



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE INSPECTOR GENERAL

March 9, 2010

**FINAL MANAGEMENT INFORMATION REPORT**

**To:** James H. Shelton III  
Assistant Deputy Secretary  
Office of Innovation and Improvement

**From:** William D. Hamel /s/  
Assistant Inspector General  
for Investigations

**Subject:** Charter School Vulnerabilities  
**Control Number ED-OIG/X42K0002**

This Management Information Report (MIR) supplements our July 2009 Office of Inspector General (OIG) MIR, *Fiscal Issues Reported in ED-OIG Work Related to LEAs and SEAs* (Control Number ED-OIG/X05J0005), which identified numerous pervasive fiscal issues as reported in 41 prior OIG audit reports, as well as examples of OIG investigations involving Local Education Agencies (LEA) and State Education Agencies (SEA). This MIR provides additional and more specific information about the results of our work involving charter schools. We provided you a draft of this report and your office generally agreed with our observations about the importance of providing adequate and appropriate oversight to charter schools.

As part of the American Recovery and Reinvestment Act of 2009, Congress dramatically increased LEA and SEA funding and expectations for transparency and accountability in how that funding is used. Therefore, it is important that SEAs and LEAs have adequate oversight of grants and account for how funding is used.

Since January 2002, when the Elementary and Secondary Education Act of 1965 (ESEA) was amended and reauthorized, ED-OIG has seen a steady increase in the number of allegations of fraud involving charter schools. The purpose of this memorandum is to alert you of our concern about vulnerabilities in the oversight of charter schools.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

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## BACKGROUND

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In October 2007, the OIG issued *An OIG Perspective on Improving Accountability and Integrity in ESEA Programs* (Control Number ED-OIG/S09H0007), which highlighted some of the major program vulnerabilities within ESEA programs, including a discussion of charter schools and concerns our auditors had identified with respect to them. For example, prior OIG audits identified a number of weaknesses regarding the use of Title I, Individuals with Disabilities Education Improvement Act, and Public Charter School Program funds in two States.

The July 2009, OIG Management Information Report *Fiscal Issues Reported in ED-OIG Work Related to LEAs and SEAs* (Control Number ED-OIG/X05J0005), also provided an example of fraud by a high level LEA official responsible for the oversight of charter schools.

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## CHARTER SCHOOL INVESTIGATIONS

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Since January 2005, the OIG has opened more than 40 charter school criminal investigations which have resulted in 18 indictments and 15 convictions of charter school officials. Twenty-four of these investigations are still open with criminal prosecutions being actively pursued, generally against multiple subjects in each case. Of the cases that have been fully adjudicated, OIG has secured over \$4.3 million in criminal restitution for public education funds that were embezzled. There were another 47 additional complaints received by OIG that were also preliminarily investigated, but were not opened into full investigations. There has been a steady increase in the number of charter school complaints for our office to examine.

Charter schools generally operate as independent entities that are supposed to fall under some oversight mechanism of the LEA or authorized chartering agency. However, as our investigations have found, LEAs or chartering agencies often fail to provide adequate oversight needed to ensure that Federal funds are properly used and accounted for.

The type of fraud OIG has been identifying generally involves some form of embezzlement of funds from the school by school executives or officials. The schemes that are used to accomplish this are varied but with the same result: theft of Federal, State and local education funds. We have found that charter school executives have falsely increased their schools' child count, thereby increasing the funding levels from which to embezzle. We have also identified an alleged grade changing scheme allowing failing students to pass. This would ensure that Adequate Yearly Progress was met so that the LEA allowed the school to continue its operations, thereby continuing a funding stream from which to embezzle. Another serious consequence of this type of scheme is that students who fail to meet academic standards are nonetheless advanced and thus deprived of proper educational services. We have also found schemes where owners or employees created companies to divert school funds, and the misuse of school credit cards for personal expenditures.



Below are some examples by state, of our case results dating from 2005 to the present which we previously reported in our Weekly Report to the Secretary.

### **California**

In 2007, the founder of the California Charter Academy, which has multiple locations throughout the State, a board member, and a Hesperia City Councilmen were indicted for misappropriation of public funds and grand theft. They were alleged to have stolen in excess of \$5,000,000 in funds from the now-closed charter school. The alleged thefts were discovered by a State audit into the school's private management firm, Educational Administrative Services Corporation, which revealed that millions were spent on personal expenses including spa treatments and personal vehicles. This matter is still pending a criminal trial.

### **Illinois**

In 2008, the principal at the now defunct Triumphant Charter School, located in Chicago, IL, was indicted for theft. The principal allegedly used a school American Express credit card to purchase goods and services for personal use. The principal made personal purchases at stores such as Louis Vuitton, Elan Furriers, Saks Fifth Avenue, Coach, and other stores, totaling over \$55,000. The principal then allegedly paid the American Express bill using the school's checking account which contained funds from various Federal education programs. This matter is still pending a trial.

### **Minnesota**

In 2006, the two former owners of the Right Step Academy, one of the first charter schools in Minnesota, were prosecuted for defrauding the school to help subsidize an extravagant lifestyle. The owners were sentenced to periods of incarceration and ordered to pay \$489,240 in restitution. Our investigation uncovered evidence that the owners set up a corporation to divert school funds for their personal use. The funds were used to purchase luxury cars, vacations, personal real estate, clothing, and house furnishings.

### **Pennsylvania**

In 2006, the Principal and Chief Administrative Officer of the Center for Economics and Law, located in Philadelphia, PA, was sentenced to prison and ordered to pay \$206,553 in restitution for his role in a scheme to inflate the student count of the school. He directed school employees to report students as enrolled who had actually dropped out of school or who had transferred to out-of-State or private schools. He knew that the local school district computer system could not readily track students once they left the district.

In 2008, the Chief Executive Officer and the Chief Financial Officer of the Raising Horizons Quest Charter School located in Philadelphia, PA, both pled guilty to one count each of conspiracy and alteration of records in a Federal investigation. The investigation revealed that they attempted to conceal their misappropriation of Federal education funds by altering credit

card statements prior to and in preparation for a local school district audit. They altered the credit card statements by removing or changing personal expenses, which included alcohol, and inserting charges purported to be for school-related expenses.

In 2009, both the CEO and the board president of the Philadelphia Academy Charter School (PACS) who were also both former Philadelphia police officers, pled guilty to multiple criminal counts for fraud against PACS. This investigation uncovered extensive and exhaustive fraudulent activity perpetrated against PACS by them, and by another co-conspirator who died prior to being charged. The co-conspirators misappropriated Federal, State, and local education funds by charging exorbitant rent through their non-profit entity which owned the school property. They also solicited bribes and kickbacks from contractors, purchased items for personal use, submitted false invoices, used school maintenance employees to conduct work on their personal properties, and attempted to destroy incriminating electronic evidence with the help of a computer company hired with school funds. The CEO was sentenced to 37 months incarceration and ordered to pay \$900,000 in restitution. The other co-conspirator is awaiting sentencing.

## **Texas**

In 2005, three officials of the Prepared Table Charter School located in Humble, TX pled guilty for their roles in a scheme to misreport student attendance data that allowed the school to receive more funding than that to which it was entitled. From academic years 1999 through 2002, the school received approximately \$2,566,565 in Federal funding. The former Chief Administrator was also indicted; however, he died in March 2005 prior to final adjudication.

In 2008, a former superintendent of the Texas Academy of Excellence located in Austin, TX, was sentenced and ordered to pay \$36,000 in restitution for misapplication of funds. The investigation disclosed that the former superintendent misapplied over \$500,000 in Federal and State education funds by using the funds to operate a child day care center and finance personal vehicles.

## **Wisconsin**

In 2008, the director of the New Hope Institute of Science and Technology, located in Milwaukee, WI, was sentenced to prison and ordered to pay \$200,000 in restitution for theft. The director controlled the New Hope Child Development Corp., an umbrella corporation for the charter school and a Wisconsin voucher school in Milwaukee. The investigation disclosed that the director used funds received by the charter school for personal purchases including luxury automobiles, furniture, funeral expenses, homes, vacations, clothing, extensive cash withdrawals, and other personal expenses.

The above examples of fraud in charter schools demonstrate that independent charter school operators who are recipients of Federal education funds require sufficient oversight. We believe it is vitally important for the Department to take affirmative measures to ensure that SEAs and LEAs provide adequate and appropriate oversight to charter schools that operate within their jurisdictions.



A draft of this management information report was provided to the Office of Innovation and Improvement, the Office of Elementary and Secondary Education, the Office of Special Education and Rehabilitative Services, and Risk Management Service for comment. OIG received formal comments from the Office of Innovation and Improvement who generally agreed with our observations about the importance of providing adequate oversight to charter schools. OII also expressed interest in working with OIG to learn more about the OIG investigations to assist the Department in determining how to enhance, when appropriate, its policies and monitoring processes in order to reduce or eliminate incidents of criminal and inappropriate behavior in charter schools receiving Federal funds. Their comments are attached to this report.

cc: Thelma Melendez de Santa Ana, Ph.D.  
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## UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INNOVATION AND IMPROVEMENT

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for Investigations  
U.S. Department of Education  
Office of Inspector General  
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MAR 9 2010

Dear Mr. Hamel:

Thank you for the opportunity to comment on the draft Management Information Report (MIR) supplement to the July 2009 Office of Inspector General (OIG) MIR, Fiscal Issues in ED-OIG Work Related to LEAs and SEAs (Control Number ED-OIG/X05J0005) on "Charter School Vulnerabilities" (Control Number ED-OIG/X42K0002). We appreciate the work that went to this report and the important information provided.

The Office of Innovation and Improvement agrees generally with the IG's "assertion that it is vitally important for the Department to take affirmative measures to ensure that LEAs provide adequate and appropriate oversight to charter schools that operate within their jurisdictions," to the extent consistent with the Department's administrative responsibilities under the programs it administers. It is important that charter schools have the appropriate controls and administrative structure in place and that there be appropriate oversight to help ensure that the school can carry out its important educational mission in an effective manner consistent with applicable laws. As noted below, there are some instances in which local educational agency (LEA) oversight may not always be as feasible given the variety of charter school authorizers that include organizations other than LEAs. Additionally, in some cases, in some programs such as the Charter Schools Program (CSP) grants may not go directly to LEAs, so our ability to ensure LEA oversight is somewhat limited. Indeed, many charter schools operate in states that do not receive any funds under the CSP, and in other cases, charter schools may not be receiving funds under Department programs.

We are committed to the intent and principles of the IG's assertion and believe that by working with the OIG we can receive and consider additional more specific information that would assist the Department in determining how to enhance when appropriate its policies and monitoring processes currently being implemented. This would help us assist in reducing or eliminating future incidents of criminal or inappropriate behavior in charter schools receiving Federal funds.

Beyond this general perspective and general comments, we have the following three specific comments:

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*Our mission is to ensure equal access to education and to promote educational excellence throughout the nation.*



First, the report recognizes that charter schools are independent entities that are generally under the authority of an LEA or authorized chartering agency. The six examples out of forty cited in the memo – examples involving schools in California, Illinois, Minnesota, Pennsylvania, Texas and Wisconsin – demonstrate the variety of authorizing chartering agencies present in these states that may include the following: State educational agencies (SEAs), LEAs, county offices of education, state boards of education, and universities. Receiving more information from OIG so that we can identify the authorized chartering agency that oversees the particular schools in these states would assist the Department in determining the proper measures to be undertaken in order to help ensure that there is adequate and appropriate oversight needed for appropriate accountability for Federal funds.

Second, the Department, in programs such as the CSP, primarily awards funds and monitors SEAs who in turn allocate funds to LEAs and other entities by formula or discretionary processes. The report does not specify which Department programs funds were “misappropriated” (e.g., Charter Schools Programs (CSP), Title I, IDEA, etc.). For example, if a charter school receives a CSP subgrant from a State, that particular State would bear primary responsibility for ensuring that the funds were spent properly, and there could be a recovery of funds to the Department. If misspent funds are primarily from Department programs other than the CSP, then the problems may extend beyond the schools' status as a “charter school.” We look forward to working with the OIG to receive more specific information that would identify the specific Department programs for which funds were misused. This would assist the Department in determining the necessary and appropriate corrective matters and other measures to take to ensure that charter schools are receiving adequate and appropriate oversight needed to ensure Federal funds are properly used and accounted for.

Third, the report includes investigations of misuse of both state and federal funds. As you aware, the Department generally has no direct oversight for state funds nor would it be appropriate for the Department to determine the measures a State would need to take in order to provide adequate and appropriate oversight to charter schools that operate within their jurisdictions. Charter schools are established according to individual State charter school laws. The enactment of State charter school laws is solely a State prerogative, and the definition of a “charter school” under State law is a matter of State policy. We would be glad to work with OIG and discuss examples of best practices of oversight in these areas, and key signs that might indicate that oversight is not sufficient.

Thank you for preparing this report and for your ongoing work to address incidents of waste, fraud and abuse.

Sincerely,



Margo K. Anderson  
Associate Assistant Deputy