaluate the legitimacy of SSLC's need for the Montgomery Complex;
- the master lease agreement be reviewed to determine whether the benefits of the lease to SSLC outweigh the conflict of interest presented by the Head Administrator's financial interest in the lease; and
- given that SAMS paid $15,000 to lease a portion of the building, that the PED and PEC review SSLC's and SAMS's lease agreements with SEC to verify that SAMS did not lease the same portion of the building as SSLC.

Although not mentioned by the OSA risk review, the provisions of the *Procurement Code* appear to require that lease agreements between charter schools and non-governmental entities be subject to the procurement process therein. Because the risk review did not discuss this point, it is unknown whether the charter schools complied with the *Procurement Code*, which contains provisions relating to conflicts of interest.

Other Risks Related to Internal Control Issues and Expenditures

The OSA risk review highlights the following other risks related to internal control issues and expenditures:

- charter school governance, where:
  - the Head Administrator plays an influential role in selecting council members, including:
    - reviewing nominations of prospective council members;
    - interviewing prospective nominees; and
    - nominating a "chosen successor" for approval by majority vote of the council;
  - the governing council, which the Head administrator has a hand in appointing, is responsible for evaluating the Head Administrator, raising concerns about the independent and impartial evaluation of the charter schools' transactions that enhance the financial interest of the Head Administrator; and
  - it appears that provisions of the *Open Meetings Act* were not being followed in at least one instance when appointing a new member to the governing council;
- travel reimbursements were either improperly calculated or not documented appropriately; and
- employee salaries and contracts, where:
  - top-level administrative staff members receive generous accruals of annual leave days, with allowance to sell back those days at the discretion of the Head Administrator;
  - adequate documentation was not available to demonstrate how the charter schools determined the salary or the full-time equivalent (FTE) for each position;
  - contracts do not specify duties to be performed, resulting in a risk that all top-level administrative staff of the charter schools may be overcompensated based on inaccurate FTE; and
  - the Head Administrator recommended that the governing council approve an amendment to his employment contract that would enhance his financial position, which raises concerns about potential violations of the *Governmental Conduct Act*.

Potential Policy Considerations for Charter School Governance:

The OSA risk review informs several potential policy considerations that the committee may wish to consider related to charter school governance. In general, the issues raised by the OSA are already either actions prohibited by current law or actions warranted to be included in charter schools' performance frameworks. As such, the committee may wish to consider the following policies directed at

- the identification of significant issues, including violations of law or performance frameworks; and
- enforcement mechanisms when issues have been identified.

Identification of Significant Issues

- Ensure that a charter authorizer has access to annual and special audit reports:

  - The *Public School Finance Act* requires that each charter school shall have an annual audit and that, at the completion of the annual or any special audit, the school district or charter school shall submit a copy of the audit report to the PED.
  - Potentially amend that section of law to include the chartering authority as a recipient of the audit report.

- Provide the Public Education Commission (PEC) with staff to conduct random internal audits of state-chartered charter schools:

  - The OSA is authorized to audit the financial affairs and transactions of an agency to be audited in whole or in part, but the OSA staff cannot reasonably perform special audits on a significant proportion of state-chartered charter schools each year.
  - According to statute, as a chartering authority, the PEC shall "monitor, in accordance with the requirements of the *Charter Schools Act* and the terms of the charter contract, the performance and legal compliance of charter schools under their authority."
  - Results of internal audits could inform PEC decisions to require corrective action plans or whether to renew charters.

- Amend provisions of the *Charter Schools Act* relating to conflicts of interest to require notification of the chartering authority when public disclosure of conflict of interest is required by other sections of law, such as the *Procurement Code*.

Enforcement Mechanisms

- Explicitly allow financial sanctions against charter schools for unsatisfactory performance reviews as part of the current structure of progressive discipline:

  - "A chartering authority may take appropriate corrective actions or exercise sanctions, as long as such sanctions do not constitute revocation, in response to the unsatisfactory review. Such actions or sanctions by the chartering authority may include requiring a governing body to develop and execute a corrective action plan with the chartering authority that sets forth time frames for compliance." [22-8B-12(F) NMSA 1978]
  - Financial sanctions could mirror those already allowed within the *Public School Finance Act* for failure to submit annual audit reports, which allow PED to withhold a portion of a district or charter school's SEG. [22-8-13.1 NMSA 1978]