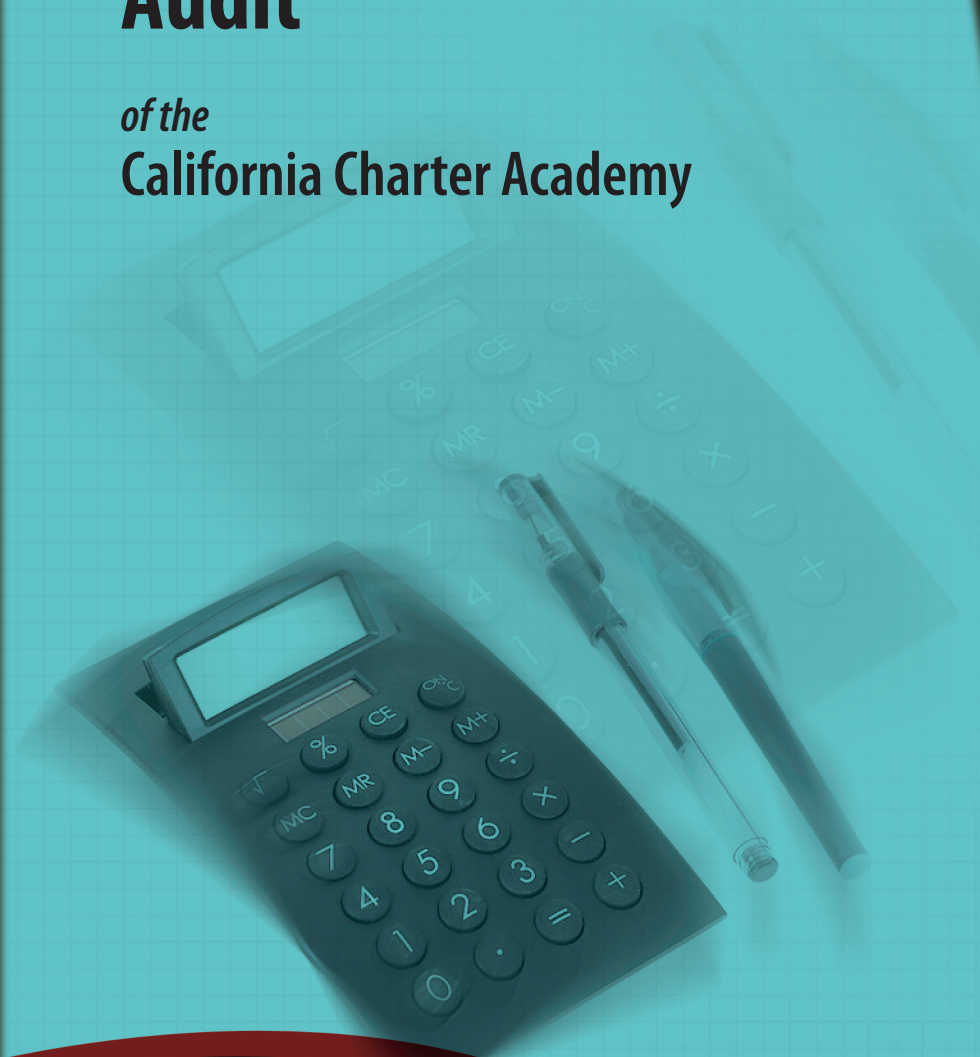


Fiscal  
& Crisis  
Management  
Assistance  
Team

**MGT**  
of America

# Extraordinary Audit

*of the*  
California Charter Academy



**Commissioned by the Superintendent  
of Public Instruction in Cooperation  
with the Orange and San Bernardino  
County Offices of Education**

*April 14, 2005*

Administrative Agent  
Larry E. Reider  
Office of Kern County  
Superintendent of Schools

Chief Executive Officer  
Thomas E. Henry



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## Executive Summary

California Education Code Section 47601, also known as the “Charter Schools Act of 1992,” was enacted “to provide opportunities for teachers, parents, pupils, and community members to establish and maintain schools that operate independently from the existing school district structure.” Charter schools are a part of the public school system but differ from traditional public schools in that charter schools are exempt from many state laws relating to specific education programs. A charter school is usually created or organized by a group of teachers, parents, and community leaders or a community-based organization, and is usually authorized by an existing local public school board or county board of education.

In 1999, C. Steven Cox founded the California Charter Academy (CCA). The CCA received its first charter from the Snowline Joint Unified School District (Snowline) and was granted charter #262. The second CCA charter, #297, was granted by the Orange Unified School District (OUSD) in July 2001. Two additional CCA charter schools were established in July 2001 when Snowline granted CCA charter #377 and the Oro Grande Elementary School District (OGESD) granted CCA charter #387.

As a result of multiple indications of irregularities at the CCAs, the state Superintendent of Public Instruction, in collaboration with the county offices of education of Orange and San Bernardino counties, initiated an investigation of the CCA. The counties contracted with the Fiscal Crisis and Management Assistance Team (FCMAT) to lead the investigation. FCMAT contracted with MGT of America to conduct the investigation of the CCA charter schools’ business operations. This report presents the findings from FCMAT/MGT’s investigation.

## Common Management and Lack of Fiscal Oversight

In March 2000, Mr. Cox created the Educational Administrative Services Corporation (EASC), a for-profit company, to provide administrative services to charter schools. All four CCA charter schools signed operating agreements engaging EASC to manage their administrative services. Under the terms of the contracts between EASC and the CCA charter schools, Mr. Cox served as chief executive officer (CEO) of all four CCA charter schools and as the CEO of EASC. These contracts granted Mr. Cox the authority to expend CCA funds and enter into contracts on behalf of the CCA charter schools. The contracts and the CCA Governing Board bylaws provided little fiscal oversight authority for the CCA Governing Board members. Numerous and substantial transfers of funds were made from the CCA charters to EASC by Mr. Cox without the approval or knowledge of the CCA boards.

The CCA boards did not exercise adequate oversight. For example, board policy and the contract with EASC provided EASC with the authority to enter into contracts without the

review or approval of the CCA boards. In addition, EASC had the authority to maintain CCA bank accounts and expend CCA funds without the prior review or approval of the CCA boards. The CCA boards were only provided the opportunity to review lists of expenditures after the fact.

Despite the large number of questionable expenditures and contracts identified by the audit team, a review of the board minutes revealed few instances in which CCA board members questioned expenditures or contracts using CCA funds. The audit team also found that financial reports and audits were not discussed in a timely manner or in detail. Oversight by the authorizing districts varied and was somewhat hampered by vaguely defined responsibility and authority in the Education Code prior to January 1, 2004.

Because significant amounts of CCA funds were redirected to EASC and others, the CCAs spent less of their charter school funding on teaching than the average California school district, and more on non-teaching expenses.

The four CCA charter schools, along with other charters, formed in December 2001 a joint powers agency (JPA) known as the American Public Agency Authority (APAA) for the provision of insurance coverage. Mr. Cox also served as CEO of APAA. The APAA board was comprised of two CCA board members and the Superintendent of Oro Grande Elementary School District. The purpose of APAA was to pool the CCA charter schools' resources and jointly establish, operate, maintain, and fund a self-insurance plan. The audit team found a number of irregularities involving the APAA, including:

- Significantly inflated insurance costs charged to members.
- Insurance policies financed twice, generating a significant influx of cash.
- \$233,000 transferred from CCAs' accounts without the approval of their boards.
- Questionable contracts and expenditures totaling \$435,000.
- Failure to pay insurance premiums, resulting in the cancellation of insurance for which some charter schools had already paid APAA.

CCA funds were transferred to APAA by Mr. Cox without CCA board knowledge or approval. Under Mr. Cox's control, APAA funds were expended for a variety of purposes unrelated to the provision of insurance to its members. APAA financed the payment of insurance premiums through loans. Ultimately, APAA failed to make payment on these loans, with the result that CCA employees were left without health insurance coverage.

As a result of Mr. Cox's serving simultaneously as CEO of the CCA charter schools, APAA and the management company (EASC), there was a lack of legal and functional separation between these entities. They had common management. This resulted in an

inability to establish and maintain adequate internal controls over cash transfers among the charters and between the charters, the JPA and EASC, because management was in a position to override any policies and procedures that may have been established by the individual charter boards. Ineffective oversight by the charter boards allowed management to enter into contractual arrangements that should have been subject to conflict of interest prohibitions.

## **Conflicts of Interest/Related Party Transactions**

The California Government Code and CCA board policy prohibit CCA board members, officers, and employees from participating in decisions and transactions that constitute a conflict of interest. A conflict of interest arises when a board member, officer, or employee is in a position to influence a decision from which he or she could benefit personally.

As CEO of the CCA charter schools, Mr. Cox had a fiduciary responsibility with respect to the funds of the charter schools, obligating him to keep, manage and expend those funds solely for the interest of the CCAs. As CEO of EASC, Mr. Cox had a similar but separate fiduciary responsibility to the private corporation. Finally, as CEO of APAA, he had a further, separate fiduciary responsibility to the joint powers agency.

Mr. Cox's service as CEO of all four CCAs and APAA, while concurrently serving as the CEO of EASC, created an inherent conflict of interest. In these multiple positions, he had the opportunity to direct millions of dollars of CCA funds to benefit himself, his corporation, his family, and his friends and associates. He took advantage of that opportunity.

For example, Mr. Cox and his company, EASC:

- Misappropriated \$3.5 million transferred from the CCA accounts to EASC without approval of the CCA governing boards.
- Inappropriately directed more than \$920,000 of CCA funds to one of his subsidiary companies.
- Used \$1.2 million of CCA funds to employ members of his family and grant them generous retroactive pay increases.
- Charged the CCAs high administrative service fees, thereby redirecting millions of dollars from the CCA instructional program to EASC.
- Increased the CCAs' administrative costs by charging the CCAs for certain administrative costs that should have been covered under the administrative service fees paid to EASC.
- Used \$1.2 million in CCA funds for questionable contracts and expenditures without competitive bids and without sufficient evidence that the goods and services were actually received, including payments to firms owned by former EASC employees and CCA board members.

- Used \$375,000 of CCA funds to pay one staff person who provided few measurable services.
- Transferred EASC employees to the CCA payroll without justification.

Some CCA board members developed legal and/or ethical conflicts of interest during their tenure on the CCA boards that could have influenced their decisions and the depth of their oversight. For example:

- Two board members served on CCA boards that funded programs that the board members administered.
- Three board members accepted political campaign contributions from Mr. Cox and/or EASC while serving on CCA board that oversaw Mr. Cox and EASC.
- One board member sold her family business to Mr. Cox and EASC while serving on a board that oversaw Mr. Cox and EASC.
- One board member received a contract from three of the CCAs while sitting on the board of a fourth CCA.
- Seven board members served in incompatible offices by concurrently serving on more than one CCA board.

### **Inappropriate Claiming of State Funds**

Education Code Section 47605 limits charter schools to operating school sites within the boundaries of the school district granting the charters. Contrary to the Education Code, the CCA operated 15 sites outside the boundaries of the authorizing district and inappropriately received at least \$8.3 million in charter school funds. In addition, Education Code Section 47602 prohibits the conversion of a private school to a charter school. Contrary to the Education Code, the CCA operated eight schools that were private school conversions for which the CCA improperly claimed \$14.8 million in charter school funds.

### **Unauthorized Access by EASC to CCA Funds**

EASC was a private corporation. It is not uncommon for charter schools to contract with private firms for the provision of services, including administrative and financial services. The spending choices made by these private firms represent business judgments that are not ordinarily the concern of public school officials. However, in the case of EASC and the CCAs, there was no functional separation between the finances of the publicly funded charter schools and the private corporation. Having one individual manage both the corporation and the charters, without effective oversight by the CCA boards, eliminated the distinction between corporate and public functions. EASC charged the CCAs high fees for management and other services, then billed a second time for some of the same services. Moreover, EASC transferred funds from the CCAs to its own accounts in the amount of



\$3.5 million over and above any fees to which it was entitled under its management contracts. These funds enriched the private corporation but contributed to the collapse of the charter schools. There was no intervening oversight by the CCA charter school boards.

Beginning in late 2002, EASC routinely spent more than it earned and therefore had to rely on the unauthorized transfers of CCA funds in order to pay its bills. At the same time that EASC was engaged in making these transfers, it was spending extravagantly for the benefit of its own employees.

Examples of the excessive spending by EASC include:

- More than \$1.1 million paid to Mr. Cox from 1999 through 2003.
- Over \$1 million in credit card charges by Mr. Cox and another EASC employee over a two-year period for personal purchases and trips, including \$42,000 for personal income taxes, \$11,000 for Disney-related merchandise and art, \$9,000 at the Disneyland Health Spa, \$18,000 for jet skis, and \$5,700 at a sporting goods store.
- Payment of \$549,000 to subsidiaries including Maniaque Marketing, Xtreme Motor Sports, Hautlab Music Group, and Maniaque Development.

## **Impact of the Closure of the CCA Charters**

The closure of the four CCA charter schools had a significant impact on CCA's students, teachers, and staff. Students were notified in August 2004 of the closure and had little time to find new school placements, a task made more difficult by delays in locating student files. Similarly, teachers and staff looking for new employment had difficulty locating a CCA-affiliated entity that could provide them the records necessary to obtain new employment or unemployment benefits. Sorting out health insurance coverage and claims was also a significant issue, as coverage had lapsed. The chartering districts, county offices of education, and the California Department of Education have all had to contend with the logistical and financial repercussions of the CCA's closure. The extent and final outcome of these effects have yet to be fully determined.

## **Response to the Audit Report**

Steven Cox, as the CEO of the California Charter Academy, was provided an opportunity to review the draft report prior to its public release. Mr. Cox was also provided the opportunity to provide a written response to the audit report that was to have been appended to the audit report. Mr. Cox did not provide a written or verbal response by the deadline set by the audit team. Therefore, this audit report does not include a response to the audit report from the responsible officials.

## Summary of Findings by Audit Issue

FCMAT and MGT were asked to investigate seven issues related to CCA charter schools' business operations. Below is a summary of findings associated with each issue.

### Summary of Audit Findings Per Issue

Issue	Summary of Findings
<p><b>Related Party Transactions</b></p>	<p><b>Did any EASC or CCA employees or board members have any conflicts of interest?</b></p> <p><b>Yes.</b> Steven Cox, as CEO of EASC and the CCAs, had a conflict of interest that led to millions of dollars of questionable transactions between the CCAs and EASC and its subsidiaries. In addition, five board members had potentially unlawful or unethical conflicts of interest, and seven board members held incompatible offices by serving on multiple CCA boards.</p>
<p><b>Location of School Sites</b></p>	<p><b>Were any classroom-based sites that commenced to provide educational services subsequent to June 30, 2002, located outside the authorized geographic boundaries of the chartering entities?</b></p> <p><b>Yes.</b> Fifteen out of 36 sites tested were located outside the geographic boundaries of the chartering entity. The CCAs claimed a total of \$8.3 million in funding for ineligible average daily attendance.</p>
<p><b>Private School Conversions</b></p>	<p><b>Were any CCA school satellite sites improperly converted from private schools?</b></p> <p><b>Yes.</b> Three of 36 sites tested were improperly converted from private schools, claiming \$9.4 million in ineligible funding. Another five sites were identified as likely private school conversions, claiming \$5.4 million in ineligible funding.</p>
<p><b>EASC</b></p>	<p><b>Were the payments made to EASC by the charter schools for administrative services reasonable?</b></p> <p><b>No.</b> The administrative services payments to EASC were comparatively high and resulted in millions of dollars being redirected from the instructional program to EASC.</p> <p><b>Did EASC provide the administrative services for which it was paid?</b></p> <p><b>Yes.</b> However, EASC shifted certain administrative costs to the CCAs rather than paying out of the EASC's administrative services fees.</p> <p><b>Did EASC inappropriately transfer funds from the CCAs to EASC?</b></p> <p><b>Yes.</b> EASC transferred \$3.5 million of CCA funds to its own accounts without approval from the CCA boards. The audit team reviewed EASC expenditures to determine whether the additional funds benefited the CCAs, but instead found several instances where EASC expenditures benefited the CEO, his family and friends.</p>
<p><b>Expenditure of Federal Implementation Grant Funds</b></p>	<p><b>Did CCA #262 administer the grants received in accordance with applicable rules and regulations?</b></p> <p><b>No.</b> \$59,600 of the federal Public Charter Schools grant expenditures could not be verified as eligible expenses, and \$284,000 of the California Education Technology Grant remains unspent and not returned to the State.</p>

Issue	Summary of Findings
<p><b>Compliance with Independent Study Requirements</b></p>	<p><b>Were the CCAs in compliance with independent study requirements?</b></p> <p><b>No.</b> Of the 110 files selected for testing, 22 were not available for review, 48 files were noncompliant with at least one criterion and 17 were noncompliant with three or more criteria.</p>
<p><b>Joint Powers Authority (APAA)</b></p>	<p><b>Were the sources of funds within APAA appropriately generated?</b></p> <p><b>No.</b> \$233,000 of CCA funds were transferred to APAA accounts without the approval of the CCA boards.</p> <p><b>Were any APAA funds or resources misused?</b></p> <p><b>Yes.</b> The audit team identified seven questionable transactions that could constitute a misappropriation of nearly \$435,000 of APAA funds.</p> <p><b>Did any APAA executives, staff, or contractors engage in any illegal or inappropriate related party transactions or have potential conflicts of interest?</b></p> <p><b>Yes.</b> Steven Cox, as CEO of APAA, EASC and the CCAs, had a conflict of interest that led to several questionable transactions.</p> <p><b>Did any CCAs or other charter school members pay for insurance coverage they did not receive?</b></p> <p><b>Yes.</b> The APAA insurance policies were canceled early for non-payment, resulting in a loss of \$181,000 for nine of the 12 other charter school members. The APAA did not secure health coverage for the four CCAs as agreed, leaving employees without coverage for July and August 2004.</p>

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## Chapter I: Background

### Charter Schools in California

California Education Code Section 47601, also known as the “Charter Schools Act of 1992,” was enacted “... to provide opportunities for teachers, parents, pupils, and community members to establish and maintain schools that operate independently from the existing school district structure.” According to this Act, the legislative intent of this law was to:

- Improve pupil learning.
- Increase learning opportunities for all pupils, especially those identified as academically low achieving.
- Encourage the use of different and innovative teaching methods.
- Create new professional opportunities for teachers.
- Provide parents and pupils with expanded choices in the types of educational opportunities that are available.
- Hold the schools accountable for meeting measurable pupil outcomes, and change from rule-based to performance-based accountability systems.
- Provide vigorous competition within the public school system to stimulate continual improvements in all public schools.

Charter schools are a part of the public school system, and may provide instruction in grades kindergarten through 12 (K-12). Charter schools differ from traditional public schools in that charter schools are exempt from many state laws relating to specific education programs. Because of these exemptions, charter schools have greater fiscal and programmatic flexibility than traditional public schools. A charter school is usually created or organized by a group of teachers, parents, and community leaders or a community-based organization, and is usually authorized by an existing local public school board or county board of education. Specific goals and operating procedures for the charter school are detailed in an agreement (or “charter”) between the authorizing board and charter organizers. Under California law, it is the local school district governing board that serves as the primary chartering authority in most cases. County school boards and the State Board of Education (SBE) may also authorize charters under certain circumstances.

Under California state law, both charter and traditional public schools use the same funding formulas. School districts and charter schools calculate each school’s average daily attendance (ADA), which is based on student enrollment and actual attendance, and report it to the California Department of Education (CDE) three times a year. Once the ADA is reported, the State Superintendent of Public Instruction apportions state school funds to

each school. Charter schools that have programs involving independent study or nonclassroom instruction undergo an additional assessment to determine whether the charter school is funding instructional and certificated staff at minimally accepted levels. Charter schools that do not meet the acceptable levels of staffing receive reduced funding. Appendix A provides a more complete overview of the California laws applicable to charter schools.

### **The California Charter Academy and the Educational Administrative Services Corporation**

In 1999, C. Steven Cox founded the California Charter Academy (CCA). The CCA received its first charter from the Snowline Joint Unified School District (Snowline) and was granted charter #262. CCA #262 started with an approximate enrollment of 1,700 students in grades K-12, and provided the educational component for several affiliated nonprofit Conservation Corps and Youth Build programs. The second CCA charter, #297, was granted by the Orange Unified School District (OUSD) in July 2001 and consisted of community nonprofit centers collaborating with educational programs. Two additional CCA charter schools were also established in July 2001. Snowline granted CCA charter #377, which focused on community nonprofit centers and the Oro Grande Elementary School District (OGESD) granted the CCA charter #387 which focused on classroom-based educational programs.

In March 2000, Mr. Cox created the Educational Administrative Services Corporation (EASC), a for-profit company, to provide administrative services to charter schools. All four CCA charter schools signed operating agreements engaging EASC to manage their administrative services. These services included running the day-to-day operations of the schools, managing business and accounting services, and overseeing curriculum development and implementation. Exhibit 1A is a pictorial representation of the CCA charter schools and their relationship to EASC.

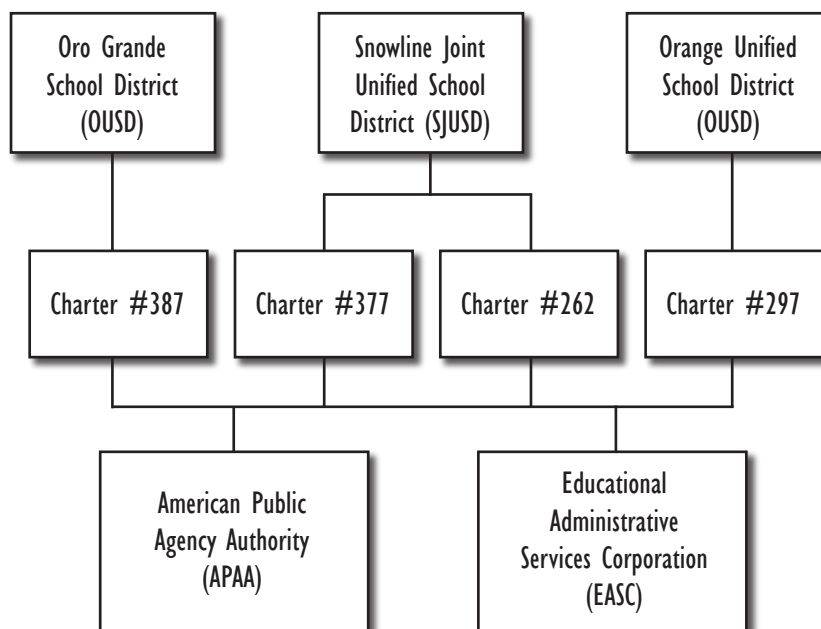
Under the terms of the contracts between EASC and the CCA charter schools, Mr. Cox served as chief executive officer (CEO) of all four CCA charter schools and as the CEO of EASC. These contracts granted Mr. Cox the authority to expend CCA funds and enter into contracts on behalf of the CCA charter schools. The contracts and the CCA Governing Board bylaws provided little fiscal oversight authority for the CCA Governing Board members. As a result, Mr. Cox and EASC had complete control over the custody, accounting, and use of CCA funds.

### **The American Public Agency Authority**

In December 2001, the four CCA charter schools formed a joint powers agency known as the American Public Agency Authority (APAA). As with other entities associated with the CCA charter schools, Mr. Cox was the CEO and controlled all of APAA's financial transactions. The purpose of APAA was to pool the CCA charter schools' resources and jointly establish, operate, maintain, and fund a self-insurance plan. The APAA insurance offerings

included workers' compensation; commercial package (general liability, property, automobile, crime, and school board legal liability); and health care (medical, dental, vision, and standard life insurance). Twelve other non-CCA schools became affiliate members of APAA and purchased comprehensive packages and workers' compensation insurance. Only the four CCA charter schools purchased health insurance through APAA.

### **Exhibit IA** **Relationship Between The Authorizing Districts, CCA Charter Schools, and EASC**



### **CCA Closures**

After operating for over three years, toward the end of July 2004, there was a growing concern that the CCA charter schools would not be financially viable to open for the 2004-05 school year. This was due both to changes in legislation limiting the eligibility of CCA students, as well as the financial status of each of the four charters. In late July and early August 2004, each of the four CCA boards voted to voluntarily close all CCA programs. As shown in Exhibit 1B, this affected over 12,000 students at CCA program sites throughout California. (Please see next page.)

**Exhibit 1B**  
**CCA Students as of June 2004**

		Number of			
		Open Sites		Adult Students	Total Students
#262	Snowline	9	487	1,061	1,548
#297	OUSD	8	315	1,563	1,878
#377	Snowline	30	1,101	3,668	4,769
#387	OGESD	28	2,654	1,263	3,917
Totals		75	4,557	7,555	12,112

### **Investigative Audit**

In 2003, CDE found that ten of CCA #387's sites authorized by OGESD were in violation of California Education Code 47605.1, resulting in the CCA having received an overpayment of \$1.6 million. In late 2003, OUSD began investigating CCA and Mr. Cox for potential violations of the Political Reform Act and conflict of interest laws for his dual role as CEO of the CCA charter schools and EASC. The OUSD also investigated CCA #297 for an illegal private school conversion. On March 18, 2004, the State's Advisory Commission on Charter Schools unanimously approved a motion requesting that the State Superintendent of Public Instruction initiate an investigation of the operations of the CCA. On April 16, 2004, the OUSD sent the CCA a notice to cure or face revocation related to the conflict of interest and illegal private school conversion issues.

On June 8, 2004, the State Superintendent of Public Instruction announced an investigation of the CCA in collaboration with the county offices of education in Orange and San Bernardino counties. The County Superintendents of Schools for Orange and San Bernardino counties contracted with the Fiscal Crisis and Management Assistance Team (FCMAT) to convene an investigative audit. FCMAT contracted with MGT of America, Inc. (MGT) to conduct the investigation and audit of the CCA charter schools' business operations. This report presents the findings from FCMAT/MGT's investigation.

### **Scope and Methodology**

FCMAT and MGT were asked to investigate and audit seven issues related to CCA charter schools' business operations. Exhibit 1C presents these issues, as well as the objectives associated with each. (Please see next page.)



## Exhibit 1C Scope of Investigative Audit

Issue	Objectives
<b>Location of School Sites</b>	<ul style="list-style-type: none"> <li>Determine whether any classroom-based sites that commenced to provide educational services subsequent to June 30, 2002, were located outside the authorized geographic boundaries of the chartering entities.</li> </ul>
<b>Compliance with Independent Study Requirements</b>	<ul style="list-style-type: none"> <li>Determine whether CCA is in compliance with independent study requirements.</li> </ul>
<b>Related Party Transactions</b>	<ul style="list-style-type: none"> <li>Determine whether related party transactions exist between the CCA schools and the businesses that provide goods and services, directly or indirectly, to the CCA charter schools.</li> </ul>
<b>Expenditure of Federal Implementation Grant Funds</b>	<ul style="list-style-type: none"> <li>Determine whether CCA #262 administered the federal Public Charter Schools grant in accordance with applicable rules and regulations.</li> </ul>
<b>Private School Conversions</b>	<ul style="list-style-type: none"> <li>Determine whether any CCA school satellite sites have been improperly converted from private schools.</li> </ul>
<b>Joint Powers Authority (APAA)</b>	<ul style="list-style-type: none"> <li>Identify the sources and uses of funds within APAA since its inception.</li> <li>Determine whether APAA executives, staff, or contractors engaged in any illegal or inappropriate related party transactions or had potential conflicts of interest.</li> <li>Determine the extent to which schools paid for insurance coverage they did not receive.</li> <li>Determine whether APAA funds or resources were misused.</li> </ul>
<b>Educational Administrative Services Corporation</b>	<ul style="list-style-type: none"> <li>Determine the reasonableness of payments made to EASC by the charter schools for administrative services.</li> <li>Determine whether EASC provided the administrative services for which it was paid.</li> <li>Determine whether EASC inappropriately transferred funds between EASC and the CCA.</li> </ul>

In addition, the original scope of the audit included a review of the residency and age of CCA students. This was in response to Title 5, Section 11960 of the California Code of Regulations, which limits the extent to which students over the age of 19 can matriculate in California charter schools. However, because this regulation did not take effect until 2004-05 and CCA did not operate any schools during the 2004-05 school year, this task was removed from the audit scope.

A number of approaches were pursued to obtain the information necessary to accomplish the objectives of this audit. To develop an in-depth understanding of the issues and potential outcomes pertaining to each task, the audit team interviewed former CCA employees and board members, EASC employees, and CCA vendors. To identify concerns among

the local community regarding CCA charter schools' business operations, the audit team developed a Web site to solicit information from the public regarding current and past concerns related to the CCA charter schools. For those allegations that fell within the scope of the audit, the audit team conducted further investigation.

The audit team also developed specific audit procedures to address each of the seven tasks identified in the audit scope. For each task, the audit team evaluated whether CCA, EASC, and/or affiliated individuals were in compliance with applicable rules and regulations, and the audit team focused its efforts on identifying particular areas of concern related to the investigative audit criteria. The audit team performed various tests and analyses to identify and substantiate instances of violations of requirements, inappropriate expenditures or fund transfers, related party transactions or conflicts of interest, and private school conversions.

As part of the investigation, the audit team conducted an extensive document review of CCA and EASC contract and vendor files, financial statements, accounting records, and personnel files. To ensure unimpeded access to and the security of these documents after the closure of the four CCA schools, the audit team helped to coordinate the move of the CCA files to a site at one of the chartering districts after the charter offices closed in August 2004.

The audit was conducted in accordance with generally accepted government auditing standards promulgated by the Comptroller General of the United States. These standards pertain to the auditor's professional qualifications, the quality of the audit effort, and the characteristics of professional and meaningful audit reports. Specifically, the audit followed the general standards pertaining to qualifications, independence, and due professional care. The standards pertaining to conducting the audit fieldwork and preparing the audit report were also followed. By following these standards, the audit team ensured the independence and objectivity of the audit team, the analysis, and the resulting findings and recommendations offered in this report.

## Chapter 2: Related Party Transactions

### Conflicts of Interest

The California Government Code and CCA board policy prohibit CCA board members, officers, and employees from participating in decisions and transactions that constitute a conflict of interest. A conflict of interest arises when a board member, officer, or employee is in a position to influence a decision in which he or she could benefit personally. Specifically, Government Code Section 1090 states that: “Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity. As used in this article, “district” means any agency of the state formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries.”

In addition, Government Code Section 87100 states that: “No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.”

### Steven Cox and EASC Violated Prohibitions Against Conflicts of Interest

All four CCA boards adopted a conflict of interest policy that subjected their board members, officers, and employees to the provisions of the State’s conflict of interest laws. That bylaw states: “The Governing Board members and designated employees shall not engage in any employment or activity which is inconsistent with, or incompatible with the board member’s duties as an officer of the school.” The bylaw further states that public officials of the CCA shall comply with the requirements of the Political Reform Act of 1974 as set forth in Government Code Section 87100 et seq. which is incorporated herein by reference. “Public officials” includes every member, officer, employee or consultant as defined, that makes, or is involved in making, governmental decisions.”

The CCA bylaws also state that a board member, officer, or employee may not make a contract in which he or she is financially interested. Any participation by a board member, officer, or employee in the process by which such a contract is developed, negotiated, and executed is a violation of Government Code Section 1090.

The services agreements between each CCA and EASC state that EASC shall serve as the CEO of the CCA. Thus, Steven Cox, as CEO of EASC, also served as CEO of all four CCAs and is therefore subject to the CCA bylaw prohibiting conflicts of interest and

related party transactions and by extension, the provisions of Government Code Sections 1090 and 87100 et seq.

Contrary to Government Code and the CCA bylaws, Mr. Cox engaged in a series of transactions and contracts in which he had a financial interest. The contracts between the CCA charter schools and EASC gave EASC the responsibility of managing the CCA charter schools' funds. Moreover, the contracts granted EASC the authority to expend CCA funds and enter into contracts on behalf of the CCA charter schools. As stated previously, a conflict of interest arises when a board member, officer or employee is in a position to influence a decision from which he or she could benefit personally. Serving in this dual role created an inherent conflict of interest as Mr. Cox held an official position with a public agency that provided him the opportunity to make decisions and take actions on behalf of the CCA charter schools that benefited his for-profit corporation, EASC.

Mr. Cox was able to use his position as CEO of both EASC and the CCAs to direct CCA funds in ways that benefited himself through his corporation, EASC, because EASC had control over the CCA charter schools' finances. As discussed later in this report, the audit team found that Mr. Cox engaged in a series of contracts and transactions in which he had a financial interest including:

- Directing CCA contracts and funds to subsidiaries of EASC.
- Placing close family members on the CCA payroll.
- Granting retroactive pay increases to family members using CCA funds.
- Establishing and collecting excessive administrative fees paid by the CCAs to EASC.
- Transferring millions of dollars from CCA bank accounts to EASC without CCA board approval.
- Deciding which costs incurred by EASC should be paid for by the CCA charter schools without CCA board approval.
- Entering into contracts with friends and former board members without competitive bidding and without CCA board approval.

Ultimately, the conflicting roles of serving as the CEO of the CCA charter schools and CEO of EASC allowed Mr. Cox to direct millions of dollars of CCA funds to benefit himself, his corporation, his family, and his friends and associates in violation of Government Code and the CCA bylaws.

## **EASC Directed Contracts and Expenditures to Its Subsidiary, “Everything for Schools”**

Contrary to the prohibitions against conflicts of interest in Government Code and the CCA bylaws, the audit team found that EASC directed CCA funds to one of its subsidiaries, Everything for Schools (EFS). Specifically, the audit team found that the EASC inappropriately directed more than \$920,000 of CCA funds to EFS from calendar years 2001 through 2003. The CCA funds directed to EFS were used to buy supplies, textbooks, and services at inflated prices.

In February 2001, EASC formed a subsidiary company known as EFS. Tad Honeycutt managed EFS while also serving as Vice President of Corporate Development for EASC. The stated purpose of EFS was to reduce the costs of the CCA charter schools by maximizing the buying power of all of the CCA charter schools’ programs. This was to be accomplished through offering the CCA charter schools the option of purchasing through a single source, namely EFS, in order to receive discounts on volume purchases.

The CCA board minutes reflect serious concerns raised by a number of board members about EFS and whether the CCA should be purchasing from a subsidiary of EASC. The CCA board policies, Section AR 3310, states that CCA’s policy is “... to purchase without any personal interest, private advantage or prejudice, seeking to obtain the maximum benefit for each tax dollar expended.” Board members also questioned the profits that might be generated from the CCA by EFS and how these might add to the administrative fee already paid to EASC.

In response to concerns raised by CCA board members, Mr. Cox presented a document entitled “EFS Guiding Principles,” which included the following statements:

*“Facts to remember about EFS:*

- 1. **EFS Is An Entirely Voluntary Option For Each CCA Program To Use.** Sites can maintain their current purchasing system, or use it in combination with EFS as long as they are pursuing the lowest price available.*
- 2. **All Savings Will Be Passed Along To Sites.** For material purchased through EFS, EASC will bear costs as the primary purchasing agent as required in AR 3311. These costs will be included in the EFS price offered to sites. There will be no additional charge for using EFS.”*

In addition, Mr. Honeycutt stated during the April 2001 board meeting of CCA #262 that, “we would not be making a profit, but we will be trying to cover costs.” At that meeting, the #262 board voted to grant EFS one year to determine what its actual costs would be, with the agreement that any surplus proceeds would be given to the CCA.

During an interview with the audit team, Mr. Honeycutt stated that EFS would add 10 percent to 15 percent to the cost of goods EFS sold to the CCA charter schools in order to cover administrative costs. Despite EASC’s claim before the CCA boards that EFS would be a low-cost option, the audit team discovered instances where EFS significantly inflated the cost charged to the CCA charter schools. For example, Exhibit 2A illustrates an instance in which EFS inflated the price of textbooks sold to CCA #377 by as much as 57 percent. The column labeled “Vendor Unit Cost to EFS” shows what the actual cost would have been for these textbooks had the CCA charter schools purchased them directly from the vendor.

### **Exhibit 2A Examples of Inflated Prices Charged by EFS**

Item	EFS Unit Cost to CCA #377	Vendor Unit Cost to EFS	Percent Increase
Basic English Composition	\$35.95	\$22.90	57%
Basic Math Skills	35.95	23.40	54
English for the World of Work	35.95	22.90	57
United States History	39.95	31.20	28
Biology	35.95	27.20	32
Algebra	39.95	27.20	47

Another practice that appears in conflict with the Guiding Principles pertains to whether EFS was a voluntary procurement option for the CCA charter schools. The audit team identified numerous occasions where EASC ordered items such as polo shirts and brochures from EFS on behalf of the four charters. However, the audit team found no evidence that the CCA charter schools requested these items or were given a choice as to whether they wanted to use CCA funds to purchase these items through EFS. Exhibit 2B provides examples of purchases made by EASC through EFS where the costs were subsequently charged to the four charters.

### **Exhibit 2B Examples of Items Purchased By EASC Through EFS and Charged to the CCA Charter Schools**

Item	EFS Invoice Amount
Polo shirts for employees	\$18,057
CCA brochures	83,340
CCA Fact Flyers	9,029
Envelopes and letterhead	21,411
<b>Total</b>	<b>\$131,837</b>

In addition to these items, EASC also directed the purchase of services through EFS using CCA funds. For example, EASC charged the charters over \$100,000 for Web design and development consulting services allegedly provided by EFS. However, the audit team could find no documentation detailing the charters' request or the boards' approval for these services. Moreover, the audit team could not find a consulting contract, description of services to be performed, or payment schedule between EFS and any of the CCA charter schools. Exhibit 2C shows that EASC charged each CCA a monthly amount for EFS' Web-design services.

**Exhibit 2C**  
**EFS Charges for Web-Design Services**

Charter	Amount Invoiced Per Month	Total Invoiced (October 2001 – June 2003)
#262	\$720	\$14,400
#297	530	11,660
#277	1,540	32,340
#387	2,020	42,420
Totals	\$4,810	\$100,820

Finally, as noted earlier, the board of CCA #262 approved the usage of EFS services for one year on the condition that any surplus proceeds would revert to the CCA. The audit team uncovered evidence that EFS inflated the costs of some of the goods it was selling to the CCA charter schools, and, therefore, generated surplus proceeds. However, rather than returning surplus proceeds to the CCA charter schools as agreed, EFS spent more than \$176,000 of its proceeds on other nonschool-related EASC business enterprises such as Xtreme Motor Sports and Hautlab Music Group, as well as other non-CCA activities. Exhibit 2D provides a listing of some of the ways that EASC spent EFS proceeds. (Please see next page.)

**Exhibit 2D**  
**EFS Proceeds Used For Non-CCA Ventures and Activities**

Item	Total 2001	Total 2002	Total 2003
Contractor/Consultant	\$26,993	\$69,209 <sup>a</sup>	
Contributions/Donations	6,073 <sup>b</sup>	3,574	
Tad Honeycutt (personal loan)		3,906	
Due from Maniaque		23,295	\$7,999
Advertising		8,208 <sup>c</sup>	
Hautlab Music Group		17,194	
Xtreme Motor Sports		1,786	
Outside Services <sup>d</sup>		7,973	
Totals by Year	\$33,066	\$135,145	\$7,999
Grand Total			\$176,210

a The EFS 2002 General Ledger reflects a contractor/consultant total of \$107,209. \$38,000 of this amount can be attributed to CISO, a private sector firm, for Web-design services. \$69,209 has no documentation.

b This amount includes \$3,000 contributed to "Honeycutt for Council," an organization promoting Mr. Honeycutt's bid for City Council.

c The EFS 2002 General Ledger reflects an advertising total of \$21,744, \$13,536 of which was education related. The remainder, \$8,208, was related to motor sports.

d The EFS 2002 General Ledger reflects an outside services total of \$7,973. Names of employees are reflected in this category. No description of services is provided.

### **Steven Cox Employed Members of His Family Using CCA Funds**

As noted earlier, Government Code Section 87100 states that no public official at any level of state or local government shall make, participate in making, or in any way attempt to use his official position to influence a governmental decision in which he knows, or has a reason to know that he has a financial interest. In addition, Government Code Section 87103 states that an official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect on the official or a member of his or her immediate family.

Contrary to the provisions of Government Code regarding conflicts of interest, the audit team found that Mr. Cox authorized unusual pay increases and allowances for his wife. For example, Mr. Cox's wife, Janet, was under contract with EASC to conduct program development for the period commencing July 1, 2002 and ending June 30, 2003. In February 2003, Mrs. Cox was placed on the CCA #262 payroll at a salary that was double what she was paid by EASC. At the same time, Mrs. Cox was given \$8,000 for the first of her two retroactive pay increases. The second adjustment came just four months later in June 2003, when Steven Cox authorized a pay increase for his wife to be implemented retroactive one full year, resulting in Mrs. Cox receiving a supplemental paycheck totaling an additional \$32,250 in retroactive pay. Mr. Cox also directed that CCA #262 reimburse EASC for all of the fees it had paid Mrs. Cox up until that point, and that she be granted retroactive California State Teachers' Retirement System retirement credit for the time she was originally billed as an EASC consultant.



In July 2004, as CCA and EASC were nearing closure, Mr. Cox signed an \$8,000 check from the account of CCA #262 payable to his wife, allegedly for a car allowance. The audit team questions whether this was a proper use of CCA funds, as Mrs. Cox was already the recipient of a vehicle and gas card privileges paid for by EASC and there was no documentation supporting the expenditure. Moreover, these actions appear to be in violation of the conflict of interest provisions of Government Code Section 87100 et seq. and may constitute a misappropriation of funds.

In another instance, Peggy Baker, Mr. Cox's sister-in-law, was hired as a Reading Program Specialist for CCA #262. Nine months later, Mr. Cox granted Mrs. Baker a 27 percent salary increase, and made this increase retroactive nine months back to her original date of hire. In the very same month, Mr. Cox again increased Ms. Baker's salary, this time an additional 11 percent, and made this increase retroactive two months. While hiring and granting multiple raises to a sister-in-law may not constitute a "financial interest" as defined in Government Code Section 87100 et seq., it does raise the question of whether it was a case of nepotism and whether the raises were an appropriate use of CCA funds.

Nepotism is defined as favoritism shown or patronage granted by persons in high office to relatives or close friends. Generally, nepotism has negative connotations, particularly with regard to public entities and public funds, and in some situations is prohibited by law or policy. For example, Education Code Section 35107(e) prohibits a school board member from voting on personnel matters that uniquely affect a relative. In another example, California State University (CSU) maintains a policy that prohibits a CSU employee from voting, making recommendations, or in any way participating in decisions about any personnel matter that may directly affect the selection, appointment, retention, compensation, promotion, or termination of a close relative. The audit team could not find any CCA policy related to nepotism. The audit team did find a number of circumstances in which the family of Mr. Cox was placed in positions within CCA using CCA funds, raising a concern as to whether the personnel actions were in the best interests of the CCAs.

The audit team identified at least eight individuals employed by CCA or EASC that are close relatives of Mr. Cox. As shown in Exhibit 2E, the family members include Mr. Cox's wife, son, in-laws, and niece and nephew who were paid a total of more than \$1.2 million between 1999 and 2004. (Please see next page.)

**Exhibit 2E**  
**EASC/CCA Employees Related to Steven Cox**

Name	Relationship to Steven Cox	Entity Employed By:	Position	Monthly Salary	Total Paid
Janet Cox	Wife	CCA #262	Director of Special Services	\$8,750	\$244,845
Marc Cox	Son	CCA #297	Program Manager	5,000	204,558
Peggy Baker	Sister-in-Law	CCA #262	Reading Program Specialist	8,333	195,807
Doug Baker	Brother-in-Law	EASC	Academic Services Manager	5,000	73,094
Sally Galindo	Sister-in-Law	CCA #262	Staff Development Coordinator	5,833	29,166
Dawn (Gill) Cox	Daughter-in-Law	EASC	Manager	4,166	220,744
Bryan Baker	Nephew	CCA #377	Program Manager	5,000	262,743
Veronica Galindo	Niece	EASC	Personnel	1,733	40,261

a Total salaries, stipends, bonuses, and consulting fees paid using CCA and EASC funds from 1999 through 2004.

The fact that Mr. Cox hired so many of his close relatives raises questions about the objectivity of the hiring process and the qualifications of the family members to perform their jobs. Moreover, pay raises and retroactive pay increases granted to some of Mr. Cox's family members raise concerns of conflicts of interest and improper use of CCA funds.

## Chapter 3: EASC Obtained Millions of Dollars from the CCA Charter Schools

### Administrative Fees

CCA Board Policy 3000 states that the governing board recognizes that money and money management comprise the foundational support of the whole school program. To make that support as effective as possible, the governing board intends to, among other things, guide the expenditure of funds so as to extract the greatest educational returns. CCA Board Policy 3300 also states that the CEO shall be responsible for carrying out a policy that purchases and use of materials and manpower shall be accomplished in accordance with good business practices, with the primary purpose of serving the program of instruction. However, in contrast to these board policies, the audit team found that the CCAs paid a relatively high percentage of their revenue to EASC for administrative services. As a result, fewer charter school funds were available to support the CCAs instructional program.

The CCA began in 1999 when Mr. Cox was granted charter #262 by Snowline. In March 2000, Mr. Cox created the EASC and became its CEO. The CCA #262 then contracted with EASC to provide administrative services and to serve as the school's CEO in exchange for 8.5 percent of the CCA charter schools' revenue. In July 2000, CCA was granted charter #297 from the OUSD. In 2001, CCA was granted charter #377 from Snowline and charter #387 from the OGESD. All four CCA charter schools contracted with EASC to provide administrative services in exchange for administrative fees ranging from 8.5 percent to 25 percent of each CCA charter school's revenues. Exhibit 3A shows the administrative fee percentages paid by each of the four CCA charter schools.

**Exhibit 3A  
EASC Administrative Fees**

CCA	EASC Fee as a Percent of Revenue
#262	8.5 percent
#297	8.5 percent
#377	10.0 percent
#387	20.5 percent – 25.0 percent <sup>a</sup>

- a In 2001, Charter #387 agreed to pay EASC 25 percent of all its revenue. In 2002, Charter #387 reduced its fee to 20.5 percent of all revenues but added a retainer of 25 percent of the estimated annual revenue to be made the first working day of each fiscal year. In 2003, CCA #387 agreed to pay EASC a fixed amount of \$3 million plus 20.5 percent of all revenues which exceeded \$14.65 million.

As shown in Exhibit 3B, the CCAs paid EASC more than \$17.8 million for administrative services. The administrative fees paid to EASC equate to approximately 12.7 percent of the CCAs' total revenue of \$139.4 million from fiscal year (FY) 2000-01 through 2003-04.

**Exhibit 3B**  
**EASC Administrative Fee Payments**

CCA	FY 00-01	FY 01-02	FY 02-03	FY 03-04	Total
#262	\$302,772	\$465,425	\$430,909	\$330,312	\$1,529,418
#297	305,595	336,698	388,616	311,719	1,342,629
#377	1,224,978	1,452,596	1,128,918	1,253,372	5,059,864
#387	-----	2,798,056	3,450,408	3,689,466	9,937,931
Totals	\$1,833,345	\$5,052,775	\$5,398,852	\$5,584,869	\$17,869,841

According to interviews with CCA board members, Mr. Cox established the administrative fee percentages that were included in the contracts with the CCA charter schools. The board members also indicated that Mr. Cox told them that the rates were lower than what other management companies were charging charter schools for administration. However, research indicates that the administrative fees charged by EASC were higher than other entities providing similar services.

The audit team contacted several agencies in California that provide administrative services to other charter schools in California. Each agency was asked to quote its administrative rates based on the same set of services provided by EASC and similar ADA of each CCA school. Three agencies responded to the request and indicated that their rates for similar services ranged from 2 percent to 7 percent of charter school revenues, as illustrated in Exhibit 3C below.

**Exhibit 3C**  
**Other Agency Administrative Fees**

Charter Service Agencies <sup>a</sup>	Fee as Percent of Revenue
X	7 percent
Y <sup>b</sup>	2.5 percent to 5 percent
Z	2 percent to 3 percent

a The agencies responded to the request for information after being assured they would not be identified in the audit report.

b Agency Y indicated that it does not provide all of the services EASC provided.

Another point of comparison for EASC's administrative fees is the administrative costs of public schools in California. According to the Association of California School Administrators, less than 7 percent of California school districts' budgets is spent on central administration. Thus, the fees charged by EASC for central administration in some cases were significantly higher than the amounts spent by average California public school districts.

This suggests that millions of dollars that could have been used for CCA instructional purposes were instead diverted to a costly contract with EASC for central administration.

Another way in which EASC increased the amount of funding it received from the CCA charter schools was by transferring existing programs and schools from one CCA charter school site to another. For example, in 2001-02, the Escuela School site was switched from CCA #297, with administrative fees of 8.5 percent, to CCA #387, with administrative fees of 20.5 percent. As a result, EASC received \$391,000 more in administrative fees than it would have if the school site had remained under CCA #297. The audit team found nine school sites that were transferred between the CCAs between school years 2000-01 and 2002-03. While two of the schools were moved to charters with lower rates, the other seven schools were moved to charters paying higher rates. Overall, the CCA charter schools paid \$1.7 million more in fees to EASC as a result of the schools being transferred to a CCA with higher administrative fee rates.

The audit team also discovered that EASC collected \$1.1 million more than it was entitled for administrative fees in FY 2002-03. EASC reduced subsequent administrative fee payments during FY 2003-04 but at an insufficient rate to repay all the unearned funds. By August 2004, EASC still owed approximately \$23,000 to CCA #297 and \$358,000 to CCA #387 for administrative fees paid to EASC that it did not earn.

## Unauthorized Transfer of Funds

Education Code Section 47633(c) states that public funds may be used for any public stated purpose authorized by the governing board of the charter school. The contracts between EASC and CCA #262, #297, and #377 stipulate that checks or electronic transfers to EASC in excess of \$10,000 require the signatures of two members of the governing boards. Penal Code Section 424 addresses misappropriation of public funds and states that a person charged with the receipt, safekeeping, transfer, or disbursement of public monies that loans or appropriates public monies to his or her own use or to the use of another is punishable by imprisonment in the state prison for two to four years.

The audit team found 37 instances in which EASC electronically transferred a total of \$3.9 million of funds from the accounts of the CCAs to its own accounts. The audit team found no evidence that the governing boards of the CCAs authorized these transfers of funds to the EASC. Moreover, even though all of these transfers exceeded \$10,000, 35 of the 37 electronic transfers of CCA funds to EASC did not have two governing board member signatures as required.<sup>1</sup> As a result, the transfer of funds without board approval may constitute a misappropriation of funds under Education Code Section 47633(c) and Penal Code Section 424.

There is evidence that EASC's management was aware that this practice was inappropriate. For example, a memo prepared by Mary Williams, Administrative Assistant to Mr.

Cox, describes a conversation with Tad Honeycutt, who was Vice President of Corporate Development for EASC and who later became CEO of Maniaque Management Group, a subsidiary of EASC. According to Ms. Williams' memo documenting the conversation, Mr. Honeycutt stated:

*“It will be found that EASC borrowed money from the charters, which is illegal. All the corporate officers will be sued for misappropriation of funds.”*

### **EASC Shifted Some of its Costs to the CCA Charter Schools Through Additional Fees**

The services agreements with CCAs #262, #297, and #377 state that the CCAs will pay EASC a percentage of the CCA's revenues in exchange for EASC providing administrative services. Specifically, the services agreements state that EASC shall perform all such services in the conduct of charter school operation including, but not limited to:

- All business services.
- All purchasing services.
- All accounting record-keeping services.
- All reporting services.
- Maintaining bank accounts and banking records.
- All custodial services.
- All custodial services pertaining to records.
- Registration record keeping and administration.
- All reports claiming ADA and other funding.
- All services related to personnel.
- Coordination and functioning of the governing board and all committees.
- Curriculum development, planning, implementation, and monitoring services.

The services agreement for CCA #387, which was the last agreement signed, doesn't provide a list of the specific services EASC will provide for its 20 percent to 25 percent of #387 revenues. The services agreement for #387 simply provides a generalized list of EASC's duties.

Contrary to the terms of the services agreements, EASC charged the CCAs for certain administrative costs that should have been covered under the services agreements. For example, EASC was to provide all custodial services pertaining to records under the terms of the administrative services contract. However, EASC charged the CCA charter schools

\$114,000 of shared costs for a document imaging system that should have been part of EASC's responsibility for maintaining the CCA charter schools' records. The administrative services contract also specifies that EASC was to provide all registration record keeping and administration services. The audit team found that EASC charged the CCA charter schools with \$107,000 of shared costs for a Student Information System that should have been EASC's responsibility under the terms of the services agreement.

Another concern relative to the shared costs is the consulting contract with Vicenti, Lloyd & Stutzman. Between July and September of 2000, EASC developed a contract between three of the CCA charter schools and Vicenti, Lloyd & Stutzman. The purpose of the contract was for one of Vicenti, Lloyd & Stutzman's staff, John Malone, to serve as the chief business officer of the CCA charter schools. However, the administrative services contract specified that EASC was to provide all business services. EASC should have paid the \$233,000 for the Vicenti, Lloyd & Stutzman contract from its administrative fees rather than charge the charters twice for the same service.

EASC was able to charge these additional costs, also known as shared costs, to the CCA charter schools because the services agreements between the CCA and EASC did not clearly describe which costs would be paid by EASC through its administrative fees and which costs would be paid by the CCA. EASC made its own unilateral interpretation of which administrative costs should be paid by it under the administrative services agreement and which administrative costs should be paid by the CCA charter schools. The governing board for CCA #262 once indicated it was going to review and formalize an agreement regarding the shared costs; however, no such actions were taken.

In total, the audit team identified at least \$7.3 million in shared costs that were allocated among the CCA charter schools and another \$624,000 reimbursed directly to EASC for administrative services in addition to the \$17.8 million paid to EASC in administrative fees. While some of the \$7.3 million in shared costs may be administrative expenses that should be paid by the CCA charter schools, the examples cited above are just a few instances in which EASC charged additional costs to the CCAs for services that should have been paid by EASC under the administrative services agreement. Additional examples of inappropriate shared costs pertaining to consulting contracts arranged by Mr. Cox and paid by the CCA charter schools are discussed in Chapter 4.

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## Chapter 4: EASC Control of CCA Finances Led to Questionable Expenditures

### Questionable Contracts and Vendor Services

The California State Constitution prohibits any public entity from making any gift of public money or thing of value to any individual, municipality, or other corporation whatsoever. Education Code Section 47633(c) states that public funds may be used for any public stated purpose authorized by the governing board of the charter school. Finally, Penal Code Section 424 addresses misappropriation of public funds and states that a person charged with the receipt, safekeeping, transfer, or disbursement of public monies that loans or appropriates public monies to his or her own use or to the use of another is punishable by imprisonment in a state prison for two to four years.

As noted earlier, EASC had the ability to enter into contracts on behalf of the CCA charter schools without seeking the prior review and approval of the CCA boards. According to the board members interviewed, the CCA boards were not provided copies of the contracts, even after they were executed by EASC. Thus, a CCA board member could only become aware of a contract by reviewing the expenditure log provided at the board meetings and by asking questions. This lack of oversight contributed to a situation in which EASC entered into several questionable contracts with CCA funds. As discussed in the following sections, EASC directed funds to these contractors and vendors without sufficient evidence that the CCAs received goods or services for which they were being charged. Disbursing public funds for goods or services that were not received could constitute a prohibited gift of public funds and/or a misappropriation of public funds.

### Maniaque Management Group

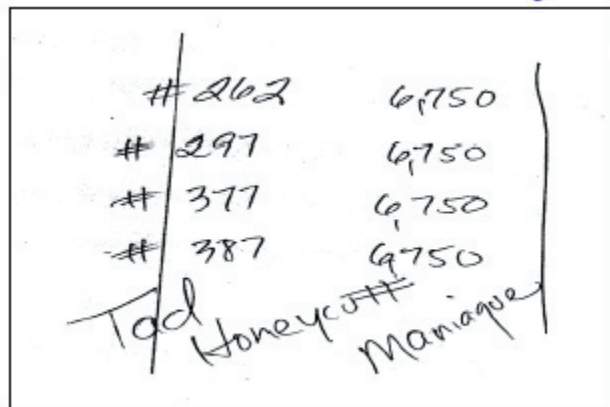
In December 2002 Tad Honeycutt, an EASC employee, formed a company known as Maniaque Management Group, Inc. (hereafter referred to as Maniaque). The officers of Maniaque were all key EASC employees, with Tad Honeycutt as CEO and Steven Cox as Director. In January 2003, Maniaque assumed control of EFS and its subsidiaries: Hautlab Music Group, Xtreme Motor Sports, and Maniaque Marketing. Initially, Mr. Cox, as CEO of EASC, and Mr. Honeycutt, as CEO of Maniaque, signed an agreement whereby EASC agreed to pay Maniaque's rent and monthly facility-related expenses for a period of three years. The arrangement changed slightly in January 2004 when Mr. Honeycutt ceased to be an EASC employee and registered a new corporation named Maniaque, Inc., in Nevada. A new agreement was executed between Mr. Cox and Mr. Honeycutt whereby they agreed to dissolve the California-based Maniaque company, have EASC pay all outstanding debts, and allow Mr. Honeycutt to take all the assets and property to the new Maniaque corporation.

In January 2004, Mr. Cox and Mr. Honeycutt signed consulting contracts for Maniaque to provide services to each of the four CCA charter schools. The four identical contracts stated that Maniaque was to be paid \$1,000 monthly for 12 months to provide grant consulting services. The contracts indicated that Maniaque would, “... research, write, submit, and attempt to obtain, for the Client, private foundation and federally managed grant/funding opportunities.”

The audit team found that Maniaque invoiced the four CCA charter schools \$1,000 each in February 2004 for grant consulting services. The audit team could find no evidence that any grant consulting services were provided by Maniaque to justify these payments.

In another example, EASC wrote four checks each for \$6,750 from the accounts of the CCA charter schools to Maniaque on June 30, 2004, just days before the CCA charter schools closed due to financial problems. Exhibit 4A is a photocopy of the only support provided for this payment.

**Exhibit 4A**  
**Example of Supporting Documentation**  
**for Payments Made to Maniaque**



The supporting document was handwritten, showing “6,750” next to each CCA number along with the words “Tad Honeycutt” and “Maniaque.” The supporting document does not show what services were provided, whether anyone within EASC or CCA approved the payment, or to which contract, if any, the payments were attributable. Despite the lack of supporting documentation, the checks were written by EASC staff, and the CCA charter schools paid Maniaque a total of \$27,000. The audit team could find no evidence of services provided by Mr. Honeycutt or Maniaque for these payments that would justify the use of CCA funds.

The payments made to Maniaque by EASC using CCA funds without sufficient evidence showing the services were actually received by the CCAs raises the question of whether the payments constitute a gift and/or a misappropriation of public funds.

### **High Desert Youth and Family Resource Center**

Another questionable use of CCA funds were contracts entered into with the High Desert Youth and Family Resource Center (HDYC). Mr. Cox signed contracts on behalf of each of the CCA charter schools with Anthony Chambers, the Executive Director of HDYC, for HDYC to provide "... motivational speaking, drug prevention and awareness, gang prevention and awareness, and other program presentations to classrooms, ..." for \$2,500 per month per charter. However, the contracts do not specify the number of hours or classes to be provided, where or when these services will be provided, nor do they require any documentation or deliverables in order to be paid.

In addition to the HDYC contracts for motivational speaking, Mr. Cox signed a separate, concurrent contract for Mr. Chambers to provide CCA #387 with the very same services as those outlined in the HDYC contracts. Thus, CCA #387 was paying both HDYC and Mr. Chambers to provide the same services during the same period of time. Mr. Chambers was to be paid another \$3,000 per month under this contract. Similar to the HDYC contracts, the contract with Mr. Chambers does not specify the number of hours or classes to be provided, where or when these services will be provided, nor do they require any documentation or deliverables in order to be paid.

In total, Mr. Chambers and HDYC received \$98,000 from the four CCA charter schools to perform motivational speaking and similar services between April and December 2003. The audit team was unable to locate any evidence of services provided in exchange for the \$98,000.

In response to questions about the services HDYC provided in exchange for the payments from the CCA charter schools, Mr. Chambers sent the audit team a letter on HDYC letterhead that stated:

*"Per our agreement with Mr. Steven Cox, the High Desert Youth Center was to make our services available to all CCA participants after school as well as summer. Services include boxing, tutoring, and homework assistance, anger management, drug & alcohol intervention classes and computer lab. These services were made available to all low-moderate income youth in the community."*

Mr. Chambers sent another letter on the same date that is not on HDYC letterhead that appears to describe the services he provided to CCA under his personal contract. In this letter, Mr. Chambers states that he provided approximately 30 hours per month engaging

students in sessions on relationships, gang and drug intervention, and career planning. He also stated that the majority of his time was spent at one site in Los Angeles and that he visited two other sites.

In summary, while the information provided by Mr. Chambers offers some insight into the services provided, the audit team believes this was a questionable use of CCA funds because the HDYC and Mr. Chambers had contracts providing the same services during the same time period. In addition, it is not clear that the services provided are commensurate with the amount paid. Finally, all four CCA charter schools were required to pay HDYC when only a few CCA sites could have benefited from the services. As a result, the audit team believes that EASC's payments to Mr. Chambers and HDYC using CCA funds may constitute a prohibited gift of public funds and/or a misappropriation of public funds.

### **Community Information Services Online**

CCA Board Policy 3310 states that the policy of the governing board is to purchase without any personal interest, private advantage or prejudice, seeking to obtain the maximum benefit for each tax dollar expended. The policy also is to avoid unfair practices, giving all qualified vendors an equal opportunity. CCA Board Policy 3313 states that no favoritism shall be extended to vendors and that no purchase shall be made from a member of the governing board nor from any enterprise in which the board member holds a substantial interest. The audit team found that contrary to the CCA policy, EASC procured computers and services from a former governing board member.

Eric Swanson was a member of the governing boards for CCA charter schools #262, #297, and #377 until June 30, 2001. The same day that he resigned from the three boards, the company for which he is president, Community Information Services Online (CISO), received a purchase order from CCA charter schools #262 and #297 to purchase computers with the charters' Education Technology Grant funding. In addition, CISO received funding from the four CCA charter schools and EASC for Internet and other services. Payments to CISO were almost \$591,000 from the CCA charter schools for services related to the Digital High School (DHS) grant and \$118,000 for Internet access and other services. Despite the amount of funds involved, EASC never asked for competitive bids for the DHS grant or Internet services, but rather offered CISO a sole-source purchase order. No contract ever existed between CCA and CISO and as a result, CISO was paid over \$708,000 without a description of the goods or services to be provided under the contract, the conditions for payment, or any other normal contract language.

The failure to conduct a competitive bid process for such a large expenditure of CCA funds not only conflicts with CCA Board Policy, but raises the question of whether EASC maximized the CCA funds it expended and whether the former board member was shown favoritism in the award of the contract. Moreover, the fact that EASC failed to describe in detail the specifications of the goods and services to be provided by CISO raises the ques-

tion of whether or how EASC was able to ensure that the CCAs received all of the goods and services for which they paid. Using CCA funds to pay for goods or services that were not received could constitute a gift of public funds and/or a misappropriation of public funds.

### **Occidental Communications Group**

During the audit team’s review of CCA expenditures, the audit team noticed a large number of disbursements to political lobbyists and consultants. While using CCA funds for lobbying purposes is not illegal, the audit team found the contracts and invoices to be vague, and the amounts paid to be questionable. For example, EASC paid Occidental Communications Group nearly \$363,000 over a four-year period although no contract existed between Occidental and the CCA charter schools. The invoices from Occidental referenced the services provided as “consulting services, on-site arrangement of meetings, research, and long-term projects.”

According to information provided to the audit team, some of the activities for which Occidental Communications was paid with CCA funds included the development of the Orange USD charter, other charter proposals that were either denied or never submitted, and proposals for a child care program and a summer camp. These activities raise questions as to why EASC charged CCA for consulting services that benefit EASC but do not appear to benefit the individual CCAs.

The services agreement between EASC and the CCAs states that checks or electronic transfers for expenditures in excess of \$10,000 require the signature of one governing board member. The EASC avoided review and signature of governing board members on payments to Occidental by dividing the monthly payments among the four CCAs. Thus no single check for any one of the CCAs was greater than \$10,000. The audit team found that EASC often divided payments to contractors among the four CCAs, which had the effect of avoiding review by the CCA governing boards. E-mail correspondence among EASC staff indicates that Steven Cox was made aware of the lack of a contract with Occidental in 2001 but failed to take action to put a contract in place and seek review and approval by the board.

In summary, the lack of a contract, combined with vague invoices for services from EASC that may or may not benefit the CCAs, raises questions as to whether the expenditures were appropriate and the best use of CCA funds. Moreover, because EASC split the expenditures among the CCAs and thereby avoided scrutiny by the CCA boards, it cannot be determined whether the CCA boards would have considered this an appropriate use of CCA funds.

### **One Highly Paid Staff Member Provided Few Measurable Services**

The audit team found at least one instance in which it is questionable whether a CCA/EASC employee provided services commensurate with his salary and position. In January 2001, Keith Olberg was hired and placed on the payroll of CCA #377. Employment records indicate that he was hired to develop a charter program for gifted students that was to be called the Honors Program. Mr. Olberg received an annual salary of \$125,000 for those years from January 2001 through February 2004. In August 2002, Mr. Olberg was transferred from the CCA #377 payroll to the EASC payroll. Mr. Olberg remained on EASC payroll until February 29, 2004, when he was terminated due to EASC's reductions in operating fees. During this audit, numerous CCA board members and staff raised questions about whether Mr. Olberg actually performed any meaningful work for the CCA charter schools.

In response to questions posed to him by the audit team, Mr. Olberg stated that his responsibilities were to advise Mr. Cox on public policy and to design an educational program. Specifically, Mr. Olberg stated:

*“My duties and responsibilities were related to public policy, exclusively, both as they pertained to the State Legislature, and to establishing an “Honors Program.”*

*As a retired State Legislator, and a Doctor of Philosophy, in political philosophy, it was my impression that Mr. Cox saw value in retaining my services to advise him on public policy issues of concern to the CCA as they came before the Legislature. Although I was not a lobbyist, and did not perform lobbying activities, I was called upon to give advice on matters pertaining to the best manner in which to approach State Government.*

*Further, as one interested in promoting high quality public education in the State of California, I proposed what has been called an “Honors Program” (others’ description of the program). The objective was to design and eventually, to offer California public school students, first in the Victor Valley and, then, perhaps later elsewhere, an opportunity for a highly demanding state curriculum which would give academically-motivated public school children an opportunity to excel in their community.”*

Over the three years he was employed by CCA and EASC, Mr. Olberg was paid over \$375,000 to, according to his employment letter, develop an Honors Program. However, the Honors Program was never fully developed. According to Mr. Olberg, the outcomes of his three years of work were: (1) providing a curricular template for establishing the Honors Program; and (2) providing ongoing policy advice and suggestions for legislative strategy to Mr. Cox on the wisest and most prudent approach to California State government.

The audit team also asked Mr. Olberg to provide a detailed description of the activities he engaged in during his time with CCA and EASC. The list of activities does not appear to be sufficiently complex or time consuming to require a highly paid position for over three years. Specifically, Mr. Olberg provided the following list of his activities.

1. *Visited campuses for schools of excellence or, as you refer, "Honors Programs," nationwide, to ascertain the strengths and weaknesses of such programs, and to consider incorporating the best curricular expectations of each. I visited, and conversed, with personnel in Idaho, Illinois, Michigan, Virginia, Maryland, and Washington, D.C., schools nationally recognized as schools of exceptional quality.*
2. *Studied various curricula to ascertain the strengths and weaknesses of each of the programs, from which to develop a strong public school "model" in the State of California.*
3. *Reviewed college entrance requirements, and recommended high school curricular programs, for top colleges and universities in California, and across the country, both as a guide for parents of high school students, and to provide college preparatory guidance for high school students and personnel at CCA, and EASC.*
4. *Advised Steven Cox, and occasionally his subordinates, on successful legislative strategies in approach(ing) the State Legislature. Such meetings occurred by phone and, when necessary, in Sacramento.*
5. *Set appointments for Steven Cox with state officials regarding educational policy issues.*
6. *Provided names, phone numbers, and contact information, for officials and education personnel in Sacramento, related to State Government, and governmental concerns.*
7. *Spoke with small community gatherings on the merits of "classical education," pursuant to the model I was attempting to establish with CCA/EASC.*
8. *Spoke several times by phone, and in the Sacramento office of CCA/EASC, with personnel from the "Great Books" curricular program/foundation, on adopting portions of their curriculum for CCA/EASC's "Honors Program."*

In addition to Mr. Olberg's salary and benefits, CCA #377 and EASC also funded many other expenses throughout the three years he was employed by the two entities. Specifically, for CCA #377 between January 2001 and August 2002, these included approximately:

- \$14,000 for rent on an office in Sacramento.
- \$2,500 for cell phone usage.
- \$2,100 for travel and conferences.
- \$2,100 for computers and Internet service.

The audit team asked Mr. Olberg why it was necessary to pay for an office in Sacramento rather than working at the CCA/EASC offices. He stated that the work he was doing was policy oriented and was strictly related to California State government. Mr. Olberg further stated that being in and around the State Capitol would benefit his work with CCA/EASC and the relationships he had established in previous years. Finally, Mr. Olberg stated that he wanted to live in Sacramento for personal reasons. In summary, the CCA charter schools paid thousands of dollars of expenses to maintain an office in Sacramento for reasons that appear to have benefited Mr. Olberg more than the CCA charter schools.

The audit team noted that the CCA paid for Mr. Olberg's office and expenses in Sacramento at the same time he was running for Secretary of State. The audit team found that some of the expenses attributed to Mr. Olberg were originally classified as political contributions. These expenses were later reclassified as operating expenses. It is unclear whether the expenses associated with Mr. Olberg should have been classified as political contributions or as operating expenses. A review of the expenses for compliance with the State's political contribution reporting requirements is outside the scope of this audit.

While it is not clear whether Mr. Olberg's salary and expenses should have been classified as political contributions, it is clear that they should not have been charged to CCA #377. Specifically, CCA #377 paid approximately \$242,000 of Mr. Olberg's salary, benefits, and expenses before he was transferred to the EASC payroll. The CCA's controller made a year-end journal entry adjustment to reclassify Mr. Olberg's expenses from CCA #377 to expenses of EASC. The note on the adjusting journal indicates it is to adjust for an outside program of EASC that was incorrectly recorded in CCA #377's accounts. EASC was to repay CCA #377 the \$242,000 improperly charged to its accounts. However, CCA accounting records indicate that EASC only repaid \$5,200. Thus, CCA #377 was not reimbursed for approximately \$237,000 improperly charged to its accounts by EASC for Mr. Olberg's salary, benefits, and expenses.

#### **EASC Transferred Employees to the CCA Charter Schools**

The audit team identified another questionable use of CCA payroll funds in which employees were transferred from EASC's payroll to that of CCA. As shown in Exhibit 4B, six employees were taken off the EASC payroll in February and March 2004 and were added to the payroll of CCA. (Please see next page.)



### Exhibit 4B Employees Transferred From EASC to CCA

Employee	Transfer Date	EASC Salary	CCA Salary	Position
Marc Cox	February 2004	\$4,166	\$5,000	Program Manager
Angie Dominquez	March 2004	3,000	3,225	Special Education Clerk
Michael Flood	March 2004	4,166	4,437	Compliance Officer
Todd Green	March 2004	4,416	4,814	Compliance Officer
Scott Hagberg	March 2004	2,416	2,634	Compliance Officer
Lyle Larsen	March 2004	2,166	2,285	Compliance Officer

As noted earlier in the report, the services agreement between EASC and the CCAs does not clearly identify the roles and responsibilities of EASC and the CCAs. Therefore, it cannot be determined with certainty whether the transfer of employees was appropriate. However, these employee transfers shifted payroll costs from EASC to CCA, thereby lessening EASC's financial difficulties. The audit team could find no documentation or board action justifying these transfers or the use of CCA funds to pay these employees. Moreover, the audit team found no evidence of changes in their job descriptions that would warrant them being transferred from EASC to CCA.

### CCA Cannot Account for All of the Grant Funds It Received

In addition to questionable employee salaries and contracts, the audit team also discovered that the CCA charter schools cannot account for all of the federal grant funds they received. On December 18, 2000, CCA #262 applied for and was subsequently awarded a charter school implementation phase grant in the amount of \$150,000 for the period of March 2001 to March 2003. In its proposal, CCA #262 stated it would use the grant funds to complement its student assessment program by establishing a Mobile Assessment Computer Coach (MACC). The MACC would travel between CCA #262's nine school sites in northern California, evaluating the basic skills of over 500 students enrolled at these campuses.

The CCA was required to submit a final report to CDE 30 days after the scheduled ending date of the grant. The final report was to indicate how the grant funds were spent and provide evidence that the grant activities were completed as proposed in the grant application. The grant closure occurs after CDE staff approves the report. The CCA #262 submitted its final grant report approximately 18 months late, and CDE closed the grant in September 2004.

The audit team reviewed the final report submitted to the CDE to determine whether there was support for the figures and activities reported. Based upon review of the detailed supporting documentation, the audit team could not verify approximately \$59,600 (or 40

percent) of the grant expenditures, including approximately \$36,000 in computers, \$23,000 in salary and benefits, and \$600 in digital subscriber line (DSL) charges. For example, the final report includes \$68,000 for software licenses and 14 computers, which is the same as the number of workstations in the MACC. However, the supporting receipts indicate that 39 computers and no software licenses were purchased for that amount. Furthermore, the audit team could only find support for four of the seven months reported as full-time work for the coach driver. There also was no supporting documentation to justify that a part-time clerical position was indeed filled. Lastly, CCA charged nearly \$900 to the grant for DSL services, but could only provide documentation to support \$300 in DSL charges.

Overall, CCA's accounting and reporting of grant expenditures is not reliable. As noted above, several reported expenditures did not match invoices, and documentation was either missing or insufficient to determine whether the expense was appropriate. The audit team also found documentation for expenditures that may have been grant related but were not included in the final report. In response to these findings, CCA's controller acknowledged the overcharge for the computers and attempted to revise other expenditure amounts.

In addition, CCA #262 and CCA #297 received grant funding through the California Education Technology Grant program in FY 2001-02 and subsequently issued a sole source purchase order to a former board member, as previously mentioned. The audit team discovered that CCA #262 did not spend all of the grant funds received for this program. Initially, CCA #262 transferred one-half of its grant funds to the other two charters for purchase of computers under this program. The accounting records indicate that CCA #262 and CCA #387 have a balance of \$284,000 that remains unspent.

This particular grant program did not require a final report of grant expenditures, but rather a signed affidavit assuring the State that the grant recipient complied with the funding conditions. According to the San Bernardino County Superintendent of Schools, CCA #262 was not selected for a post grant audit by the California Technology Assistance Project organization. The audit team could not find any evidence that the unspent grant funds were returned to the State.

## **Chapter 5: California Charter Academy Schools Received At Least \$23 Million More In Charter School Funding Than They Were Entitled**

### **Charter School Funding**

Like all California public schools, the CCA charter schools received funding from the CDE based on the program sites' ADA. Schools claim ADA based on the cumulative attendance of students during each reporting period. For example, one student who attends school each day for the entire reporting period is eligible for 1.0 ADA. The amount of ADA claimed by program sites correlates directly into dollars - the higher the ADA for a program, the more funds that program will receive from the State. The ADA funding rates vary by school year and grade level. Students from higher grade levels receive more funding than students from lower grade levels. For example, ADA rates ranged from \$4,128 for a student in kindergarten in school year 1999-00, to \$5,658 for a student in 12th grade in school year 2003-04.

Three times a year, school districts calculate ADA and report it to the CDE. After the CCA charter schools' ADA is reported to CDE, the State Superintendent of Public Instruction apportions state school funds to the county office of education, which then provides the funds to the CCA charter schools.<sup>2</sup> The ADA that the audit team used to estimate ineligible charter school funding was from the annual ADA reports submitted by CCA to CDE.

### **School Sites Outside the Chartering Districts' Boundaries**

One method by which the CCA charter schools overclaimed ADA was by starting new school sites outside of the chartering districts' boundaries and claiming their students' attendance. Until 2002, California districts were permitted to open charter schools anywhere in the state. However, in 2002 AB 1994 was signed into law. It included an amendment to California Education Code Section 47605(a)(1) stating that a charter school may only operate a program site that is inside the boundaries of the school district or county office of education granting the charter. Section 47605.1(e)(1) did provide an exception for those sites "established or acquired" before July 1, 2002. As of June 2004, the CCAs had opened over 170 program sites around California, stretching from ten miles north of the Mexican border to 60 miles north of Sacramento.

The audit team reviewed a sample of sites from all four CCA charter schools to determine whether they maintained program sites in compliance with California Education Code Section 47605(a)(1). The audit team reviewed 36 sites located outside the chartering districts' geographic boundaries to determine whether they met the following criteria:

- The site's first lease started after June 30, 2002.
- The site was identified by CCA as having started after June 30, 2002.

Of the 36 sites, the audit team confirmed that 15 were started after June 30, 2002, and should have been ineligible for state charter school funding. Exhibit 5A identifies the ineligible sites and, if available, the total ADA that CCA claimed for them during FYs 2002-03 and 2003-04.

**Exhibit 5A**  
**CCA School Sites Started After June 30, 2002**  
**Outside the Chartering Districts' Boundaries**

CCA	School Site Name	Ineligible ADA		Total Ineligible ADA
		School Year 2002-03	School Year 2003-04	
CCA #262	Avalon	0.00	124.66	124.66
CCA #262	Bakersfield	not available	not available	not available
CCA #262	High Desert	116.67	109.49	226.16
CCA #377	El Monte	114.20	0.00	114.20
CCA #377	Norwalk-Whittier	not available	not available	not available
CCA #377	Norwalk-Crescent	not available	not available	not available
CCA #377	Riverside	142.98	150.73	293.71
CCA #377	Torrance	16.81	46.75	63.56
CCA #387	Gardena	0.00	0.00	0.00 <sup>a</sup>
CCA #387	Stockton-Fremont	81.16 (est.)	87.11	168.27 (est.) <sup>b</sup>
CCA #387	Stockton-Main	38.81 (est.)	41.65	80.46 (est.) <sup>c</sup>
CCA #387	Village-Elementary	254.10	358.04	612.14
CCA #387	Winton-Highway 140	not available	not available	not available
CCA #387	Winton-Galt	6.05 (est.)	6.05	12.10 (est.) <sup>d</sup>
CCA #387	Winton-Patterson	16.26 (est.)	16.26	32.52 (est.) <sup>e</sup>
Totals		787.04	940.74	1,727.78

a The Gardena site is documented as starting after June 30, 2002 outside the OGESD. According to the landlord, the site was only open for a few months. The CCA did not claim any ADA for this site during the school year 2002-03, which is when it was in operation.

b The audit team was able to identify the amount of ADA claimed by the Stockton-Fremont site for school year 2003-04. For the 2002-03 school year, the audit team was only able to identify the combined ADA that was claimed by both the Stockton-Main site and the Stockton-Fremont site. The audit team used the percentage of ADA allocated between the Main site and the Fremont site in 2003-04 to estimate the ADA for Stockton-Fremont during the 2002-03 year.

c The audit team was able to identify the amount of ADA claimed by the Stockton-Main site for school year 2003-04. However, for the 2002-03 school year, the audit team was only able to identify the combined ADA that was claimed by both the Stockton-Main site and the Stockton-Fremont site. The audit team used the percentage of ADA allocated between the Main site and the Fremont site in 2003-04 to estimate the ADA for Stockton-Main during the 2002-03 year.

d The audit team was only able to identify the ADA claimed by the Winton-Galt site for school year 2003-04. The 2002-03 ADA was reported for all Winton sites, and not broken down into specific sites. The audit team took the 2003-04 ADA reported by the Winton-Galt site and doubled it to get an estimate of ADA for 2002-03 and 2003-04.

e The audit team was only able to identify the ADA claimed by the Winton-Patterson site for school year 2003-04. The 2002-03 ADA was reported for all Winton sites, and not broken down into specific sites. The audit team took the 2003-04 ADA reported by the Winton-Patterson site and doubled it to get an estimate of ADA for 2002-03 and 2003-04.

During school years 2002-03 and 2003-04, the CCA charter schools reported 1,727.78 ADA for 11 of the 15 ineligible sites. The audit team could not determine the ADA for the remaining four sites because the ADA was recorded by teachers rather than by site. For the 11 sites for which the audit team could calculate ADA, the audit team estimates that the CCA inappropriately received at least \$8.3 million in charter school funds.

## Private School Conversions

The CCA charter schools also overclaimed ADA by operating school sites that were formerly private schools. California Education Code Section 47602(b) states “No charter shall be granted under this part that authorizes the conversion of any private school to a charter school.” A charter school cannot claim ADA for students attending programs that were converted from private schools.

The audit team reviewed a sample of sites from all CCA charter schools to determine whether there were programs in violation of California Education Code Section 47602(b). The audit team reviewed 36 sites to determine whether they met the following criteria:

- The site address matched another school site identified by either the California State Controller’s Office (SCO) or CDE as formerly a private school.<sup>3</sup>
- An Internet search of a site’s physical address found Web pages that suggested the site was formerly a private school.

Of the 36 sites the audit team reviewed, three sites were confirmed private school conversions and should have been ineligible for state charter school funding. Specifically, the audit team interviewed the sites’ program administrators and obtained written verification that their sites were former California Honors School programs. In addition, one site (San Diego-Vista) was identified by the Orange USD as a private school conversion in April 2004. The CCA claimed 1,945.37 ADA for these three sites from school years 2001-02 through 2003-04. As a result, the CCA inappropriately received approximately \$9.4 million more in charter school funding than it was entitled. Exhibit 5B identifies the ineligible sites and the total ADA claimed during FYs 2001-02, 2002-03, and 2003-04. (Please see next page.)

**Exhibit 5B & C**  
**CCA School Sites Confirmed and Suspected to be Former Private Schools**

CCA Charter	Site Name	Ineligible ADA for			Total Ineligible ADA
		2001-02	2002-03	2003-04	

<b>Written Confirmation</b>					
CCA #387	Dinuba	0.00	34.34	23.95	58.29
CCA #387	North Highlands	274.80	638.91	741.98	1,655.69
CCA #297	San Diego-Vista	43.11	103.31	84.97	231.39
Totals		317.91	776.56	850.90	1,945.37

<b>Verbal Confirmation</b>					
CCA #297	Hilltop/Chula Vista	36.57	55.25	97.15	188.97
CCA #387	Elk Grove	110.57	116.36	143.70	370.63
CCA #387	Mayfair–McCreery	60.99	88.83	115.70	265.52
CCA #387	Modesto	46.90	65.06	74.62	186.58
CCA #387	Sonora	0.00	46.87	19.89	66.76
Totals		255.03	372.37	451.06	1,078.46

In addition to the three programs that were confirmed to be private school conversions, the audit team identified five likely but unconfirmed private school conversion sites. For five of these suspected sites, the audit team received verbal confirmation from the program administrators or landlords that the CCA site was a continuation of a CHS or SSA site that was previously a private school. However, the audit team was unable to obtain written confirmation that the site was a continuation of a site that was previously a private school. Therefore, these sites are classified as suspected former private schools. Exhibit 5C identifies the potentially ineligible sites and the total ADA claimed during FYs 2001-02, 2002-03, and 2003-04.

During school years 2001-02, 2002-03, and 2003-04, the CCA charter schools reported 1,078.46 in ADA for the five potentially ineligible sites. For the five sites suspected to be in violation of California Education Code Section 47602(b), the audit team estimates that the CCA inappropriately received at least \$5.4 million of state funding.

### **Independent Study Attendance Claims**

The CCA also overclaimed ADA by reporting ineligible independent study student attendance. The audit team reviewed a sample of files pertaining to students who had independent study status to determine whether they appeared to meet the minimum requirements for receiving credit. The team found that the majority of written agreements had excep-

tions, that student files did not include sufficient work samples, and that the CCA charter schools had a history of noncompliance with independent study requirements.

In order to test CCA charter schools' compliance with the laws and regulations governing independent study, the audit team selected a sample of 110 independent study student files for review. Because the audit team found that 20 percent of the CCA students' files could not be located or were inaccessible, the audit team worked with the remaining 88 files, which were being maintained by the chartering districts.

To receive ADA apportionments, an independent study program must comply with attendance reporting, student file maintenance requirements, and student-teacher ratios outlined in the California Education Code and California Code of Regulations. For example, Section 51747 of the California Education Code requires that a local education agency (LEA) have policies in place for creating independent study contracts that describe the work students will perform and how a certificated LEA employee will assign attendance value to that work. The charter school must maintain sufficient records of completed student work to justify the attendance claims made for apportionments.

The audit team reviewed 88 independent study files for compliance with requirements of the California Education Code and found that approximately 55 percent of the student agreements the audit team reviewed were noncompliant with one or more attributes. Furthermore, approximately 20 percent of the written agreements were noncompliant with three or more attributes. Specifically, the audit team found that of the 88 files tested:

- 13 files did not state the manner, time, frequency, and place for submitting a pupil's assignments and for reporting his or her progress.
- 19 files did not state the objectives and methods of study for the pupil's work, and the methods utilized to evaluate that work.
- 13 files did not state the specific resources, including materials and personnel, that would be made available to the pupil.
- 13 files did not include a statement of the policies adopted regarding the maximum length of time allowed between the assignment and the completion of a pupil's assigned work.
- 46 files did not state the number of missed assignments allowed prior to an evaluation of whether or not the pupil should be allowed to continue in independent study.
- 10 files did not state the duration of the independent study agreement, including the beginning and ending dates for the pupil's participation in independent study under the agreement.
- 17 files did not include a statement indicating the number of course credits or, for the elementary grades, other measures of academic accomplishment appropriate to the agreement, to be earned by the pupil upon completion.

- 17 files did not include a statement that independent study is an optional educational alternative in which no pupil may be required to participate.
- 13 files did not contain a written agreement signed prior to the commencement of independent study by the pupil, the pupil's parent or legal guardian, the certificated employee who was designated as having responsibility for the general supervision of independent study, and all persons who had direct responsibility for providing assistance to the pupil.
- 15 files did not include student work samples bearing signed or initialed notations by the supervising teacher.

Historical audits indicate that CCA has had a history of noncompliance with independent study requirements. Some of the findings noted by the previous auditors included:

- Student contracts were not signed or dated by students or teachers.
- Days of apportionment were received before the student signed the contract.
- Some student files contained no learning logs and no work samples.

The sample of independent student files tested by the audit team was not a statistically representative sample and the results of the testing cannot be projected across the entire population of CCA independent students. Nevertheless, the number and frequency of the exceptions the audit team noted, combined with the missing or inaccessible student files and the history of documented problems, leads to the conclusion that CCA may have been out of compliance with state laws and regulations for a significant portion of the independent study students for whom the CCA claimed state ADA apportionment.

EASC was responsible for registration record keeping as well as preparing and submitting all reports related to claiming ADA. Therefore, EASC is responsible for any ADA claims that include ineligible CCA independent study students.



## Chapter 6: EASC’s Excessive Spending of Unauthorized Funds Contributed to the Failure of the California Charter Academy

As discussed earlier, the audit team found that EASC routinely made unauthorized transfers of CCAs’ funds to the accounts of EASC. These transfers were in violation of the fiduciary responsibility that the CCA staff owed to the CCAs. A review of the timing, frequency, and amount of those transfers demonstrates that EASC was consistently spending more than it was generating in fee revenues from the CCAs. The audit team then reviewed EASC’s accounting records to determine whether the additional funds were used to benefit the CCA charter schools in a manner consistent with the fiduciary responsibility that the CCA staff had to the respective CCA charters. The audit team found several examples of excessive spending by EASC. The unauthorized transfer of funds from the CCA to EASC contributed to a serious CCA cash flow problem and ultimately closure of the CCA.

Examples of EASC’s spending include employee American Express bills in excess of over \$1.4 million over the course of two years; dramatic increases in employee salaries; generous company car and car stipend policies; non-charter school business ventures; and elaborate annual banquets. In many cases these expenditures benefited specific individuals: Mr. Cox, his family members, and Mr. Honeycutt, EASC’s Vice President of Corporate Development. The following sections describe EASC’s spending and unauthorized transfers of CCA funds.

### EASC Transferred Funds from the CCAs in Excess of the Fees to Which It was Entitled in Order to Pay Expenses of the Corporation

As discussed in Chapter 3, the audit team found that EASC made a total of 37 unauthorized transfers of CCA funds to EASC’s accounts between September 2001 and August 2004. As shown in Exhibit 6A, EASC transferred more than \$3.5 million from the CCAs. The \$3.5 million was in addition to the amounts already paid to EASC for its administrative services. These funds were not repaid by the time the CCAs closed in August 2004.

**Exhibit 6A**  
**Unauthorized and Nonrepaid Transfers from the CCAs to EASC**

Charter	FY 2002-03	FY 2003-04	Total
#262	\$380	\$156,572	\$156,952
#297	120,000	400,000	520,000
#377	235,000	1,054,000	1,289,000
#387	695,000	902,213	1,597,213
Totals	\$1,050,380	\$2,512,785	\$3,563,165

These unauthorized transfers were for amounts in addition to the authorized monthly payments for administrative fees earned by EASC, and appear to have been driven by the fact that EASC's expenditures exceeded its revenues to the point that it could not meet its monthly obligations. This problem was raised as a concern by EASC's Controller, Jean Cummings, during an EASC management meeting on August 26, 2003, in which she noted in a memorandum:

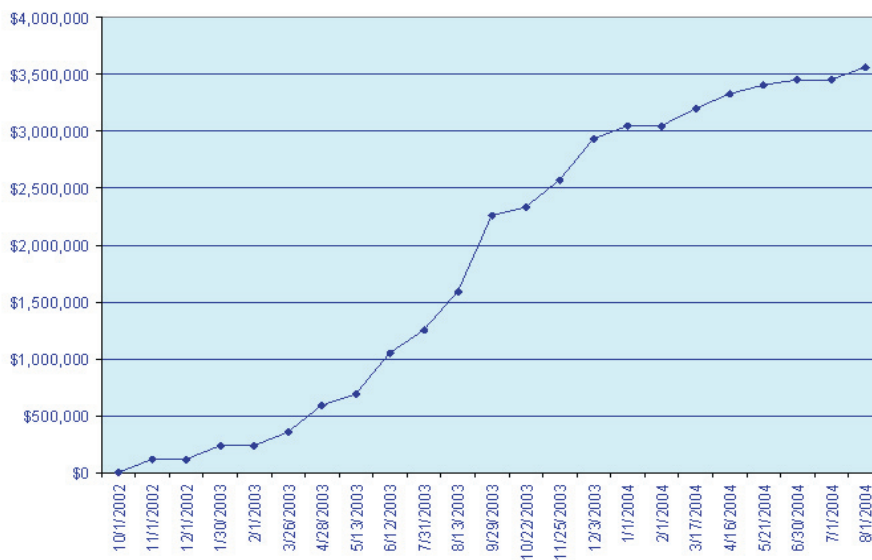
*"[The] Charters have loaned EASC in excess of \$1,295,000 for payroll since January – June 2003 above management fees and an additional \$280,000 for July and August were transferred also."*

The EASC management was repeatedly made aware of the ongoing problem but failed to take corrective action. In a follow-up memo to Mr. Cox dated January 11, 2004, Ms. Cummings reiterated her concerns, stating:

*"Revenues for the charters are more than sufficient to cover expenditures that would be used for charter activity only. However, there is continuous [expenditures] that are not providing any cost benefit for the CCA and EASC entities that the charters have been funding with advances to EASC."*

As shown in Exhibit 6B, the frequency and cumulative amount of the unauthorized transfers grew rapidly. In a six-month period between May 2003 and December 2003, the cumulative amount grew from a little more than \$500,000 to just under \$3 million.

**Exhibit 6B**  
**Pattern of Unauthorized Transfers From CCA to EASC**



The audit team also found that 22 of the 37 unauthorized transfers were deposited directly in EASC's payroll accounts. The dates of the advances into EASC's payroll accounts are typically around the middle and end of the month, which coincides with EASC's payroll cycle. The audit team believes this is an indication that EASC routinely spent more than it earned and therefore had to rely on unauthorized transfers of CCA funds in order to have sufficient funds to pay its own payroll.

## **EASC Payroll Grew Faster Than Attendance of the CCA Charter Schools**

EASC's payroll grew dramatically from FYs 2000-01 to 2003-04, at the same time the CCA charter schools were growing. However, the audit team found that EASC's total payroll grew faster than the enrollment of the CCA charter schools, contributing to a cash shortage for EASC. For example, EASC's total payroll grew from \$2.1 million in FY 2001-02 to \$3.7 million in FY 2002-03 (72 percent), while ADA grew by just 29 percent during the same time period. Another indication that EASC's growth in payroll was not connected to the growth in ADA is illustrated by EASC's payroll cost per ADA. EASC's total payroll divided by ADA claimed in FY 2000-01 equaled \$381 per ADA claimed. That figure grew to \$458 per ADA in FY 2003-04, indicating that EASC's total payroll was growing faster than the growth in ADA.

The majority of these transfers from the CCA bank accounts were placed in EASC's payroll accounts just before payroll was due to be paid to EASC employees. In addition, the number of unauthorized transfers as well as the dollar amounts transferred increased beginning in FY 2002-03.

The increases in EASC's payroll also coincide with a major change in the way in which EASC handled the unauthorized transfers from the CCA bank accounts. As of June 30, 2002, EASC had repaid the CCA charter schools for any unauthorized use of CCA funds. However, beginning in FY 2002-03, when EASC's payroll increased dramatically, it no longer repaid the CCA charter schools for all of the funds inappropriately transferred from their accounts. As noted earlier, by August 2004, EASC owed the CCAs \$3.5 million for unauthorized transfers that it never repaid.

Finally, the audit team found some significant growth in salaries as illustrated by the salary history of Mr. Cox. According to EASC's payroll records, Mr. Cox's EASC salary increased from \$54,000 for the last six months of 1999 to a high of \$472,000 for calendar year 2002. Exhibit 6C provides Mr. Cox's salary history from 1999 through 2003. (Please see next page.)

**Exhibit 6C**  
**1999-2003 Pay History for Steven Cox**

Entity	Year	Salary/ Vacation	BONUS/ ADVANCE <sup>a</sup>	402B/401K/ CAR ALLOWANCE <sup>b</sup>	Total Paid
CCA #262	1999 <sup>c</sup>	\$24,000	\$30,000	—	\$54,000
CCA #262/ EASC	2000	112,260	10,000	\$5,807	128,067
EASC	2001	152,495	158,580	6,500	317,575
EASC	2002	225,775	246,515	—	472,290
EASC	2003	140,944	73,903	—	214,847
Total					\$1,186,779

a Some of these advances/bonuses were intended to cover Mr. Cox's personal American Express charges and the resulting increase in taxes, as discussed in this chapter.

b Mr. Cox received a car allowance in 2000 prior to purchasing an EASC company car. The allowance stopped in April 2000.

c CCA #262 started in July 1999, so Mr. Cox's salary for the calendar year 1999 only reflects six months of pay.

## **EASC Engaged in Excessive Spending for Purposes Unrelated to the Programs or Needs of the CCAs**

Because EASC did not repay the \$3.5 million of unauthorized transfers from the CCAs' account, the audit team reviewed EASC's expenditures to determine whether the additional funds were used for charter school purposes. During the course of the review, the audit team identified a large dollar amount of expenditures that were unrelated to the goods and services required under the contract between CCA and EASC. Because these funds were not authorized by the CCA board, the expenditure of the \$3.5 million by EASC is an inappropriate use of the CCA funds. Moreover, the nature and amount of these expenditures help explain why EASC consistently spent more than it earned. Examples of EASC's excessive spending include rapid growth in EASC's payroll, credit card charges for personal travel and purchases, generous allocation of company paid vehicles, funding noncharter school businesses through EASC, and expensive banquets. The unauthorized transfer of funds taken from the CCAs by EASC ultimately contributed to the financial instability and closure of the CCA schools. EASC's spending is discussed in more detail in the following sections.

### **American Express Charges**

EASC granted corporate American Express credit card privileges to 13 of its employees. American Express charges for this two-year period totaled approximately \$1.5 million. The transactions of two employees were particularly noteworthy due to the magnitude and nature of the charges. Specifically, Mr. Cox compiled a total of \$712,813 in American Express charges from June 2001 to December 2003. In addition, Mr. Honeycutt compiled a total of \$295,565 within a 24-month period.

For example, over a six-month period of time, Mr. Cox's charges to his corporate American Express card included, among others, the following charges:

- \$42,639 in U.S. income tax payments.
- \$11,080 in Disney-related merchandise and art.
- \$9,173 in charges at the Disneyland Health Spa.
- \$8,124 in shop-at-home/television shopping purchases.
- \$3,155 for tickets to a rock concert.

The EASC accounting department identified approximately \$69,000 of Mr. Cox's American Express charges from 2001 as personal rather than business related. Mr. Cox's personal American Express charges were later reclassified as a "bonus" and added to his 2001 salary, so that he did not have to reimburse the corporation for paying his charges.

Similar to Mr. Cox, Mr. Honeycutt's American Express transactions were often quite significant and did not appear to be related to educational purposes. Some of Mr. Honeycutt's significant purchases charged over a three-month time frame included but were not limited to:

- \$18,000 for two jet skis.
- \$5,726 at the Point Loma Sport Fish San Diego Sporting Goods Store.
- \$3,487 at the Wheels and Tires Outlet.
- \$1,942 at a Guitar Center.

These are merely a few examples from the \$1.5 million charged to EASC corporate American Express credit cards that do not appear to be related to charter school administration.

### **EASC Company Cars and Car Stipends**

EASC utilized funds earned or transferred from CCA to provide generous perks to key EASC employees and to Cox family members. These included the use of company cars, gas charge cards, and vehicle stipends. At some point between March 2002 and July 2004, there were at least 12 EASC and/or CCA employees who were recipients of an EASC funded vehicle, as shown in Exhibit 6D. Six of the 12 were members of Mr. Cox's family. (Please see next page.)

**Exhibit 6D**  
**Recipients of EASC-Funded Vehicles <sup>a</sup>**

Assigned Driver	Auto Year/Make/Model	Gas Card Privileges
<i>Related to Steven Cox:</i>		
Steven Cox	2002 Cadillac Escalade	Yes
Steven Cox/Janet Cox (Wife)	2001 Ford Excursion	Yes
Dawn Cox (Daughter-in-Law)	2000 Dodge Durango	No
Dawn Cox (Daughter-in-Law)	1999 Ford 250 Lift Gate	No
Marc Cox (Son)	2001 Dodge Durango Truck	Yes
Peggy Baker (Sister-in-Law)	2000 Dodge Durango	No
<i>Not Related to Steven Cox:</i>		
Joe Andreasen	2002 Lincoln LS Sedan	No
Mike Davis	2002 Audi TT Roadster	No
Michael Klink	2000 Pontiac Grand Am	Yes
Mike Lacey	2001 Chrysler Sebring	Yes
Mike Flood	2001 Ford Expedition	Yes
Ron Moser	1996 Chevrolet Astro Van	No
Unassigned	1997 GMC Cargo Van	N/A

Source: The CCA and EASC Master Vehicle List.

<sup>a</sup> This list of automobiles is notable both due to the number and expense. One former CCA board member reported in an interview that when he resigned from the board to become an EASC employee, he was told by Mr. Cox that EASC would pay for him to drive the car of his choice.

In addition to these automobiles, the Vehicle Master List also includes vehicles for Mr. Honeycutt (a 2002 Ford 150) and Ron Moser (a 2002 Audi 4D) with a notation that these cars were related to Maniaque (see subsequent section of this chapter. However, the audit team was unable to confirm that EASC held the titles to these cars.

Although the audit team could not locate the original purchase documents, the EASC general ledger indicated that the outstanding loans on the vehicles totaled \$260,500. The actual amount spent to acquire the vehicles is likely greater than the outstanding loan balances. The EASC financial records indicate that EASC payments for vehicle loans totaled at least \$8,300 per month.

### **EASC Funded Non-CCA School Business Ventures**

The original intent of EASC was to provide administrative services to charter schools. However, in its second year of operation, EASC began to diversify and venture into non-school-related businesses. The EASC spent significant amounts of money on operating expenses, staffing, and assets for a company started by an EASC employee.

In December 2002, Mr. Honeycutt, an EASC employee, formed a company known as Maniaque Management Group, Inc. (hereafter referred to as Maniaque). The officers of Maniaque were all key EASC employees, as follows:

- Tad Honeycutt—CEO (also Vice President of Corporate Development for EASC).
- Karen Mitchell—Chief Financial Officer (also EASC employee).
- C. Steven Cox—Director/Authorized Signatory (also CEO of EASC and all CCA charter schools).
- Barbara Flood—Secretary (also EASC corporate secretary).
- Mary Williams—Authorized Signatory (also EASC administrative assistant to Mr. Cox).

In January 2003, Maniaque assumed control of Everything For Schools and its subsidiaries: Hautlab Music Group, Xtreme Motor Sports, and Maniaque Marketing. Of the three EFS subsidiaries, only Maniaque Marketing provided school-related services. The variety of services offered by each of the EFS subsidiary companies is illustrated in Exhibit 6E.

**Exhibit 6E<sup>a</sup>**  
**Services Offered by Maniaque Management Group**

Entity	Services Offered
<b>Maniaque Marketing</b>	Commercial and political marketing materials design and printing services. Screen printing and embroidery. Grant writing. Charter school development expansion, Incentive Revenue Arizona, other states and international.
<b>Xtreme Motor Sports</b>	Web site sales of lithographs. Racetrack sales of lithographs. Design and printing of race track programs and marketing materials. Television sales of lithographs.
<b>Hautlab Music Group</b>	Hautwire Magazine advertising sales. Hautlab merchandise sales. Hautlab clothing sales. Concert ticket revenues. Compact disc sales. Sale of artists. Meeting services for bands not on the Hautlab label.
<b>Maniaque Development</b>	Land Sales Homes Sales

Initially, Mr. Cox, as CEO of EASC, and Mr. Honeycutt, as CEO of Maniaque, signed an agreement whereby EASC agreed to pay Maniaque’s rent and monthly facility-related expenses for a period of three years. The agreement also stated that EASC would provide Maniaque with vehicles, furniture (both existing and new), computers, a new copier, and a phone system; EASC would “lease” its employees to Maniaque.<sup>4</sup> The EASC would also provide American Express credit card privileges to Mr. Honeycutt and Karen Mitchell.

The arrangement changed slightly in January 2004 when Mr. Honeycutt ceased to be an EASC employee and registered a new corporation named Maniaque, Inc., in Nevada. A new agreement was executed between Mr. Cox and Mr. Honeycutt whereby they agreed to dissolve the California-based Maniaque company, have EASC pay all outstanding debts, and allow Mr. Honeycutt to take all the assets and property to the new Maniaque corporation.

As shown in Exhibit 6F, EASC paid approximately \$549,000 for Maniaque expenses between January 2003 and July 2004. This amount does not include the salaries of approximately 23 EASC employees who were “leased” to Maniaque, and who generated an average payroll of \$35,000 per month for EASC.

**Exhibit 6F**  
**Maniaque Expenses Paid by EASC**

Category	Amount
Rent	\$78,539
Electricity	9,972
Gas	2,324
Telephones	12,071
Cellular Phones	37,280
Internet Service	8,659
Xerox	39,891
American Express Charges	127,433
Hautlab <sup>a</sup>	98,602
General contractor	58,551
Furniture maker	31,786
Other	43,869
<b>Total</b>	<b>\$548,977</b>

<sup>a</sup> The audit team found checks written directly from EASC to Hautlab totaling \$98,602; however, there are indications that EASC spent even more on the record company. For example, several of the charges on Mr. Honeycutt’s EASC American Express bill (such as the Guitar Center charges identified in Section 4.1 of this chapter) appear related to Hautlab. Similarly, Mr. Honeycutt’s automotive-related American Express charges could have been connected to the Xtreme Sports business venture. The audit team did not have access to Maniaque’s accounting records and thus could not confirm the nature or use of those purchases.



As discussed in Chapter 4, Steven Cox and Tad Honeycutt also entered into contracts to have Maniaque provide grant consulting services to the CCAs. Finally, Chapter 7 of this report discusses Steven Cox's agreement to advance \$278,000 of American Public Agency Authority (APAA) funds to Mr. Honeycutt and Maniaque for marketing services.

### **Banquets**

EASC held the annual CCA awards banquets at Disneyland in April 2002 and May 2003. The estimated cost of the 2002 awards banquet was \$66,000 and the estimated cost of the 2003 awards banquet was \$89,000. However, it is highly likely that banquet costs far exceeded this amount. Travel and resort costs were the responsibility of the travelers, but the invitation stated that CCA program directors may choose to reimburse expenses for their employees.

All employees on CCA direct and indirect payroll were invited to the awards banquets, along with current and former CCA board members, EASC employees, and other CCA/EASC affiliates including legal counsel. The banquet, reception, dinner, and dancing were free of charge to all attendees and their guests and considered a "staff in-service."

The audit team located a Disneyland Resort invoice charging EASC for 690 dinners. The total invoice from the Disneyland Resort for banquet facilities, food and beverages, audio-visual equipment, valet parking, resort tickets, and lodging at the hotel totaled close to \$56,000. In addition, Mr. Cox's American Express bill carried approximately \$33,000 in additional charges related to this event, most of which were Disneyland Hotel and/or health spa charges. Ultimately, EASC paid at least \$89,000 related to the May 2003 awards banquet.

These expenses are significant not only because of their sizeable sum, but also because the 2003 banquet took place at the same time EASC was experiencing cash flow problems and was unable to meet its payroll obligations. The audit team found nine unauthorized transfers from various CCA bank accounts to EASC payroll accounts from May to September 2003 totaling \$1.3 million. Thus, while EASC spent at least \$89,000 to hold an awards banquet at Disneyland, CCA funds were illegally transferred to fund EASC's payroll.

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## Chapter 7: EASC Misappropriated APAA Funds

### APAA Background

In December 2001, the CCA charter schools formed a joint powers authority (JPA). A JPA is a public agency formed by two or more government agencies for a common purpose. The JPA formed by the CCA charter schools was the American Public Agency Authority (APAA), and its stated purpose was to pool resources and jointly establish, operate, maintain, and fund a self-insurance plan. The APAA's pooled insurance offerings included a liability package, workers' compensation, and health care. As with other entities associated with the CCA charter schools, Mr. Cox was the CEO and controlled all of APAA's financial transactions.

The APAA board was comprised of persons affiliated with the CCA charter schools including Jimmy Melton and Francis Beatty, who served on other CCA boards, and Ken Larson, Superintendent of the OGESD. Mr. Cox and several EASC staff, including his daughter-in-law Dawn Cox, carried out the daily operations of APAA.

In addition to the CCA charter schools, 12 other charter schools became affiliate members of APAA and purchased either the liability package and/or workers' compensation insurance as shown in Exhibit 7A.

### Exhibit 7A APAA Members

Charter Name	Start Date	Workers' Compensation	Liability Package	Health Care
<b>Founding Members</b>				
CCA #262	11/02	✓	✓	✓
CCA #297	11/02	✓	✓	✓
CCA #377	11/02	✓	✓	✓
CCA #387	11/02	✓	✓	✓
<b>Affiliate Members</b>				
Albor	04/03		✓	
Aurora	11/02	✓	✓	
CAVA-Kern	11/03		✓	
CAVA-Jamestown	11/03		✓	
CAVA-San Diego	11/03		✓	
Creative Arts	01/04	✓	✓	
Discovery <sup>a</sup>	11/03		✓	
Excelsior	07/04	✓	✓	
Explorer <sup>a</sup>	11/03		✓	
Guidance	07/04	✓		
High Desert	07/04	✓	✓	
Mattole	09/03		✓	

<sup>a</sup> Discovery and Explorer were EASC charter schools based in Arizona.

The audit team found that EASC misappropriated a significant portion of APAA funds on a variety of questionable consulting contracts and personal expenditures. The APAA ultimately was forced to close and the CCA charter schools, affiliate member charter schools, and their employees were left without insurance coverage for which the charter schools had already paid.

### **APAA Received A Significant Amount of Cash in an Eight-Month Period**

In the eight-month span from December 2003 to July 2004, APAA received a total of \$1.6 million in cash from a variety of sources. As shown in Exhibit 7B, the cash that flowed through APAA came from three primary sources:

- Insurance payments from the CCA charter schools and other member charter schools.
- Financing of the insurance policies from Desert Community Bank.
- Improper transfer of funds from the CCA charter schools' bank accounts to the accounts of APAA.

### **APAA Inflated the Cost of its Insurance Coverage**

One source of funds for the APAA was the periodic insurance payments from its member agencies. One would expect that APAA would charge its member agencies rates sufficient to recoup the cost of the insurance coverage plus a modest mark-up to cover APAA operating costs. However, the audit team found that APAA inflated the costs of insurance to its members by significant margins. For example, APAA paid the insurance company \$5,589 for Albor's charter school liability package, yet charged Albor \$16,958 for the same policy. Likewise, APAA paid the insurance companies \$10,745 for workers' compensation and liability package policies for the Creative Arts charter school, yet charged Creative Arts \$22,530 for those same policies.

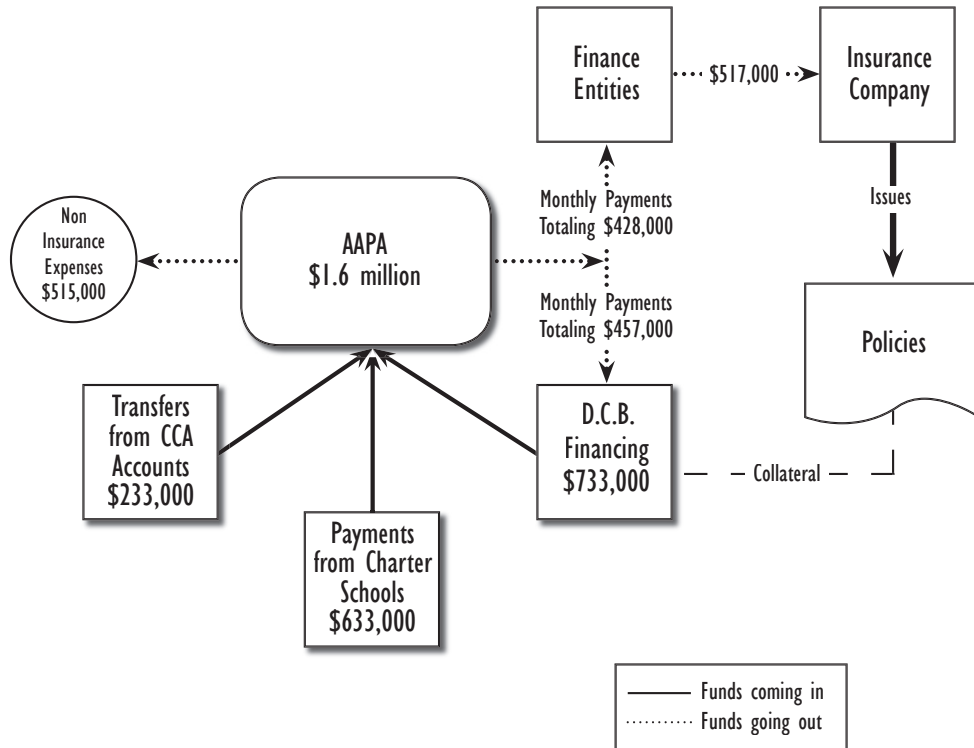
### **Dual Financing of Insurance Policies**

Another source of funds for the APAA was the proceeds from bank loans. Starting in November 2003, Mr. Cox coordinated a complicated funding scheme in which APAA essentially financed the same policies twice. The APAA did not have the cash to make the advance payment of \$517,000 in premiums to the insurance carriers. As shown in Exhibit 7B, APAA arranged to purchase the policies through two financing entities. The APAA agreed to make monthly payments to the two financing entities.

A consultant to APAA prepared insurance proposals for each participating member indicating the coverage provided and the members' inflated premium amount. The members made payments to APAA according to the terms and rates specified in their insurance proposals.

The periodic payments that APAA received from its member agencies should have been sufficient to cover the APAA’s payments to the financing entities. However, for reasons that are not clear, Mr. Cox decided to seek additional loans for APAA.

**Exhibit 7B  
Illustration of APAA’s Funding Mechanism**



Based on the information presented in the insurance proposals, Desert Community Bank loaned APAA \$733,000. Thus, APAA knowingly financed the same insurance policies twice: first through the financing entities and second through Desert Community Bank. The fact that APAA insurance proposals reflected inflated rates for its member agencies allowed APAA to borrow \$733,000 against insurance policies that cost APAA only \$517,000. The net result was a significant influx of cash that exceeded the APAA’s immediate cash demands.

**Transfer of Funds from the CCA Charter Schools**

The California State Constitution prohibits any public entity from making any gift of public money or thing of value to any individual, municipality, or other corporation whatsoever. Education Code Section 47633(c) states that public funds may be used for any public stated purpose authorized by the governing board of the charter school. Finally, Penal Code Section 424 addresses misappropriation of public funds and states that a person

charged with the receipt, safekeeping, transfer, or disbursement of public monies that loans or appropriates public monies to his or her own use or to the use of another is punishable by imprisonment in the state prison for two to four years.

The third major source of funds for the APAA came directly from the CCA charter schools' bank accounts. The EASC inappropriately transferred \$233,000 from the CCA charter schools' bank accounts to APAA. As with the other transfers of funds discussed earlier in this report, EASC did not seek or receive the approval of the CCA boards to transfer the funds to the APAA. Moreover, there is no supporting documentation describing the purpose of the transfers. Thus, the transfer of funds from the CCA charter schools to APAA without CCA board approval appears to be a misappropriation of funds.

### **Questionable Uses of APAA Funds**

The APAA generated excess cash through inflated insurance rates, a bank loan, and through transfers of funds from the CCA charter schools. Rather than repay the financing entities in full with the influx of funds it received, APAA continued to make monthly payments to the financing entities and Desert Community Bank. The APAA used approximately \$515,000 of the remaining funds for its daily operations and for a series of questionable contracts and expenditures. None of the APAA contracts or expenditures reviewed by the audit team were approved by the APAA board. Thus, the use of APAA funds for questionable contracts and expenditures that were not reviewed and approved by the APAA board may constitute misappropriation of funds. The questionable contracts and expenditures are discussed in more detail in the following paragraphs.

### **Questionable Marketing Contracts**

On January 1, 2004, Mr. Cox, as CEO of APAA, and Mr. Honeycutt, as CEO of Maniaque, signed a four-year contract in which Maniaque was to provide marketing services to APAA including "identifying, contacting, recruiting, and procuring members." The contract stated Maniaque was to receive 10 percent of the payments due APAA from new members actually procured. Just five days later, Mr. Cox and Mr. Honeycutt executed an addendum to this contract in which APAA agreed to advance to Maniaque \$195,000 in a series of payments. In actuality, APAA advanced a total of \$278,000. The APAA board was not made aware of the contract signed by Mr. Cox and Mr. Honeycutt nor was it asked to approve the contract at the time of execution.

Approximately seven months after the Maniaque contract was signed and the \$278,000 was advanced to Maniaque, Mr. Honeycutt brought the contract to the APAA board for approval at the last board meeting in August 2004. Given the poor financial condition of APAA, the board pulled all the action items from the agenda including the Maniaque contract. The APAA was closed shortly thereafter and Maniaque never repaid the unearned advance.

There is evidence that Maniaque conducted some marketing services in which it sent interest survey forms to charter schools. Approximately 30 charter schools responded by returning the forms and requesting more information. Of those leads, Maniaque successfully recruited one new affiliate member, for which APAA received payment of \$7,045. Thus, Maniaque only earned \$700 of the \$278,000 advanced per the contract terms. Although the terms of the agreement with Maniaque required the repayment of any unearned advance, Maniaque has not repaid any portion of the advance to APAA. As a result, the advance payments paid to Maniaque by EASC using APAA funds may constitute a gift of public funds and/or a misappropriation of public funds.

Another contract for marketing and recruitment services was awarded to Paul David Barrish in November 2002. The contract terms stated Mr. Barrish would be paid \$5,000 per month for a period up to one year, retroactive to July 2002. Until November 2003, the EASC paid Mr. Barrish a total of \$85,000, because APAA did not have any funds at the time the contract was signed. The APAA later reimbursed EASC for the payments to Mr. Barrish. The APAA paid an additional \$35,000 directly to Mr. Barrish between December 2003 and July 2004, even though his contract had expired.

The audit team did not find any evidence that Mr. Barrish recruited any of the 12 APAA affiliate members. However, there is evidence that Mr. Barrish was involved in the APAA health insurance offering and performed some noninsurance-related services for EASC. Nonetheless, the audit team questions whether the \$120,000 paid to Mr. Barrish for services outside the scope of his expired contract is a proper use of APAA funds and in the best interests of its members. Moreover, because the APAA board did not approve the contract or expenditures, the payments may constitute a misappropriation of funds.

### **Questionable Expenditures**

In addition to the marketing contracts, the audit team found approximately \$157,000 in other questionable or inappropriate expenditures. These expenditures appear to have benefited EASC, Mr. Cox or his associates rather than the members of APAA. None of these expenditures were approved by the APAA board and therefore may constitute a misappropriation of funds.

For example, Mr. Cox wrote himself a \$2,500 check for expense reimbursements although no supporting documentation was provided to justify the amount. In another example, APAA paid \$1,800 so that Mr. Honeycutt's company could exhibit at a charter school conference, even though APAA had already begun advancing the \$278,000 to Maniaque.

Three other questionable expenditures pertain to instances where APAA funds were passed through other entities in order to pay expenses that did not relate to APAA business. For example, in February 2004, APAA wrote a \$25,000 check to CCA #377 without board approval or any supporting documentation to justify the amount. On the same day, CCA #377

paid \$25,000 to a nonprofit organization associated with one of the school sites. According to Jean Cummings, CCA controller, Mr. Cox had given the APAA check to EASC accounting and instructed the subsequent payment from CCA #377 to the organization. It appears that APAA funds were used to make a payment that did not benefit APAA or its members.

Also in February 2004, Mr. Cox instructed EASC accounting to write two APAA checks totaling \$132,000 to CCA #387 and then write a check from CCA #387 to EASC. Like the other pass-through scenario, the APAA checks did not have board approval or any supporting documentation to justify the amounts. In actuality, EASC accounting used \$12,000 to reimburse CCA #387 for expenses related to the Hesperia school construction project and only transferred \$120,000 to EASC.

According to the EASC general ledger, the \$120,000 passed through CCA #387 was used to reimburse EASC for several questionable expenditures, including the \$85,000 for Paul David Barrish mentioned previously, \$30,000 in American Express charges by Mr. Cox, \$13,000 in legal fees and property taxes, \$3,000 to Disneyland Resort, and other miscellaneous expenses. While the legal fees and property taxes are likely related to APAA business, the American Express statements reflect more questionable spending by Mr. Cox. These charges included another \$27,000 in lodging, food, and health spa services at Disneyland, of which \$12,000 was charged over a weekend during March 2003 and \$9,300 was charged in just one day at the end of that same month. It does not appear that these charges provided any benefit to the APAA or its members.

Another Disneyland-related expenditure was paid directly by APAA in February 2004. In this instance, APAA paid \$4,400 in lodging for Mr. Cox, his wife, son, daughter-in-law, sister-in-law, brother-in-law, and two representatives from Arthur J. Gallagher, APAA's insurance broker, to stay the weekend at the Grand Californian Hotel in Disneyland. In response to an audit inquiry, the two insurance representatives stated that during a meeting at the Story Tellers Café restaurant at the Grand Californian Hotel, Mr. Cox invited them and their families to spend the weekend at the hotel, which they did although they were not aware that APAA was paying for the stay.

The last example pertains to a pass-through of \$3,500 in APAA funds between Mr. Cox, Jeff Gibson, and another consultant. On January 5, 2004, APAA wrote a \$3,500 check to the National Association of Independent Charter Schools (NAICS) with a description of annual dues. All but one of the officers and board members of NAICS were affiliated with EASC or the CCA charter schools as shown in Exhibit 7C. (Please see next page.)



**Exhibit 7C**  
**Officers and Board Members of NAICS**

NAICS Officers	
President	Steven Cox
Vice President	Gloria Reyes
Clerk/Treasurer	John Malone
NAICS Board Members	
Steven Cox	George Runner
Gloria Reyes	Chuck Gehrke
John Malone	Eric Woolery (ex-officio)

The \$3,500 APAA check to NAICS was signed by Jean Cummings and Mr. Cox. Three days later, the check was deposited by Mr. Cox as Director of NAICS into a new Desert Community Bank account. That same day, Jeff Gibson of Occidental Communications wrote a check from the new NAICS bank account to his own company for the same amount. There was no other activity in the NAICS bank account and the February bank statement indicated the account was closed. Furthermore, the audit team could not find any evidence that NAICS was ever a viable entity.

According to Mr. Gibson, the NAICS funds were transferred to him so that his company could pay an invoice to Julia Willis-Leon for coordination of a NAICS conference in Las Vegas that was never held. Mr. Gibson provided a copy of a check dated January 9, 2004, from his company to Ms. Willis-Leon for \$3,500. It is unclear why the funds were passed through various entities in this fashion. Nonetheless, this expenditure provided no apparent benefit for APAA or its members and could constitute misappropriation of funds.

### **APAA Forced to Close**

With the combination of its noninsurance related expenditures and the monthly financing payments to the financing entities and the bank, APAA soon experienced cash-flow problems. By the end of June 2004, APAA only had \$7,000 in its bank account. Nonetheless, APAA had arranged to secure health insurance for the CCA charter schools starting in July. The APAA did not have sufficient funds to pay the \$295,000 premium to Kaiser for medical insurance and did not inform the CCA charter schools about the situation. Ultimately, the charters closed before they became aware of the status of the health insurance and the fact that their employees were left without coverage for the months of July and August.

The APAA board meeting on August 2, 2004 was the first record of the APAA board being provided any financial information. At the meeting, EASC's chief operating officer, Mike Davis, told the board that Desert Community Bank had frozen all bank accounts, including the APAA account. APAA board member Francis Beatty was not present at the meeting,

as he had resigned the day before. After the meeting, Ken Larson also resigned from the APAA board. The next day, the chair and only remaining board member, Jimmy Melton, approved any activity for the sale of the Hesperia school to be transacted by Mike Davis and/or Jean Cummings (contracted controller for EASC and the CCA charter schools). Mr. Melton then resigned from the APAA board.

Just two days later, on August 5, 2004, Desert Community Bank negotiated a grant deed in lieu of foreclosure with Mike Davis and Jean Cummings as the appointed representatives of APAA. The transaction transferred the Hesperia school site to Desert Community Bank in exchange for release of \$4 million borrowed by CCAs #387 and #377 for their lines of credit and the school construction loan.

Subsequently, Desert Community Bank sold the school to a local school district for \$4.1 million even though the property was appraised at \$4.7 million in January 2003 and the total cost of the Hesperia land, school construction, furniture and equipment was \$5.9 million. Given the amount invested in the property and the appraised value, it is not clear whether transferring the property to Desert Community Bank was proper and in the best interests of APAA and the CCA charter schools.

In September 2004, the workers' compensation and liability package policies for APAA were canceled for nonpayment of the financing agreements. Since the CCA charter schools and the remaining three affiliate members only paid a portion of their contributions due to APAA, the early cancellation of the policies did not impact them financially. However, as shown in Exhibit 7D, nine of the 12 affiliate members lost approximately \$181,000 because they paid APAA for coverage they ultimately did not receive. (Please see next page.)

**Exhibit 7D**  
**APAA Member Loss Summary Due to Early Cancellation**  
**of Insurance Policies**

Charter Name	Coverage Paid	Coverage Received	Lost Premiums
<b>Founding Members</b>			
CCA #262	43%	75% - 83%	-----
CCA #297	51%	75% - 83%	-----
CCA #377	43%	75% - 83%	-----
CCA #387	43%	75% - 83%	-----
<b>Affiliate Members</b>			
Albor	100%	83%	\$7,522
Aurora	100%	75% - 83%	2,616
CAVA – Kern	100%	83%	2,952
CAVA – Jamestown	100%	83%	338
CAVA – San Diego	100%	83%	1,872
Creative Arts	50%	75% - 83%	0
Discovery	26%	83%	0
Excelsior	100%	0%	128,484
Explorer	26%	83%	0
Guidance	100%	0%	7,045
High Desert	100%	0%	23,961
Mattole	100%	83%	5,966
<b>Total</b>			<b>\$180,756</b>

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## Chapter 8: Conflicts of Interest and Inadequate Oversight Contributed to the Failure of the CCA

### Some CCA Board Members May Have Had Legal and Ethical Conflicts of Interest

California Government Code and CCA board policy prohibit CCA board members, officers, and employees from participating in decisions and transactions that constitute a conflict of interest. A conflict of interest arises when a board member, officer, or employee is in a position to influence a decision from which he or she could benefit personally. Specifically, Government Code Section 1090 states that: “Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity. As used in this article, “district” means any agency of the state formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries.”

In addition, Government Code Section 87100 states that: “No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.”

All four CCA boards adopted a conflict of interest policy that subjects its board members, officers, and employees to the provisions of the State’s conflict of interest laws. That bylaw states that “... the Governing Board members and designated employees shall not engage in any employment or activity which is inconsistent with, or incompatible with the board member’s duties as an officer of the school. Public officials of the CCA shall comply with the requirements of the Political Reform Act of 1974 as set forth in Government Code Section 87100 et seq. which is incorporated herein by reference. “Public officials” includes every member, officer, employee or consultant as defined, that makes, or is involved in making, governmental decisions.”

In addition to legal conflicts of interest, there are also ethical conflicts of interest. An ethical conflict of interest can be defined as a situation in which a person has an interest sufficient to appear to influence the objective exercise of his or her duties. The test of an ethical conflict of interest is to determine whether the situation is likely to interfere or appear to interfere with the independent judgment one is supposed to show as a professional performing his or her duties.

Some CCA board members had or developed legal and/or ethical conflicts of interest during their tenures on the CCA boards that could have influenced their decisions and the depth of their oversight. The following are examples of the potential conflicts of interest involving CCA board members that were identified by the audit team.

Gloria Reyes served on the boards of #262 and #297. Ms. Reyes is also the CEO of Abrazar, a community-based organization that received \$4.6 million of funding from CCA #262 and #297. Ms. Reyes served on the boards of #262 and later #297 at the same time her program was receiving funding through those charters. Thus, Ms. Reyes was in a position to make decisions on budgets for the various programs offered through #262 and #297 while at the same time being the recipient of those funds as the CEO of Abrazar. Other board members such as Jimmy Melton and Andrew Delgado were eventually asked to resign from the boards that oversaw their own programs. That was not the case with Ms. Reyes.

The audit team also found that Ms. Reyes' sister, Rosa Elena Ortega, served as the program director of the Abrazar program. The CCA reimbursed Abrazar \$3,000 to \$4,000 per month for the salary of Ms. Ortega. At the same time, Ms. Ortega was also included on the CCA payroll where her salary ranged from \$3,400 to \$3,700 per month. In essence, the CCA was paying the salary of Ms. Ortega twice each month. These duplicate payments spanned at least two and one-half years during which Gloria Reyes served on the CCA boards and served as CEO of Abrazar.

Jimmy Melton was the program manager for a program under #262 and also served on the #262 board for over one year, but eventually stepped down to avoid the potential conflict of interest of overseeing his own program. However, Mr. Melton continued to serve on the boards of #377, #387, and the APAA. Therefore, he continued to participate in decisions that would affect Mr. Cox and EASC, who could in turn affect decisions related to Mr. Melton's program. Another concern about a potential conflict of interest relates to Mr. Melton using his connection with Mr. Cox to obtain a position for his wife at EASC.

JoAnn Almond served on all four CCA boards from their inception until their closure. During her tenure on the boards, there arose three situations that constituted potential conflicts of interest. Ms. Almond accepted a \$250 political contribution from EASC while serving on the CCA boards. Furthermore, Ms. Almond also sold her family business to EASC for \$160,000. Ms. Almond and her husband received a down payment and Mr. Cox signed a security agreement stating that EASC would pay Ms. Almond and her husband approximately \$2,300 per month for five years until the balance was fully paid. Finally, Ms. Almond's son was hired by #262, a charter that she oversaw, in October 2003.

William J. Postmus served on the #262 board from 1999 to 2000, and the #297 board from 2000 to 2001. While he was serving on the two boards, Mr. Postmus accepted \$25,450 in political contributions for his Board of Supervisors campaign from Mr. Cox and EASC.

CCA board minutes indicate that Mr. Postmus recused himself from the vote on a contract between the CCA and EASC. In addition, Mr. Postmus' father received a consulting contract with #297 during the time that Mr. Postmus served on that charter's board.

Ed Scott served on the board of #377 from May 2001 to March 2003. During this time period, the company for which he served as president received a consulting contract with the other three CCA charter schools for a total of \$21,000. In addition Mr. Scott accepted an in-kind political contribution from EASC for his State Assembly campaign while he sat on the board of #377.

### **Some Board Members Served in Incompatible Offices**

Potential conflicts also arose when CCA board members served concurrently on multiple CCA boards. The common law doctrine of "incompatible offices" restricts the ability of public officials to hold two different public offices simultaneously if the offices have overlapping and conflicting public duties. Moreover, CCA Bylaw 9270 states that no board member shall simultaneously occupy another public office where there exists a potential conflict or overlap in the functions or responsibilities of the two offices.

The fact that all of the CCA charter schools were managed by EASC and that the CCA charter schools' finances and activities were closely connected to one another increased the potential that a decision made by one CCA board could affect another CCA. Thus, if a board member sat on boards of multiple CCA charter schools that could be affected by a single decision, the board member would have to prioritize the interests of one of the CCA charter schools over another.

For example, the audit team found an instance in which one CCA board took formal action to authorize the transfer of funds to another CCA. Specifically, on August 26, 2002, the CCA #377 board voted to transfer \$1.1 million to CCA #387 for reasons that are not clearly stated in the board minutes. Board member Jimmy Melton moved the motion to transfer the funds, board member JoAnn Almond seconded the motion, and they and board member Francis Beatty voted in favor of the transfer. These same three board members comprised the entire board of CCA #387, the recipient of the funds. In such a case, a board member sitting on both boards could not simultaneously represent the best interests of both charter schools and the situation would therefore constitute incompatible offices.

As shown in Exhibit 8A, of the 24 individuals that the audit team identified as having served as CCA board members at some time, seven board members served concurrently on more than one CCA board. (Please see next page.)

**Exhibit 8A**  
**Concurrent CCA Board Membership**

Name	#262	#377	#297	#387
Francis Beatty	✓	✓	✓	✓
JoAnn Almond	✓	✓	✓	✓
Jimmy Melton	✓	✓		✓
Beth Donnan	✓	✓		
Eric Swanson	✓	✓	✓	
Gloria Reyes	✓		✓	
Bill Postmus Jr.	✓		✓	

### **Inadequate Oversight by the CCA Boards**

The audit team found that the CCA boards did not proactively review and/or approve contracts and expenditures made by EASC using CCA funds. The CCA’s board policy AR 3000(b) states that: “The governing board also wishes to give close scrutiny and due consideration to each and every financial operation of the school so that it may fully discharge its legal responsibilities in regard to school finance.” Despite the wishes expressed in this board policy, each of the CCA boards entered into a contract granting EASC the authority to maintain CCA bank accounts and issue checks. In addition, CCA board policy AR 3000(b) provides the CEO (EASC) with the authority to approve all contracts entered on behalf of the CCA charter schools.

While most school boards review and approve contracts and expenditures exceeding a certain dollar amount prior to execution, the CCA boards mostly relied on reviewing lists of expenditures after the fact. The CCA boards were provided reports from the accounting system that listed all of the invoices or checks during a given time period. These reports would contain hundreds of payee names and expenditure amounts that board members were expected to review and approve after funds had already been expended. As detailed in the previous chapters in this report, the audit team identified dozens of instances of questionable uses of CCA funds that were neither identified nor questioned by the CCA boards. A review of the CCA board minutes identified few instances in which a CCA board member questioned an expenditure or contract.

The services agreements for CCA #262, #297, and #377 did require two board members to sign any check or electronic transfer to EASC and one board member to sign any check or electronic transfer in excess of \$10,000. The contract for CCA #387 does not require board member signatures for any expenditure. While requiring board member signatures for certain expenditures is a mitigating control, it does not equate to the same level of oversight as prior review and approval by the entire board. The audit team found several instances in which electronic transfers to EASC were not signed by CCA board members as required by the contract. Finally, the audit team found that those checks and transfers that were signed by board members were most often signed by one of the same group of



three board members. The CCA Board Bylaw 9010 states that an individual board member has no individual authority and that individual board members may not commit the charter school to any policy, act, or expenditure. Thus, the signature of one or two board members on a check or transfer in excess of \$10,000 does not constitute review or approval by the CCA board.

Another audit team concern is the CCA boards' lack of scrutiny over the CCA's financial position. CCA board policy AR 3000(a) states that the governing board responsibilities include, among other things, considering reports of the financial condition of the charter. The audit team found that the CCA boards were provided with periodic financial reports for review and approval. The board minutes indicate few instances in which a budget or financial report was discussed in a timely manner or explored in detail. For example, the independent audit report for CCA #387 for FY 2002-03 was signed by the auditor on January 23, 2004. That audit report was not presented to the board until four months later on May 25, 2004. The audit report showed that #387 had a general fund deficit of \$2.5 million for the year. Furthermore, the audit included a "going concern" note, indicating that the auditors noted that CCA #387 was at risk of financial insolvency. The board minutes do not indicate that this issue was questioned or discussed in detail by the board. Close scrutiny of the finances of the CCA charter schools, even when presented with information that should have triggered significant concern, discussion, and action, was not found.

The boards were also hampered by EASC staff members that were allegedly unresponsive to the CCA board members. While the vast majority of expenditure reports presented to the CCA boards were approved without comment or question, board minutes did note some instances in which board members requested more detailed information or questioned expenditures. In interviews, some board members stated that they were frustrated that they could not get the information they needed to make informed decisions. For example, board member Donnan, who sat on the boards of #262 and #377, stated that she could not get the information she felt she needed and that she felt she had no rights or authority as a board member to force the EASC staff to provide the information.

In another example, board member Scott, who served on the board of #377 for approximately two years, stated that he felt that things were hidden from board members, and that the board was never provided with answers for some of the issues he questioned. He also stated that EASC staff were clearly irritated with his questions and that it appeared that EASC wanted a "rubber stamp board." Mr. Scott resigned from the board when Mr. Cox offered him a job working for EASC.

## Oversight by the Authorizing School Districts

Prior to January 1, 2004, school districts that authorized charter schools received little direction from the California Education Code as to their responsibilities for overseeing the schools they chartered. Although the responsibilities of a chartering agency were not clearly articulated in law, Section 47613 of the California Education Code allowed a chartering agency to charge for the actual costs of supervisory oversight, not to exceed 3 percent of the revenue of the charter school unless a Memorandum of Understanding or contract exists for specific additional services with associated costs. As a result, school districts like Snowline, Oro Grande ESD, and Orange USD that chartered the CCA charter schools had to determine the nature and extent of their oversight activities.

Assembly Bill 1137, enacted in October 2003, provided new oversight requirements for school districts authorizing charter schools. Specifically, Section 47604.32 was added to the California Education Code, to read: “Each chartering authority, in addition to any other duties imposed by this part, shall do all of the following with respect to each charter school under its authority:

- (a) Identify at least one staff member as a contact person for the charter school.
- (b) Visit each charter school at least annually.
- (c) Ensure that each charter school under its authority complies with all reports required of charter schools by law.
- (d) Monitor the fiscal condition of each charter school under its authority.
- (e) Provide timely notification to the department if any of the following circumstances occur or will occur with regard to a charter school for which it is the chartering authority:
  - (1) A renewal of the charter is granted or denied.
  - (2) The charter is revoked.
  - (3) The charter school will cease operation for any reason.
- (f) The cost of performing the duties required by this section shall be funded with supervisory oversight fees collected pursuant to Section 47613.”

These provisions did not affect the CCA chartering authorities of Orange USD, Snowline, and Oro Grande ESD until the last eight months of CCA charter schools’ existence because Section 47604.32 did not become effective until January 1, 2004.

Each of the three districts entered into agreements with the CCA charter schools that provided their district with 3 percent of the respective charter school’s revenues. Because the CCAs did not always pay the chartering authorities for their oversight fees, the actual revenues provided to these districts by the CCA charter schools ranged up to \$373,000

per year. The audit team found that as part of the activities funded by these revenues, the districts attempted to provide some degree of oversight to the CCA charter schools.

The Superintendent of Oro Grande ESD stated that the law did not specify what was required for oversight and that his district focused its oversight efforts on the quality of education. This statement had some validity prior to the passage of AB 1994 and AB 1137.

The Superintendent of Snowline stated that his district was not “in the money loop” and that in his opinion the district had no oversight responsibility for charter school finances. Nevertheless, the chartering districts did have some insight into the finances of the charter schools. For example, representatives from the chartering districts were often present at the CCA board meetings where the CCA charter schools’ finances were discussed, albeit at a high level. In addition, the chartering districts received the audited financial statements each year. These financial statements contained information that could have raised questions about the financial activities of the CCA charter schools and EASC. As noted earlier, the independent audit report for CCA #387 for FY 2002-03 showed that #387 included a going concern note and showed a general fund deficit of \$2.5 million for the year. However, there is no indication that OGESD raised any concerns about the deficit.

In another example, the audited financial statements for FY 2002-03 showed that EASC owed #377 over \$755,000. The Superintendent of #377’s authorizing district, Snowline, stated that the financial statements were presented to his board but he does not recall seeing that EASC borrowed money from #377. He added that he would not be concerned about this as long as the funding was accounted for.

In interviews, the superintendents of the authorizing districts expressed frustration with the undefined oversight responsibilities and their inability to take corrective action should problems be identified. Specifically, the Superintendent of Snowline noted that the charter school funds flowed from the state to the county and the charter school rather than through his district. Therefore, the district did not have the ability or authority to withhold funds from the charter school if it noted unsatisfactory practices. He also stated that the only formal corrective action available to him was to revoke the charter.

In response to questions from the audit team, the legal counsel for Orange USD stated that oversight efforts included the following:

- Designation of a district employee as liaison to the charter school.
- Participation in CCA #297 board meetings.
- Receipt and review of CCA #297 board agendas/minutes.
- Receipt and review of audit reports and other mandated reports.
- Receipt and review of annual budgets and interim reports.

- Receipt and review of documentation from CCA #297 external auditors verifying the attendance accounting system and procedures.
- Receipt and review of STAR Certification of Compliance and related testing forms.
- Receipt and review of state testing information, test reports and files and school site data collection forms.
- Review of performance standards in accordance with Education Code Section 47607 as amended by AB 1137.
- Review of independent study program and CCA #297 SB 740 determination.
- Correspondence to State regarding inaccuracies in CCA #297 SB 740 submittals.
- Participation in meetings with charter school personnel regarding various aspects of programmatic and financial operations.
- Visitation of charter school site.
- Investigation of charter operations.
- Request and review of public records from various county offices of education to review funding issues.
- Investigation of charter vendor relationships.
- Investigation of Steven Cox and his interests in EASC.
- Evaluation of legal requirements of charter school and CCA compliance therewith.
- Study session by district board regarding charter school laws and regulations.

As discussed in Chapter 1 of this report, OUSD began investigating CCA and Mr. Cox in the spring of 2003 for potential violations of the Political Reform Act and conflict of interest laws for his dual role as CEO of the CCA charter schools and EASC. The OUSD also investigated CCA for an illegal private school conversion. On April 16, 2004, the OUSD sent the CCA a notice to cure or face revocation related to the conflict of interest and illegal private school conversion issues. Because CCA #297 failed to demonstrate cure within the time allotted, OUSD proceeded toward revocation of the CCA charter #297.

## Chapter 9: The Effects of EASC’s Misuse of the California Charter Academy Funds

### Effects of EASC Spending on CCA Charter Schools’ Expenditures

As discussed in Chapter 3, each charter paid EASC between 8.5 percent and 25 percent for administering the CCA, fees that were significantly higher than the 2 percent to 7 percent typically charged by other charter school management companies. Furthermore, as discussed throughout this report, EASC allocated significant amounts of CCA funding to other purposes such as political consultants and lobbyists, questionable engagements with vendors whose contracts did not require defined deliverables, and fund transfers between the charters and EASC without CCA board approvals.

One effect of EASC directing so much of CCA’s funding to these administrative and service costs is that the charters had less money to spend on their teachers and program staff. Each CCA spent notably less on personnel and significantly more on services and operating expenses than was typical of school districts in California. Exhibit 9A summarizes major categories of CCA expenditures for 2002-03 and compares them to the average expenditures of California school districts.

**Exhibit 9A**  
**Comparison of CCA and Average of California School District Expenditures 2002-03<sup>a</sup>**

Expenditures	CCA #262	CCA #297	CCA #377	CCA #387	Elementary Districts	High School Districts	Unified Districts
Certificated Nonmanagement Salaries	34%	28%	23%	17%	45%	42%	45%
Administrator Salaries	5	7	4	3	6	5	5
Classified Nonmanagement Salaries	13	16	10	13	13	15	14
Benefits	13	15	10	9	16	15	16
Subtotals, Personnel Expenses	64%	66%	47%	43%	80%	78%	80%
Books & Supplies	8%	9%	6%	6%	5%	5%	5%
Services & Other Operating Expenses	22	24	24	28	9	9	9
Capital Outlay	1	1	1	22	1	1	1
Other Outgo	5	1	22	0	6	7	4

<sup>a</sup> Reported as percentage of total expenditures and other outgo.

As shown in Exhibit 9A, the CCA charter schools devoted significantly less of their resources to teaching than the average California school district. For example, teachers' salaries are reflected in the line entitled "Certificated Nonmanagement Salaries." Whereas the average California school district devoted somewhere between 42 percent and 45 percent of its expenditures to teachers' salaries, the CCA charter schools only devoted between 17 percent and 34 percent of their expenditures to this purpose.

Exhibit 9A also shows that the CCA's administrative and other overhead costs are much higher than the average California school district. For example, administrative fees paid to EASC, consulting expenses, and other nonteaching-related expenses are captured in the line entitled "Services & Other Operating Expenses." Whereas the average California school district devoted approximately 9 percent of its expenditures to this category of expenses, the CCA charter schools devoted between 22 percent and 24 percent of their expenditures to these purposes.

Exhibit 9B compares two of the CCA's actual expenditures to what their expenditures would have been if they were consistent with the average California unified school district. As shown in Exhibit 9B, CCA #387 only spent \$4.2 million on teachers' salaries shown in the "Certificated Nonmanagement Salaries" line, whereas the average school district would have spent \$11 million given the same amount of total expenditures. Thus, the average California school district would have spent nearly \$7 million more on teachers' salaries than CCA #387. The CCA #387 funds that were not spent on teachers' salaries were instead spent on administration and capital outlay. Whereas the average California school district would have spent \$2.2 million on administration and other overhead costs captured in the category of "Services & Other Operating Expenses," CCA #387 spent \$7 million, a difference of \$4.8 million. The CCA #387 also had significant capital outlay expenditures during FY 2002-03 accounting for another \$5.4 million. While the CCA charter schools spent significantly less on teachers, they did spend more than the average school district on books and supplies. (Please see next page.)

**Exhibit 9B**  
**Difference Between CCA Actual Expenditures and Average Unified School District Expenditures, 2002-03**

Expenditures	Average of Unified Districts	CCA #262 Expenditures			CCA #387 Expenditures		
		Actual	Using Average District percentages <sup>a</sup>	Difference	Actual	Using Average District percentages <sup>a</sup>	Difference
Certificated Nonmanagement Salaries	45.05%	\$1,914,863	\$2,526,315	(\$611,452)	\$4,223,846	\$11,170,294	(\$6,946,448)
Administrator Salaries	5.22	276,035	292,727	(16,692)	833,459	1,294,316	(460,857)
Classified Nonmanagement Salaries	13.98	639,328	783,971	(144,643)	3,201,190	3,466,387	(265,197)
Benefits	16.09	734,947	902,296	(167,349)	2,320,559	3,989,568	(1,669,009)
Subtotals, Personnel Expenses	80.34%	\$3,565,173	\$4,505,309	(\$940,136)	\$10,579,054	\$19,920,565	
Books & Supplies	5.38%	\$473,382	\$301,700	\$171,682	\$1,604,720	\$1,333,989	\$270,731
Services & Other Operating Expenses	9.06	1,234,871	508,067	726,804	7,065,967	2,246,457	4,819,510
Capital Outlay	0.83	38,377	46,545	(8,168)	5,428,560 <sup>b</sup>	205,801	5,222,759
Other Outgo	4.39	296,000	246,183	49,817	117,025	1,088,515	(971,490)
Totals	100.00%	\$5,607,803	\$5,607,803	\$0	\$24,795,326	\$24,795,326	

a The audit team multiplied the percentage of expenditures from the average of California's unified school districts by the CCA's

b Capital Outlay for CCA #387 includes construction costs of the Hesperia School site mentioned in Chapter 6.

c Totals may not total due to rounding.

Table 9B is consistent with assessments conducted by CDE and the State Board of Education, which found that the CCA charter schools allocated fewer resources to personnel and instruction than the levels required to receive full state charter school funding under SB 740 regulations. According to SB 740 legislation, nonclassroom-based charter schools can only be fully (100 percent) funded if (1) their certificated staff compensation equals or exceeds 50 percent of total public revenues, (2) their percentage of total revenue spent on instruction and student services equals or exceeds 80 percent, and (3) the charter school's pupil-teacher ratio is equal to or less than the pupil-teacher ratio of the largest unified school district in the county or counties in which the charter school operates. As shown in Exhibit 9C, none of the three CCAs with nonclassroom-based instruction qualified to receive 100 percent funding in 2002-03. (Please see next page.)

**Exhibit 9C**  
**2002-03 SB 740 Funding Determination Criteria**

Expenditures	State Requirement <sup>c</sup>	CCA #262	CCA #297	CCA #377
Certificated Employee Compensation <sup>a</sup>	≥ 50%	28%	19%	21%
Instructional Costs <sup>b</sup>	≥ 80%	58%	71%	57%

a As a percentage of total public revenue.

b As a percentage of subtotal revenue (total revenue excluding prior year's ending balance).

c Required in order to receive 100 percent funding allocation.

In both 2002-03 and 2003-04, the two years the CCA charter schools operated after implementation of SB 740, SBE funded the three CCAs with nonclassroom-based programs at only 70 percent.

That the charters spent so much on services and operating costs meant that they had fewer resources available for personnel and instruction. Anecdotal evidence supports this finding. Multiple CCA program managers reported that their programs did not have enough funds to purchase books or supplies or were not reimbursed for purchasing necessary supplies. Some CCA board members also stated that they heard complaints from programs that were experiencing problems with obtaining supplies and/or reimbursements.

### Effects of CCA Closure

The ultimate closure of the four charters had a significant impact on the CCA's students, teachers, and staff. In August 2004, students and staff were notified that CCA programs would not be reopening later that month. Students under the age of 19 had a short time frame to find new school placements before the school year began, a challenge made even more difficult by delays in locating student files. Similarly, teachers and staff looking to find new employment are still experiencing delays in locating a CCA-affiliated entity that could provide them the evidence of past employment necessary to attain a new position or unemployment benefits, and to determine due credit for vacation, sick leave, and retirement. Sorting out health insurance coverage and claims was also a significant issue for CCA employees, and several individuals experienced costly problems or procedures after CCA's coverage had lapsed.

The impacts that resulted from CCA's closure were experienced by more than just CCA students and employees. When CCA closed, the APAA joint powers authority was also discontinued; thus, the other member charter schools were left without the insurance coverage for which they had already paid. Other entities impacted by the charters' closure included the various CCA oversight bodies. The chartering districts, county offices of education, and the State Department of Education have all had to contend with the logistical and financial repercussions of the CCA's closure. The extent and final outcome of these effects have not yet been fully determined.



## Effects on CCA Students

The dates on which each CCA closed varied by charter, ranging from July 28 to August 11, 2004. Thus, most CCA students found out about the school closures in mid-August. While this was likely an inconvenience for all CCA students, it was especially problematic for students under the age of 19, who needed to immediately find a place in another California elementary or secondary school to begin the 2004-05 academic year. The number of minors displaced by the CCA closure varied by charter, as summarized by Exhibit 9D, and totaled approximately 4,500 students.

**Exhibit 9D**  
**Number of Minors Displaced by CCA Closure**

Student Grade Level	CCA #262	CCA #297	CCA #377	CCA #387
Kindergarten	13	0	37	242
1 <sup>st</sup>	8	10	24	232
2 <sup>nd</sup>	18	8	29	231
3 <sup>rd</sup>	17	5	22	211
4 <sup>th</sup>	14	16	28	201
5 <sup>th</sup>	17	14	17	218
6 <sup>th</sup>	25	20	22	255
7 <sup>th</sup>	21	19	35	271
8 <sup>th</sup>	37	15	30	233
9 <sup>th</sup>	91	80	242	269
10 <sup>th</sup>	113	60	289	169
11 <sup>th</sup>	85	52	222	117
12 <sup>th</sup>	28	16	104	5
Totals by Charter	487	315	1,101	2,654
Grand Total				4,557

Source: Former CCA Registrar and Manager, Student Records/Attendance.

The CDE took the lead in coordinating with the charter school associations, county office of education, and districts to assist students and families with new school placements. Students and schools were challenged to begin the school year without having immediate access to their student files or transcripts. This was most problematic for students in grades 9 through 12 who needed official transcripts to receive credit for courses they had taken and be placed at proper class levels at their new schools.

The CCA program managers were instructed to sort and box student record files, including official transcripts, for collection. However, because the CCA offices closed at the same time as the programs, there were no official CCA employees left to retrieve the files and transport them from the program sites. Some former CCA employees volunteered their time and

vehicles for this purpose, but file retrieval from most programs did not begin until after the chartering districts took over the task, approximately two weeks after CCA's closure.

The task of obtaining student records from certain programs was further complicated by landlords who were still owed lease funds from CCA and were therefore reluctant to relinquish any property left behind, including files. This was despite the fact that in August 2004 the State Superintendent of Public Instruction issued a subpoena to aid the districts in collecting student records. According to the individual tasked with overseeing student files for Snowline and OGESD, the majority of student files were not all accounted for and collected by the chartering districts until several months after the closure. Even then, files from certain programs were still missing or incomplete; for example, as of the end of November 2004 only 85 percent of CCA #387's student files had been obtained by the chartering district.

Not only did it take some time for the files to be gathered in a central location, the closure of the CCA administrative offices also meant that there were few individuals available to respond to student file requests. Because of the large number of displaced students, the CCA and district offices were inundated with calls requesting files and transcripts, at one point reaching a volume of approximately 200 to 500 calls a day. Both the two consultants hired by two of the authorizing districts to respond to these requests and the superintendent of one chartering district referred to the task of collecting and processing student records as "overwhelming." It took several weeks for the districts to obtain the files and arrange sufficient staffing levels to begin to respond to these requests. In the words of the former CCA Registrar and Manager of Student Records and Attendance (Registrar), "the timing was horrible because the students needed to get in school and in many cases they needed those records, and one or two people just couldn't handle the volume of the requests."

Additionally, many of the former CCA high school students found that the credits received from CCA were not readily accepted at other schools due to a combination of missing or incomplete transcripts, lack of accredited standing, and/or little to no documentation that the CCA charter schools were meeting California state content standards.

### **Effects on CCA Teachers and Staff**

Like CCA students, CCA staff also learned of the charters' closing in early-to-mid August, leaving them little time to find new positions elsewhere before the beginning of the 2004-05 school year. In fact, many CCA employees were unable to find a new position in a timely fashion. As of mid-November 2004, 334 CCA employees had filed unemployment claims with the state Employment Development Department. One of the consultants helping to respond to former CCA employees' requests reported anecdotal evidence that many employees also resorted to cashing in their retirement system contributions in order to supplement their incomes while they are unemployed, which will affect their retirement earnings in later years.

Similar to those difficulties experienced by students needing their records and transcripts, CCA employees also encountered difficulties in obtaining timely information as a result of the CCA and EASC administrative offices' closure. A memo from a CCA administrative staffer sent just after the last two charters closed stated that the offices were receiving an "overwhelming number of phone calls requesting information" regarding benefits and retirement credits. These requests continued at high volume throughout the next several months, as former employees attempted to attain new positions, file for unemployment benefits, and sort out their retirement and vacation pay/sick leave credit. Even after two of the chartering districts hired consultants to handle the requests for employment verification and assist in the charter closure, delays still resulted from the fact that there were no longer CCA or EASC managers on hand to sign official documents such as teacher credential renewals.

In addition to problems and inconveniences finding new jobs and settling retirement and vacation/sick leave credits, the CCA closure also left employees without health care benefits. The CCA employees were originally notified in late August that their health benefits coverage ended as of July 31, 2004. However, in mid-September it became known that some health providers actually stopped providing benefits as of July 1, 2004. The CCA employees were also left without the option of obtaining health benefits through the Consolidated Omnibus Budget Reconciliation Act (COBRA). The COBRA is supposed to give workers who lose their health benefits the right to choose to continue group health benefits provided by their group health plan for a limited period of time; in the case of CCA, however, the group health plan ceased to exist when APAA dissolved and the CCAs closed. This resulted in many employees being stuck with bills for procedures they or their dependents underwent during the period when they thought they were still covered or before they were able to arrange new coverage.

### **Effects on Oversight Bodies and Other Charters**

In addition to CCA students and employees, the closure of the charters affected other entities that were less directly involved with CCA's day-to-day operations. As discussed in Chapter 6, these include the other non-CCA charter schools that joined APAA, several of which did not receive the workers' compensation and general liability insurance for which they paid. Specifically, four APAA-member charters received only 75 percent to 83 percent of the coverage for which they paid (a loss of over \$21,000), and three charters paid over \$159,000 and received no coverage at all. In addition to these non-CCA entities, the various CCA oversight bodies also experienced effects from the closure of the four CCA charter schools. These entities included the three chartering districts, the two county offices of education, and CDE.

When the four charters and EASC closed, some entity had to assume responsibility for attending to former CCA students' and employees' immediate needs. As noted earlier, these requests

were quite significant in volume, especially in the first four to six weeks following the closures. Due to the urgency of meeting minor students' transfer needs, the chartering districts assumed much of the responsibility for the immediate tasks. Two of the three chartering districts hired five full-time consultants to oversee the collection and redistribution of student files and transcripts, organize CCA files, reconcile CCA 2003-04 finances, and respond to employee questions and requests. This was in addition to the time district staff spent addressing questions and correspondence. Furthermore, one superintendent estimated that his district spent approximately \$2,000 for travel expenses to recover student records and \$3,000 for postage to forward those records.

In addition to the issues and logistics regarding CCA student and employee needs, the CCA's closure raised the question of what entity bore responsibility for its financial assets and liabilities. While two of the chartering districts hired a consultant to "close the books" for 2003-04 and summarize the CCA's financial status at the time of its closure, it still remains unclear which entity bears financial responsibility for CCA.

The issue of the CCA's assets and liabilities is quite significant. Some of the charters' assets have gone unclaimed because of the uncertainty as to which entity bears responsibility. These include furniture, computers, copy machines, and books and materials, which were left at program sites upon their closure. As a result of nonpayments of rent, some landlords impounded what CCA programs left on the property, contributing to the uncertainty regarding the location of CCA's material assets. A summary accounting of the whereabouts and total value of CCA's assets remains undetermined and is a part of the bankruptcy proceedings. In addition, the CCA and APAA owned several pieces of property, including a school in Hesperia, a parcel of land in Barstow, and several properties purchased from the U.S. Department of Housing and Urban Development. Immediately upon the dissolution of APAA, the bank recorded a deed in lieu of foreclosure and took ownership of the Hesperia property (along with all of the material assets it contained). What will become of the other properties has not yet been determined.

In addition to its many unclaimed assets, CCA also accrued an undetermined amount of debts and liabilities. These include rents owed for CCA program sites, CCA employee vacation pay out, unpaid bills, and amounts owed to the other charters. Exhibit 9F summarizes estimated liabilities for three of the charters as of June 30, 2004. (Please see next page.)

**Exhibit 9E**  
**CCA Estimated Liabilities as of June 30, 2004**

Type of Liability	CCA #262	CCA #377	CCA #387
Accounts Payable (vendor)	\$139,366	\$341,333	\$579,969
Government Entity (state, county, district)	467,178	196,412	697,488
Employee (retirement, vacation pay)	344,300	647,913	902,447
Due to Other Funds (other CCA charter schools, EASC, APAA)	1,269,911	2,223,157	6,068,211
<b>Total</b>	<b>\$2,220,755</b>	<b>\$3,408,815</b>	<b>\$8,248,115</b>

Source: Unaudited CCA Balance Sheet, June 30, 2004.

The estimated liabilities presented in Exhibit 9E do not include the unpaid rent and bills incurred after June 30, 2004. At this time, the charter's true financial position remains unclear because CCA's total assets remain undetermined and it is uncertain how the liabilities will be settled. However, actions have been taken to answer these questions. An involuntary bankruptcy motion was filed by creditors of both EASC and CCA on December 18, 2004. An Order of Relief was granted in both cases on January 18, 2005, after which the United States Bankruptcy Court appointed Chapter 7 Bankruptcy Trustees to begin investigating the assets, liabilities, and financial affairs of EASC and CCA.

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## Chapter 10: Recommendations

In this chapter, the audit team presents recommendations to the SPI and the county superintendents drawn from the findings in this report. It is clear that the statutes and regulations in effect at the time did not prevent the abusive practices and illegalities connected with the California Charter Academy. Nor did they give clear direction to those responsible for granting CCA its charters, and for governing the charters themselves, including diligent monitoring of their financial dealings. These recommendations include policy considerations addressed to the SPI and county superintendents to decide whether these matters are best addressed in more carefully drafted charters and charter agreements, statutes, regulations, better training and direction to charter school governing boards, or a combination of the above.

### Refer Findings to Law Enforcement

The audit team identified numerous instances of potential criminal wrongdoing by individuals and firms associated with EASC and the CCA charter schools. They include:

- Transferring over \$3.9 million of funds without CCA board approval from the bank accounts of the CCA charter schools to EASC's bank accounts.
- Conflicts of interest involving EASC corporate officers and CCA board members.
- Misappropriating public funds for personal use.
- Improperly claiming at least \$23 million in ADA for school sites outside of district boundaries, private school conversions, and ineligible independent study attendance students.
- Questionable contracts, personnel actions, and expenditures using public funds.
- Providing false claims to obtain public funds.
- Income tax implications.
- Malfeasance or nonfeasance on the part of board members responsible for overseeing the CCA charter schools and APAA.

Education Code Section 42638(b) states that if the county superintendent determines that there is evidence that fraud or misappropriation of funds has occurred, the county superintendent shall notify the governing board of the school district, the SCO, the Superintendent of Public Instruction, and the local district attorney. Where appropriate, referral also should be made to the Fair Political Practices Commission with regard to conflict of interest issues and campaign contributions made by EASC and its officers.

## **Address Issues Arising from the Closure of the CCA Charter Schools**

The closure of the CCA charter schools and EASC occurred suddenly, leaving officials from the authorizing districts, county superintendents of schools, and CDE with little time to respond. As a result, there are several issues that require the attention of these entities:

- Consider a close-out financial audit for each of the four CCA charter schools for FYs 2003-04 and 2004-05.
- Recover assets from former CCA sites.
- Investigate the propriety of the seizure by Desert Community Bank of CCA and APAA assets such as the Hesperia school site.
- Submit claims to the federal bankruptcy trustee for any state charter school funds improperly claimed by and paid to the CCA charter schools.
- Work with law enforcement to seek the seizure and forfeiture of assets held by former EASC and CCA officers and staff or other individuals and firms who misappropriated funds from the CCA charter schools or APAA.
- File an involuntary bankruptcy petition for the CCA charter schools with federal bankruptcy court. The bankruptcy trustee will identify all of the CCA charter school assets and liabilities and distribute the remaining assets according to federal bankruptcy law.
- Consider pursuing civil claims against former EASC and CCA employees who are responsible for improperly claiming and receiving charter school funds. In this regard, pierce the corporate veil of EASC to reach the personal assets of that corporation, because EASC was operating as the alter ego of CCA and public funds were misappropriated by EASC officers and employees for their personal benefit.

## **Improve Oversight by Charter School Governing Boards**

Many of the issues identified in this audit could have been avoided or mitigated if the governing boards of the CCA charter schools had exercised due diligence in their oversight role. The SPI and county superintendents should consider the following:

- The responsibility of charter school boards to review and approve actions by private contractors to expend charter school funds and hire, dismiss and set salaries for charter school employees.
- The ability of charter school employers or private contractors to nominate or appoint members of a charter school's governing board.
- The need for charter school governing boards to provide advance review and approval of contracts and expenditures exceeding a certain dollar amount.



- The need for charter school board members to select the school’s auditors and receive, review, and respond to the audit reports.
- The need for charter school board members to receive training regarding their legal and fiduciary responsibilities, and to be held personally responsible for not fulfilling their fiduciary responsibilities.

### **Improve Oversight by the Authorizing Entity**

Individual school districts are the primary authorizing entity for charter schools in California. The audit team found that prior to the passage of AB 1137, which became effective January 1, 2004, the roles and responsibilities of the authorizing entity to oversee the charter schools it authorized were not well defined. As a result, the type and extent of oversight provided by the districts that authorized the CCA charter schools varied. More importantly, the oversight provided was not sufficient to identify and correct the problems that led to the closure of the CCA charter schools. California school districts vary tremendously in terms of size, resources, and capabilities. As a result, not all school districts have the same capabilities to provide oversight for charter schools they may authorize. Moreover, districts can become dependent on the administrative fees paid by the charter schools they are required to oversee. The SPI and the county superintendents should consider the following:

- The capacity of school districts to provide the requisite oversight of the charter schools they authorize.
- The desirability of having the county superintendent of schools or other oversight agency comment on or approve the financial and fiscal accountability provisions of charters and charter agreements (memorandums of understanding) before the charter becomes operational.
- Clarification of the oversight responsibilities and authority given to charter school authorizing entities.
- The desirability of having one or more voting members of a charter school’s governing board appointed by the chartering agency.
- Providing authorizing entities with clear authority to prevent fiscal mismanagement by charter schools short of charter revocation.
- Developing an audit guide for charter schools.
- Delineating the roles, responsibilities, and liabilities of an authorizing entity for those situations in which a charter school fails and/or closes.

## **Improve Controls over the Custody and Use of Charter School Funds**

Some of the issues identified in the audit are the result of a lack of traditional internal controls over the custody and use of funds. These problems were exacerbated by allowing a private corporation to have unchecked access and control over the charter school funds and the inherent conflict of interest of having the CEO of that private corporation also serve as the CEO of the charter schools. The SPI and county superintendents should consider the following:

- Specifying the circumstances under which charter school funds can be loaned or advanced to another public or private entity.
- Developing a range of appropriate administrative fees that charter schools are authorized to pay to other public and private entities.
- Opening the financial records of entities providing administrative services to charter schools for review and inspection by the charter schools, the authorizing entity, county superintendent of schools, CDE, SCO, and/or the Bureau of State Audits.
- The need for competitive bid limits to be specified in charters, memorandums of understanding or charter board policies.
- Specifying the minimum contents of a purchase order or contract issued by charter schools.
- Requiring charter schools to adopt nepotism policies.
- Requiring the charter school boards of charter schools that join a JPA to monitor that funds paid to the JPA are properly accounted for.

## **Compliance with State Laws and Regulations**

The audit found that the CCA charter schools and EASC improperly claimed at least \$23 million in charter school funds for school sites that were either outside the authorizing entities' boundaries or were illegal conversions of private schools. Moreover, the CCA charter schools had a history of noncompliance with independent study requirements. The SPI and county superintendents should consider the following:

- When significant program or fiscal concerns are identified, empowering the authorizing agency to require a compliance audit as a part the charter school's annual independent financial audit.
- Developing general closure procedures for charter schools.

## Appendix A: Legal Review

### AN OVERVIEW OF CALIFORNIA LAW APPLICABLE TO CHARTER SCHOOLS

#### I

##### PURPOSE, INTENT AND VALIDITY OF THE CHARTER SCHOOL LAW

In 1992, the Legislature passed the Charter Schools Act of 1992.<sup>1</sup> The Legislature stated that it was its intent in enacting the Charter School Law to provide opportunities for teachers, parents, pupils and community members to establish and maintain schools that operate independently from the existing school district structure as a method to accomplish improved pupil learning, increase learning opportunities for all pupils, encourage the use of different and innovative teaching methods, create new professional opportunities for teachers, provide parents and pupils with expanded choices in the types of educational opportunities that are available within the public school system, hold schools accountable for meeting measurable pupil outcomes, and provide vigorous competition within the public school system to stimulate continual improvements in all public schools.<sup>2</sup>

The validity of the Charter Schools Act was challenged in court. The Court of Appeal in Wilson v. State Board of Education<sup>3</sup> held that the Charter Schools Act does not offend state constitutional provisions requiring public schools to be under the exclusive control and jurisdiction of officers in the public school system. Nor does it offend state constitutional provisions prohibiting the appropriation of public money for the support of sectarian or denominational schools. The Court of Appeal held that the Charter Schools Act does not create a separate school system in violation of the provisions of the California Constitution requiring the Legislature to provide for a system of common schools, because charter schools are public schools. The court held that the Charter School Act's delegation of certain educational functions to parent and teachers who write the charters and operate the schools does not violate the California Constitution.<sup>4</sup>

## II

### DUTIES OF CHARTER SCHOOLS

The Charter School Law prohibits the conversion of any private school to a charter school. The Charter School Law also prohibits a charter school from receiving public funds for a pupil if the pupil also attends a private school that charges the pupil's family for tuition. The State Board of Education is required to adopt regulations to implement this requirement.<sup>5</sup>

The Charter School Law does not prohibit any private person or organization from providing funding or other assistance to the establishment or operation of a charter school.<sup>6</sup> Charter schools may elect to operate as or be operated by a non-profit public benefit corporation.<sup>7</sup> The governing board of a school district that grants a charter for the establishment of a charter school formed and organized pursuant to the Charter School Law shall be entitled to a single representative on the board of directors of the non-profit public corporation.<sup>8</sup> A school district or county office of education that grants a charter to a charter school to be operated by, or as, a non-profit public benefit corporation, is not liable for the debts or obligations of the charter school or for claims arising from the performance of acts, errors or omissions by the charter school, if the authority has complied with all oversight responsibilities required by law, including but not limited to those required by Section 47604.32 and Section 47605(m).<sup>9</sup>

A charter school is required to promptly respond to all reasonable inquiries, including, but not limited to, inquiries regarding its financial records, from its chartering authority, the county office of education that has jurisdiction over the school's chartering authority, or from the Superintendent of Public Instruction and shall consult with the chartering authority, the county office of education or the Superintendent of Public Instruction regarding any inquiries.<sup>10</sup>

### III

#### DUTIES OF CHARTERING AUTHORITY

Beginning January 1, 2004, each chartering authority, in addition to any other duties imposed under the Charter School Law, is required to do all of the following with respect to each charter school under its authority:

1. Identify at least one staff member as a contact person for the charter school.
2. Visit each charter school at least annually.
3. Ensure that each charter school under its authority complies with all reports required of charter schools by law.
4. Monitor the fiscal condition of each charter school under its authority.
5. Provide timely notification to the California Department of Education if any of the following circumstances occur or will occur with regard to a charter school for which it is the chartering authority:
  - a. A renewal of the charter is granted or denied.
  - b. The charter is revoked.
  - c. The charter school will cease operation for any reason.<sup>11</sup>

Prior to January 1, 2004, the Education Code did not contain specific authority that granted school districts the power to require charter schools to provide information to the chartering district.

The cost of performing the above duties is to be funded by the supervisory oversight fees collected pursuant to Section 47613.<sup>12</sup>

Under Section 47613, a chartering agency may charge for the actual costs of supervisory oversight of a charter school not to exceed 1% of the revenue of the charter school.<sup>13</sup> A chartering agency may charge for the actual costs for supervisory oversight of a charter school not to exceed 3% of the revenue of the charter school if the charter school is able to obtain substantially rent-free facilities from the chartering agency.<sup>14</sup> The charter school may separately purchase administrative or other services from the chartering agency or any other source.<sup>15</sup>

## IV

### ANNUAL REPORTS OF CHARTER SCHOOLS

Effective January 1, 2004, each charter school is required to annually prepare and submit reports to its chartering authority and the county superintendent of schools or if the county board of education is a chartering authority, then only to the county superintendent of schools:

1. On or before July 1, a preliminary budget. For a charter school in its first year of operation, the information submitted pursuant to subdivision (g) of Section 47605 satisfies this requirement.
2. On or before December 15, an interim financial report. This report shall reflect changes through October 31.
3. On or before March 15, a second interim financial report. This report shall reflect changes through January 31.
4. On or before September 15, a final unaudited report for the full prior year.<sup>16</sup>

The chartering authority is required to use the financial information it obtains from the charter school to assess the fiscal condition of the charter school. The cost of assessing the fiscal condition of the charter school is to be funded with the supervisory oversight fees that the chartering authority collects.<sup>17</sup>

Prior to January 1, 2004, charter schools were not required to submit these financial reports to the chartering authority.

## V

**AUTHORITY OF THE COUNTY SUPERINTENDENT AND  
STATE SUPERINTENDENT**

In addition to the authority to make reasonable inquiries to the charter school pursuant to Section 47604.3, a county superintendent of schools may, based upon written complaints by parents or other information that justifies the investigation, monitor the operations of a charter school located within the county and conduct an investigation into the operations of that charter school. If a county superintendent of schools monitors or investigates a charter school pursuant to Section 47604.4, the county office of education shall not incur any liability beyond the cost of the investigation.<sup>18</sup> The charter school is required to notify the county superintendent of schools of the county in which it is located of the location of the charter school, including the location of each site, prior to commencing operations.<sup>19</sup>

The State Board of Education, whether or not it is the authority that granted the charter, may, based upon the recommendation of the Superintendent of Public Instruction, take appropriate action, including, but not limited to, revocation of the schools charter, when the State Board of Education finds any of the following:

1. Gross financial mismanagement that jeopardizes the financial stability of the charter school.
2. Illegal or substantially improper use of charter school funds for the personal benefit of any officer, director or fiduciary of the charter school.
3. Substantial and sustained departure from measurably successful practices such that continued departure would jeopardize the educational development of the school's pupils.<sup>20</sup>

## VI

## GEOGRAPHIC LIMITATIONS

Prior to July 1, 2002, there were no geographic limitations on charter schools and charter schools could be located anywhere in the State. California Charter Academy (CCA) had 170 program sites located from 10 miles north of the Mexican border to 60 miles north of Sacramento.)

After July 1, 2002, the charter school that is granted a charter from the governing board of a school district or county office of education and commences providing educational services to pupils on or after July 1, 2002, must locate in accordance with the geographic and site limitations of Section 47605 (i.e., sites must be located within school district boundaries except under very limited circumstances).<sup>21</sup>

A charter school that receives approval of its charter from a governing board of a school district, a county office of education, or the State Board of Education prior to July 1, 2002, but does not commence operations until after January 1, 2003, is subject to the geographic limitations of Section 47605 and must be located within school district boundaries except under very limited circumstances.<sup>22</sup>

For a charter school that was granted approval of its charter prior to July 1, 2002, and provided educational services to pupils before July 1, 2002, these geographic limitations only apply to any new educational services or school sites established or required by the charter school on or after July 1, 2002.<sup>23</sup> As shown in this report, CCA appears to have violated this provision by continuing to locate new facilities outside the boundaries of its chartering authorities. For a charter school that was granted approval of its charter prior to July 1, 2002, but did not provide educational services to pupils before July 1, 2002, the geographic limitations shall only apply upon the expiration of a charter that is in existence on January 1, 2003.<sup>24</sup>

By June 30, 2005, or upon the expiration of a charter that is in existence on January 1, 2003, whichever is later, all charter schools will be required to comply with the geographic limitations for school sites (i.e., within the boundaries of the school district) at which educational services are provided to pupils regardless of whether the charter school initially received approval of its charter school petition prior to July 1, 2002. To achieve compliance with the geographic limitation requirements, a charter school will be required to receive approval of a charter petition in accordance with the petition requirements of Section 47605.<sup>25</sup>



## VII

### CONTROL OF CHARTER SCHOOLS

A charter school shall be deemed to be under the exclusive control of the officers of the public schools for purposes of Article IX, Section 8 of the California Constitution with regard to the appropriation of public monies to be apportioned to any charter school, including, but not limited to, appropriations made for the purposes of the Charter School Law. The average daily attendance in a charter school may not, in any event, be generated by a pupil who is not a California resident. To remain eligible for generating charter school apportionments, a pupil over 19 years of age must be continuously enrolled in public school and makes satisfactory progress toward award of a high school diploma.<sup>26</sup>

A charter school shall be deemed to be a school district for the purposes of Education Code sections 14000, et seq. (apportionment of state school funds), 41301 (state school funding), 41302.5 (Proposition 98 funding of schools), sections 41850, et seq. (state funding of home to school transportation), and section 8 and 8.5 of Article XVI of the California Constitution (Proposition 98 – public school funding).<sup>27</sup>

Notwithstanding any other provisions of law and as a condition of apportionment, a charter school is required to do all of the following:

1. Offer, at a minimum, the same number of minutes of instruction set forth in Education Code section 46201(a)(3) for the appropriate grade levels.
2. Maintain written contemporaneous records that document all pupil attendance and make these records available for audit and inspection.
3. Certify that its pupils have participated in the state testing programs in the same manner as other pupils attending public schools as a condition of apportionment of state funding.<sup>28</sup>

A reduction in apportionment shall be proportional to the magnitude of the exception that causes the reduction. The Superintendent of Public Instruction shall withhold from the charter school's apportionment for average daily attendance for each charter school that fails to offer pupils the minimum number of minutes of instruction required, the sum of that apportionment multiplied by the percentage of the minimum number of minutes of instruction at each grade level that the charter school failed to offer.<sup>29</sup>

A charter school that has an approved charter may receive funding for nonclassroom-based instruction only if a determination for funding is made by the State Board of Education pursuant to Education Code section 47634.2. The determination for funding shall be subject to any conditions or limitations the State Board of Education may prescribe.<sup>30</sup>

Charter school funds may only be used for public school purposes as approved by the governing board of the charter school.<sup>31</sup> As shown in this report, CCA violated these requirements.

## VIII

### INDEPENDENT STUDY

Notwithstanding any other provision of law and except to the extent inconsistent with Section 47612.5 (instructional minutes) and 47634.2 (separate funding scheme for charter schools operating independent study programs), a charter school that provides independent study must comply with all of the provisions in the Education Code for independent study set forth at sections 51745, et seq., implementing regulations, and as a condition of receiving state apportionments must do all of the following:

1. Offer, at a minimum, the same number of minutes as other schools in the public school system for each grade level as required by law.
2. Maintain written contemporaneous records that document all pupil attendance and make these records available for audit and inspection.
3. Certify that its pupils have participated in state testing programs in the same manner as other pupils attending public schools.

The State Board of Education is required to adopt regulations that apply the independent study requirements to charter schools.<sup>32</sup>

The governing board of a school district, a county office of education, or a charter school may offer independent study to meet the educational needs of pupils.<sup>33</sup> Educational opportunities offered through independent study may include the following:

1. Special assignments extending the content of regular courses of instruction.
2. Individualized study in a particular area of interest or in a subject not currently available in the regular school curriculum.
3. Individualized alternative education designed to teach the knowledge and skills of the core curriculum. Independent study shall not be provided as an alternative curriculum.
4. Continuing and special study during travel.

5. Volunteer community service activities that support and strengthen student achievement.<sup>34</sup>

A special education student may not participate in independent study unless his or her individualized educational program specifically provides for that participation.<sup>35</sup> A temporarily disabled student may not receive individual instruction through independent study.<sup>36</sup> No courses included among the courses required for high school graduation shall be offered exclusively through independent study.<sup>37</sup>

The ratio of average daily attendance for independent study pupils 18 years of age or less to school district full-time equivalent certificated employees responsible for independent study, calculated as specified by the State Department of Education, shall not exceed the equivalent ratio of pupils to full-time certificated employees for all other educational programs operated by the school district.<sup>38</sup>

A charter school, school district or county office of education shall not be eligible to receive apportionments for independent study by pupils regardless of age, unless it has adopted written policies, pursuant to rules and regulations adopted by the Superintendent of Public Instruction that include, but are not limited to, all of the following:

1. The maximum length of time, by grade level and type of program, that may elapse between the time an independent study assignment is made and the date by which the pupil must complete the assigned work.
2. The number of missed assignments that will be allowed before an evaluation is conducted to determine whether it is in the best interest of the pupil to remain in independent study or whether he or she should return to the regular school program. A written record of the findings of any evaluation made pursuant to this subdivision shall be maintained in the pupil's permanent record.
3. A requirement that a current written agreement for each independent study pupil be maintained on file including, but not limited to all of the following:
  - a. The manner, time, frequency and place for submitting a pupil's assignments and for reporting his or her progress.
  - b. The objectives and methods of study for the pupil's work, and the methods utilized to evaluate that work.
  - c. The specific resources, including materials and personnel that will be made available to the pupil.

- d. A statement of the policies adopted regarding the maximum length of time allowed between the assignment and the completion of the pupil's assigned work, and the number of missed assignments allowed prior to an evaluation of whether or not the pupil should be allowed to continue in independent study.
- e. The duration of the independent study agreement, including the beginning and ending dates for the pupil's participation in independent study under the agreement. No independent study agreement shall be valid for any period longer than one semester or one-half year for a school on a year-round calendar.
- f. A statement of the number of course credits or, for the elementary grades, other measures of academic accomplishment appropriate to the agreement, to be earned by the pupil upon completion.
- g. The inclusion of a statement in each independent study agreement that independent study is an optional educational alternative in which no pupil may be required to participate.
- h. Each written agreement shall be signed, prior to the commencement of independent study, by the pupil, the pupil's parent, legal guardian or caregiver, if the pupil is less than 18 years of age, the certificated employee who has been designated as having responsibility for the general supervision of independent study, and all persons who have direct responsibility for providing assistance to the pupil.<sup>39</sup>

A charter school may not claim state funding for the independent study of a pupil, whether characterized as home study or otherwise, if the agency has provided any funds or other thing of value to the pupil or his or her parent or guardian that the agency does not provide to pupils who attend regular classes or to their parents or guardians. A charter school may not claim state funding for the independent study of a pupil, whether characterized as home study or otherwise, if the charter school has provided any funds or other thing of value to the pupil or his or her parent or guardian that a school district could not legally provide to a similarly situated pupil of the school district or to his or her parent or guardian.<sup>40</sup>

As shown in this report, CCA did not comply with the independent study requirements.

## IX

### CONFLICT OF INTEREST

There are two important bodies of statutory law which address potential conflicts of interest of school district board members:

1. Government Code Sections 1090, et seq., pertaining to contractual conflicts of interest, and
2. The Political Reform Act of 1974.<sup>41</sup>

The conflict of interest statutes are based on the belief that a board member cannot serve two masters simultaneously and that the duties of public office demand the absolute loyalty and undivided, uncompromised allegiance of the individual that holds that office.<sup>42</sup> The purpose of the conflict of interest statutes is to eliminate temptation, avoid the appearance of impropriety and limit the possibility of improper personal influence on a board member's decisions.<sup>43</sup>

Government Code Section 1090 provides in pertinent part:

“Members of the Legislature, State, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.”

The Attorney General stated that Section 1090 was enacted to prevent “self-dealing” in contracts by public officials.<sup>44</sup>

In a 1983 opinion the Attorney General stated:

“Section 1090 of the Government Code codifies the common law prohibition and the general policy of this state against public officials having a personal interest in contracts they make in their official capacities. Mindful of the ancient adage, that ‘no man can serve two masters,’ a self-evident truth, as trite and impregnable as the ‘law of gravity,’ the section was enacted to ensure that public officials ‘making’ official contracts not be distracted by personal financial gain from exercising absolute loyalty and undivided allegiance to the best interest of the entity which they serve, and at least with respect to

those contracts, it does so by removing or limiting the possibility of their being able to bring any direct or indirect personal influence to bear on an official decision regarding them. The mechanism of the section is one of prohibiting public officials from being personally financially interested as private individuals in any such contract. ...”<sup>45</sup>

In a 1993 opinion, the Attorney General stated:

“... Section 1090 is concerned with financial interests, other than remote or minimal interests, which would prevent officials from exercising absolute loyalty and undivided allegiance in furthering the best interests of their public agencies. Moreover, when Section 1090 is applicable to one member of the governing body of a public entity, the prescription cannot be avoided by having the interested member abstain; the entire governing body is precluded from entering into the contract. A contract which violates Section 1090 is void.”<sup>46</sup>

Even if the terms of the contract might be advantageous to the public agency, Section 1090 would still prohibit entering into the contract.<sup>47</sup>

Government Code Section 1092 provides that every contract made in violation of Section 1090 may be avoided by any party except the official with the conflict of interest. Despite the wording “may be avoided,” the case law holds that any contract made in violation of Section 1090 is void, not merely voidable.<sup>48</sup>

A public officer who is found guilty of willfully violating any of the provisions of Sections 1090, et seq., is punishable by a fine of not more than \$1,000 or imprisonment in state prison.<sup>49</sup> Additionally, such an individual is forever disqualified from holding any office in this state. In People v. Honig,<sup>50</sup> the Court of Appeal affirmed the conviction of former State Superintendent of Public Instruction Bill Honig for violating Government Code sections 1090 and 1097.

The Political Reform Act of 1974 prohibits board members and management employees from participating in decisions if the board’s decision (including, but not limited to contracts) will have a material effect on the board member, the management employee or his immediate family.<sup>51</sup> Government Code section 87100 states:

“No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.”

Government Code Section 87103(c) states:

“An official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official or a member of his or her immediate family or on:

\* \* \*

(c) Any source of income, other than gifts and other than loans by a commercial lending institution in the regular course of business on terms available to the public without regard to official status, aggregating two hundred fifty dollars (\$250) or more in value provided to, received by or promised to the public official within 12 months prior to the time when the decision is made.”

However, Government Code Section 82030(b)(2) states that “income” does not include:

“Salary and reimbursement for expenses or per diem received from a state, local, or federal government agency and reimbursement for travel expenses and per diem received from a bona fide educational, academic, or charitable organization.”

Since the spouse’s salary is received from a local government agency, it does not constitute “income” within the meaning of Government Code Section 87103(c).<sup>52</sup> A regulation of the California Fair Political Practices Commission expands on this exception, as follows:

“(c) Notwithstanding subsection (a) an official does not have to disqualify himself or herself from a governmental decision if:



(1) The decision only affects the salary, per diem, or reimbursement for expenses the official or his or her spouse receives from a state or local government agency. This subsection does not apply to decisions to hire, fire, promote, demote, or discipline an official's spouse, or to set a salary for an official's spouse that is different from salaries paid to other employees of the spouse's agency in the same job classification or position."<sup>53</sup>

Since the charter schools are part of the public school system, the conflict of interest provisions would apply. As shown in this report, there were numerous instances cited in which the conflict of interest laws were ignored by CCA.

**(Footnotes)**

<sup>1</sup> The two instances in which CCA board members did sign the transfers does not constitute board approval, as two board members cannot speak for the entire board.

<sup>2</sup> For CCA charter schools that offer nonclassroom instruction, final funding determinations are based upon both ADA and additional considerations, as per SB 740, passed in 2002. These considerations include the percentage of revenue a CCA spends on instruction-related activities and certificated teacher salaries.

<sup>3</sup> The California SCO conducted an audit of the Sierra Summit Academy (SSA) and the California Honors School (CHS), which were former non-CCA schools. The SCO concluded that 13 out of 22 SSA/CHS sites were private school conversions. The audit team used the SCO's findings to determine whether there were any CCA sites that were at the same location as sites that were deemed to be Sierra Summit or California Honors private school conversions.

<sup>4</sup> Maniaque did not provide EASC with any payment in exchange for "leasing" EASC employees.

<sup>5</sup> These estimates are based on unaudited balance sheets prepared by the contractor hired by OGESD and Snowline to complete initial 2003-04 financial reports for CCA charter schools #262, #377, and #387. Preparing financial statements for CCA #297 was not included in the contractor's scope of work.

<sup>6</sup> Education Code Sections 47600, et seq.

<sup>7</sup> Education Code Section 47601.

<sup>8</sup> 89 Cal.Rptr.2d 745, 75 Cal.App.4th 1125 (1999).

<sup>9</sup> Ibid.

<sup>10</sup> Education Code Section 47602(b).

<sup>11</sup> Education Code Section 47603.

<sup>12</sup> Education Code Section 47604(a).

<sup>13</sup> Education Code Section 47604(b).

<sup>14</sup> Education Code Section 47604(c). Education Code Section 47604.32 (effective January 1, 2004) states:

"Each chartering authority, in addition to any other duties imposed by this part, shall do all of the following with respect to each charter school under its authority:

- (a) Identify at least one staff member as a contact person for the charter school.
- (b) Visit each charter school at least annually.
- (c) Ensure that each charter school under its authority complies with all reports required of charter schools by law.
- (d) Monitor the fiscal condition of each charter school under its authority.
- (e) Provide timely notification to the department if any of the following circumstances occur or will occur with regard to a charter school for which it is the chartering authority.
  - (1) A renewal of the charter is granted or denied.
  - (2) The charter is revoked.
  - (3) The charter school will cease operation for any reason.
- (f) The cost of performing the duties required by this section shall be funded with supervisory oversight fees collected pursuant to Section 47613."

Section 47605(m) states: "A description of the rights of any employee of the school district upon leaving the employment of the school district to work in a charter school, and of any rights of return to the school district after the employment at a charter school."

- <sup>15</sup> Education Code Section 47604.3.  
<sup>16</sup> Education Code Section 47604.32.  
<sup>17</sup> Education Code Section 47604.32.  
<sup>18</sup> Education Code Section 47613(a).  
<sup>19</sup> Education Code Section 47613(b).  
<sup>20</sup> Education Code Section 47613(d).  
<sup>21</sup> Education Code Section 47604.33(a).  
<sup>22</sup> Education Code Section 47604.33.  
<sup>23</sup> Education Code Section 47604.4.  
<sup>24</sup> Education Code Section 47604.4(b).  
<sup>25</sup> Education Code Section 47604.5.  
<sup>26</sup> Education Code Section 47605.1(a)(1).  
<sup>27</sup> Education Code Section 47605.1(a)(3).  
<sup>28</sup> Education Code Section 47605.1(e)(1).  
<sup>29</sup> Education Code Section 47605.1(e)(2).  
<sup>30</sup> Education Code Section 47605.1(e)(3).  
<sup>31</sup> Education Code Section 47612.  
<sup>32</sup> Education Code Section 47612(c).  
<sup>33</sup> Education Code Section 47612.5(a).  
<sup>34</sup> Education Code Section 47612.5(c).  
<sup>35</sup> Education Code Section 47612.5(d).  
<sup>36</sup> Education Code Sections 47633(c), 47634(j).  
<sup>37</sup> Education Code Section 47612.5(b).  
<sup>38</sup> See Education Code Sections 51745, et seq.; Ops.Cal.Atty.Gen. 253 (1995).  
<sup>39</sup> Education Code Section 51745(a).  
<sup>40</sup> Education Code Section 51745(c).  
<sup>41</sup> Education Code Section 51745(d).  
<sup>42</sup> Education Code Section 51745(e).  
<sup>43</sup> Education Code Section 51745.6(a).  
<sup>44</sup> Education Code section 51747(c).  
<sup>45</sup> Education Code section 51747.3(a).  
<sup>46</sup> Government Code sections 81000, et seq.  
<sup>47</sup> *People v. Honig*, 48 Cal.App.4th 289 (1996); *Thomson v. Call*, 38 Cal.3d 633 (1985).  
<sup>48</sup> *Ibid.*  
<sup>49</sup> See 66 Ops.Cal.Atty.Gen. 156, 157-158 (1983).  
<sup>50</sup> *Id.* at 157-158.  
<sup>51</sup> 76 Ops.Cal.Atty.Gen. 118, 119 (1993).  
<sup>52</sup> See *Thomson v. Call*, 38 Cal.3d 633, 645-646 (1985); *Frazer-Yamor Agency, Inc. v. County of Del Norte*, 68 Cal.App.3d 201, 214-215 (1977); 84 Ops.Cal.Atty.Gen. 158, 161-162 (2001).  
<sup>53</sup> *Thomson v. Call*, (1985) 38 Cal.3d 633; *People v. Drinkhouse*, (1970) 4 Cal.App.3d 931.  
<sup>54</sup> Government Code section 1097.  
<sup>55</sup> *People v. Honig*, 48 Cal.App.4th 289 (1996); *Thomson v. Call*, 38 Cal.3d 633 (1985).  
<sup>56</sup> Government Code sections 81000, et seq.  
<sup>57</sup> See, also 61 Ops.Cal.Atty.Gen. 412, 414-415 (1978); *Bach v. McNelis*, (1989) 207 Cal.App.3d 852, 866-67.  
<sup>58</sup> Title 2 California Code of Regulations section 18702.1(c)(1).

## **Appendix B**

### **Response to the Audit Report**

Steven Cox, as the CEO of the California Charter Academy, was provided an opportunity to review the draft report prior to its public release. Mr. Cox was also provided the opportunity to provide a written response to the audit report that was to have been appended to the audit report. Mr. Cox did not provide a written or verbal response by the deadline set by the audit team. Therefore, this audit report does not include a response to the audit report from the responsible officials.