

# Risking Public Money: Illinois Charter School Fraud

Best Practices to Protect Public Dollars  
& Prevent Financial Mismanagement



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## ABOUT THE AUTHORS

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**The Center for Popular Democracy** is a nonprofit organization that promotes equity, opportunity, and a dynamic democracy in partnership with innovative base-building organizations, organizing networks and alliances, and progressive unions across the country.



**Action Now** is a grassroots organization working on racial, social, and economic justice in the Chicago metro area. Our issue campaigns come out of listening to community residents through regular monthly meetings, engaging the base by going door-to-door and mobilizing all residents to take part in their community.

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# Risking Public Money: Illinois Charter School Fraud

## Best Practices to Protect Public Dollars & Prevent Financial Mismanagement

Center for Popular Democracy  
Action Now

January 2015

### Executive Summary

In 2010, fourteen years after Illinois passed its charter school law, the U.S. Department of Education raised a red flag about the state's oversight of fiscal controls at its charter schools, finding that the state "has no system in place for monitoring [charter schools]." Four years later, this problem continues. To date, \$13.1 million in fraud by charter school officials has been uncovered in Illinois. Because of the lack of transparency and necessary oversight, total fraud is estimated at **\$27.7 million in 2014 alone**. Our research uncovered three fundamental flaws with the state's oversight of charter schools:

- **Oversight depends heavily on self-reporting by charter schools, or by whistleblowers.** Illinois oversight agencies rely almost entirely on complaints from whistleblowers and audits paid for by charter operators. Both methods are important to uncover fraud; however, neither is a systematic approach to fraud detection, nor are they effective in fraud prevention.
- **General auditing techniques alone do not uncover fraud.** The audits commissioned by the charters and provided to Illinois oversight agencies use general auditing techniques, not those specifically designed to uncover fraud. The current processes may expose inaccuracies or inefficiencies; however, without audits targeted at uncovering financial fraud, state and local agencies will rarely be able to detect fraud without a whistleblower.
- **Adequate staffing is necessary to detect and eliminate fraud.** We found evidence that the government agencies tasked with investigating fraud are severely understaffed, which is prohibitive to conducting high quality, time-intensive audits of any type.

We propose the following targeted reforms of the existing oversight structure to remedy these flaws:

### Mandate Audits Designed to Detect and Prevent Fraud

- Charter schools should institute an internal fraud risk management program, including an annual fraud risk assessment and audits that specifically investigate high-risk areas;
- Charter schools should commission audits of internal controls over financial reporting that are integrated with an audit of financial statements;

- Existing oversight bodies should perform targeted fraud audits focused on areas of risk or weakness through the annual fraud risk assessments; and
- Auditing teams should include members certified in Financial Forensics trained to detect fraud.

## Increase Transparency & Accountability

- All annual audits and fraud risk assessments should be posted on the websites of charter school authorizers, typically the local school system;
- Charter authorizers should create a system to categorize and rank charter audits by fraud risk levels to facilitate transparency and public engagement;
- Charter schools should voluntarily make the findings of their internal assessments public;
- Charter school authorizers should perform comprehensive reviews once every three years;
- The Attorney General's office should conduct a review of all charter schools in Illinois to identify inadequate school oversight by boards of directors or executives and publicize the findings; and
- The state should impose a moratorium on new charter schools until the state oversight system is adequately reformed.

Despite the possibility of almost \$30 million lost to fraud in the last year alone, charter schools continue to experience unprecedented growth. Since 2003, charter school enrollment in Illinois has grown by 680 percent. Illinois students, their families, and taxpayers cannot afford to lose a dollar more in public funds as a result of fraud, misspending, or misdirection within the charter school system. The reforms proposed herein require a smart investment and a commitment to the future of Illinois' youth and all its communities.

## Introduction

Illinois passed its charter school law in 1996 and has received significant federal dollars to help launch and expand its charter school program.<sup>1</sup> Since 2003, charter school enrollment in the state has grown by 680 percent.<sup>2</sup> Currently, 59,338 students are enrolled in charter schools in Illinois.<sup>3</sup> In 2015, that number is projected to jump to 64,434.<sup>4</sup> 92 percent of those students are enrolled in charters authorized by Chicago Public Schools (CPS).<sup>5</sup> Chicago Public Schools' budget for the city's charter schools is substantial: \$616 million for FY 2015,<sup>6</sup> representing an increase of 11 percent over 2014.<sup>7</sup>

In an effort to ensure that charter schools in Illinois are accountable to students, their families, and taxpayers, state lawmakers and local school districts have enacted laws that require some external examinations of charter schools. Under these regulations, every charter school is required to:

- Obtain an annual third-party financial audit;
- Submit a copy of its annual third-party financial audit and a copy of its Federal nonprofit tax filing to the State Board of Education; and
- Submit an annual report that includes budget information to the State Board of Education.<sup>8</sup>

Under Illinois law, each authorizer—typically the school district in which the charter school operates—is primarily responsible for ensuring that charter schools comply with state and federal requirements, and for submitting assurances to the state that these requirements are being met. Most authorizers require some additional reporting from the charter schools they authorize. In Chicago, for example, where 90 percent of Illinois charter schools are located,<sup>9</sup> charter schools are also required to:

- Submit a copy of the state-required annual third-party financial audit to Chicago Public Schools (CPS);
- Submit detailed and summarized budgets to CPS annually;
- Submit quarterly financial reports including budgets; and
- Submit any changes to their fiscal policies and procedures manual to CPS.<sup>10</sup>

Despite this regulatory system, in 2010—14 years after Illinois passed their charter school law—the federal government raised a red flag about Illinois' oversight deficiencies, finding that the state's system for monitoring charter schools was poorly designed.<sup>11</sup> The U.S. Department of Education (Department) report determined that Illinois was in need of additional monitoring to “determine if special conditions should be imposed, including, but not limited to, designating the [Illinois State Board of Education] as high-risk...”<sup>12</sup>

The Department uses eight indicators to review states for compliance with its fiscal control

### Illinois Charter School Landscape

There are 16 sixteen charter schools not authorized by Chicago Public School in the state of Illinois. Each are required to do some amount of additional financial reporting to their authorizers, but none as much as those authorized by Chicago Public Schools.

Our research covered 9 of the 16 charter schools that are not authorized by CPS. The authorizers we examined are: The Illinois State Charter School Commission, Beardstown Community Unit School District 15, Rockford School District 205, and East St. Louis School District 189.

### Federal Audit of Illinois Charter School Oversight System

“The Illinois [charter school office] has no system in place for monitoring [charter school] projects. [Illinois] does not monitor [charter schools] for compliance in specific areas such as fiscal procedures, competitive bidding processes or contracting procedures, conflicts of interest, direct administration or supervision of grant funds, or recordkeeping.” —Illinois Monitoring Report, prepared for the U.S. Department of Education, March 3, 2010

requirements. Of those eight indicators, Illinois failed to fully meet the federal requirements in five of the indicators and received the lowest possible score on three indicators.\*<sup>13</sup>

Considering the Department’s concerns regarding Illinois’ lax charter school oversight system and the findings of this independent report, it is predictable that fraud exists within the charter system in Illinois. Thus far, \$13.1 million in charter official fraud, waste, or abuse has been uncovered.<sup>14</sup> Because of the inadequacy of Illinois’ current oversight system, however, it is likely that the discovered amount is only the tip of the iceberg.

Using the methodology outlined in the 2014 *Report to Nations on Occupational Fraud and Abuse* developed by the Association for Certified Fraud Examiners (ACFE), a global anti-fraud leader, Illinois charter school fraud is estimated to be \$27.7 million in 2014 alone.<sup>†</sup><sup>15</sup> Illinois is not alone; recent reports of charter school fraud in other states, including states with stronger oversight systems than Illinois, have uncovered millions in fraud committed by charter officials. In May 2014, the authors of this report released a national study of 15 large charter markets that found over \$100 million in losses to taxpayers due to fraud, waste, and abuse cases,<sup>16</sup> making a compelling case for a fraud detection and prevention system in Illinois. See Appendix A for examples of cases of fraud, waste, and abuse in Illinois and other states.

## Holes in Oversight Increase Fraud Risk

The current system of oversight in Illinois relies heavily on information provided by charter schools themselves. Under the state regulatory structure, charter schools are required to commission annual financial audits by outside auditors. The audits provide assurances to the authorizers<sup>17</sup> and the state that the charter schools are using public funds in accordance with state and federal regulations. The state then uses the information provided by authorizers to assure the Department that the charters are following federal regulations.<sup>18</sup> Our research included a review of a large sample of the 2012 annual financial audits for Illinois charter organizations currently operating schools in Illinois. The review revealed that, rather than detecting and preventing fraud, the audits commissioned by the charters simply check accuracy in reporting.<sup>§</sup>

### Illinois Charter School Fraud Example

#### \$250,000 in Fraud at Triumphant Charter School

The former head of Chicago’s now-closed Triumphant Charter School, Helen Hawkins, was found guilty of theft of charter school funds in 2001 after an investigation by the Chicago Public Schools’ Office of Inspector General.

The investigation revealed more than \$250,000 in purchases with the school’s credit card including:

- Over \$30,000 in personal items from Lord & Taylor and Saks Fifth Avenue, and at brand-name shops such as Louis Vuitton, Coach and Tommy Hilfiger;
- More than \$2000 on hair care and cosmetic products;
- \$5,800 for jewelry;
- \$18,000 for food and beverages;
- \$31,000 for telephone and internet use;
- \$71,000 for travel expenses, and
- Hundreds for diet pills and personal car repairs.

The investigation also found that Hawkins commingled charter school funds with funds from another school in which she was involved, and she made large disbursements to family members. Following the OIG report, the charter school agreement between CPS and the school was terminated.

Sources: CPS Office of the Inspector General Annual Reports: 2009 & 2010; [http://www.huffingtonpost.com/2010/02/17/helen-hawkins-former-scho\\_n\\_466223.html](http://www.huffingtonpost.com/2010/02/17/helen-hawkins-former-scho_n_466223.html)

\* The Department found one indicator inapplicable to Illinois. Full copies of these sections of the Department of Education report are included in Appendix C of this report.

† Assumes 5 percent of total revenues lost to fraud. Estimates total Illinois charter school revenue for 2014 at \$554 million. This is a conservative estimate, as it only accounts for revenues received at CPS-authorized charters.

‡ A 2012 training conducted for the Illinois State Treasurers’ Office estimates fraud at 10% of revenue, which would estimate IL charter school fraud at \$55.4 million. Source: <http://www.treasurer.il.gov/education/Presentations/Forum2012Session6-RedFlagsofMunicipalFraud.pdf>

§ Review of FY 2012 Annual Financial Audits for 34 Chicago Public Schools charter operators (some operating multiple schools), obtained through a Freedom of Information Request.

In addition to the information the state requires, during the renewal process, most authorizers require copies of charter schools' conflicts of interest policies; copies of its budgets; and other financial documents that demonstrate the charters' financial health.<sup>20</sup> Despite authorizers requiring volumes of additional information from charter schools, our research found that none of the oversight procedures employed by authorizers are designed to detect or prevent fraud. As flagged by the Department's report, Illinois' authorizer and state-level oversight system is reactive and triggered primarily by complaints.<sup>21</sup> In fact, the most high-profile case of fraud uncovered at an Illinois charter school to date was exposed not by oversight agencies or auditors, but by the *Chicago Sun-Times*, which uncovered conflicts of interest at UNO Charter School Network. The exposé triggered an investigation by the Securities and Exchange Commission that resulted in charges that UNO had defrauded investors in a \$37.5 million bond deal.<sup>22</sup>

### UNO Charter School Network: Gaping Holes in Oversight Created Culture Ripe for Abuse

In 2010 and 2011, UNO Charter School entered into two grant agreements with the Illinois Department of Commerce and Economic Opportunity (IDCEO) to build three schools. Unlike the Illinois Charter School Law, these grants actually did require UNO to certify that it had no conflicts of interest and to immediately report any conflicts that arose. In 2011 and 2012, UNO contracted with two companies owned by brothers of UNO's chief operating officer. UNO agreed to pay one company \$11 million to supply and install windows and the other company \$1.9 million to serve as the owner's representative during construction. UNO did not notify IDCEO in writing of either conflicted transaction.

In 2011, UNO conducted a \$37.5 million dollar bond offering in which it issued an official statement to investors in bond offering documents that devoted an entire subsection to the subject of conflicts of interest. UNO disclosed the smaller conflicted contract, but did not disclose the much larger contract for windows. In addition, nothing in the bond offering documents disclosed that UNO was already in breach of the conflict of interest policy in the state grant agreement, nor did it disclose that had IDCEO exercised its rights under the grant agreements and recouped the entire amount of the grants, UNO would not have had the cash to repay the grants and therefore would have had to liquidate its charter schools – the very revenue-producing assets essential for repayment of the bonds.

In June 2014, the SEC filed a case in U.S. District Court, charging UNO with defrauding investors in the bond deal. UNO settled the charges, by agreeing to improve its internal procedures and training and to appoint an independent monitor to oversee the organization's contracting for a year. The SEC reports that its investigation into UNO and its employees is continuing, and in September 2014, the IRS opened an investigation into the bond deals.

The fraud at UNO Charter School Network highlights the need for stricter fraud oversight in Illinois charter schools. In the UNO case, despite fraud charges from the federal Securities and Exchange Commission and, now, notification of an audit by the IRS, UNO has not been charged with any violations by the state or the Chicago Public Schools, its authorizer. Neither CPS nor the ISBE prohibited UNO's practices or had reporting requirements that would have detected them.

In fact, the fraud was only discovered because of a series of reports by the *Chicago Sun-Times* questioning whether the charter school's contracting was in violation of the state grants. Even after the *Sun-Times* reported on the conflicts, CPS unanimously voted to extend UNO's charter an additional five years.

A joint report by *Chicago Magazine* and the non-profit, non-partisan Better Government Association on the downfall of the UNO Charter School Network and its CEO found that "UNO and its CEO thrived mainly because of gaping loopholes in the charter school system. While UNO has received a staggering \$280 million in public money over the past five years to spend on education, neither Chicago Public Schools nor the Illinois State Board of Education provided enough oversight. Without that, insiders say, UNO developed a free-wheeling culture that was ripe for abuse."

Sources: <http://www.chicagomag.com/Chicago-Magazine/February-2014/uno-juan-rangel/>; <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541965772#.VDW0KIZ2Rig>; <http://www.sec.gov/litigation/complaints/2014/comp-pr2014-110.pdf>; <http://politics.suntimes.com/article/chicago/uno-charter-schools-now-target-irs-audit-over-bonds/wed-09032014-617pm>

Both the Illinois State Board of Education and Chicago Public Schools share authority and responsibility in investigating possible fraud at public schools, which include charter schools. Neither agency, however, is tasked with auditing charter schools on a regular schedule, nor with performing audits specifically designed to detect fraud:

- **The Illinois State Board of Education’s Federal and State Monitoring Division** is tasked with monitoring fiscal controls of federal and state grant funds at school districts,<sup>23</sup> including four charter schools that are authorized by the Illinois State Charter School Commission.\*\* Our review of 20 of the Division’s most recent audits of charters and school districts that include charters revealed that they are limited in scope, looking only at funds received in the form of state and federal grants, and not the per pupil payments that charter schools receive from local school districts.<sup>††</sup> In addition, the Division’s audits are infrequent, with a goal of monitoring the state’s school districts and the four state-authorized charter schools only once every five years.<sup>24</sup> In fact, in the 2013 auditing cycle, the Division conducted only one charter school audit.<sup>25</sup>
- **The Chicago Public Schools’ Office of the Inspector General** (OIG) investigates allegations of fraud, waste, and financial mismanagement.<sup>26</sup> Because 90 percent of Illinois charter schools are in Chicago, the Chicago OIG plays a pivotal role in fraud prevention and detection. A review the OIG’s annual reports demonstrate, however, that an OIG investigation uncovered charter school fraud only once in 13 years.<sup>27</sup> Our analysis of the OIG’s methodology found that OIG investigations are not proactive in nature; instead, they are largely triggered by complaints made by members of the public, parents, or school staff, and occur sporadically.<sup>28</sup> Additionally, in 2013, only 22.2 percent of complaints received by the Inspector General’s office resulted in any type of investigation, which can be attributed to chronic understaffing—another prominent barrier to fraud prevention and detection. In the OIG’s 2013 annual report, the Inspector General wrote that understaffing “**creates a substantial risk that waste, fraud, financial mismanagement and employee misconduct go undetected.**”<sup>29</sup>

Because of the numerous other state and local agencies tasked with auditing charter schools in other states, one might expect to have more agencies involved in the oversight of charter schools in Illinois. Our research, however, found that none of the other agencies have oversight over Illinois charter schools, including such prominent offices as the Illinois State Comptroller; the Illinois Auditor General; the Chicago Comptroller; the Chicago Auditor General; the Chicago Inspector General; and the comptrollers and treasurers of the many cities and counties outside Chicago with charter schools.<sup>30</sup>

Furthermore, our research found school district Superintendents who claimed to have no oversight authority over charter schools assigned to their districts between renewal periods beyond requiring the charters to provide a copy of their annual financial audit.<sup>31</sup>

### External Oversight Lacking

“The Charter School has its own Governing Board which oversees operations of the school. Our district pays tuition to the Charter School for students we send there. Other than that, we have no governance over the school other than to reapprove them when the current agreement ends in two years.”

—Reggie Clinton, Superintendent, Beardstown CUSD #15 via email in response to a public records request for oversight documents regarding charter schools in his district

\*\* The Illinois State Charter School Commission-authorized schools are treated as stand-alone Local Education Agencies (LEAs), or school districts, under the Charter School Law.

†† Review of 19 monitoring and audit reports written by the ISBE Federal and State Monitoring Division, received through a FOIA request.



## Systems that Detect and Prevent Fraud

No oversight agencies regularly audit charter schools; only third-party auditors—hired by the charter schools themselves—regularly audit charter schools in Illinois. Although many of the techniques used and areas covered by the charters' independent auditors overlap with the methodologies that fraud auditors employ during fraud audits, they differ in purpose. A fraud audit aims specifically to uncover fraud by detecting asset misappropriation, financial reporting fraud, and corruption.<sup>32</sup> As noted by Conan Albrecht, a Brigham Young University professor who teaches information systems and fraud auditing techniques, "Traditional audits...can uncover fraud, but they don't seek it out. Instead, they look at records to check if prices charged on contracts were reasonable or if contractors have compliant accounting systems in place."<sup>33</sup>

At a minimum, Illinois' charter school oversight requires regularly scheduled audits conducted by authorizers and the Illinois State Board of Education. More effective oversight to protect the state's sizable public investment in charter schools would require fraud controls to be implemented on the school level and would require targeted fraud audits by oversight bodies.

### Internal Control Systems at Charter Schools

Given the millions in Illinois charter school fraud that has already been uncovered; the millions more likely undetected in the state; and the large amounts of charter fraud occurring nationwide the state should require the active participation of these institutions in identifying possible vulnerabilities, ideally enforced by legal mandates. Charter schools should, however, voluntarily implement a robust internal fraud-prevention program, which would include:

### Case Study: Blatant Fraud Goes Unnoticed by Auditors

Between March 2005 and December 2009, the CEO and Board President of New Media Technology Charter School in Pennsylvania stole more than \$500,000 in taxpayer funds and used the public money to prop up a restaurant and pay off debts associated with a failed internet company. Meanwhile, the school lacked textbooks, failed to meet its pension obligations, and occasionally had payroll checks returned for insufficient funds.<sup>(1)</sup> During each of the years that New Media's operators were committing fraud, the third-party auditors hired by the charter school to conduct financial audits failed to uncover the fraud. Instead, parents' complaints and a newspaper exposé triggered an investigation into the operations of New Media Technology Charter School.<sup>(2)</sup> One could imagine a scenario where the charter operators of New Media were slightly savvy; this fraud might have been able to continue even longer.

As our research shows, Illinois oversight agencies depend almost entirely on annual financial audits to protect the state's taxpayers from fraud. We compared the audit reports for New Media Charter School from 2007 through 2009 with a large sample of audits of Illinois charter schools. We found that the audits for New Media and the audits for Illinois schools use the same limited methodology. Some close variation on the following statements appears in every audit we reviewed:

- *"An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements."* In other words: the auditors tested a set of transactions to see if they matched up with the numbers disclosed by management in their financial statements, but did not conduct a comprehensive review of all transactions to determine whether or not fraud was occurring.
- *"Our considering of internal control over financial report... was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses."* In other words: the auditors conducted some tests to determine whether school is following policies designed to assure internal controls over the company's finances, but they did not undertake a comprehensive review of the school's financial controls.

This limited scope did not detect even the blatant fraud at New Media Charter School, and it may not detect fraud at Illinois charter schools. Yet, these limited audits are the foundation of the Illinois charter school oversight system. Fraud detection in Illinois charter schools should not be dependent upon parent complaints, media exposés, and whistleblowers. Instead, it should be proactive and employ forensic accounting methodologies.

Sources:

(1) Martha Woodall, "Two sentenced in theft from Philadelphia New Media charter school," *Philadelphia Inquirer*, July 15, 2012 [http://articles.philly.com/2012-07-15/news/32675514\\_1\\_fiscal-mismanagement-and-conflicts-lotus-academy-charter-school](http://articles.philly.com/2012-07-15/news/32675514_1_fiscal-mismanagement-and-conflicts-lotus-academy-charter-school) (accessed September 24, 2014).

(2) Martha Woodall, "Charter-School Probes Expand," *Philadelphia Inquirer*, August 16, 2009.

<sup>33</sup> A detailed overview of fraud audit methodology can be found in Appendix B.

- Taking proactive steps to educate all staff and board members about fraud;
- Ensuring that at least one executive-level manager coordinates and oversees the fraud risk assessment and reports to the board, oversight bodies, and school community;
- Implementing reporting procedures that include conflict disclosure, whistleblower protections, and a clear investigation process;
- Undergoing and posting a fraud risk assessment conducted by a consultant expert in applicable standards, key risk indicators, anti-fraud methodology, control activities, and detection procedures; and
- Developing and implementing quality assurance, continuous monitoring, and, where necessary, corrective action plans, with clear benchmarks and reporting.<sup>34</sup>

These internal measures will help contribute to a culture of vigilance that protects the public's interest and ensure that all resources intended for the education of Illinois' children are appropriately deployed. Adopting such a program would also help identify areas of vulnerability in each charter school, more efficiently targeting areas for particular attention by oversight agencies.

An effective internal control system includes conducting a fraud risk assessment that:

- Identifies inherent fraud risks through the explicit consideration of all types of fraud schemes and scenarios; incentives, pressures, and opportunities to commit fraud; and fraud risks specific to the organization;
- Assesses the likelihood and significance of inherent fraud risk based on historical information, known fraud schemes, and interviews with staff, including business process owners;
- Creates effective and appropriate responses to possible, existing, or residual fraud risks; and
- Performs a cost-benefit analysis of fraud risks to help the organization decide which controls or specific fraud detection procedures to implement.<sup>35</sup>

A portion of the fraud that has occurred in Illinois can be attributed to weak internal controls. And, because hundreds of millions of public tax dollars are allocated to the charter system each year, it is important that all charter schools adopt strong internal control systems to assess the risk of fraud. Charter school management and governing boards must establish strong internal controls, and charter school oversight agencies must ensure their auditing protocols incorporate regular audits of those internal controls and conduct targeted fraud audits. Similarly, the Attorney General's Office, as the principle non-profit oversight agency, should conduct and publicly release the findings of a study of these non-profit entities' internal fraud-prevention systems. The state legislature should fully fund the agencies to ensure that they have the resources to take the necessary action.

### Key Role Governing Boards Play

The three premiere auditing membership associations, the Institute of Internal Auditors, the American Institute of Certified Public Accountants, and the Association of Certified Fraud Examiners, recently partnered to develop a fraud mitigation guide titled, *Managing the Business Risk of Fraud: A Practical Guide*. The *Guide* explains the key role governing boards play:

The board of directors should ensure that its own governance practices set the tone for fraud risk management and that management implements policies that encourage ethical behavior, including processes for employees, customers, vendors, and other third parties to report instances where those standards are not met. The board should also monitor the organization's fraud risk management effectiveness, which should be a regular item on its agenda. To this end, the board should appoint one executive-level member of management to be responsible for coordinating fraud risk management and reporting to the board on the topic.<sup>36</sup>

## Fraud Audits by Oversight Agencies.

Currently, the Illinois State Board of Education and authorizers require charter schools to submit annual financial audits. This basic requirement is insufficient at preventing and detecting fraud, and oversight agencies must broaden the parameters of their oversight by conducting their own audits of the state's charter schools, including targeted fraud audits designed specifically to detect asset misappropriation, financial reporting fraud, and corruption.<sup>37</sup> These fraud audits should begin with a review of the internal fraud-control system itself. Studies show that while fraud can occur in companies with strong or weak internal control mechanisms, companies with the best track record of preventing and detecting fraud are those with the strongest internal control fraud risk management programs.<sup>38</sup>

For schools with stronger internal control systems, oversight agencies would use a fraud risk assessment to identify areas of particular vulnerability and target areas for the fraud audit. Where internal control systems are weaker, the authorizer would conduct broader fraud audits. In order to facilitate fraud audits across oversight agencies, agencies should coordinate to identify possible fraud schemes, how they occur, and what symptoms they exhibit.

To accomplish this goal, we recommend that Illinois state law should be amended to require Chicago Public Schools (in the case of CPS-authorized schools) and the Illinois State Board of Education's Federal and State Monitoring Division (in the case of charter schools authorized by school districts outside Chicago and the Illinois State Charter School Commission) to perform charter school fraud risk assessments and fraud audits. That auditing authority should then be exercised in coordination with charter authorizers and the ISBE.

## Appropriate Staffing and Training

The Chicago Public Schools' Inspector General warned that understaffing in his office, **"creates a substantial risk that waste, fraud, financial mismanagement and employee misconduct go undetected."**<sup>39</sup>

Even if authorizers and the Illinois State Board of Education are assigned the primary responsibility for oversight of fraud detection and prevention at charter schools, they will not be able to fulfill their new mandate without the staff, time, or other resources they need to adequately monitor charter schools. The state must fully fund authorizers and the State Board of Education at levels that allow them to hire and train sufficient staff to carry out necessary oversight functions to detect waste, fraud, and abuse.

### Government Agencies Adopt Proactive Fraud Practices

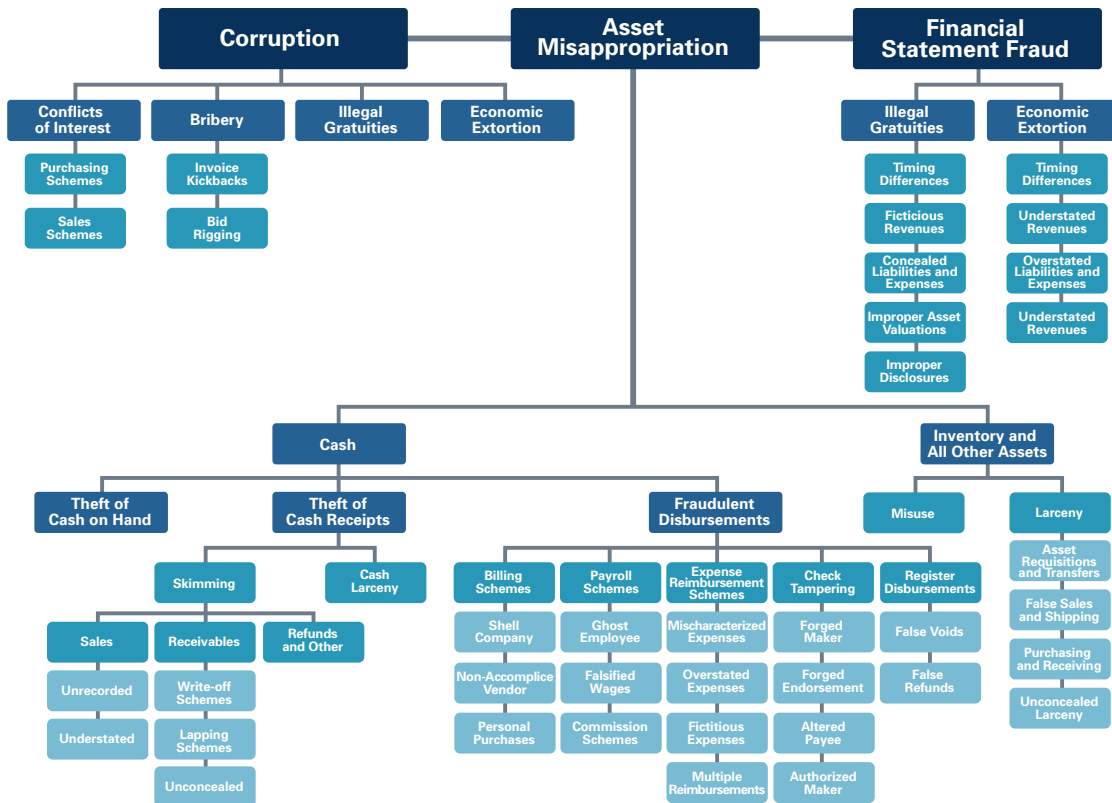
Recognizing the difference between traditional audits and fraud audits, the United States General Services Administration (GSA) inspector general's office recently rolled out a five-person team devoted to using forensic auditing techniques to dig up evidence of fraud. They did this after other agencies, including the Department of Defense, NASA, and the EPA brought on their own fraud auditing teams. The GSA and other agencies did this at the urging of the National Procurement Fraud Task Force, an interagency group that promotes the prevention, early detection and prosecution of fraud. The GSA explained their move in a press release stating,

"As new computer-based data-mining techniques have evolved, new possibilities have emerged for auditors to be more proactive in looking for improper activity such as fraud. Now, auditors have tools that can allow them to more easily and regularly analyze and compare vast sets of data to reveal patterns of behavior that would evade traditional audit reviews...Forensic auditors try to match symptoms of fraud, think about how perpetrators might defraud the system, and then run tests to see if the symptoms of that kind of fraud show up...By being more proactive—through regular forensic audits—auditors can help keep some fraud from ballooning into multimillion-dollar cases."

Source: <http://www.gsaig.gov/index.cfm/news/first-blog-entry/?keywords=proactive%20fraud%20detection>

## Fraud Tree

The Association of Certified Fraud Examiners (ACFE) has diagrammed a 'fraud tree' to explain the distinction between the three major types of fraud.<sup>40</sup> Asset misappropriation fraud is the most common type of fraud committed within corporations, and it is also the type of fraud most commonly found in Illinois' charter schools. This type of fraud involves the misuse or theft of assets belonging to a company.<sup>41</sup> According to a 2014 global fraud study conducted by the ACFE, 85 percent of all internal fraud schemes involved asset misappropriation.<sup>42</sup>



## Recommendations

The state of Illinois and local school districts spend hundreds of millions of dollars a year on charter schools, and have experienced at least \$13.1 million in detected fraud, waste, and abuse by charter officials.<sup>43</sup> Because of the lack of transparency and necessary oversight, total fraud is estimated at **\$27.7 million in 2014 alone**. Additional revenue is necessary to accomplish the recommendations found within this section, at small cost to taxpayers in comparison to the millions of dollars lost to fraud in past and current fraud cases, and the millions likely to be saved through oversight and prevention.

In order to uncover existing fraud schemes and to dissuade future fraud, we recommend that every charter school be required to conduct a fraud risk assessment that is updated annually. We also recommend requiring the use of an external fraud risk assessment consultant with expertise in applicable standards, key risk indicators, anti-fraud methodology, control activities, and detection procedures to assist charter school governing boards and management in their fraud risk assessments.

In addition to the above measures, we recommend every charter school institute a fraud risk management program that includes:

- Taking proactive steps to educate all staff and board members about fraud;
- Ensuring that one executive-level manager coordinates and oversees the fraud-risk assessment and reports to the board, oversight bodies, and school community;
- Implementing reporting procedures that include conflict disclosure, whistleblower protections, and a clear investigation process;
- Undergoing and posting a fraud risk assessment conducted by a consultant expert in applicable standards, key risk indicators, anti-fraud methodology, control activities, and detection procedures; and
- Developing and implementing quality assurance, continuous monitoring, and, where necessary, corrective action plans with clear benchmarks and reporting.

Until fraud risk management programs are mandated by law, we recommend charter schools voluntarily establish the programs and make their fraud risk assessments public.

Furthermore, we recommend requiring the Illinois State Board of Education and Chicago Public Schools to conduct fraud audits of charter schools. Fraud audits should be the responsibility of authorizers; however, because 90 percent of charter schools are in Chicago, and many authorizers outside Chicago only authorize one school and do not have the resources to pay for an outside fraud auditor or to keep a certified fraud auditor on staff, we recommend that the Illinois State Board of Education's Federal and State Monitoring Division conduct these fraud audits for all authorizers outside Chicago. Chicago Public Schools and the Illinois State Board of Education should perform targeted fraud audits focused on and limited to all areas of weakness identified during the charter school's most recent fraud risk assessment. We recommend that targeted fraud audits occur once every three years. Until the legislature mandates fraud audits, we call on authorizers to broaden the rules governing their reviews to include fraud audits.

In order to accomplish the above recommendations, we recommend the establishment of a joint audit calendar between authorizers and the State Board of Education to coordinate charter auditing between oversight entities.

We recommend all Chicago Public Schools and ISBE Federal and State Monitoring Division auditors assigned to charter schools be certified in Fraud Examinations by the Association of Certified Fraud Examiners; in Financial Forensics by the American Institute of Certified Public Accountants; or by an equivalent certification body. If current auditors do not have this certification, they should be provided the time and funding to acquire it. If auditors lack certain critical elements of their fraud auditing team, such as a forensic fraud computer expert, we recommend they be required to contract with an independent firm or be required to collaborate with another auditing body.

To increase accountability and transparency, we recommend that all annual audits and fraud risk assessments be posted on the authorizer website within 60 days and require authorizers to design a system that categorizes audits by fraud risk levels.

We propose that the Attorney General's office conduct a fully funded review of all charter schools in Illinois to determine what steps nonprofit governing boards and executives have taken to prevent and detect fraud, including an exhaustive review of fraud risk assessments and management programs of each charter school over the past 10 years. The findings and recommendations of the investigation should be presented in a public report.

## Conclusion

After uncovering \$13.1 million in charter school fraud in the 18 years since charter schools were approved in the state,<sup>44</sup> we estimate that Illinois experienced \$27.7 million in charter school fraud in 2014 alone.<sup>45</sup> With \$616 million in taxpayer funds budgeted to charter schools in 2015, it is crucial that the state take steps immediately to detect, prevent, and deter fraud.<sup>46</sup>

We recommend that the legislature implement legal mandates that require fraud risk assessments and audits at the school level, as well as by authorizers and by the Illinois State Board of Education. Our recommendations include providing oversight agencies with the budgets necessary to adequately staff necessary oversight programs.

Illinois lawmakers have not given oversight bodies the mandate to detect and eliminate fraud in its incipient stages. The state cannot afford the risk of adding new charter schools under an already inadequate oversight system. We urge the state legislature to establish a moratorium on new charter schools until these recommendations are met. In some cases, the ability of charter schools to defraud the public has come to light; however, there exist with certainty many cases of fraud and abuse in which whistleblowers have not yet come forward, or complaints have not been linked to malfeasance. Until the recommendations in this report are implemented, fraud will continue to go undetected.

We recommend lifting the moratorium in 12 months only if, at that time, all charter schools in Illinois have undergone a fraud risk assessment and established fraud risk management programs that conform to the recommendations found within this report.

# Appendix A—Known Fraud, Waste, and Abuse in Illinois: Just the Tip of the Iceberg?

Because the current oversight system in Illinois lacks adequacy, it is likely that the amount of fraud, waste and abuse that has been uncovered in Illinois is only the tip of the iceberg. Recent reports of charter school fraud in other states, including states with stronger oversight systems than Illinois, have uncovered millions in fraud committed by charter officials. Below are details on Illinois' known cases of fraud, as well as examples of charter school fraud discovered in other states, which could easily happen in Illinois.

## IL: Triumphant Charter School

The former head of Chicago's now-closed Triumphant charter school, Helen Hawkins, was found guilty after an investigation which questioned more than \$250,000 in purchases with the school's credit card, including over \$30,000 in personal items from Lord & Taylor and Saks Fifth Avenue. Hawkins spent thousands of dollars on hair care and cosmetic products, jewelry and diet pills.<sup>47</sup>

## IL: UNO Charter School Network

In 2014, the Federal Securities and Exchange Commission (SEC) charged UNO Charter School Network with defrauding investors in a \$37.5 million bond offering for school construction by making materially misleading statements about transactions that presented a conflict of interest. According to the SEC's complaint, UNO failed to notify the state of two construction contracts totaling \$12.9 million with the brothers of one of UNO's top executives. Additionally, the charter school operator failed to notify bond investors that the state could take the loan that the bond was assured with back for the non-disclosure of the contracts. The conflicts of interest uncovered in a series of *Sun-Times* articles in 2013.<sup>48</sup>

In August 2014, the IRS notified the state that it had opened an investigation into the organization's bond issuance.<sup>49</sup>

## NJ: Adelaide L. Sanford Charter School

In June, 2013, the state of New Jersey revoked the charter of Adelaide Sanford Charter School, citing the school's poor academic performance and its repeated failure to comply with regulations. The state Education Department cited school founder and community activist Frederica Bey and others for refusing to turn over records and rectify conflicts of interest, including inflated rent payments from the school to Women in Support of the Million Man March (WISOMM), an organization founded by Bey and on whose board Bey and her daughter serve. A complaint filed by the US Attorney's office alleges that Bey used \$345,000 in federal money intended for programs for at-risk youth to pay WISOMM's bills. Several members of the Adelaide Sanford board had asked the state Education Department to intervene.

Sources: [http://blog.nj.com/njv\\_barry\\_carter/2013/06/newark\\_charter\\_school\\_closes\\_a.html](http://blog.nj.com/njv_barry_carter/2013/06/newark_charter_school_closes_a.html)

[http://www.nj.com/esssex/index.ssf/2013/06/christie\\_administration\\_closing\\_newark\\_charter\\_school\\_founded\\_by\\_city\\_activist\\_fredrica\\_bey.html](http://www.nj.com/esssex/index.ssf/2013/06/christie_administration_closing_newark_charter_school_founded_by_city_activist_fredrica_bey.html)

[http://www.nj.com/news/index.ssf/2013/05/newark\\_charter\\_school\\_sanford.html](http://www.nj.com/news/index.ssf/2013/05/newark_charter_school_sanford.html)

## OH: Cincinnati College Preparatory Academy Charter School

After receiving an anonymous tip, the Ohio Auditor of State's office investigated the Cincinnati College Preparatory Academy Charter School and found that administrators stole at least \$148,000 of taxpayer money. Superintendent Dr. Lisa Hamm and school treasurer Stephanie Millard were indicted in March of 2013 on multiple criminal charges. The two are alleged to have used school funds to pay for things such as sightseeing tours through Europe, a \$20,000 tour of California, and a Chicago trip to a Tina Turner concert, all under the guise of visiting schools to identify best practices or for professional development.

Source: <http://www.wcpo.com/news/local-news/charter-school-officials-to-appear-in-court-for-allegedly-spending-148k-in-school-funds>

## OH: Lorain Arts Academy Charter School

Arts Academy charter school in Lorain, Ohio, and Arts Academy West charter school in Cleveland were closed by the state in June 2011 after a state audit found that the school had failed to keep required financial records and had significant debts. The school's founder, Alexis Rainbow, and the director of the school's sponsoring agency, Jorethia Chuck, were both accused of ethics violations by state auditors and by each other. Rainbow allegedly made payments from the school's account to various businesses that she owned. The audit also found improper spending and financial mismanagement on

the part of consultants hired by both women. The school's closure left Ohio taxpayers with about \$75,000 in unpaid bills, many of which had piled up unopened in the schools' mail.

Sources: <http://chronicle.northcoastnow.com/2012/05/18/lorain-arts-academy-flunks-audit/>

[http://www.cleveland.com/metro/index.ssf/2012/03/debts\\_of\\_arts\\_academy\\_and\\_arts.html](http://www.cleveland.com/metro/index.ssf/2012/03/debts_of_arts_academy_and_arts.html)

### **PA: Agora Cyber Charter School**

Dorothy June Brown, founder of Laboratory, Ad Prima, Planet Abacus, and Agora Cyber charter schools, will be retried beginning in September, 2014 for defrauding the schools of \$6.5 million and conspiring to conceal the fraud. A jury acquitted Brown of three charges in January and deadlocked on the other 54 charges. Two other administrators were acquitted of conspiracy and obstructing justice; another two pleaded guilty and testified against Brown in her first trial. Brown severed ties with Agora Cyber Charter in 2009 as part of the settlement of several civil suits.

Sources: [http://articles.philly.com/2014-04-15/news/49159242\\_1\\_dorothy-june-brown-agora-cyber-charter-ad-prima](http://articles.philly.com/2014-04-15/news/49159242_1_dorothy-june-brown-agora-cyber-charter-ad-prima)

[http://www.philly.com/philly/education/20140415\\_Retrial\\_set\\_in\\_charter\\_school\\_fraud\\_case.html](http://www.philly.com/philly/education/20140415_Retrial_set_in_charter_school_fraud_case.html)

<http://www.fbi.gov/philadelphia/press-releases/2012/charter-school-founder-dorothy-june-brown-charged-in-6-million-fraud-scheme>

### **PA: Harambee Institute of Science Technology Charter School**

Masai Skief plead guilty to two counts of wire fraud by which he embezzled \$88,000 from the Harambee Institute of Science Technology Charter School. The former chief executive of the school used the money for personal expenses, including a down-payment on a house. After pleading guilty, the U.S. Attorney's Office found that he continued to use the school's debit card, stealing an additional \$12,500. A U.S. District Judge sentenced him to 3 years in Federal prison on February 11, 2014.

Sources: [http://articles.philly.com/2014-01-12/news/46092814\\_1\\_plea-agreement-masai-skief-harambee-institute](http://articles.philly.com/2014-01-12/news/46092814_1_plea-agreement-masai-skief-harambee-institute)

[http://articles.philly.com/2014-02-12/news/47238840\\_1\\_harambee-institute-masai-skief-john-skief](http://articles.philly.com/2014-02-12/news/47238840_1_harambee-institute-masai-skief-john-skief)

### **MI: George Washington Carver Academy Charter School**

Shantell Bell, former treasurer of the George Washington Carver Academy in Highland Park, was sentenced to five years' probation for embezzling \$25,000 from the school to purchase a Detroit home. The school notified the Michigan State Police of the theft after learning of it from Bell's ex-boyfriend, and the Attorney General's Public Integrity Unit pursued the case against Bell. They found that in March 2009, Bell had requested a check to purchase text books, which she had converted to a cashier's check and then used it for a down payment on the home.

Sources: <http://www.examiner.com/article/former-highland-park-charter-school-treasurer-charged-with-embezzlement>

[https://www.michigan.gov/ag/0,4534,7-164-34739\\_34811-262330--,00.html](https://www.michigan.gov/ag/0,4534,7-164-34739_34811-262330--,00.html)

### **MN: Right Step Academy Charter School**

The husband and wife owners of the former Right Step Academy charter school in St. Paul, Minnesota were sentenced to federal prison on March 24, 2006 after being convicted of fraud. After an investigation by officials from the IRS and U.S. Department of Education, William and Shirley Pierce were found guilty of defrauding their former school of thousands of dollars. It is estimated that couple charged over \$357,625 to the school and used the money for such personal expenses as a Caribbean cruise vacation and season tickets to the Minnesota Timberwolves.

Source: <http://www2.ed.gov/about/offices/list/oig/invreports/mn052006.html>

### **MN: Oh Day Aki/Heart of the Earth Charter School**

The former executive director of the Oh Day Aki/Heart of the Earth Charter School in Minnesota pleaded guilty to stealing over \$1 million from the school by forging signatures on dozens of checks. Joel Pourier embezzled the money from 2003 to 2008 and used the funds to pay for such extravagances as trips to strip clubs. At the same time, the charter school, founded to educate low-income American Indian youth, lacked appropriate funding for educational necessities such as textbooks and other supplies.

Source: <http://www.startribune.com/local/minneapolis/97951354.html>

### **WI: New Hope Institute of Science and Technology**

In 2008, Rosella Tucker, founder and director of the now-closed New Hope Institute of Science and Technology charter school in Milwaukee, was convicted in federal court of embezzling \$300,000 in public money and sentenced to two years in prison. Tucker acknowledged taking U.S. Department of Education money intended for the school, which she started



through a charter agreement with Milwaukee Public Schools. She spent about \$200,000 on personal expenses, including cars, funeral arrangements and home improvement, according to court documents. Tucker has argued that the remainder of the money she received was legitimate reimbursement for school-related expenses. Tucker embezzled the \$300,000 from 2003 to 2005. The Milwaukee School Board voted to close New Hope Institute of Science and Technology in February 2006, amid problems that included unpaid bills and lack of appropriate teacher licensure.

Sources: <http://www.jsonline.com/news/education/29420144.html#ixzz2z4VdIL7d.html>

<http://www.jsonline.com/news/milwaukee/112892364.html#ixzz2ziaCvli9>

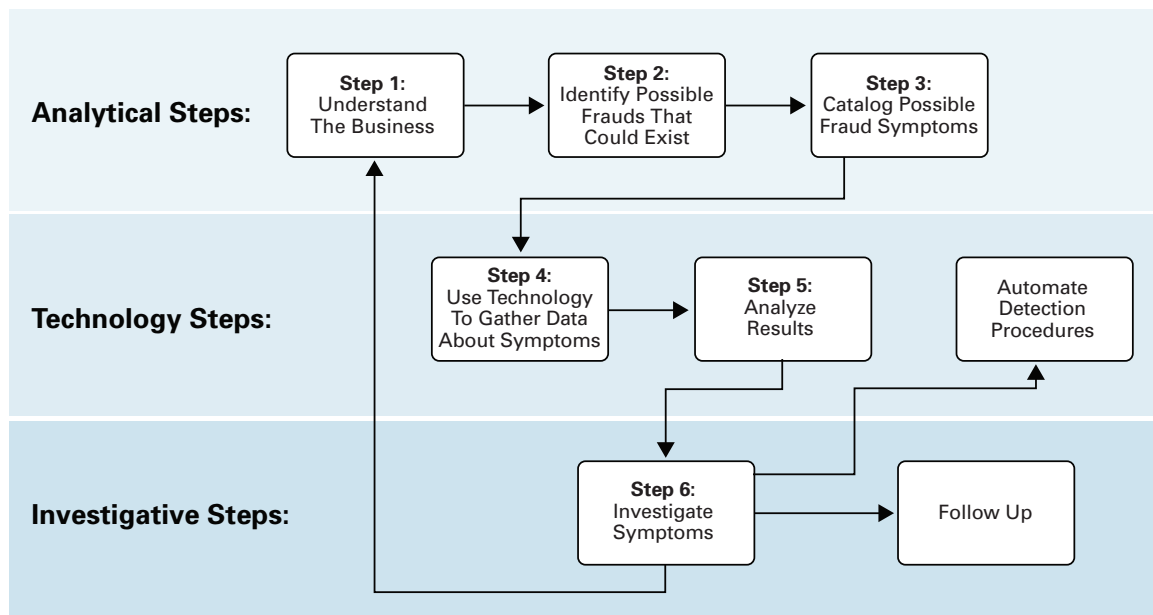
<http://www.jsonline.com/news/education/29420144.html#ixzz2ziZJL95F>

<http://www.jsonline.com/news/milwaukee/112892364.html>

<http://www2.ed.gov/about/offices/list/oig/invtreports/wi012008.html>

## Appendix B: Fraud Audit Methodology

Fraud audits involve six core analytical, technological, and investigative steps.<sup>50</sup> The below fraud steps are those taught by Dr. Conan Albrecht, a professor who teaches fraud auditing techniques at Brigham Young University. The first three steps are those performed during a fraud risk assessment. The targeted fraud audit would begin at Step four.



**Step 1: Understand the Business**—Develop a firm understanding of the business being examined. Having a detailed understanding of the business underlies the entire strategic fraud detection process.<sup>51</sup> This step includes:

- Inclusion of an experienced business employee on detection team
- Tour the business
- Interview key personnel
- Analysis of financial statements
- Work with auditors/security personnel

**Step 2: Identify Possible Frauds that Could Exist**—Once fraud examiners feel confident that they understand the business, they determine what possible frauds might exist or could occur in the operation being examined. This risk assessment step requires an understanding of the nature of different frauds, how they occur, and what symptoms they exhibit.<sup>52</sup> This step includes:

- Divide business unit into individual functions
- Determine the players
- Determine types of interactions between insiders and outsiders
- Ask questions such as:

- a. How could employees commit fraud alone?
- b. How could vendors commit fraud alone?
- c. How could vendors/employees collude?
- e. Develop a list of possible frauds specific to this business unit

**Step 3: Catalog Possible Fraud Symptoms**—This step involves the cataloging of frauds identified in Step 2. A matrix, tree diagram, or brainstorming map can be created that correlates specific symptoms with specific possible frauds.<sup>53</sup>

- a. Analytical anomalies
- b. Document or record symptoms
- c. Internal control symptoms
- d. Lifestyle symptoms
- e. Behavioral symptoms
- f. Tips and complaints

**Step 4: Use Technology to Gather Data About Symptoms**—Once symptoms are defined in Step 3, supporting data is extracted from company databases and other sources. While traditional audit procedures call for limited transaction tests, such as those currently employed by authorizer auditors, technology-based fraud-detection queries are run against full transaction populations. Because even significant frauds can occur in very few transactions, the use of sampling potentially misses fraudulent records (sampling error) and circumvents the ability of computers to quickly analyze full populations.<sup>54</sup> This step includes:

- a. Pulling data from company databases.
- b. Creating custom data warehouses to store data.

**Step 5: Analyze and Refine Results**—Once relevant data are retrieved, they are compared against expectations and models. Computerized algorithms examine records and highlight anomalies, unknown values, suggestive trends, or outliers that should be analyzed directly by examiners. This step includes:<sup>55</sup>

- a. Analysis using time algorithms, statistical queries, and other tools.
- b. Conducting iterative runs to hone results.

**Step 6: Investigate Symptoms**—Once anomalies are highlighted and determined to be indicators of fraud, they are investigated either using traditional or technology-based approaches. Investigation of leads are only done on anomalies that cannot be explained through continued analysis. This step includes:<sup>56</sup>

- a. Use computer-based analyses for efficiency
- b. Work with auditors and/or security personnel
- c. Refine algorithms and queries from steps 4 and 5

**Additional Activities—After Process:** Fraud examiners then follow up on all identified symptoms. While finding fraud is certainly the primary objective, the process often highlights control weaknesses, ineffective systems, undocumented policies, and data errors. Each of these anomalies should be corrected to make company processes more efficient and effective. This step includes:<sup>57</sup>

- a. Follow-up on suspected frauds
- b. Automate detection procedures
- c. Use lessons learned to cycle through the process again

# Appendix C: U.S. Department of Education Charter Schools Program “Illinois Monitoring Report”

In 2010, the U.S. Department of Education commissioned a comprehensive review of Illinois’ performance and compliance under the state’s federal charter school grant. Illinois has received four U.S. Department of Education Charter School Program (CSP) grants since 1996, totaling \$21 million.

The following pages show the full text – obtained under a Freedom of Information request – of the report sections on “Subgrantee Monitoring and Performance” and “Administrative and Fiscal Responsibilities.” These are the sections of the report which look at the Illinois State Board of Education’s monitoring of charter schools for compliance with requirements regarding the fiscal controls and objectives of the program, as well as the State Board’s use of and control over the grant funds.

The Department of Education report uses eight indicators to review states for “monitoring and performance” and administrative and fiscal responsibilities under the Charter School Program, but one indicator is deemed “not applicable” to Illinois). Of the seven indicators applicable to Illinois, the state failed to fully meet the requirements five times (4.1, 4.2, 5.1, 5.5, and 5.6).

#### The rating system is as follows:

- 1 – State does not meet this indicator.
- 2 – State partially meets this indicator.
- 3 – State fully meets this indicator.

#### Definitions:

**SEA:** State Education Agency. In this case, the Illinois State Board of Education.

**Subgrantees:** The recipients of grant funds from the State Education Agency. In this case, the charter schools.

**CSO:** Charter School Office. The office of the State Education Agency which monitors charter schools.

**LEA:** Local Education Agency, or school district. In Illinois, the four charter schools which have been authorized by the state are considered LEAs as well.

**CSP:** Charter School Project. The U.S. Department of Education grant program being monitored in the WestEd report.

**ED:** The U.S. Department of Education.

## The Report

### 4. Subgrantee Monitoring and Performance

The responsibility of an SEA to monitor subgrantees to ensure that they adhere to Federal rules and regulations and accomplish their performance objectives is an important condition of the Federal grant. This section focuses on the SEA’s monitoring of subgrantees to assure compliance with applicable Federal requirements and progress toward subgrantee performance objectives. It includes indicators that cover the State’s responsibilities for monitoring:

- Subgrantees’ compliance with applicable Federal laws, rules, and regulations regarding the fiscal and administrative aspects of the program; and
- The performance of subgrantee projects with regard to desired results.

**Indicator 4.1: The SEA monitors subgrantee projects to assure compliance with applicable Federal requirements, including, but not limited to, those regarding fiscal procedures, competitive bidding processes and contracting procedures, conflicts of interest, direct administration or supervision of grant funds, recordkeeping, and compliance with IDEA.** In accordance with 34 CFR 80.40, the State demonstrates that it regularly monitors subgrantee projects for compliance with applicable Federal requirements.

Observations: The Illinois CSO has no system in place for monitoring subgrantee projects. ISBE does not monitor subgrantee projects for compliance in specific areas such as fiscal procedures, competitive bidding processes or contracting procedures, conflicts of interest, direct administration or supervision of grant funds, or recordkeeping. Rather, the ISBE charter school staff stated that they look into compliance issues only if there is a complaint. For example, the CSO director stated that the Chicago Public Schools separately monitors the charter schools that it has authorized. Except for periodic reports on disbursements of subgrant funds, no monitoring information about specific schools is gathered or reviewed by the CSO. The ISBE staff member who has responsibility for the one SBE-chartered school (which is an LEA) advised that she visits that school once every two years.

Although not sufficient for subgrant monitoring purposes, ISBE program offices, specifically those handling financial and grant matters and special education, monitor LEAs. They do not monitor individual schools within LEAs. The LEA submits all assurances about the handling of State and Federal financial matters and it is considered the district’s responsibility to see that the charter school complies with all requirements just as it would do for all its other schools. Representatives from the ISBE special education division confirmed that they do not perform systematic monitoring of charter schools because those schools are typically not their own districts, but they will respond to complaints related to a school.

While the State relies heavily on other departments in the ISBE (e.g., special education), or LEAs to conduct compliance monitoring, there appears to be little coordination with the monitoring of projects under the CSP program. In addition, conversations with subgrantee school staff confirmed that there is no regular monitoring process for their subgrant projects carried out by the State.

Rating and Justification: 1 State does not meet the indicator. The State provided no evidence that it monitors subgrantee projects for compliance with applicable Federal requirements including, but not limited to, those regarding fiscal procedures, competitive bidding processes, contracting procedures, conflicts of interest, direct administration or supervision of grant funds, recordkeeping, and compliance with IDEA.

Recommendation: The State needs to immediately develop and implement a monitoring program for its CSP subgrantee projects to ensure compliance with applicable Federal requirements.

In addition, the monitoring team recommends that ED further review the performance management and/or the financial problems documented as part of this monitoring process that have affected the administration of this grant project to determine if special conditions should be imposed, including, but not limited to, designating the grantee as high-risk in accordance with 34 CFR 74.14 and 80.12.

**Indicator 4.2: The SEA monitors subgrantee projects to assure that the charter school is meeting its performance objectives and improving educational results for all students. In accordance with 34 CFR 80.40,** the State demonstrates that it regularly monitors subgrantee projects to determine if the charter school is making satisfactory progress toward achieving the objectives described in its approved subgrant application that results in improving educational results for all students.

Observations: The State’s application for an initial CSP subgrant requires the applicant to provide a narrative that includes the charter school’s student performance objectives and how the charter school will determine its progress toward achieving those objectives. To meet the Continuation Grant requirements for a second or third year grant, charter schools with a CSP subgrant are required to provide a performance report. Each of the charter school’s goals must be addressed and the grantee is required to report the progress the charter school has made in meeting the goals set forth in its initial application. The RFP also requires that a rationale be provided for modifications made or planned to be made to any goals during the continuation grant period. Any obstructions to meeting the goals must be addressed, as well as how the Federal Charter School Start-Up funding has assisted the charter school in meeting its educational goals. However, there is no follow-up review of these reports to provide additional guidance or technical assistance to subgrant projects.

The State compiles an annual report summarizing various charter school statistics in fulfillment of a reporting requirement. (See Appendix 20: *Illinois Charter School Annual Report: January 2009*.) That report includes data on enrollments over four years, demographics, ethnicity, students with disabilities, certification, performance on state tests, AYP status and other test results for charter school students. The report is submitted to the State Board of Education and placed on the State website. There is no follow up relating to these data or other performance aspects of a charter school’s operation.

Rating and Justification: 2 – State partially meets the indicator. Although the State is collecting some program data through continuation applications and preparing annual reports, it is unclear how the information is used for the purposes of monitoring subgrant projects.

Recommendations: The State needs to take immediate steps to develop and implement monitoring procedures to assure that the charter school is meeting its performance objectives and improving educational results for all students.

**5. Administrative and Fiscal Responsibilities**

CSP grantees incur a number of administrative and fiscal responsibilities under Federal statute and regulations. This section focuses on the SEA’s use of and controls over the grant funds and on the State’s administrative responsibilities with regard to the CSP grant. It includes indicators that cover the State’s responsibilities in:

- Properly disbursing and accounting for Federal funds;
- Using grant funds for administrative expenses and other defined purposes;
- Maintaining and retaining grantee and subgrantee financial and programmatic records related to the CSP grant funds;
- Directly administering or supervising the State CSP program;
- Ensuring against conflicts of interest in the CSP grant program; and
- Complying with Federal procurement standards.

**Indicator 5.1: The SEA uses fiscal control and fund accounting procedures that ensure proper disbursement of and accounting for Federal funds, including, but not limited to, allowable, allocable, and reasonable use of CSP grant funds. In accordance with section 5204(f)(3) of the ESEA, the SEA demonstrates fiscal controls and accounting procedures to ensure an eligible applicant receiving a subgrant under this program uses the grant or subgrant funds only for:**

- Post-award planning and design of the educational program, which may include—
  - Refinement of the desired educational results and of the methods for measuring progress toward achieving those results; and
  - Professional development of teachers and other staff who will work in the charter school; and
- Initial implementation of the charter school, which may include—
  - Informing the community about the school;
  - Acquiring necessary equipment and educational materials and supplies;
  - Acquiring or developing curriculum materials; and
  - Other initial operational costs that cannot be met from State or local sources.

The State also demonstrates that both the SEA and the eligible applicants document and implement policies and procedures to avoid apparent and actual conflicts of interest in administering and awarding the CSP grant program, and that the SEA’s and subgrantees’ procurement standards conform to Federal and State procurement standards.

Observations:*State Accounting and Disbursement Procedures*

A template of cost categories is maintained in the State's electronic system of accounts. The Financial Reimbursement Information System (FRISA) is a component of the system that allows LEAs to access information about specific grants. All grant awards are loaded into the system. Each charter school subgrant has a set of expenditures broken down by activities and then broken down by monthly expenditure categories identified in its approved budget. The electronic system tracks the account expenditure over time and releases approved expenditures as they are requested over time. There has been no case that the monitoring team is aware of where funds were denied because of inappropriate expenditure.

The subgrant cover page (see, for example, Appendix 21: *Cambridge Lakes Charter School Subgrant*, cover page and attachment 1-3) for each school has information about the developer, approved budget level, beginning and end dates, and payment and electronic transfer instructions. The budget timeline by month and how much in each category will be expended for that period is established for a year. Changes under 10% or less than \$2,000 can be made without approval. Changes within or between expenditure categories must receive prior approval from the charter school office director.

Traditionally, subgrant payments are made on a monthly basis. Expenditure reports are approved for payment only if they match the approved budget and expenditure plan. Quarterly Expenditure reports show the planned versus actual expenditures for that period. If it is found that the project is significantly underspent, a change in the allocation is made or funds are frozen, enabling excess funds to be absorbed in the following month.

However, this does not appear to be the case for CSP subgrantees. The monitoring team is concerned with the State's practice of not disbursing grant funds until late in the fiscal year (which is based on a June 30 fiscal year end date). A major difficulty with the disbursement system is that most of the time subgrant funds are not released until the last quarter of the fiscal year. Consequently, subgrantees may have a very limited amount of time to spend down grant funds.

In many cases subgrantees had only between one and two months to spend their entire annual allocation and, if funds remained on June 30, they were returned to the State. In one case, a school's planning budget of \$77,221 had to be spent between April and June (See Appendix 14: *Amandla Subgrant Application for Planning and Design*). Similarly, Amandla Charter School's implementation subgrant funds became available to the school sometime during May and needed to be expended before June 30 or else the funds reverted back to the State. In the case of Cambridge Lakes, \$199,983 had to be spent between May 1 and June 30. (See Appendix 21: *Cambridge Lakes Charter School Subgrant*.) The effect of these shortened funding periods severely diminishes the usefulness of the start-up funds provided. In addition, the current funding schedule may

impede a subgrantee’s ability to negotiate contracts in a timely manner or may result in cash-flow issues.

*Use of CSP Grant Funds by Subgrantees*

ISBE’s RFP on pages 4 and 5 indicates what subgrant funds can be spent for as follows:

*Charter schools eligible for planning grants can use subgrant funds for the:*

1. *development and refinement of the curriculum;*
2. *professional development for teachers and other staff who will work in the charter school;*
3. *chief administrator’s salary and benefits for up to two months prior to the charter school’s opening;*
4. *refinement of the desired educational results and of the methods for measuring progress toward achieving those results; and*
5. *publicizing/promoting charter schools.*

*Charter schools ready to begin operations may use funds to:*

1. *inform the community about the school;*
2. *acquire necessary equipment and educational materials and supplies;*
3. *acquire or develop curriculum materials; and*
4. *for initial operational costs that are necessary to meet the goals of the charter school, such as establishing a media center, computer lab, or cafeteria.*

Further, the RFP states that subgrantees may not use grant funds for normal operating costs unless they are unexpected or out of the ordinary and then these may be claimed for one year only (e.g., unexpected services due to influx of numerous special education students). Grant funds also must not be used for administrative fees or expenses of the school district with which the applicant is working unless the applicant voluntarily enters into a mutually agreed upon arrangement with the school district for the provision of administrative services. Funds must not be used for building construction or renovation or for ordinary salaries and benefits. The RFP references State and Federal Grant Administrative Policy issued by the ISBE Funding and Disbursement Division and available on the ISBE website at

[http://www.isbe.net/funding/pdf/fiscal\\_procedure\\_handbk.pdf](http://www.isbe.net/funding/pdf/fiscal_procedure_handbk.pdf).

Charter schools are responsible for annual external audits and the school district is responsible for submitting quarterly expenditure reports for the school to the State. In all other respects, charter schools are looked upon as any other school with the LEA responsible for their fiscal integrity.

A workshop presented by the ISBE fiscal office offers training and technical assistance on fiscal policies primarily to school districts, but charter schools may also attend. Conflicts of interest and procurement regulations are covered in these trainings. There is no training offered from the charter school office itself. If a developer has a question they can call the office and be referred to various statewide documents such as *State and*



*Federal Grant Administration Policy and Fiscal Requirements and Procedures.* (See Appendix 22.) CSP subgrant applicants can also find guidance and outlines for the budget narrative in the subgrant RFP. Subgrantees indicated that when they contacted the State charter school office, they usually received help.

Rating and Justification: 1 – State does not meet the indicator. The monitoring team is concerned that the State’s policies and practices related to the release of subgrant funds do not ensure the proper disbursement of and accounting for Federal CSP funds.

Recommendations: The State needs to take immediate steps to strengthen its fiscal policies and procedures to ensure proper disbursement of and accounting for Federal funds, including, but not limited to, allowable, allocable, and reasonable use of CSP grant funds.

In addition, the monitoring team recommends that ED further review the performance management and/or the financial problems documented as part of this monitoring process that have affected the administration of this grant project to determine if special conditions should be imposed, including, but not limited to, designating the grantee as high-risk in accordance with 34 CFR 74.14 and 80.12.

**Indicator 5.2: The State uses no more than 5 percent of CSP grant funds for appropriate administrative expenses. In accordance with section 5204(f)(4)(A) of the ESEA,** the State demonstrates that it reserves no more than 5 percent of the total grant funds for administrative expenses associated with the State charter school grant program and that these funds are used for appropriate administrative purposes.

Observations: The Budget division of ISBE keeps track of the expenditure of administrative funds for the CSP grant. Staff of that unit appear to be the only ones who know how much has been spent and for what. When asked for information on the budget and expenditures for administering the State’s charter school grant program, the charter school office director indicated he had no idea and had to call someone in the budget office to come and speak with the monitoring team.

The administrative budget supports a half-time charter school office director, required travel expenses, an evaluation contract (not yet awarded at the time of the monitoring visit) and a membership fee to the INCS, the State charter school association. (The staff position that monitors the one charter school authorized by the State is funded directly by the State.)

Not including the charter school evaluation estimated to cost \$50,000 per year, at the time of the monitoring visit charter school office administrative expenditures to date totaled \$57,194. The administrative funds set-aside equaling five percent of the total CSP grant funding was estimated at \$405,952.

The amount of unexpended funds for the State’s entire charter schools grant program is also worth mentioning. The SEA budget office sends information from the Federal Grant

Administration and Payment System (GAPS) on a monthly basis, and a full summary expenditure report on a quarterly basis, to inform the charter school office of program expenditure status at a given period of time. According to these records, at the time of the monitoring visit the amount of non-disbursed funds still available for the current period was \$4.38 million. This is in addition to carry-over funds also available from the previous grant period.

Rating and Justification: 3 – State fully meets the indicator. The State has used no more than 5 percent of grant funds for administrative purposes.

Recommendations: Although the State uses no more than 5 percent of grant funds for administrative purposes, the State is strongly encouraged to continue to develop its administrative program to ensure that it supports the goals of the CSP.

**Indicator 5.3: The State ensures that the LEA does not deduct funds for administrative expenses or fees unless the eligible applicant enters voluntarily into an administrative services arrangement with the relevant LEA. In accordance with section 5204(f)(4)(B) of the ESEA,** the State demonstrates that LEAs do not deduct funds for administrative fees or expenses from subgrants awarded to eligible applicants or, in the event such expenses or fees are deducted, that the eligible applicant has entered voluntarily into a mutually agreed-upon arrangement for administrative services with the relevant LEA.

Observations: The State Funding and Disbursement Services Division disburses all subgrant funds directly to the charter school and also keeps track of the funds. No subgrant funds other than those in the approved budget are allocated by the State. The only time a district would have access to any subgrant funds would be if they are part of the approved budget of the charter school. There were no instances of the budgets examined by the monitoring team that such a budget category was identified. There would be no instance in which subgrant funds would be approved to be expended by the LEA and not approved by the charter school that submits the budget to the State in the first place. There have been no instances to the review team’s knowledge that a district has used subgrant funds without the explicit endorsement and approval of the charter school.

Rating and Justification: 3 – State fully meets the indicator. The State ensures that the LEA does not deduct funds for administrative expenses or fees unless the eligible applicant enters voluntarily into an administrative services arrangement with the relevant LEA.

Recommendations: None.

**Indicator 5.4: The State reserves no more than 10 percent of CSP grant funds for the establishment of a revolving loan fund. In accordance with section 5204(f)(5) of the ESEA,** the SEA demonstrates that it reserves no more than 10 percent of the total grant funds for the establishment of a revolving loan fund and that if the State reserves

funds for this purpose, such funds are used to make loans to eligible applicants that have received a subgrant for the initial operation of the charter school grant program of the eligible applicant until such time as the recipient begins receiving ongoing operational support from State or local financing sources.

Observations: The State does not use CSP grant funds to establish a revolving loan fund.

Section (3) of the State Charter School Law (105 ILC 527A-11.5) addresses the State's Revolving Loan Fund. The State Legislature established this loan fund for the purpose of supporting charter schools in their start-up phase. Loans from the revolving fund are to be repaid on a specified schedule. The funds are available to help charter schools pay for start-up costs associated with acquiring textbooks, furniture, supplies and materials. Funds used for this program of support come from the State treasury, not from Federal CSP funds.

Rating and Justification: N/A

Recommendation: N/A

**Indicator 5.5: All financial and programmatic records, supporting documents, statistical records, and other records of grantees and subgrantees related to the CSP grant funds are maintained and retained for grant monitoring and audit purposes. In accordance with 34 CFR 75.730–75.732 and 34 CFR 80.42, the State maintains all financial and programmatic records, supporting documents, statistical records, and other records of grantees and subgrantees. Grantee records should fully show:**

- The amount of funds under the grant and subgrants;
- How the grantee and subgrantees use the funds;
- The total cost of the project;
- The share of the cost provided from other sources; and
- Other records to facilitate an effective audit.

Observations: The records related to the State's charter school grant and all current subgrantee applications, award notices, amendments, and email communications are maintained in the director's cubicle in a file cabinet. The files for each subgrantee were placed in a folder with the grant documents stapled together and additional items placed behind the grant application. The subgrantee's application in that folder applied only to the current fiscal year. In order to view previous funded years for a subgrantee, one had to look in stored records for previous years. The program director and his colleague had access to these files. At the time of the visit, the project director noted that some of the subgrantee files that he was working on were currently on his desk and not in the file cabinet.

The charter school office does not maintain the records on financial disbursements. These can be found in the financial office. The charter school program director receives updates on a quarterly basis, and can also request information between quarterly reports.

However, the charter school director did not appear to be knowledgeable about the program’s financial records.

The subgrantee records are kept in the director’s office for a short time after the grant has ended, at which time they are sent to the ISBE archives. Seven years after the end of the State’s grant from ED, the State’s records of the grant are sent to the State archives facility, although the monitoring team did not receive a documented policy as to this timeline.

Rating and Justification: 2 – State partially meets the indicator. While the Charter School Office maintains a set of grant files for the CSP grant and for subgrantees, they contain information only for the current year and complete organized files for management of the overall grant program are not readily available for monitoring progress.

Recommendations: The State needs to further strengthen its procedures to maintain and retain grant and subgrant-related records.

**Indicator 5.6: The SEA directly administers or supervises the administration of the State CSP program. In accordance with 34 CFR 75.700 and 75.701,** the State demonstrates that CSO and/or other SEA personnel administer or supervise the administration of the grant project on a day-to-day basis.

Observations: According to ED records, ISBE committed one full time equivalent staff person to oversee this project. Currently, the director of the charter schools program is a half-time position at ISBE. The CSO director reports to the director of the division of Educator and School Development. In addition to charter schools, that division includes teacher certification and renewal, university program approval, private business and vocational schools, alternative learning, general public school compliance, and non-public school approval. Another half-time position is dedicated to supporting the one charter school authorized by the State. This position also informally supports the charter schools program, for example, by attending meetings.

The SEA has allocated only a half-time position to carry out all of the responsibilities of the charter school office. The other responsibilities assigned to the officer in charge of charter schools represent considerably larger amounts of State funds and appear to be a higher priority. The CSO director asserts he is doing all that is possible, given his overall commitment level.

As noted in previous sections of this report, many of the State’s actions to administer this grant are reactive rather than proactive. This reactive mode limits the direct administration and supervision required by the grant, including key responsibilities such as subgrant monitoring.

Rating and Justification: 1 – State does not meet the indicator. The SEA appears to provide minimal services to directly administer or supervise the administration of the State CSP program.

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