



CSIS California School Information Services

Imperial County Office of Education

regarding the

Imagine Schools at Imperial Valley

AB 139 Extraordinary Audit

March 12, 2019

Michael H. Fine
Chief Executive Officer





March 12, 2019

J. Todd Finnell, Ed.D., Superintendent
Imperial County Office of Education
1398 Sperber Road
El Centro, CA 92243

Dear Superintendent Finnell:

In April 2018, the Imperial County Office of Education (COE) and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement to conduct an AB 139 review to determine if possible fraud, misappropriation of funds or other illegal practices at the Imagine Schools at Imperial Valley. Specifically, the agreement stated that FCMAT would perform the following:

1. Determine whether the charter school engaged in related-party transactions and, if so, whether those transactions were conducted in accordance with established national and state policies, standards and procedures and were transparent.
 - a. To the extent reasonably possible, identify related parties.
 - b. Review the charter petition and articles of incorporation and bylaws.
 - c. Review contracts, purchase orders and memoranda of understanding, for fiscal years 2015-16 through 2017-18 to date.
 - d. Review financial transactions of the charter school and any related party for fiscal years 2015-16 through 2017-18.
 - e. Review any charter property or assets transferred to any related party for fiscal years 2015-16 through 2017-18.
 - f. Review the independent audits for fiscal years ending June 30, 2014; June 30, 2015; June 30, 2016; and June 30, 2017.
2. Determine if expenditures made by the charter school are for legitimate educational purposes and in accordance with approved contracts, purchase orders and memoranda of understanding.
3. Determine whether any conflict of interest standards may have been violated by any of the charter school's local public officials, designated employees, or any "consultant to the organization who makes, participates in making, or acts

FCMAT

Michael H. Fine, Chief Executive Officer

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in a staff capacity for making governmental decisions” as defined in the Political Reform Act (PRA) of 1974 (Government Code Sections 81000 – 91014).

- a. Review applicable PA Form 700 filings from 2013 through 2018.
- b. Review applicable board meeting minutes and other documents.

The main focus of this review was to determine, based on the sample testing performed and auditor’s judgment, whether (1) the charter was involved in any related-party transactions that were in conflict with state and federal policies and standards, or that violated conflict of interest laws, and whether the charter was involved in financial transactions that were not for legitimate educational purposes; and (2) based on that assessment, determine whether fraud, misappropriation of funds or other illegal fiscal practices may have occurred.

The team reviewed and tested recorded transactions for fiscal years 2015-16 through 2017-18 to date to determine if fraud, misappropriation of funds or other illegal activities may have occurred. Testing for this review was based on a sample of transactions and records for this period. Testing and review results are intended to provide reasonable but not absolute certainty about whether the charter’s financial transactions and activity were sufficiently accurate.

This final report contains the study team’s findings and recommendations in the above areas of review. FCMAT appreciates the opportunity to serve the Imperial County Office of Education and the Imagine Schools at Imperial Valley, and extends thanks to all the staff for their assistance during fieldwork.

Sincerely,



Michael H. Fine
Chief Executive Officer

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About FCMAT

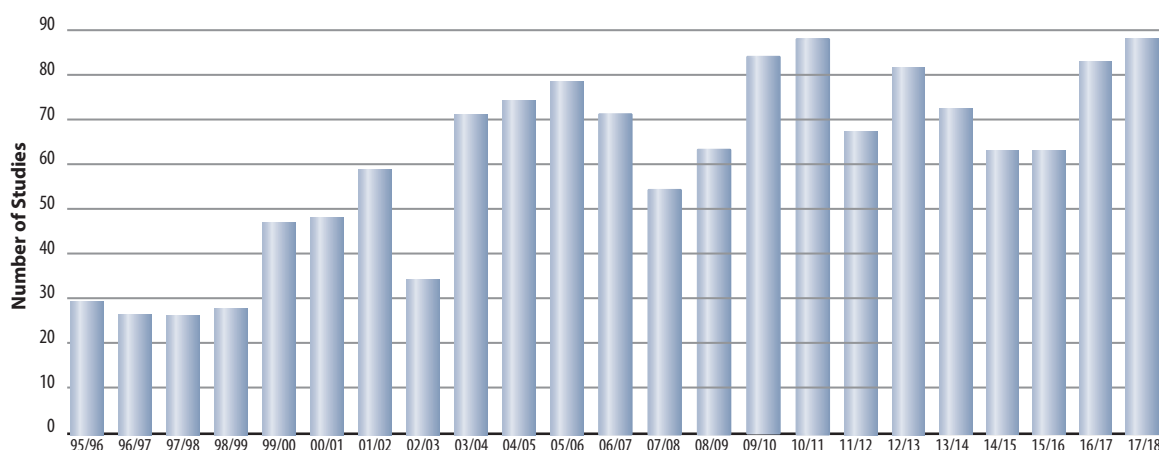
FCMAT's primary mission is to assist California's local K-14 educational agencies to identify, prevent, and resolve financial, human resources and data management challenges. FCMAT provides fiscal and data management assistance, professional development training, product development and other related school business and data services. FCMAT's fiscal and management assistance services are used not just to help avert fiscal crisis, but to promote sound financial practices, support the training and development of chief business officials and help to create efficient organizational operations. FCMAT's data management services are used to help local educational agencies (LEAs) meet state reporting responsibilities, improve data quality, and inform instructional program decisions.

FCMAT may be requested to provide fiscal crisis or management assistance by a school district, charter school, community college, county office of education, the state Superintendent of Public Instruction, or the Legislature.

When a request or assignment is received, FCMAT assembles a study team that works closely with the LEA to define the scope of work, conduct on-site fieldwork and provide a written report with findings and recommendations to help resolve issues, overcome challenges and plan for the future.

FCMAT has continued to make adjustments in the types of support provided based on the changing dynamics of K-14 LEAs and the implementation of major educational reforms.

Studies by Fiscal Year



FCMAT also develops and provides numerous publications, software tools, workshops and professional development opportunities to help LEAs operate more effectively and fulfill their fiscal oversight and data management responsibilities. The California School Information Services (CSIS) division of FCMAT assists the California Department of Education with the implementation of the California Longitudinal Pupil Achievement Data System (CALPADS). CSIS also hosts and maintains the Ed-Data website (www.ed-data.org) and provides technical expertise to the Ed-Data partnership: the California Department of Education, EdSource and FCMAT.

FCMAT was created by Assembly Bill (AB) 1200 in 1992 to assist LEAs to meet and sustain their financial obligations. AB 107 in 1997 charged FCMAT with responsibility for CSIS and its state-wide data management work. AB 1115 in 1999 codified CSIS' mission.

AB 1200 is also a statewide plan for county offices of education and school districts to work together locally to improve fiscal procedures and accountability standards. AB 2756 (2004) provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans.

In January 2006, Senate Bill 430 (charter schools) and AB 1366 (community colleges) became law and expanded FCMAT's services to those types of LEAs.

On September 17, 2018 AB 1840 was signed into law. This legislation changed the how fiscally insolvent districts are administered once an emergency appropriation has been made, shifting the former state-centric system to be more consistent with the principles of local control, and providing new responsibilities to FCMAT associated with the process.

Since 1992, FCMAT has been engaged to perform more than 1,000 reviews for LEAs, including school districts, county offices of education, charter schools and community colleges. The Kern County Superintendent of Schools is the administrative agent for FCMAT. The team is led by Michael H. Fine, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

Introduction

Background

The El Centro Elementary School District is located in Imperial Valley. The district is the authorizer of Imagine School Imperial Valley, a charter school. The charter school was originally authorized and began operations in August 2010 as a K-8 school. The district granted the charter school its first five-year renewal of July 1, 2013 – June 30, 2018 in January 2013.

Under a new superintendent at the district, in October 2017, the charter school sought a second renewal of its charter for a five-year term of July 1, 2018 – June 30, 2023. On January 31, 2018, the district denied the charter school's second renewal. In a letter dated February 16, 2018, the charter school appealed the district's denial to the Imperial County Office of Education. The charter school rebutted the district's causes for denial in a subsequent letter to the county dated February 19, 2018.

The charter school's original, first, and second renewal charter petitions describe its governance structure and provide the structural documents disclosing its relationship with Imagine Schools Non-Profit, Inc. (ISNP, Inc.) as the sole statutory member of the charter school. The charter petitions describe the charter school's national, regional, and local network roles, duties, services, responsibilities, and management structures and positions. The petitions also describe how the charter school's facilities at 1150 North Imperial Avenue, El Centro, CA were developed from a rundown unoccupied Sears department store into a 33-classroom building with a cafeteria/multipurpose room, media center, computer lab, library, offices, and other spaces.

ISNP, Inc. is the Virginia-based national headquarters or parent nonprofit for the Imagine Schools national network. The network consists of over 50 charter schools serving more than 35,000 students in 11 states. The organization also has several regional headquarters; the closest is in Arizona. The national and regional headquarters provide a vast network and array of services to the charter schools. The services include but are not limited to curriculum review and development, professional training and development, educational and operational leadership, financial and attendance accounting, compliance oversight, legal counsel services, facility acquisition, development, and leasing, risk management, human resources and benefits management, information technology development, infrastructure, program and systems implementation, maintenance, and local, regional, and national programs.

To assist charter schools in obtaining educational facilities, the national headquarters utilizes a financing limited liability company known as Schoolhouse Finance LLC. The charter school subleases its facilities at 1150 North Imperial Avenue, El Centro, CA from Schoolhouse. Schoolhouse Finance LLC leases the charter school location from Imagine 26 Partners, LLC. Imagine 26 Partners, LLC is the landlord of the facility located at 1150 North Imperial Avenue, Imperial Valley. This report determines that Imagine 26 Partners, LLC is not related to the charter school, national headquarters, or any other charter school affiliate.

While the charter school's petition for second renewal was on appeal with the county office, the district continued its own examination into the operations of the charter school. In a letter dated March 13, 2018, the district presented its findings to the county office and requested a Fiscal Crisis and Management Assistance Team (FCMAT) audit of the charter school. As part of the county office's oversight responsibilities, it requested an Assembly Bill (AB) 139 extraordinary audit of the charter school.

On April 18, 2018, FCMAT entered into an agreement with the county office for an AB 139 extraordinary audit to determine if fraud, misappropriation of funds or other illegal practices may have occurred at the charter school.

Study and Report Guidelines (AB 139 Audit Authority)

Education Code Section 1241.5(b)(c) permits a county superintendent of schools to review or audit the expenditures and internal controls of any school district or charter school in the county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. This review or audit is known as an AB 139 extraordinary audit.

The Education Code provides for a review or audit conducted by the county superintendent focused on the alleged fraud, misappropriation of funds, or other illegal fiscal practices to be conducted in a timely and efficient manner. In addition, Education Code Section 47604.4(a) states:

In addition to the authority granted by Sections 1241.5 and 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 that county and conduct an investigation into the operations of the charter school.

Because the purpose of an AB 139 extraordinary audit is to determine if fraud, misappropriation of funds or other illegal fiscal practices may have occurred, it is referred to as a fraud audit. Education Code Section 42638 (b) states that on completion of the fraud audit:

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 State Controller, the Superintendent of Public Instruction, and the local district attorney.

FCMAT focused on the allegations that the charter school was involved in undisclosed related-party transactions that were in conflict with state and federal policies and standards, or that violated conflict of interest laws, and whether the charter school was involved in financial transactions that were not for legitimate educational purposes.

In writing its reports, FCMAT uses the Associated Press Stylebook, a comprehensive guide to usage and accepted style that emphasizes conciseness and clarity. In addition, this guide emphasizes plain language, discourages the use of jargon and capitalizes relatively few terms.

Conducting a Fraud Audit

The fraud audit is conducted based on the team's experience and judgment. Fraud audits have many components including fieldwork, obtaining and examining available original source documents; when possible corroborating documents and information through third party sources; interviewing potential witnesses; gaining an understanding of internal controls applicable to the scope of the fieldwork; and assessing factors such as intent, capability, opportunity, and possible pressures or motives.

Although there are many different types of fraud, occupational fraud, including asset misappropriation and corruption, may occur when employees are in positions of trust and have access to assets. Embezzlement occurs when someone who is lawfully entrusted with property takes it for his or her personal use. Common elements in all fraud include the following:

- Intent, or knowingly committing a wrongful act
- Misrepresentation or intentional false and willful representation(s) of a material fact
- Reliance on weaknesses in the internal control structure or an individual relies on the fraudulent information
- Concealment to hide the act or facts
- Damages, loss or injury by the deceived party

Fraud Audit Fieldwork

Fraud audit fieldwork consists of gathering information and documentation pertaining to specific allegations; establishing an audit plan, interviewing potential witnesses and assembling evidence from internal and external sources; performing various audit procedures to determine whether fraud may have occurred; evaluating the loss associated with the alleged fraud; and determining who was involved and how it may have occurred. The FCMAT study team's fieldwork took place between July 2018 and January 2019.

The fieldwork focused on determining whether there is sufficient evidence to indicate that fraud, misappropriation of charter school funds, or other illegal practices may have transpired through related-party transactions specific to expenditures that were not for legitimate educational purposes and were in conflict with state and federal policies and standards, or violated conflict of interest laws.

Scope and Procedures

The audit consisted of gathering adequate information specific to the allegations, establishing an audit plan, and performing various audit test procedures to determine whether fraud may have occurred, and if so, evaluate the alleged loss and determine who was involved and how it occurred.

Investigating allegations of fraud requires several steps such as conducting interviews with potential witnesses, management, staff and others, and gathering available evidence from internal and external sources. FCMAT conducted interviews with national, regional, and local management personnel; business office personnel; school staff members; national and local independent audit firms, and the landlord. The interviews and fieldwork were designed to obtain information related to the charter school's business practices, events, contracts, and expenditures that transpired during the 2015-16 through 2017-18 fiscal years. The charter school's annual independent audits were reviewed for fiscal years ending June 30, 2014 through 2017, and Form 700 statements of economic interest were reviewed for fiscal years 2013 through 2018.

FCMAT also reviewed, analyzed and examined business records, general ledgers, purchasing activity, reimbursements, and payroll records; board policy and administrative regulations; board meeting minutes; email correspondence, contracts, audit reports, and other internal documents secured from the charter school, regional and national headquarters, and independent third-party sources.

Transaction Sampling

FCMAT developed and conducted audit procedures to analyze and evaluate the allegations and identify potential outcomes. Fraud audit scope, objectives, and substantive transaction testing was based on the audit team's experience and professional judgment and did not include the testing of all available transactions and records. The sample population is represented by the documents and other evidence and information provided by the charter school, district, and county office that were available for review as related to the study guideline objectives. The transaction sample is derived from the sample population by selecting transactions randomly and/or specifically selecting transactions based on auditor judgment.

Transactions selected were analyzed and compared with charter petition documents, board policy, administrative regulations, operational procedures and industry standard or best practice procedures. Transactions sampled were compared to contract terms, documentation of receipts for expenditures, and evaluated for proper authorizations and reasonableness based on the team's judgment and technical expertise in charter school business operations, internal controls, and accounting practices.

The total population of district transactions available for review was selected from the fiscal years beginning July 1, 2015 through June 30, 2018. Sample testing and examination results are intended to provide reasonable but not absolute assurance on the accuracy of the transactions and financial activity and/or identify if fraud, misappropriation of funds or other illegal acts may have taken place during the period under review.

The types of business records analyzed and tested at the charter school included invoices, credit card statements, receipts, travel documentation, transaction authorizations, management contracts, and other information from third parties.

FCMAT examined a total sample of 47 charter school expenditures to determine if the expenditures were for educational purposes. Of the 47 expenditures, 11 were specific to national headquarters and Schoolhouse contracts. Table 1 presents the results of the operating transactions analysis.

Table 1

| Operating Expenditures Sample Transactions | 07/01/2015 - 06/30/2018 Number | 07/01/2015 - 06/30/2018 Dollar |
|---|---|---|
| Sample Population | 5,793 | \$14,951,876.96 |
| Transaction Sample | 47 | \$1,157,390.17 |
| Percent Sampled to Total Population | 0.8% | 7.7% |
| Total Irregularities or Deficiencies | 0 | 0 |
| Entities with Substantial Contracts (Indirect Fees and Leases) | | |
| Imagine Schools, Inc. | | |
| Transaction Sample | 4 | \$153,470.32 |
| Imagine Schools Non-Profit, Inc. | | |
| Transaction Sample | 6 | \$683,825.70 |
| Schoolhouse Finance, LLC | | |
| Transaction Sample | 1 | \$115,756.16 |
| Total | 11 | \$953,052.18 |
| Total Irregularities or Deficiencies | 0 | 0 |

The results of the operating expenditures transaction analysis showed no irregularities or deficiencies. An irregularity or deficiency is defined as a transaction that is not properly approved, proper best practices documentation is not available, or the invoice amounts fail to properly calculate mathematically. However, because the charter school contract invoices were limited in description and calculation details, additional analysis was performed to gain a further understanding of certain transactions and is presented in the findings section below.

Study Team

The FCMAT study team was composed of the following members:

Michael W. Ammermon, CPA, CFE, CRFAC, DABFA
FCMAT Intervention Specialist
San Clemente, CA

Laura Haywood
FCMAT Technical Writer
Bakersfield, CA

Paul S. Horvat, CPA, CFE, MBA
FCMAT Consultant
La Verne, CA

Each team member reviewed the draft report to confirm its accuracy and to achieve consensus on the final recommendations.

Findings

The charter school began operations in August 2010. The original charter petition and first renewal charter petition provided the charter school with at least seven years of previously acceptable operations through June 30, 2017, with the same operational procedures in place until the charter's closure as of June 30, 2018. The district approved the charter school's original charter petition and its first renewal charter petition. An authorizer approved charter petition represents the primary contract or governing document between the authorizer and the charter school. Both the original and renewal charter petitions delineated the charter school's existing governance structure, services provided by the national headquarters, and the facilities lease.

Operating and Contract Expenditures

Operating expenditures sampled included payments to vendors for contracts, goods and services, employee expense reimbursements, and invoices for indirect fee charges. Indirect fee obligations of the charter school are prepared by the national headquarters regional office located in Apache Junction, Arizona.

Of the transactions sampled, payments for indirect fees for services reconciled with the amounts documented in invoices. However, the invoices for indirect fees failed to present the supporting detail amounts and information to show how the payment amount was determined. During discussions with the regional office management team, FCMAT explained what is needed to properly substantiate the expenditures.

The regional office management team was easily able to produce the supporting documents, calculations, and other evidence necessary to substantiate the sampled invoices and charter school payments. FCMAT further explained that if the charter school's on-site documentation had contained the detailed information provided during the FCMAT audit, and if that detailed information had been provided to El Centro ESD, there may have been less misunderstanding about the source and educational purpose of the charter school's expenditures. The charter school and regional office management teams both agreed that their documentation has improved because of the FCMAT audit.

Based on FCMAT's analysis of expenditures of \$14,951,876.96 during the sample period, \$7,935,332.49 or 53.07% represents authorized charter school payments for indirect fees and leases. The regional office is responsible for processing charges for various expenditures such as indirect fees, services, loss mitigation costs, and leases. These charges are billed to the charter school monthly. The regional office team explained that the regional finance accountant prepares invoices for the charter school's indirect fees and loss mitigation expenses.

The regional finance accountant calculates the indirect fee amounts based on the information from various general ledger accounts that the accountant obtains from the charter school's general ledger. FCMAT's transaction sample of 47 transactions included indirect fee invoices. The transaction sample shown below in Table 2 is an example of how the indirect fee is determined and FCMAT's recalculation of the invoice amount calculated by the regional finance accountant.

Table 2

| GL Account | Description | Amount |
|---------------------|--------------------------------------|----------------------|
| 401-0000-8011-01-00 | Local Control Funding Formula (LCFF) | \$ 715,367.00 |
| 405-0000-8096-01-00 | In Lieu Taxes | 17,648.13 |
| 405-1100-8560-01-00 | Lottery | 21,897.64 |
| 405-1400-8012-01-00 | Education Protection Account | 242,135.00 |
| 405-1400-8012-01-00 | Education Protection Account | 8,268.00 |
| Subtotal | | \$ 1,005,315.77 |
| MGMT Fee Multiplier | | 12.0% |
| Total | | <u>\$ 120,637.89</u> |

The \$120,637.89 traces to and agrees with charter school invoice #0000000259 in June 2017. To confirm the charter school's fee invoice calculations, FCMAT recalculated all fees in the sample. Calculated fees agreed to the invoices with no exceptions.

The regional finance accountant is an additional accounting layer of checks and balances for the charter school. The accountant has access to the charter school's accounting system and compares the amounts in both the national headquarters' and charter school's accounts monthly to ensure they balance. When timing differences occur, the regional finance accountant prepares a reconciliation and an adjustment that is included in the charter school's subsequent month's invoice. Timing differences may occur when a fee or expense is calculated based on a set of amounts that are known at the time of the calculation but after the calculation is made and invoice issued, additional factors that affect the calculation become known and are adjusted in a subsequent invoice.

The authorizing district can request documents from the charter school as part of its oversight responsibility. And even with regional finance accountant involvement, if the documents at the charter school location in Imperial Valley fail to contain the supporting details necessary to fully substantiate authorized payments, and the authorizing district is not provided the entire full picture of the transaction(s), the records of the charter school are considered incomplete. This means that each paid invoice should contain all information necessary to substantiate the educational purpose of the payment. Where calculations and allocations are used to create the invoices, each invoice should include full details of how amounts are calculated and other supporting documents such as spreadsheet analysis and cost source documents. Even if the amounts and information of an invoice are repeated month after month, each invoice should be able to stand on its own without need for explanation. Once again, the charter management and regional management team agreed that the invoices at the charter school site should have contained the additional documentation and information that was provided and available at the regional office.

In addition to the 47 operating expenditure transactions, FCMAT examined four teacher contract payroll stipends. The stipends examined were board approved, agreed with the salary schedule, and presented no irregularities or deficiencies. Of the 47 sampled operating expenditures, seven were for employee expense reimbursements. The seven employee reimbursements were properly approved, documented, and were for education-related activities.

Facilities Sublease - School Building Campus

The Landlord – Imagine 26 Partners, LLC

The primary allegation about the charter school lease at 1150 North Imperial Avenue, El Centro, CA in the Imperial Valley is that it is a sublease with Schoolhouse and that Schoolhouse is leasing the property from Imagine 26 Partners LLC. Imagine 26 is alleged to be related to ISNP, Inc. or other Imagine Schools organizations including but not limited to Schoolhouse.

FCMAT researched Imagine 26 as well as other Imagine nonprofit organizations to identify if there were any connections between principals or businesses of these entities. No connections were found between any Imagine 26 landlord entities or Imagine charter schools at the national, regional, or local levels. FCMAT also obtained secretary of state filings for Imagine 26 and another similar Imagine 26 property found in Coachella Valley. In Coachella Valley, an LLC entity was found named Skyline Imagine 26 Partners LLC (Skyline). The amended articles of organization of Skyline identified that its new LLC name is Coachella Imagine 26 Partners LLC (Coachella Imagine 26). Both Imagine 26 and Coachella Imagine 26 have the same address and partner names as the headquarters for Imagine 26 in Beverly Hills.

FCMAT met with a principal owner and manager of Imagine 26 at its office in Beverly Hills on December 5, 2018. The owner explained that he often names numerous properties based on tenant names, streets or cities in the area that the properties are located. The Skyline property was renamed to Coachella Imagine 26 Partners LLC because its new tenant was the Imagine Charter School in Coachella Valley, authorized by the Riverside County Office of Education.

The former Sears shopping center in Imperial Valley was purchased by Imagine 26 to be renovated for the Imagine charter school in Imperial Valley. Because there was no previous tenant or ownership of the building by Imagine 26, the former Sears shopping center location was purchased and placed in the limited liability company specifically created and named for the Imperial Valley charter school as Imagine 26 Partners, LLC to easily differentiate the property by name.

The Imagine 26 principal owner explained that neither he nor his partner are related to any of the Imagine Charter School individuals or businesses in any way. During this conversation he explained that until the purchase of the Sears location for the charter school, he did not even know where El Centro, California was and had never been there previously. FCMAT was provided a letter dated August 8, 2018 written to the California Department of Education (CDE) on Imagine 26 letterhead describing that there is no related party relationship, how Schoolhouse is involved, and rent issues. The CDE letter body is presented in Image 1.

Image 1

Re: Lease Agreement between Imagine 26 Partners, LLC (“Landlord”) and Schoolhouse Finance, LLC (“Tenant”)

To Whom it May Concern:

This letter is in response to the recent report that was provided by the California Department of Education, Charter Schools Division (CDE). It has come to our attention that CDE is concerned of a potential conflict of interest existing between Imagine 26 Partners LLC, Schoolhouse Finance, and Imagine Schools. In an effort to clarify the relationships, we would like to inform you that the property where the ISIV charter school is located is owned by Imagine 26 Partners, LLC. While the inclusion of the word “Imagine” in this entity’s name can appear confusing, Imagine 26 Partners, LLC is in no way related to any ISNP affiliated entity, nor any of their respective directors, officers or employees. It is also important to note that no ISNP affiliated entity has ever owned the ISIV facility.

Schoolhouse Finance contracted with Imagine 26 Partners, LLC to develop and lease the school facility for the benefit of ISIV. ISIV was a new school with absolutely no credit history, therefore Imagine 26 Partners needed significant credit support to develop, complete tenant improvements, and lease the facility. Schoolhouse Finance has provided that credit support for Imagine 26 Partners and has carried the risk of entering into a long-term lease for the benefit of ISIV.

The terms of the lease between Schoolhouse Finance and Imagine 26 Partners have at all times been fully transparent and disclosed. Additionally, there is no evidence that the rent is above market if one considers the timeframe when the lease was entered into, as well as the long-term credit support needed by Schoolhouse Finance.

We will be happy to provide any additional information you deem necessary to clarify this business transaction. Please feel free to contact me at Removed for further clarification and information.

The CDE letter summarized several issues that the Imagine 26 owner further explained during FCMAT’s meeting:

- The total square footage tenant improvements that Imagine 26 paid for was at least \$100 per square foot for roughly 55,000 square feet totaling \$5,500,000.
- Of the \$5,500,000, Schoolhouse contributed \$500,000, leaving Imagine 26’s improvement cost at \$5 million.
- Of the \$100 per square foot in tenant improvements, at least \$20 per square foot went to unseen improvements such as the underground sewer and water pipes, re-establishing the underground utilities, etc.
- There was a short time frame to renovate the building between March and September 2010, which contributed to higher costs. The roofing and exterior were exceptionally difficult because of the extreme heat imposed on laborers.
- Imagine 26 purchased the entire shopping center, which was abandoned, vandalized, had people living in the property, the copper pipe and wiring stripped and stolen, roofing hanging down, and needed a tremendous amount of rehabilitation.
- The property was purchased specifically for the charter school’s needs; no other available facilities could meet the school’s size requirement.
- Because Imagine 26 was taking such a huge risk and financing the purchase and renovations of the property specifically for the charter school, it required a guaranteed long-term lease from Schoolhouse. Although the charter school has closed, Schoolhouse continues to make the lease payments.

- If Schoolhouse had not signed a long-term lease and not guaranteed the lease, then Imagine 26 would not have spent the money in El Centro for a charter school facility that required a large amount of square footage and would have no other use except as a school.
- Considering the charter school location is the only one of its type and size in El Centro, and the renovations were so costly, the rental price per square foot is reasonable.
- While the charter school's second renewal was pending, Imagine 26 alleges it spent an additional \$312,739.95 for engineering, construction, and repairs for earthquake improvements. An August 21, 2018 email was produced summarizing the \$312,739.95 cost.
- Imagine 26 anticipated other tenants would be attracted to the shopping center; however, only the city library has committed to being a tenant. Because of the lack of tenant interest and the ongoing monthly carrying cost of security and other costs for the shopping center, Imagine 26 decided to donate the remaining shopping center to the city.
- The charter school facility was not donated to the city because Imagine 26 expressly financed, purchased, renovated, and built to order the shopping center location specifically for the charter school. Imagine 26 thought it was doing a good thing by helping the charter school. However, Imagine 26 is a business, and with a guaranteed long-term lease with Schoolhouse, it can recover its costs and make some money.
- Because of the success Imagine 26 had with the charter school before it was closed, it later assisted the Imagine Charter School in Coachella Valley with facilities.

The School Site Facility

FCMAT obtained from the charter school 62 pictures of the Sears shopping center, inside and outside. The pictures are alleged to have been taken and provided to Schoolhouse by a contractor or realtor who could show what the shopping center looked like when it was abandoned. The metadata of the pictures indicates the photographs were taken on January 30, 2005, five years before renovations in 2010.

Image 2 and Image 3 are two pictures selected to represent the condition of the shopping center prior to Imagine 26's renovations.

Image 2*Image 3*

The Charter School Lease

FCMAT requested the charter school obtain comparable square footage lease data in the El Centro area that might be compared to the charter school's sublease with Schoolhouse. The charter school engaged a licensed real estate broker with an office in El Centro to assist with lease comparisons. The broker's methodology used a total square footage for sublease between Schoolhouse and the charter school of 52,419 +/-, and states, "Current Year Base Rent = \$2.21 PSF/Month \$1,389,074 per year (with escalations)."

The broker identified two large leased properties, but their square footage was less than the charter school's 52,419 square feet. Table 3 summarizes the broker's analysis.

Table 3

| Description | Square Feet | Montly Base Rent per Square Foot | Annual Base Rent | Annual Rent Escalation Percentage |
|----------------|-------------|----------------------------------|------------------|-----------------------------------|
| Property 1 | 15,000 | \$1.95 | \$351,000 | 2.50% |
| Property 2 | 29,920 | \$1.40 | \$502,656 | 3.00% |
| Market Average | 22,460 | \$1.675 | \$451,446 | |
| Charter School | 52,419 | \$2.21 | \$1,389,074 | 1.90% |

There is a \$1,078 difference between the broker's annual base rent amount of \$1,389,074 and FCMAT's calculation of annual base rent. Calculating annual base rent using 52,419 square feet x \$2.21 per square foot x 12 months is \$1,390,152. The broker's calculated annual base rent of \$1,389,074 most likely rounded the \$2.21 per square foot amount up from \$2.208 per square foot because $\$1,389,074 / 52,419 \text{ square foot} / 12 \text{ months}$ is \$1,389,074. The difference of \$1,078 is immaterial to this analysis of annual rent.

The broker's analysis summarized the charter school lease or subject lease with Schoolhouse as follows: "Please be advised that the subject lease is commercially reasonable in today's present market."

Because there were allegedly no other facilities available for the size requirements of the charter school, the El Centro real estate market in the year 2010 or in 2018 did not have highly comparable 50,000-square-foot buildings for rent. The broker's opinion is the charter school lease is reasonable.

The lease between the charter school and Schoolhouse is \$1,389,074 annually. The lease between Schoolhouse and Imagine 26 is \$1,128,148 annually. The charter school pays \$260,926 more annually to Schoolhouse than Schoolhouse pays Imagine 26.

The original charter petition approved by the district, at Section D, Facilities, pages 84 – 86, describes the proposed facilities requirements. The arrangement with Schoolhouse is disclosed at page 86 in the original approved charter petition, which states:

Imagine School at Imperial Valley has arrangements with Schoolhouse Finance, LLC (SHF), a wholly owned subsidiary of Imagine Schools Non Profit, to finance the construction of the elementary school facility, including all startup costs for computers, curriculum and furnishings. Under this agreement SHF agrees to finance all costs associated with the completion of the facility, including but not limited to, all construction, required site improvements and land acquisition. In exchange for Schoolhouse Finance's commitment to proceed in good faith to finance the construction, the school agrees to execute a lease with SHF.

The renewal charter petition that was approved by the district describes at Section D, Facilities, page 100, that the school has developed a facility, as follows:

ISIV is located at 1150 North Imperial Avenue in El Centro.

ISIV has developed a facility with 33 classrooms averaging more than 700 square feet each for its core instruction of students in grades K-8, 1 classroom for special education, designated space for fine arts instruction, student & adult restrooms, administrative offices, reception area, multi-purpose room, kitchen, media center, outdoor play area, basketball court, playground equipment, teacher's workroom, data room, mechanical room, storage and parking.

The charter school and Imagine management explained that the reason for the higher payment to Schoolhouse by the charter school was because of the risk Schoolhouse was taking to build a very large school facility in a city where there would be no other use for the facility should the charter close. Adding to the risk was that Imagine 26 required Schoolhouse to guarantee a long-term lease without any exit provision should the charter school close. Therefore, if the charter school closed, Schoolhouse would have no recourse to recover rent and would remain on the lease. Imagine management's proof of the risk is the fact that the charter school has closed, and Schoolhouse remains liable and continues to make payments on the charter school facility lease.

Charter School Audit Report Lease and National Headquarters Disclosures

FCMAT obtained independent audit reports for the charter school's fiscal years ending June 30, 2014 – 2017. The audit reports disclose at Note 1, Summary of Significant Accounting Policies:

The School is a subsidiary company of Imagine Schools Non-Profit, Inc., a Virginia non-profit corporation (Imagine or Management Company).

The auditor has termed the national headquarters, or Imagine Schools Non-Profit, Inc., as the management company. The charter school auditor has disclosed in each of the charter school audit reports at Note 1 and Note 5 the relationship of the national headquarters and the charter school. The audit report Note 5, Related Parties, sets out several categories describing the management company or national headquarters arrangements with the charter school. Related parties categories disclosures in the 2014-2017 audit reports of the charter school include: promissory note for tenant improvements on sublease, leases of equipment, promissory note to finance the purchase of a bus, sublease of facility, management company service agreement, and due to management company (other agreements).

The charter school audit report's related parties note incorporates a table detailing the beginning balance, charges, payments, and ending balance in each year for management fee, reimbursable expenses, facilities lease, promissory notes, advances, and loss mitigation fee. The related party audit report note illustrates in a table the remaining sublease payment by year through the end of the sublease. The sublease notes section states:

The School entered into a Sublease Facilities Agreement with the Management Company (a related party). The lease term expires June 30, 2030. The lease requires monthly payments of \$115,756 ...

The audit report disclosures of related parties and the categories of services between the national headquarters and the charter school are thorough. The audit reports also define other services such as loss mitigation.

Loss Mitigation Program – Financial Safety Net Insurance

The loss mitigation program is a pool of funds maintained by the national headquarters in which its charter schools may elect to participate. It is a form of insurance that the charter school can use to hedge against financial going concern matters. A going concern is a financial condition or set of circumstances that could prohibit the charter school from continuing its operations and result in its closure.

The charter school and district entered into a Memorandum of Understanding (MOU) that was revised in April 2013. MOU Section VI, Legal Relationship, states at page eight:

If Charter School should contract all or any portion of the work or activities to be performed under this MOU or the Charter, Charter School shall required [sic] each contractor to indemnify, hold harmless and defend the District, its officers, employees and agents in accordance with the terms of the preceding paragraph.

And page 15 of Section XII, District-Provided Services, states:

The Charter School shall retain the authority to contract with third parties for any services required to operate the Charter School in accordance with the law, this MOU, and the approved Charter.

Neither the district MOU nor charter petition require the charter school to obtain permission to use other service providers, whether related parties or not. Regarding vendors or services, the MOU specifically states at page six and seven, "... selection of the auditor shall be subject to approval from the District." Therefore, other than the audit firm selection, the charter school is free to select its own vendors and service providers and pay any educational purpose fee or expenditure it considers necessary and approves.

The MOU has no provision whereby the district determines what an educational purpose expenditure represents; therefore, it is left to the charter school board and management to determine how to spend its funds for the education of its students.

The affiliate agreement the charter school signed with the national headquarters is effective July 27, 2010. The national headquarters affiliate agreement contains a provision for contingency support. Contingency support includes a loss mitigation program. The charter school agreed to participate in the national headquarters loss mitigation program. Affiliate agreement Section 2, Imagine Commitment, subsection (n) at page 3 of the agreement states:

Imagine Schools are also eligible to participate in the Imagine Loss Mitigation Program, which provides a financial safety net and debt relief for Imagine Schools that may experience periods of significant financial hardship.

Affiliate agreement Section 3, Contingency Support, and page 4, Loss Mitigation state:

The Imagine Loss Mitigation Program is a voluntary debt relief program designed to ensure that each participating Imagine School is given the best opportunity to survive these challenges by providing a financial safety net that helps the school avoid incurring debt amounts so substantial that they may result in school closure or risk to the charter authorization. The Charter School hereby elects to participate in the Imagine Loss Mitigation Program upon the terms and conditions set forth herein.

Affiliate agreement Section 4, Payment, subsection (c), Loss Mitigation Allocation, defines the payment for loss mitigation to the national headquarters as a percentage of per-pupil funding

of 1% in year one, 2.5% in year two, 3% in year three, 2.5% in years four and five, 2% in years 6-10, and 1% in years 11-20.

The loss mitigation fee is reconciled and finalized by the charter school's independent auditor. FCMAT examined the auditor loss mitigation fee adjusting journal entries and other supporting documents provided by the charter school. The charter school audit reports fully disclose the loss mitigation program at Note 5, Related Parties. A representative audit report related party note disclosure describes the loss mitigation program with the national headquarters as:

The School elected to participate in a loss mitigation program with the Management Company for a fee of 2% of revenue as defined under the agreement. The fee escalates through year three to 3% and declines to 1% in year eleven through year twenty. The Management Company will forgive 90% on balances due on operating advances in excess of \$250,000 in the current year or 90% of cumulative advances in excess of \$500,000. The 3% fee for the year ended June 30, 2014 was \$135,817.

The audit report note identifies in each year the amount of loss mitigation program fees the charter school paid the national headquarters.

The MOU between the charter school and district contains provisions for percentage fees. The MOU states the charter school will pay 1% for oversight, 2% for curriculum and staff professional development, and 2% for special education services. These services total 5% of the charter school state apportionment revenue funding.

FCMAT examined and compiled the payments the charter school made into the loss mitigation program. The charter school paid the national headquarters a total of \$999,849.30 for the program between fiscal years 2010-11 and 2017-18. The analysis also identified that the national headquarters loss mitigation program contributed \$1,211,665 to the charter school over the same time period. Table 4 presents the loss mitigation program contributions analysis.

Table 4

| Loss Mitigation Program | | |
|--------------------------------|-------------------------|----------------------------------|
| | Contributions By | Contributions Received By |
| Fiscal Year | Charter School | Charter from Program |
| 2010-11 | \$ 47,492.43 | \$ 797,847.00 |
| 2011-12 | 86,112.29 | - |
| 2012-13 | 124,263.77 | - |
| 2013-14 | 135,816.99 | 20,000.00 |
| 2014-15 | 159,758.00 | 105,205.00 |
| 2015-16 | 143,859.58 | - |
| 2016-17 | 149,881.24 | 288,613.00 |
| 2017-18 | 152,665.00 | - |
| | \$ 999,849.30 | \$ 1,211,665.00 |

As a result of entering into the affiliate agreement loss mitigation program with the national headquarters, over the eight years shown in Table 4, the charter school benefited by receiving \$211,815.70 more than contributed. The net effect is that it was a worthwhile educational expense for the charter school. The affiliate agreement also sets out the administrative services the national headquarters provides for the charter school.

Administrative Services 12% Cost

Administrative services are defined in the charter school's affiliate agreement. The affiliate agreement is also known as a management agreement. The affiliate agreement contains a provision for various support services and materials offered by the national headquarters and regional support management and teams. The affiliate agreement defines the development and operational support services and benefits that are available and provided by the national and regional management and support staff network of teams. Fourteen categories of services and benefits are listed in the affiliate agreement at Section 2, Imagine Commitment. These categories are:

Charter Development. Imagine assists its schools with all aspects of the charter application, contracting, and renewal process.

Educational Program Development and Implementation. Imagine makes available instructional staff to implement the educational program at each Imagine School. Imagine provides curriculum development and support services, as requested. Imagine provides a proprietary K-8 curriculum, including a proprietary character education curriculum for grades 5-12, which may be used by Imagine Schools. Imagine assists with coordination of school-wide scope and sequence in core content areas, development of pacing guides and student action plans, and curriculum alignment to state standards, as needed. Imagine also provides expertise and guidance in connection with national accreditation processes.

Assessment Services. Imagine assists in coordinating administration and interpretation of standardized student assessments administered each fall and spring to measure same-student learning gains. Imagine also assists with administration and interpretation of results of all state and district assessments. Imagine consults with instructional leaders, as appropriate, to develop instructional goals and objectives based on assessment results.

Personnel Resources: Imagine provides a nationwide system for staff recruitment, including coordination and development of the Imagine Schools Growing Our Leaders Program, and salary and benefits administration, including administration of the Imagine retirement plan.

Professional Development. Imagine assists in coordinating professional development opportunities for charter school staff, including an annual New Principals' Boot Camp and an annual National Forum and Celebration.

Sharing Best Practices. Imagine facilitates the sharing of best practices among Imagine Schools regionally and nationally through administrator meetings and conference calls, regional and national task forces, newsletters, a web-based intranet, School of Excellence Program Reviews, an annual New Principals' Boot Camp, and an annual National Forum and Celebration.

General Administration. Imagine provides administrative expertise in all areas of charter school operations, including assistance, as needed, with procurement and financing of contract equipment and other contract services, conduct of school site needs assessments, development of school-wide and region-wide performance plans, and development of operating guidelines, policies and procedures.

Financial Administration. Imagine provides support and assistance, as needed, in developing the annual charter school budget, selecting and working with an indepen-

dent auditing firm, and preparing periodic financial reports required by the charter sponsor or other organizations. Imagine provides access to financial accounting software products tailored to meet the needs of Imagine Schools and technical assistance in connection with the accounting software and other financial reporting questions. Imagine assists with the design and implementation of appropriate internal accounting controls.

Facilities Development. Imagine assists with identification, procurement, development, and equipping of suitable facilities for operation of the charter school. Imagine provides guidance and support, as requested, with respect to facilities maintenance and repairs.

Technology Support. Imagine provides IT consultation services as requested, including assisting with the development of individual Imagine school websites and providing links from the national Imagine website to individual Imagine schools sites. Imagine maintains a web-based intranet and e-mail capabilities to enable communication among Imagine Schools personnel throughout the nation, and coordinates use of and assistance with technology data systems for management of student data.

Marketing and Public Relations. Imagine provides assistance, as requested, with development of enrollment and marketing plans and materials. Imagine also provides consultation and support in the areas of crisis management and stakeholder communications.

Compliance Support. Imagine provides guidance and support in completing all reports required by the charter sponsor and such other local, state and federal authorities as may have jurisdiction over the charter school.

Risk Management. Imagine assists in all aspects of insurance program procurement and administration, including national pooled product bidding to attain cost savings, claims management and monitoring, and acting as a liaison as requested with the carrier.

Contingency Support. Imagine provides working capital advances to Imagine Schools needing short-term financial assistance. Imagine Schools are also eligible to participate in the Imagine Loss Mitigation Program, which provides a financial safety net and debt relief for Imagine Schools that may experience periods of significant financial hardship.

In connection with delivering the aforementioned services and benefits, Imagine will furnish to the Charter School all of the necessary school site staff, including without limitation such administrative, instructional and non-instructional school site staff as may be required by the Charter School to sustain the operations of the Charter School (collectively, the “Loaned Employees”). Loaned Employees may be assigned to work at the Charter School site on a full or part-time basis. If on a part-time basis, the Loaned Employees may also be assigned to work at other Imagine Schools.

Loaned Employees, in collaboration with Imagine’s regional and national managerial and support staff, shall be responsible for the administration and supervision of the personnel, materials, equipment, and facilities necessary for the provision of educational services to students, and the management, operation and maintenance of the Charter School.

Charter Petition and Audit Report Disclosures About Agreements

The original charter petition authorized by the district describes the financial services available from the national headquarters at Section C, Administrative Services, page 84, and in the district-authorized renewal charter petition at Section C, Administrative Services, pages 99-100. The affiliate agreement describes in greater detail the total services available to the charter school.

The charter school's audit report for the fiscal year ending June 30, 2014 describes at Note 5, Related Parties the financial component of the services agreement between the national headquarters and the charter school as follows:

The School has entered into a service agreement, commencing in June 2010. The contract is for management services for a term of five years, and may be cancelled or terminated pursuant to the terms and conditions as set forth in the charter. Under the management agreement, the Management Company will manage and operate the School during the term of the agreement. The management fee is 12% of revenue as defined by the agreement. Current year management fees charged under this agreement totaled \$651,922.

The audit report note identifies in each year the amount of management fees the charter school paid the national headquarters.

The audit report's related parties disclosure also documents in the section titled, "due to management company (other agreements)," the many services the national headquarters provides the charter school. The charter school's June 30, 2014 - 2017 audit report(s) related parties disclosure states,

The School has entered into multiple agreements with the Management Company. The Management Company is responsible for organizing, developing, managing, staffing, and operating the School. During the current year, the Management Company charged fees to the School for management services as described above. The amount due to the Management Company also reflects activity for operating advances and invoices for certain expenses paid on behalf of the School.

When applicable, such as in the June 30, 2015 and 2017 audit reports, the related parties Note 5 section, "due to management company (other agreements)," includes an additional disclosure that states:

In addition, the School reimbursed the Management Company for various other expenses. The Management Company also advanced funds to the School during the year for operating expenses.

Administrative Services

The administrative services provided by the national headquarters and regional management and staff is significant. The fee of 12% is not unreasonable based on FCMAT's experience with many charter management organizations and other charter school back office service providers. While FCMAT was able to trace affiliate agreement payments by the charter school, the real issue is whether those services are deliverable and are for legitimate educational expenses.

To determine if the national headquarters and regional management and support staff have the capacity and capability to deliver the services identified in the affiliate agreement, FCMAT visited the Arizona regional offices on two separate occasions and also visited the Virginia national headquarters.

The first visit to the Arizona regional offices was during the Imagine Schools – Southwest Group conference. The conference, based on FCMAT’s best count of attendance, consisted of approximately 250 management and staff from approximately 17 charter schools. During both visits to the Arizona regional offices to further evaluate capacity and ability to deliver services, FCMAT met with and was introduced to or observed many management and staff at the office, including but not limited to:

- Both chief executive officers of the national headquarters
- Executive vice president of the Southwest Group
- Regional finance director
- Chief academic officer
- Three regional academic directors
- Chief communications officer
- Regional information technology director
- Regional information technology staff
- Human resources
- Benefits and payroll
- Regional academic coaches

At the national headquarters in Virginia, FCMAT met with or was introduced to many management and staff, including but not limited to:

- Both chief executive officers of the national headquarters
- President of Schoolhouse
- Financial manager for Schoolhouse
- Vice president / treasurer
- Chief financial officer
- Chief general counsel
- Human resources director
- Two accounting managers
- Two senior accountants
- Treasury accountant
- Payroll systems administrator

In total, according to the national headquarters chief executive officer, chief financial officer, and deputy general legal counsel, there are approximately 110 corporate and regional employees. Of the 110 employees, there is a national academic team, academic and assessment coordinators, school development staff, facilities management staff, and chief communications and development officer.

To identify capacity and types of services and staff utilized, FCMAT examined:

- Calendars of the finance staff 2017-18 and 2018-19 meetings
- Seven selected business group administrative meeting agendas
- Fourteen selected 2017 and 2018 leaders meeting agendas
- Seven marketing and promotional tools
- Six instructional and school leadership educational development materials
- Various PowerPoint training presentations
- Various documents identifying types of services and support by specific individual name and title by topics of finance, business, leadership, technical assistance, and curriculum
- Various professional development plans
- Other agendas, plans, and schedules supporting new teacher training and other regional training
- The national headquarters developed internet-based platforms for training, support, and numerous other services and assistance tools. Examples of the internet platform are:
 - Leadership folder containing meeting agendas and PowerPoint presentations of what is discussed
 - Regional director folder containing training materials about how to improve and bring more quality to the schools
 - Marketing folder containing examples of materials available to the schools for reaching out through social media and pre-made materials for the school's use
 - Indirect folder containing budget meeting materials and documentation of who attends
- The expense reports for three selected regional employees alleged to have provided services at the charter school

Overall, the national and regional teams are responsible for promoting and developing educational programs, curriculums, operations academies, enrollment, marketing, and benefits. A national summit is held in Florida that brings all charter school principals, assistant principals, deans of students, and academic coaches to this learning event.

During FCMAT's on-site fieldwork at the charter school in El Centro, regional offices in Arizona, and national headquarters in Virginia, the team determined that the national and regional headquarters have the capacity and capability to provide the services described in the affiliate agreement, and that all expenditure transactions and services examined promoted or supported an educational purpose.

Related Parties

Related parties do not necessarily create a fraudulent relationship. In fact, related parties may provide benefits including favorable terms or services to an organization. What is necessary is that related-party transactions should be transparent and fully disclosed.

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 850-10-50 contains the disclosure requirements for related-party relationships and transactions. The disclosure requirements are for:

- Affiliates of the entity.
- Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity.
- Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management.
- Principal owners of the entity and members of their immediate families.
- Management of the entity and members of their immediate families.
- Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.
- Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests. The FASB ASC glossary also defines the terms: affiliate, control, immediate family, management, and principal owners.

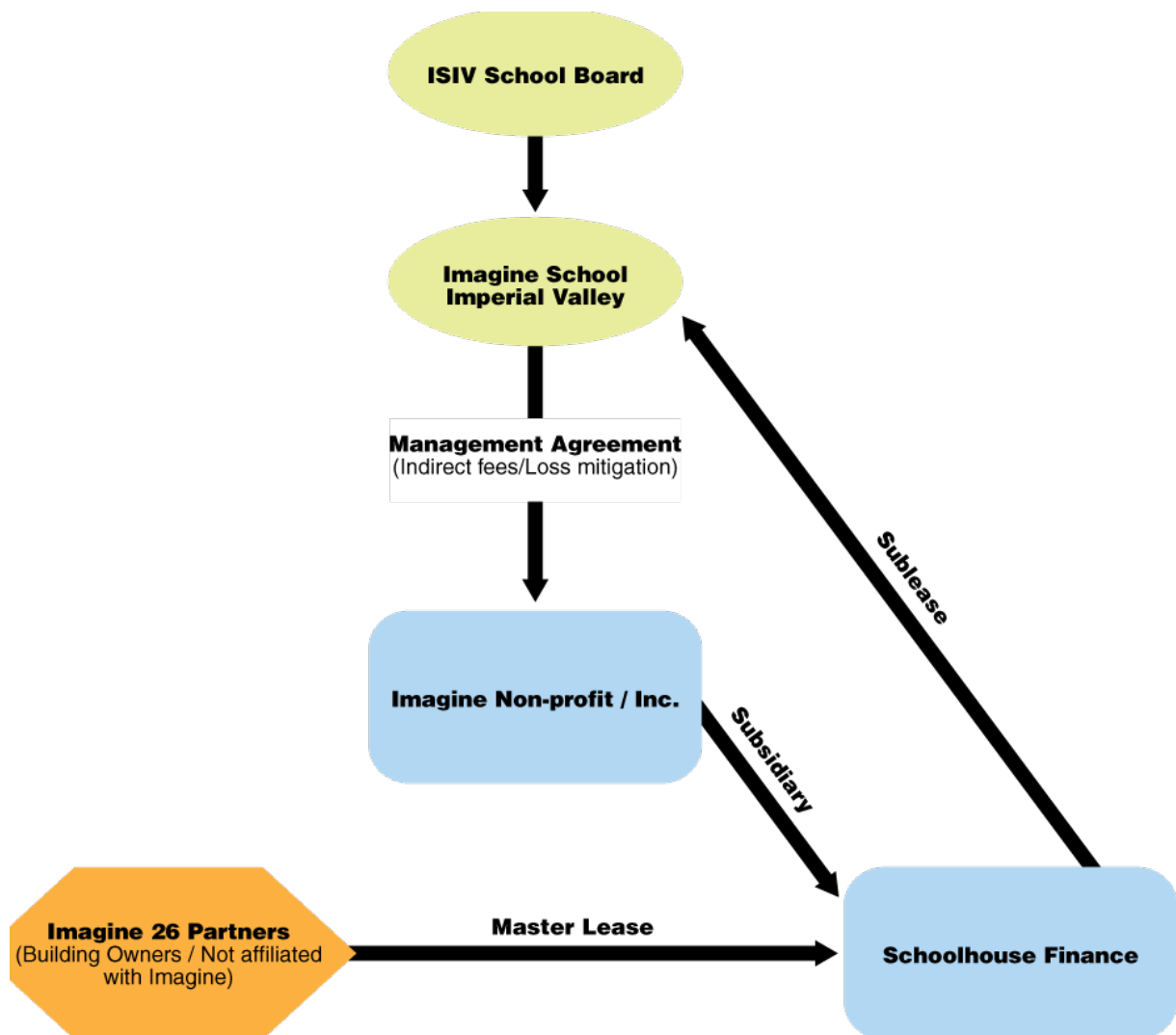
The executive management of the charter school is responsible for documenting conflict of interest disclosure reporting requirements in detail and fully disclosing to the auditors, governing board and the authorizing agency all current and potential related-party transactions. Disclosure is required for compliance with Generally Accepted Accounting Principles (GAAP). Failure to disclose related-party transactions may be a departure from GAAP, which may result in a qualified or adverse audit opinion and the potential for civil and criminal prosecution.

FCMAT reviewed the charter school's vendor documents, contracts, financial transactions, purchases and general ledger financial transactions; interviewed management, and reviewed emails to identify and review potential undisclosed related parties. The charter school's independent audit reports identify related parties in the notes to the audit report at Note One, Summary of Significant Accounting Policies, Nature of Activities, and Note Five, Related Parties.

The audit report defines the charter school as a subsidiary company of Imagine Schools Non-Profit, Inc., a Virginia nonprofit corporation. The audit report terms the Imagine Schools Non-Profit, Inc., a Virginia nonprofit corporation, as either Imagine or Management Company. Note Five of the audit report is specific to related parties. All sections of audit report Note Five are specific to the management company or Imagine Schools Non-Profit, Inc., a Virginia nonprofit corporation, which is the national headquarters of Imagine Schools.

The Imagine Charter School Structure and Network of Organizations

The national and regional operations of the Imagine charter school network are substantial. Image 4 and Image 5 below are reproduced from organization charts provided by the charter school. ISIV in Image 4 below means Imagine Schools Imperial Valley, which is the charter school.

Image 4

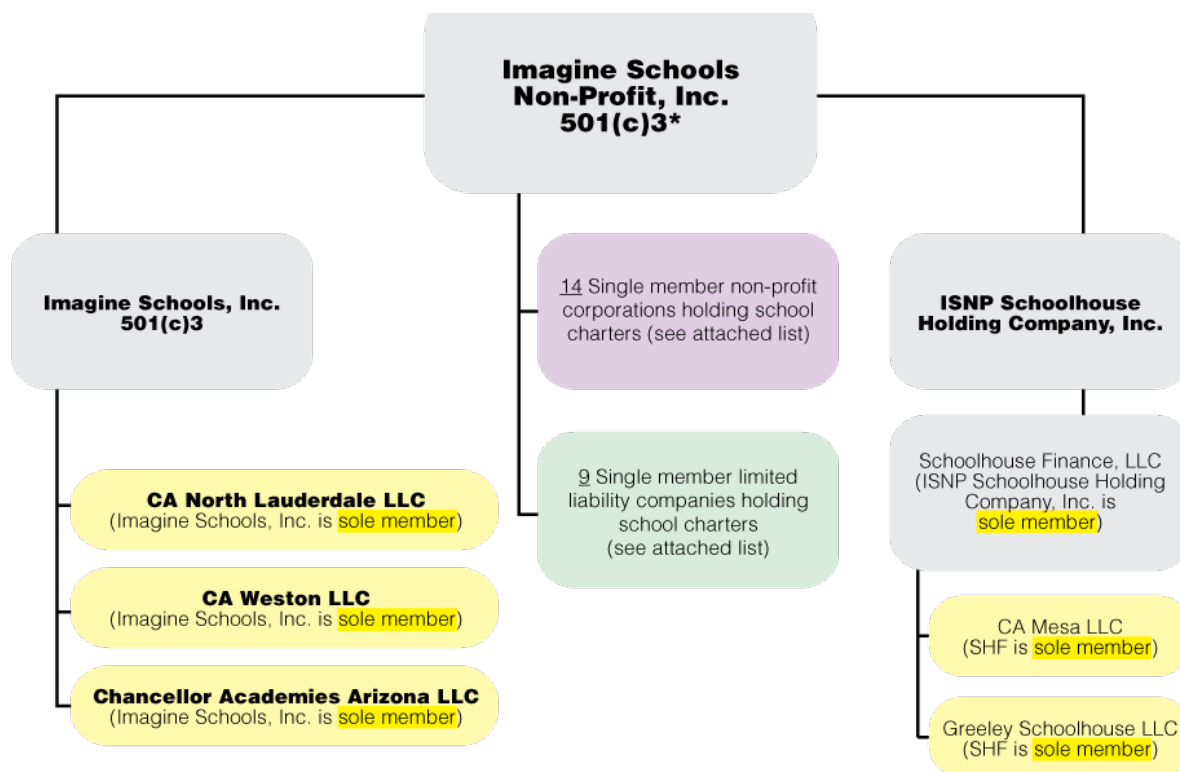
The entities, agreements, and leases described in Image 4 are documented in this report and the charter school's audit reports.

Image 5 describes the overall structure of the entire Imagine Schools organization. The organization chart in Image 5 has a note at the bottom of the chart that states:

Imagine Schools Non-Profit, Inc. (ISNP) is a Virginia non-profit corporation and federally tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. It is governed by its board of directors pursuant to its bylaws and applicable law and has no members. ISNP is the sole member of Imagine Schools, Inc., ISNP Schoolhouse Holding Company, Inc. and each of the single member non-profit corporations and single member limited liability companies.”

Imagine Schools Non-Profit, Inc., is an IRS-recognized 501(c)(3) organization exempt from income tax.

Image 5



Note: Imagine Schools Non-Profit, Inc. (ISNP) is a Virginia non-profit corporation and federally tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. It is governed by its board of directors pursuant to its bylaws and applicable law and has no members. ISNP is the sole member of Imagine Schools, Inc., ISNP Schoolhouse Holding Company, Inc. and each of the single member non-profit corporations and single member limited liability companies.

Imagine Schools has charter schools throughout the United States. Each state may have its own requirements for how schools should be organized. At least nine of the schools are structured as individual limited liability corporations (LLCs) and are considered single member disregarded entities. An LLC is an entity created by statute in each state. Formation of an LLC includes making elections of how the LLC is organized. Depending on the elections by the LLC, the IRS will treat the LLC as a corporation, partnership, or as part of the owner's tax return. Treating the LLC as part of the owner's tax return, as does Imagine Schools Non-Profit, Inc., means the LLC is a disregarded entity. This means the single member charter school LLCs are disregarded or ignored as a separate entity from the national headquarters nonprofit for income tax purposes, which makes them part of the nonprofit. The LLC remains separate for employment tax and other excise taxes such as things that are made or sold. If it were allowed, another similar treatment to disregarded entities would be to structure the schools under an IRS nonprofit group exemption. A group exemption is the IRS's recognition of a group of organizations as tax-exempt because they are affiliated with a central organization.

The charter school is formed under its own 501(c)(3) nonprofit public benefit corporation, Imagine School at Imperial Valley. The auditor of the charter school prepares the Imagine School at Imperial Valley nonprofit tax return. The charter school is part of Image 5 above at caption "14 Single member non-profit corporations holding school charters."

The organization structure of the entire Imagine national network of schools and supporting organizations is common and has characteristics similar to other national charter school network organizations. Based on FCMAT's analysis and sample testing of transactions, there are no undisclosed related-party issues specific to the charter school's audited financial statements.

Sole Statutory Member

The charter school's bylaws reference Statutory Member and Sole Statutory Member throughout. The national headquarters is the sole statutory member of the charter school. The charter school bylaws state at Section 3, Rights of Statutory Member:

The Statutory Member (as defined in Section 5056 of the California Nonprofit Public Benefit Corporation Law) shall have the right, as set forth in these Bylaws, to elect or appoint members of the Board of Directors, to remove members of the Board of Directors, to vote on the disposition of all or substantially all of the Corporation's assets, to vote on any merger and its principal terms and any amendment of those terms, and to vote on any election to dissolve the Corporation, and as otherwise required under the California Nonprofit Public Benefit Corporation Law and/or set forth in these Bylaws.

Sections 10 and 11 of the bylaws states,

Section 10. Removal of Directors. A Director may only be removed by the Statutory Member. The Statutory Member may remove a Director with or without cause.

Section 11. Vacancies Filled by Statutory Member. Vacancies on the Board of Directors shall be filled by the Statutory Member.

The charter school's MOU with the district states at Section IV, Governance and Compliance Issues, subsection B, Conflicts of Interest, page four:

As such, Charter School agrees to follow the prohibitions of Government Code 1090 *et seq.*, except that the parties agree that teachers and other employees of the Charter

School will be permitted to serve on the governing board, to the extent consistent with the Charter and Bylaws ...

The charter school's bylaws contain the provisions for sole statutory member. The bylaws were provided as part of the charter school's initial charter petition and first renewal charter petition. These petitions were approved by the authorizer. Neither the charter petition nor MOU require the charter school to issue consolidated financial statements or request consolidated financial statements from the national headquarters.

The reporting or sole statutory membership relationships in the audit report and possible consolidation of the sole member with the charter school are conditional upon many factors. The most important factor in determining if consolidated financial statements should be issued is the auditor's judgment. If the sole member relationship is hidden from the auditor or not transparent in all aspects, these are causes for concern. The sole member relationship was not hidden.

Also important to sole member relationships are factors such as the materiality of the combined control, dependence, and size of the charter school compared to the total organization, and the economic interest the sole member may exert over the charter school. If there is a material economic interest of the sole member in the charter school and the sole member can exercise significant control over the charter school, then the charter school may be required to issue consolidated financial statements. However, using the same conditions of control, economic interest, dependence, and comparative size of the charter school to the total organization, when fully disclosed to the auditor and the auditor issues full disclosure audited financial statements defining the related parties, the auditor may decide consolidation is not necessary unless required by the authorizer.

FCMAT met with the auditor of the charter school and spoke with national headquarters auditors during our meetings in Virginia at the national headquarters. FCMAT's determination is both audit firms are experienced in charter school, nonprofit, and for-profit entities and audits. Both audit firms are aware of what sole statutory member means and the responsibilities of determining if consolidated financial reports are necessary.

The national headquarters made available for FCMAT's review its fully consolidated financial statements for the entire organization. The national headquarters audit report for the fiscal year ending June 30, 2017, Notes A and B, fully describe the consolidation of the nonprofits and their subsidiaries. Note A describes the organization and business and Note B describes the principles of consolidation as follows:

Note A:

Imagine Schools Non-Profit, Inc. ("ISNP" or the "Company") is a Delaware nonprofit nonstock corporation organized and operated exclusively for educational and charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code. The primary purpose of ISNP is to advance education in the United States by providing school choice. To that end, ISNP provides public charter school education and related services to elementary and secondary school students throughout the United States.

The Company operates public charter schools through its individually chartered, wholly owned nonprofit and limited liability subsidiary corporations. ISNP's activities include all aspects of school functions, such as educational, operational and fiscal responsibilities. The primary funding for each charter school subsidiary is the per-pupil funding that is determined and funded by each school's state or locality.

On April 30, 2015, ISNP received a donation of 100% of the capital stock of Imagine Schools, Inc. (“ISI Gift”). Upon receipt of the donation, Imagine Schools Inc. (“ISI”) and its wholly owned subsidiaries, including Schoolhouse Finance, LLC (“SHF”) became wholly owned subsidiaries of ISNP. Immediately upon receipt of the donation, ISI assigned its 100% membership interest in SHF to ISNP Schoolhouse Holding Company, Inc. (“SHF Holding”), a wholly owned subsidiary of ISNP, and amended and restated its Certificate of Incorporation to convert into a nonprofit nonstock corporation in the State of Delaware. On May 29, 2015, ISI applied for exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code. The ISI exemption application was approved on July 1, 2015 with an exemption effective date of May 29, 2015.

ISI, as a wholly owned subsidiary of ISNP, is a nonprofit nonstock corporation organized and operated exclusively for educational and charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code. ISI primarily serves elementary and secondary school students by providing a full array of services related to public charter school education, including recruiting, employing, training, and developing educators and education administrators at every grade level, designing and developing curricula to promote academic growth and character development among students, instructing and evaluating students, and providing fiscal, administrative, and logistical supervision and oversight of local schools, and developing and implementing best educational practices across the entire educational spectrum. ISI’s services are facilitated through partnerships and agreements with local nonprofit charter school boards, municipalities, and other nonprofit entities throughout the United States, including its parent corporation, ISNP. By engaging in such services, ISI also supports and broadens the educational and charitable purposes of its parent entity, ISNP.

SHF is a Virginia limited liability company and a wholly-owned subsidiary of SHF Holding, which is a wholly-owned subsidiary of ISNP. SHF’s primary purpose is to provide school buildings for the charter schools that are operated by either ISNP or ISI. School buildings have generally been leased by SHF and sub-leased to each charter school.

SHF has executed long-term financing for certain school buildings, including sale-leaseback or mortgage financing. As part of its sale-leaseback transactions, SHF has entered into long-term leases with the purchasers for the rentals of the buildings and sub-leases with corresponding individual ISNP and ISI charter schools.”

Note B:

The consolidated financial statements include the accounts of the Company and its subsidiaries described in Note A. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company’s consolidated statement of activities includes the revenues and expenses of ISNP’s subsidiary charter schools. Additionally, the consolidated statement of activities includes the revenues and expenses of the independent nonprofit charter schools operated by ISI under its operating agreements with those schools. The amounts are included in the Consolidated Statement of Activities due to certain provisions of the operating agreements, including ISI’s commitment, under certain circumstances, to provide funding to the independent nonprofit schools for working capital require-

ments. Net surplus/deficit amounts related to such independent charter schools which are, under the operating agreements, not attributable to ISI, are excluded from the consolidated financial statements of the Company.

All amounts receivable (net of any related provision for doubtful accounts) or payable to such independent nonprofit charter schools are included in the consolidated balance sheets. Other Statement of Financial Position amounts of the independent nonprofit charter schools operated by ISI are not included in the Consolidated Statement of Financial Position of the Company.

The national headquarters auditors explained that the individual schools are not considered for consolidated financial reporting because the reporting to the states is at the individual school level. Unless there is a specific requirement by a state or authorizer, or other tests are met, individual charter schools audit reports are not consolidated, but fully disclose the relationships. If the charter management organization (CMO) is significantly dependent on the charter school or the charter school has a material or significant tie to another entity, then based on the auditor's judgment, a consolidated charter school audit report would be issued. This view or auditor's judgment is also shared by many reputable audit firms in California.

The district did not require consolidated financial reporting, and both the charter school auditor and national headquarters auditor determined consolidated financial reports are not required. Because the sole member relationship as a related party is disclosed, there is no related party nondisclosure issue of the charter school.

Statements of Economic Interests - Form 700

The state of California requires every elected and public employee who makes or influences governmental decisions to submit a Statement of Economic Interest, also known as Form 700. The Fair Political Practices Commission (FPPC) is responsible for the administration of the California Political Reform Act, which regulates campaign financing, conflicts of interest, lobbying, and governmental ethics. Form 700 is part of the documentation process for disclosure of economic interests or lack thereof.

The FPPC does not maintain a database of Form 700s for many local governmental agencies such as charter school board members. The FPPC website, <http://www.fppc.ca.gov/transparency/form-700-filed-by-public-officials/form700-search/form700-old.html>, states,

NOTE: This search only includes state-level elected officials, elected judges, city councilmembers, and certain other officials. Local planning commissioners, special district board members, school board members, and many other local officials do not file Form 700s directly with the FPPC. You must contact the local filing officer to determine how to obtain Form 700s for these other officials. [emphasis added]

The charter school's conflict of interest code at section Designated Employees states:

Employees of this Charter School, including governing board members and candidates for election and/or appointment to the governing board, who hold positions that involve the making or participation in the making, of decisions that may foreseeably have a material effect on any financial interest, shall be "designated employees." The designated positions are listed in "Exhibit A" attached to this policy and incorporated by reference herein.

Three management employees of the charter school or regional office meet the definition of designated employees. These designated employees provided their signed national headquarters Annual Conflicts of Interest Questionnaire form; however, no Form 700s were completed. Charter school management explained that they thought the national headquarters conflicts of interest form was sufficient and now understand that Form 700 for California purposes is the required document.

Charter school board member Form 700s were available but incomplete for the years examined. Review of board member Form 700s indicated some board members were not aware of how to properly complete the form. For example, one board member completed the 2015 Form 700 using a 2014/2015 form and checked the Annual box pre-printed for the calendar year 2014. But in the same form, they also wrote in that the period covered is January 1, 2015 through December 31, 2015. The board member signed and dated the form in January 2015. In examining the 2015/2016 Form 700s, the same board member checked the Annual box pre-printed for 2015 and this time did not write in that the time period was for 2016. Yet the board member signed the form in June 2016.

Review of charter school board minutes in June 2016 identified that the board was aware of and discussed Form 700s, but FCMAT could not confirm if 2016 Form 700s were or were not available or submitted by the charter school board members.

FCMAT's collective review of board member Form 700s demonstrates that the forms are being discussed and filled out, but the charter school fails to have a properly completed Form 700 for each board member for each year examined except for 2015. There is insufficient evidence to demonstrate intent by the charter school to not obtain Form 700s. Since there are Form 700s that are either misdated or completed incorrectly, it is possible the charter school believed it possessed the correct Form 700s for each board member for each year.

As with expenditure and other documentation issues discussed in this report, the national headquarters, regional office, and charter school's California Form 700 compliance, documentation, and understanding needs improvement.

Recommendation/Conclusion

In accordance with the authority granted in Education Code Sections 1241.5, 47604.3, and 47604.4(a), FCMAT focused on the allegations of fraud, misappropriation of funds, or other illegal fiscal practices to determine whether the charter school and/or its personnel were involved in or may have committed fraudulent activities.

Based on the findings in this report, FCMAT concludes there is insufficient evidence to demonstrate that fraud, misappropriation of funds, or other illegal fiscal practices may have occurred.

Appendix A

Study Agreement



CSIS California School Information Services

**FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
AB139 STUDY AGREEMENT
April 18, 2018**

The Fiscal Crisis and Management Assistance Team (FCMAT), hereinafter referred to as the team, and the Imperial County Office of Education, hereinafter referred to as the COE, mutually agree as follows:

1. BASIS OF AGREEMENT

The team provides a variety of services to local educational agencies (LEAs). Pursuant to the provisions of Education Code (EC) Section 1241.5 (c), a county superintendent of schools may review or audit the expenditures and internal controls of any charter in his or her county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. The extraordinary audits conducted by the county superintendent shall be focused on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and shall be conducted in a timely and efficient manner.

All work shall be performed in accordance with the terms and conditions of this agreement.

2. SCOPE OF THE WORK

A. Scope and Objectives of the Study

The COE has requested FCMAT to assign professionals to conduct an AB 139 Extraordinary Audit. This audit will be conducted pursuant to Education Code Section 1241.5 (c). The COE has received information regarding possible fraud, misappropriation of funds or other illegal practices at the Imagine Schools at Imperial Valley and is requesting that FCMAT review the following:

1. Determine whether the charter school engaged in related-party transactions and, if so, whether those transactions were conducted in accordance with established national and state policies, standards and procedures and were transparent.
 - a. To the extent reasonably possible, identify related parties.
 - b. Review the charter petition and articles of incorporation and bylaws.
 - c. Review contracts, purchase orders and memoranda of understanding, for fiscal years 2015-16 through 2017-18 to date.

- d. Review financial transactions of the charter school and any related party for fiscal years 2015-16 through 2017-18.
 - e. Review any charter property or assets transferred to any related party for fiscal years 2015-16 through 2017-18.
 - f. Review the annual independent audits for fiscal years ending June 30, 2014; June 30, 2015; June 30, 2016; and June 30, 2017.
2. Determine if expenditures made by the charter school are for legitimate educational purposes and in accordance with approved contracts, purchase orders and memoranda of understanding.
 3. Determine whether any conflict of interest standards may have been violated by any of the charter school's local public officials, designated employees, or any "consultant to the organization who makes, participates in making, or acts in a staff capacity for making governmental decisions" as defined in the Political Reform Act (PRA) of 1974 (Government Code Sections 81000 – 91014).
 - a. Review applicable PRA Form 700 filings from 2013 through 2018.
 - b. Review applicable board meeting minutes and other documents.

The main focus of this review is to determine, based on the sample testing performed and auditor's judgment, whether (1) the charter was involved in any related-party transactions that were in conflict with state and federal policies and standards, or that violated conflict of interest laws, and whether the charter was involved in financial transactions that were not for legitimate educational purposes; and (2) based on that assessment, determine whether fraud, misappropriation of funds or other illegal fiscal practices may have occurred.

The team will review and test recorded transactions for fiscal years 2015-16 through 2017-18 to date to determine if fraud, misappropriation of funds or other illegal activities may have occurred. Testing for this review will be based on a sample of transactions and records for this period. Testing and review results are intended to provide reasonable but not absolute certainty about whether the charter's financial transactions and activity were sufficiently accurate.

B. Services and Products to be Provided

1. Orientation Meeting - The team will conduct an orientation session at the charter to brief management and supervisory personnel on the team's procedures and the purpose and schedule of the study.
2. On-site Review - The team will conduct an on-site review at the district office and at charter sites if necessary; and will continue to review pertinent documents off-site.
3. Progress Reports - The team will inform the COE of material issues as the review is performed.

4. Exit Meeting – The team will hold an exit meeting at the conclusion of the on-site review to inform the COE of any significant findings to that point.
5. Draft Report – When appropriate, electronic copies of a preliminary draft report will be delivered to the COE’s administration for review and comment on a schedule determined by the team.
6. Final Report - Electronic copies of the final report will be delivered to the COE following completion of the review. Printed copies are available from the FCMAT office upon request.
7. Follow-Up Support – If requested, the team will meet with the COE and/or charter to discuss the findings and recommendations of the report.

3. **PROJECT PERSONNEL**

The FCMAT study team may also include:

- A. *To Be Determined FCMAT Staff*
- B. *To Be Determined FCMAT Consultant*

Other equally qualified staff or consultants will be substituted in the event one of the above individuals is unable to participate in the study.

4. **PROJECT COSTS**

The cost for studies requested pursuant to EC 42127.8 (d) (1) shall be:

- A. \$1,100 per day for each staff team member while on site, conducting fieldwork at other locations, presenting reports, or participating in meetings. The cost of independent FCMAT consultants will be billed at their actual daily rate for all work performed.
- B. All out-of-pocket expenses, including travel, meals and lodging.

Based on the elements noted in Section 2A, the total estimated cost of the study will be \$36, 200.

- C. Any change to the scope will affect the estimate of total cost.

Payments for FCMAT services may be reimbursed from funds pursuant to EC 1241.5 set aside for this purpose. Other payments, when deemed necessary, are payable to Kern County Superintendent of Schools - Administrative Agent, located at 1300 17th Street, City Centre, Bakersfield, CA 93301.

5. **RESPONSIBILITIES OF THE COE AND/OR CHARTER**

- A. Provide office and conference room space during on-site reviews.
- B. Provide the following if requested:
 - 1. Policies, regulations and prior reports addressing the study request
 - 2. Current or proposed organizational charts
 - 3. Current and two prior years' audit reports
 - 4. Any documents requested on a supplemental list. Documents requested on the supplemental list should be provided to FCMAT only in electronic format; if only hard copies are available, they should be scanned by the charter and sent to FCMAT in an electronic format
 - 5. Documents should be provided in advance of fieldwork; any delay in the receipt of the requested documents may affect the start date and/or completion date of the project. Upon approval of the signed study agreement, access will be provided to FCMAT's online SharePoint document repository where the charter shall upload all requested documents.
- C. The COE's administration will review a preliminary draft copy of the report. Any comments regarding the accuracy of the data presented in the report or the practicability of the recommendations will be reviewed with the team prior to completion of the final report.

Pursuant to EC 45125.1(c), representatives of FCMAT will have limited contact with pupils. The charter shall take appropriate steps to comply with EC 45125.1(c).

6. **PROJECT SCHEDULE**

The following schedule outlines the planned completion dates for different phases of the study and will be established upon the receipt of a signed study agreement:

| | |
|--------------------------------------|-------------------------|
| <i>Orientation:</i> | <i>To be determined</i> |
| <i>Staff Interviews:</i> | <i>To be determined</i> |
| <i>Exit Meeting:</i> | <i>To be determined</i> |
| <i>Preliminary Report Submitted:</i> | <i>To be determined</i> |
| <i>Final Report Submitted:</i> | <i>To be determined</i> |

7. **COMMENCEMENT, TERMINATION AND COMPLETION OF WORK**

FCMAT will begin work as soon as it has assembled an available and appropriate study team consisting of FCMAT staff and independent consultants, taking into consideration other jobs FCMAT has previously undertaken and assignments from the state. The team will work expeditiously to complete its work and deliver its report, subject to the cooperation of the charter and any other parties from which, in the team's judgment, it must obtain information. Once the team has completed its fieldwork, it will proceed to prepare a preliminary draft report and a final report. Prior to completion of fieldwork, the COE may terminate its request for service and will be responsible for all costs incurred by FCMAT to the date of termination under Section 4 (Project Costs). If the COE does

not provide written notice of termination prior to completion of fieldwork, the team will complete its work and deliver its report and the COE will be responsible for the full costs. The COE understands and agrees that FCMAT is a state agency and all FCMAT reports are published on the FCMAT website and made available to interested parties in state government. In the absence of extraordinary circumstances, FCMAT will not withhold preparation, publication and distribution of a report once fieldwork has been completed, and the COE shall not request that it do so.

8. INDEPENDENT CONTRACTOR

FCMAT is an independent contractor and is not an employee or engaged in any manner with the COE. The manner in which FCMAT's services are rendered shall be within its sole control and discretion. FCMAT representatives are not authorized to speak for, represent, or obligate the COE in any manner without prior express written authorization from an officer of the COE.

9. INSURANCE

During the term of this agreement, FCMAT shall maintain liability insurance of not less than \$1 million unless otherwise agreed upon in writing by the COE, automobile liability insurance in the amount required under California state law, and workers compensation as required under California state law. FCMAT shall provide certificates of insurance, with Imperial County Office of Education named as additional insured, indicating applicable insurance coverages upon request.

10. HOLD HARMLESS

FCMAT shall hold the COE, its board, officers, agents and employees harmless from all suits, claims and liabilities resulting from negligent acts or omissions of its board, officers, agents and employees undertaken under this agreement. Conversely, the COE shall hold FCMAT, its board, officers, agents and employees harmless from all suits, claims and liabilities resulting from negligent acts or omissions of its board, officers, agents and employees undertaken under this agreement.

11. CONTACT PERSON

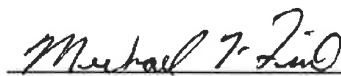
Contact: Todd Finnell, County Superintendent
 Telephone: (760) 312-6440
 E-mail Address: todd.finnell@icoe.org



4/18/18

Todd Finnell, County Superintendent
 Imperial County Office of Education

Date



April 18, 2018

Michael H. Fine
 Chief Executive Officer
 Fiscal Crisis & Management Assistance Team

Date