

# STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



## KINSTON CHARTER ACADEMY

KINSTON, NORTH CAROLINA

INVESTIGATIVE REPORT

JANUARY 2015



**NC**  **OSA**  
The Taxpayers' Watchdog

# EXECUTIVE SUMMARY

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## **PURPOSE**

The Office of the State Auditor received allegations from the North Carolina Department of Public Instruction (DPI) regarding potential misspending by administrators at Kinston Charter Academy (School).

## **BACKGROUND**

The School opened in 2004 and served students from Lenoir, Pitt, and Greene counties in kindergarten through eighth grade. The School relinquished its charter on September 4, 2013, in response to DPI's concerns about the School's finances and administrative oversight.

## **KEY FINDINGS**

- School received \$666,818 of state appropriations despite multiple citations for fiscal mismanagement.
- School overstated attendance estimate which inflated state funds received by more than \$300,000.
- Inexperience and limited participation led to inadequate board and administrative oversight of School.
- School employed Chief Executive Officer/Principal's (CEO) unqualified relatives, at a cost of \$92,500 in the School's final year.
- Despite ultimately owing more than \$370,000 in payroll obligations, questionable payments of more than \$11,000 were made to the CEO and his wife.
- Declining student attendance, unrealized private donations, and high operating costs contributed to School's insolvency.

## **KEY RECOMMENDATIONS**

- The State Board of Education (State Board) should establish guidelines regarding the frequency and significance of financial performance/compliance issues that are allowed before a school charter is revoked or not renewed.
- The State Board should seek legislative changes to revise its annual funding model to require documentation from schools to support projected attendance increases, especially for schools with financial performance or compliance issues.
- The State Board should require charter schools to include at least one board member with training and/or experience in school administration, one board member with a business background, and one senior administrator with a school administration background.
- The State Board should prohibit familial relationships at charter schools between board members and senior administrators.
- DPI should consider pursuing civil action to recover any misspent funds including more than \$11,000 of vacation payouts to the CEO and his wife.
- The State Board should closely review a school's projected financial solvency when approving the initial charter or renewing charters.

*The key findings and recommendations in this summary may not be inclusive of all the findings and recommendations in this report.*

STATE OF NORTH CAROLINA  
**Office of the State Auditor**



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## AUDITOR'S TRANSMITTAL

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January 28, 2015

The Honorable Pat McCrory, Governor  
Members of the North Carolina General Assembly  
Dr. June St. Clair Atkinson, State Superintendent of Public Instruction  
Mr. William Cobey, Chairman, State Board of Education  
Mr. Ozie Lee Hall, Jr., Chief Executive Officer/Principal, Kinston Charter Academy  
Demyra R. McDonald Hall, Chairman of the Board, Kinston Charter Academy

Ladies and Gentlemen:

Pursuant to North Carolina General Statute §147-64.6(c)(16), we have completed an investigation of allegations concerning Kinston Charter Academy. The results of our investigation, along with recommendations for corrective action, are contained in this report.

Copies of this report have been provided to the Governor, the Attorney General and other appropriate officials in accordance with G.S. §147-64.6(c)(12). We appreciate the cooperation received from management and the employees of Kinston Charter Academy and the North Carolina Department of Public Instruction during our investigation.

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor



Beth A. Wood, CPA  
State Auditor

# Table of Contents

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	<b>PAGE</b>
INTRODUCTION.....	1
BACKGROUND.....	2
FINDINGS AND RECOMMENDATIONS.....	4
MATTERS FOR FURTHER CONSIDERATION.....	16
APPENDICES.....	17
RESPONSE FROM STATE BOARD OF EDUCATION AND DEPARTMENT OF PUBLIC INSTRUCTION.....	28
STATE AUDITOR’S RESPONSE.....	44
RESPONSE FROM KINSTON CHARTER ACADEMY.....	46
ORDERING INFORMATION.....	72

Article V, Chapter 147 of the North Carolina General Statutes, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency and any organization that receives public funding. The Auditor also has the power to summon people to produce records and to answer questions under oath.



# **INTRODUCTION AND ORGANIZATION OVERVIEW**

The Office of the State Auditor received allegations from the North Carolina Department of Public Instruction (DPI) concerning the operations of Kinston Charter Academy (School) which relinquished its charter on September 4, 2013. DPI suspected potential misspending of state and federal funds by the School's Chief Executive Officer/Principal.

Our investigation of these allegations included the following procedures:

- Review of *North Carolina General Statutes*, *North Carolina Administrative Code*, and State Board of Education and DPI policies and procedures
- Interviews of DPI's Office of Charter Schools and Division of School Business Services staff, School employees and board members, local school systems officials, public accounting firm representatives, various bank/credit union officials, and other state government representatives from the North Carolina Department of Commerce's Division of Employment Security and the North Carolina Department of State Treasurer's State Health Plan and State Retirement System
- Examination and analysis of the School's available financial documents and records
- Examination of charter school financial and academic summary data
- Forensic examination of selected School computers

This report presents the results of our investigation. The investigation was conducted pursuant to *North Carolina General Statute §147-64.6(c)(16)*.

### **Charter Schools**

The North Carolina General Assembly ratified House Bill 955 on June 21, 1996,<sup>1</sup> which established charter schools in North Carolina. A board of directors of a non-profit entity operates each charter school and submits an application for its charter to the North Carolina Charter School Advisory Board<sup>2</sup> with final approval by the State Board of Education (State Board). Each charter school's board of directors makes decisions regarding each school's operations, budget, and curriculum.

Charter schools are public schools and are accountable to the State Board for compliance with applicable laws and the provisions of their charters. Charter schools are publicly-funded. The State Board provides funding based on an allocation per student as required by law.

### **Kinston Charter Academy**<sup>3</sup>

A Kinston businessman founded Kinston Charter Academy (School) in 2004 with the assistance of the Greater Kinston Community Development Corporation to provide more educational opportunities for local children. The School purchased a vacant manufacturing building in Kinston and retro-fitted it into an academic building with multiple classrooms, a library, and cafeteria. The School served children from kindergarten through eighth grade and provided transportation for students from Lenoir, Pitt, and Greene counties.

The School was led by a Chief Executive Officer/Principal (CEO) under the direction of a volunteer board of directors. In accordance with the Charter School Act, the board was responsible for operations including budgeting and curriculum. The CEO acted as both the financial and academic leader of the School.

The School experienced financial solvency problems from its inception. The CEO said that the School would have closed due to financial problems in 2007 if not for personal loans that five of the eight board members took out.<sup>4</sup> The North Carolina Department of Public Instruction (DPI) cited the School on multiple occasions from 2008 through 2013 regarding financial deficiencies. DPI raised the warning status in 2010 and began to take more serious actions against the School in 2013.

In August 2013, DPI notified the School of its intention to recommend that the State Board revoke the School's charter. On September 4, 2013, the State Board planned to initiate revocation but the School surrendered its charter voluntarily at the State Board meeting. The School's last day of classes was September 6, 2013. The existing students transferred either to other charter schools, such as Children's Village Academy in Kinston, or to public schools in Lenoir and Pitt counties.

### **State Board of Education**<sup>5</sup>

The State Board consists of the Lieutenant Governor and the State Treasurer who serve as ex-officio members with 11 other members appointed by the Governor and confirmed by the

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<sup>1</sup> North Carolina General Statute §115C-238.29A

<sup>2</sup> The Charter School Advisory Board makes recommendations to the State Board on the adoptions of rules governing charter schools; approval of charters; and renewal, non-renewal, or revocations of charters.

<sup>3</sup> <http://www.kinstoncharter.com/>

<sup>4</sup> The CEO's wife (board chair) was one of three board members who did not secure a personal loan to keep the School open in 2007.

<sup>5</sup> <http://stateboard.ncpublicschools.gov/>

General Assembly. Pursuant to the State Constitution, “State Board of Education shall supervise and administer the free public school system and the educational funds provided for its support, and shall make all needed rules and regulations subject to laws enacted by the General Assembly.” The State Board establishes official policies specific to charter schools.

### **North Carolina Department of Public Instruction**<sup>6</sup>

DPI is charged with implementing the State’s public school laws and the State Board’s policies and procedures governing kindergarten through 12th grade public education, including charter schools. The elected State Superintendent of Public Instruction leads DPI under the policy direction of the State Board.

#### *Office of Charter Schools*<sup>7</sup>

The Office of Charter Schools provides guidance, support, and oversight for 126 approved charter schools.<sup>8</sup> The Office of Charter Schools included a director and five other positions when Kinston Charter Academy closed. These employees provide training and programmatic oversight of charter schools and coordinate financial oversight with DPI’s Division of School Business Services.

#### *Division of School Business Services*

The Division of School Business Services is responsible for monitoring all financial, salary, student accounting, and allotment laws and policies for public and charter schools. This division also works with local school districts and charter schools to ensure compliance with state and federal laws. The division has 30 positions. Its employees collect, compile, analyze, and report financial, student, and personnel data for all 115 local school districts and 126 charter schools<sup>9</sup> throughout the State.

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<sup>6</sup> <http://www.ncpublicschools.org/organization/>

<sup>7</sup> <http://www.ncpublicschools.org/charterschools/>

<sup>8</sup> As of September 2013

<sup>9</sup> Ibid.





# **FINDINGS, RECOMMENDATIONS, AND RESPONSES**

## 1. SCHOOL RECEIVED \$666,818 OF STATE APPROPRIATIONS IN JULY 2013 DESPITE MULTIPLE CITATIONS FOR FISCAL MISMANAGEMENT

The North Carolina Department of Public Instruction (DPI) cited Kinston Charter Academy (School) for financial deficiencies multiple times over six years. However, the State Board of Education (State Board) did not initiate revocation of the School's charter until after the School received \$666,818 of state-appropriated funds in July 2013. As a result, the Chief Executive Officer/Principal (CEO) was able to spend state funds appropriated for the 2013-14 school year to pay expenses incurred during the prior school year. For example:

- On July 22, 2013, the School paid off two \$100,000 loans obtained on May 31, 2013, and June 27, 2013. These loans were paid in full after the School received its initial installment of state funds for 2013-14. (See Finding 6)
- After receiving its initial 2013-14 installment from DPI, the School paid the Department of State Treasurer's State Health Plan \$80,731 for unpaid contributions from the previous school year. (See Finding 5)

State law<sup>10</sup> and the State Board's *Policy Manual* outline the actions DPI may take including recommending termination or nonrenewal of a charter to the State Board for "failure to meet generally accepted standards of fiscal management." However, state law and State Board policies do not have established criteria for recommending revocation of a school's charter specific to the length or magnitude of financial issues. Instead, DPI takes action on a case-by-case basis through the annual review of audited financial statements and the charter renewal process.<sup>11</sup>

Under state law and State Board policy, circumstances such as repeated deficit fund balances or declining financial ratios do not automatically initiate the charter revocation process. Even though the School accumulated deficit fund balances during six of seven years, these financial deficiencies were not enough to initiate charter revocation.

DPI cited the School multiple times for financial issues beginning in 2008 but the State Board did not initiate revocation of the School's charter until 2013. (See Appendix A)

- On June 5, 2008, DPI placed the School on "Financial Probationary Status" due to the School's \$354,292 deficit fund balance for the fiscal year ended June 30, 2007. (See Appendix B)
- On March 24, 2010, DPI raised the action to the highest level, "Financial Disciplinary Status."
- On March 8, 2012, DPI notified the School that the remaining allotments for the 2011-12 school year would be provided in monthly installments rather than a lump sum installment for the final third of the academic year.<sup>12</sup> However, during the

<sup>10</sup> North Carolina General Statute § 115-238.29G

<sup>11</sup> The State Board may grant a charter lasting up to 10 years with renewal of the original charter to last as long as 10 years.

<sup>12</sup> Charter schools typically receive allotments in three installments per year with 34% provided after the General Assembly adjourns, 34% in October, and the remaining 32% in February.

2012-13 and 2013-14 school years, DPI returned the School to the three installments per year schedule rather than keeping it on a monthly installment schedule.

- On June 5, 2013, DPI placed the School on “Governance Cautionary Status” for failure to submit employee benefit contributions.<sup>13</sup>
- On August 2, 2013, the Office of Charter Schools sent the School a letter warning of the potential closing of the School.
- On August 16, 2013, the Office of Charter Schools raised the disciplinary status to “Governance Noncompliance Status” and sent another letter indicating DPI’s intention to recommend initiation of revocation of the School’s charter at the next State Board meeting on September 4, 2013, for failure to respond to or resolve issues identified in the June 2013 letter.

During the final year of the School’s operation, DPI exchanged multiple communications with the School regarding concerns about finances, programmatic issues, and academic performance. (See Appendix C) In a March 12, 2013 phone call, the CEO acknowledged that the School had “budgeting concerns” and mentioned “the possibility that the school would be closing.” Nevertheless, DPI provided the full initial installment of \$666,818 in July 2013.

DPI could not recover any of the state-appropriated funds. In July, August, and September 2013, the School spent the entire first installment of the allotment for the 2013-14 school year even though it closed on September 6, 2013, the ninth day of classes. (See Appendix D) The funds were intended to last until the School’s next installment was paid in October. However, the School voluntarily surrendered its charter at the State Board meeting on September 4, 2013.

### **RECOMMENDATIONS**

The State Board should establish guidelines regarding the frequency and significance of financial performance/compliance issues that are allowed before a charter is revoked or not renewed.

The State Board should establish criteria to consider taking more prompt action if a charter school experiences financial performance issues.

The State Board should consider requiring any charter school on financial probationary, financial disciplinary, governance cautionary, or governance noncompliance status to submit monthly financial statements to DPI’s Division of School Business Services for review.

For schools cited for financial performance/compliance issues, the State Board should consider only permitting monthly installments rather than the larger, three installments per year. The charter school should demonstrate and document significant financial improvements over a full academic year prior to reinstating the larger installment schedule.

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<sup>13</sup> The School withheld funds from employee paychecks but did not submit health insurance premiums to the Department of State Treasurer’s State Health Plan and retirement contributions to the Department of State Treasurer’s State Retirement System.

The State Board should adopt policies and procedures for recovery of state funds when a school’s charter is revoked or relinquished prior to the end of the academic year.

The State Board and DPI should seek legal counsel regarding potential civil action concerning the CEO’s mismanagement of the \$666,818 initial installment of the 2013-14 allotment.

**Note: This finding referred to the State Bureau of Investigation and the District Attorney for Lenoir County.**

**2. SCHOOL OVERSTATED ATTENDANCE ESTIMATE WHICH INFLATED STATE FUNDS RECEIVED BY MORE THAN \$300,000**

Kinston Charter Academy (School) estimated its initial Average Daily Membership (ADM)<sup>14</sup> by 20% more than the previous year’s planning ADM.<sup>15</sup> (See Table 1) The School received \$666,818 in July 2013 for an estimated initial ADM of 366 students even though the School’s ADM decreased each of the previous three years. As permitted by state law, the estimated ADM of 366 for 2013-14 is exactly 20% greater than the planning ADM of 305, which was the higher of the first two months’ ADM for the prior school year.

<b>Academic Year</b>	<b>Planning ADM</b>	<b>Estimated Initial ADM</b>	<b>% Increase</b>
2009-10	362	381	5.2%
2010-11	358	387	8.1%
2011-12	344	413	20.1%
2012-13	310	372	20.0%
2013-14	305	366	20.0%

Actual attendance on September 3, 2013, was 189 students, according to the Chief Executive Officer/Principal (CEO). The School provided no evidence supporting an estimated student attendance increase. As shown in Table 2, the ADM actually decreased each of the prior three school years.

Because the CEO overstated ADM by 177 students, the School received an initial installment of its allotment of state-appropriated funds which was inflated by more than \$300,000. Because the North Carolina Department of Public Instruction (DPI) does not

<sup>14</sup> Each charter school’s allocation is provided according to its ADM and the dollars per ADM for the local school district in which the charter school is located. According to the 2013-14 *Allotment Policy Manual*, ADM is “the sum of the number of days in membership for all students in individual Local Education Agencies (LEAs), divided by the number of school days in the term.” Average daily membership provides a more accurate count of the number of students than enrollment.

<sup>15</sup> Planning ADM is the higher of the first two months ADM of the prior year. Charter schools are permitted to request an initial installment for the planning ADM plus a 20% increase.

correct an overstated initial ADM until the second installment is adjusted in October,<sup>16</sup> the School was able to spend the initial installment before DPI could recover the funds.

<b>Academic Year</b>	<b>ADM<sup>17</sup></b>	<b>Estimated Initial ADM<sup>18</sup></b>	<b>% Initial ADM Overstated</b>
2009-10	346	381	10.1%
2010-11	331	387	16.9%
2011-12	296	413	39.5%
2012-13	274	372	35.8%
2013-14	189 <sup>19</sup>	366	93.7%

The School took advantage of the State’s annual funding model<sup>20</sup> to pay existing financial obligations rather than costs related to the upcoming school year. The CEO said that the School’s financial situation caused it to regularly pay existing obligations with each year’s initial installment. For example, the School used the initial installment in July 2013 to pay off short-term loans that had excessive fees. (See Findings 1 and 6)

The State’s funding model allowed the School to receive the maximum amount the State allows for the first funding installment each school year without documenting any actual increase in student attendance or seeking approval from the State Board of Education (State Board). According to state law<sup>21</sup> and the *Allotment Policy Manual*, charter schools estimate their ADM prior to each school year’s start. Each school’s initial installment is based on this estimate. The existing policy allows a school to estimate attendance that is 20% higher than the prior year’s planning ADM. State law and the *Allotment Policy Manual* only requires that charter schools obtain approval from the State Board if the estimated student attendance increases are more than 20%.

**RECOMMENDATIONS**

The State Board should seek legislative changes to revise the annual funding model to require documentation supporting increases over prior-year ADM, especially for schools with financial performance/compliance issues, to provide a more realistic estimate of expected student attendance.

**Note: This finding referred to the State Bureau of Investigation and the District Attorney for Lenoir County.**

<sup>16</sup> DPI recalculates the ADM after the first month’s totals are submitted and decreases the second installment if that first month ADM is lower than originally estimated.

<sup>17</sup> Year-end ADM based on School’s statistical profile on DPI website: <http://apps.schools.nc.gov/pls/apex/f?p=1:71:0::NO::>

<sup>18</sup> Estimated Initial ADM provided by DPI’s Division of School Business Services

<sup>19</sup> Amount provided by CEO. This amount is not indicative of a full school year but rather the nine days of operation during the 2013-14 school year.

<sup>20</sup> North Carolina General Statute § 115C-238.29H

<sup>21</sup> North Carolina General Statute § 115C-238.29D(e), (f)

### 3. INEXPERIENCE AND LIMITED PARTICIPATION LED TO INADEQUATE BOARD AND ADMINISTRATIVE OVERSIGHT OF SCHOOL

Kinston Charter Academy's (School) volunteer board and Chief Executive Officer/Principal (CEO) lacked experience in school administration. In addition, board members frequently did not attend board meetings. Their lack of experience and involvement resulted in insufficient oversight.

#### **Board and CEO Lacked Background/Experience to Properly Oversee School**

The School's board did not include individuals with education degrees or prior experience in teaching or school administration and the CEO had no prior experience in education until joining the School as a contractor in 2007. The School's board included individuals with experience in social work, private law practice, military, and law enforcement.

Although the CEO received degrees in education and administration,<sup>22</sup> his background lacked key qualifications for the position as specified in the School's 2004 charter. He told investigators that he "ran an alternative school" in Wilmington, Delaware from 1986 to 1990.<sup>23</sup> However, the CEO provided no documentation (no information on students, teachers, curriculum, address, hours of instruction) to support that claim. The Delaware Department of Education and Delaware Public Archives could not verify the school's existence.

While some charter schools may be successful with boards or administrators without education or experience in academics or finance, the lack of education or experience increased the risk that the School would not be properly managed. According to the Business Plan in the School's charter application, the School's "governance will be entirely in the hands of the Board of Directors." Further, the charter states the board "will be responsible for the curriculum and overall management, including hiring staff, the budget, and school operations."

Despite the School's dire financial situation, the board approved several expenses already paid by cashier's check and often with limited supporting documentation. These expenses included vacation leave payouts to the CEO and his wife, who was serving as the board chair, and a new laptop computer for the CEO. The board's lack of business judgment was demonstrated by a board member who told investigators the board approved the vacation payouts to the CEO and his wife to retain the CEO. Those payouts were made even though the School was unable to pay teachers and other school administrators in its final month of operation. (See Finding 5) State law and State Board of Education (State Board) policies did not require charter school boards or administrators to have education or experience in teaching, school administration, or

<sup>22</sup> Master of Arts in Education and Master of Science in Administration through Central Michigan University's program at Seymour Johnson Air Force Base in Goldsboro, NC

<sup>23</sup> The CEO's resume' indicates that he had a high school degree at the time that he said he led the alternative school.

finance. The School's charter application requires the CEO to have "experience in teaching and school administration" and prefers a "doctorate in administration."

**Limited Board Meeting Attendance Led to Inadequate Oversight**

During the final year of operation, board meetings sometimes included only two of five members in physical attendance:<sup>24</sup> the chair and an original member. The other three members, with a year or less tenure on the board, were routinely either absent or attended via telephone.

An inactive or inattentive board increases the risk of poor management oversight. Because the board chair married the School's CEO, she recused herself from voting on many issues, leaving only two board members to vote on important matters such as obtaining short-term financing, determining which expenses to pay, and ultimately deciding to relinquish the charter.

The General Statutes and State Board policies did not specify board member attendance requirements. The School's charter and by-laws also did not include attendance requirements for board members.

**RECOMMENDATIONS**

The State Board should require all charter school boards to have at least one member with training and/or experience in school administration as well as one member with a business background. Strong consideration should be given to charter school applications that include multiple board members and senior administrators with school administration backgrounds. Preferably, the State Board should require at least one member of a charter school's senior administration to have a background in school administration.

The State Board should establish attendance requirements for all charter school boards. Failure to document active board participation should be considered when determining whether to renew or revoke a school's charter.

For charter schools under financial probationary or disciplinary status, DPI should require that board members certify their review of expenditures and comparison of expenditures to the school's budget on a monthly basis.

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**4. SCHOOL INCURRED UNNECESSARY EXPENSES DUE TO THE EMPLOYMENT OF CEO'S UNQUALIFIED RELATIVES**

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Despite its strained finances, Kinston Charter Academy (School) paid the Chief Executive Officer/Principal's (CEO) family members \$92,500 during its final year of operation. Because these family members had limited related educational or work experience for the duties they performed, these payroll expenses appeared unnecessary and contributed to inadequate school administration.

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<sup>24</sup> Initially, the board consisted of 10 members but membership decreased to five during the final years of operation.

According to the CEO, a board member, and the board minutes, the board approved the hiring of all staff in one motion at a board meeting. However, the CEO's wife was the board chair and his first cousin held another board position.

In addition to serving as board chair, the CEO's wife held the position of "Dean of Students." However, she was a licensed attorney who did not have a degree in education nor any experience as a teacher or school administrator. The CEO's wife received \$50,000 in salary during the 2012-13 school year. In addition, the wife received \$2,000 for "contracted legal services" from the School from June through August 2011. The CEO said those payments were not necessarily "legal services" but rather "reimbursements" because she "handled some matters for the School such as Lenoir County and Acadia Northstar litigation."

The CEO's daughter was hired as the School's academic officer despite a lack of teaching or school administration experience. She received \$40,000 in salary during the 2012-13 school year. The CEO said her duties included monitoring lesson plans for elementary school classes and helping with implementation of Common Core standards. The daughter was a recent college graduate with a degree in American Studies. The CEO told us that she had never worked in a school previous to her employment at the School. She replaced the associate principal who had over 20 years of experience in public schools with her most recent job as "an assistant to the Superintendent" according to the CEO.

Another daughter of the CEO received \$2,500 for website re-design in August 2013. However, the CEO acknowledged that the new website never became operational.

The School did not have a nepotism policy in its original 2004 charter. The North Carolina Department of Public Instruction (DPI) did not require one until 2012. According to DPI officials, the School would have been required to develop a nepotism policy as part of the charter renewal process.

Nepotism may conflict with hiring and promoting the most qualified candidate for a job.<sup>25</sup> In publicly-funded organizations, nepotism may create the appearance of impropriety. Hiring someone based on familial relationships rather than credentials and experience may lead to inferior service.<sup>26</sup>

## RECOMMENDATIONS

The State Board of Education (State Board) should prohibit familial relationships at charter schools between board members and senior administrators.

The State Board should consider prohibiting the employment of family members at charter schools. At a minimum, the State Board should require that the hiring of family members of charter school administrators or board members be specifically approved by the charter school's board.

Charter schools should be required to notify the Office of Charter Schools of the hiring of family members.

<sup>25</sup> <http://smallbusiness.chron.com/business-ethics-nepotism-72225.html>

<sup>26</sup> [http://www.scu.edu/ethics/practicing/focusareas/government\\_ethics/introduction/cronyism.html](http://www.scu.edu/ethics/practicing/focusareas/government_ethics/introduction/cronyism.html)



Each charter school’s board should ensure that family members hired or appointed have the necessary qualifications.

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**5. DESPITE ULTIMATELY OWING MORE THAN \$370,000 IN PAYROLL OBLIGATIONS, QUESTIONABLE PAYMENTS MADE TO SCHOOL’S CEO AND HIS WIFE**

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Kinston Charter Academy (School) regularly missed salary payments to teachers and staff and failed to submit required employee benefit payments to state and federal agencies. The School’s payroll obligations totaled more than \$370,000 as of July 2014. (See Table 3)

- From December 2009 through July 2012, the School repeatedly failed to submit required unemployment tax payments to the North Carolina Department of Commerce, Division of Employment Security (DES). The School entered into a payment arrangement with DES and submitted payments for the next five months until stopping in January 2013.
- The School repeatedly missed monthly salary payments to teachers and staff and then made up those payments at a later date. The CEO said that teachers “made sacrifices” when “the School had cash flow issues” and “worked like May and June without pay.” He said that alleged bonus payments in July 2011 were payments to make up for when “one month there was no payroll and the other month...only maybe the bus drivers got paid.” The CEO said similar delayed salary payments “happened almost every year” with teachers and staff receiving payment once the next year’s first installment of state funds arrived in July.
- Due to spending its entire initial 2013-14 installment, the School did not pay salaries or benefits to employees for September 2013 and did not submit required payroll taxes (state and federal). These amounts remained unpaid as of July 2014.
- The School also failed to submit State Retirement System contributions on 20 occasions during its last four years of operation with the last submission in July 2013. After receiving its initial 2013-14 installment from the North Carolina Department of Public Instruction (DPI), the School submitted \$80,731 for State Health Plan contributions not paid during the 2012-13 school year. The School still owes interest on the delinquent balance.

Unemployment Taxes	\$285,290
Salaries (for September 2013)	30,261
Federal Tax Withholdings	34,592
State Tax Withholdings	6,312
Retirement Contributions	11,256
Life, Accident, and Disability Insurance	2,483
State Health Plan (interest accrued as of June 2014)	631
<b>Total</b>	<b>\$370,825</b>

<sup>27</sup> Amounts still owed as of July 2014.

The lack of employee benefit submissions resulted in DPI issuing another financial disciplinary status notification and “governance” notification, which led to the School surrendering its charter in September 2013. (See Finding 1)

Despite the potential closing of the School and its financial problems, the School paid the Chief Executive Officer/Principal (CEO) and his wife more than \$11,000 for vacation leave during the last month of operation. According to the board minutes, the CEO received \$9,943 for unused annual leave and the board chair/CEO’s wife received \$1,155 for “an advance from her annual leave” in August 2013. The Board approved these payments at its meeting on September 12, 2013, eight days after the School relinquished its charter.

The CEO gave conflicting statements regarding why he and his wife accepted these payments given the financial situation. First, he said “we were going to leave” because he said he had secured a management team to keep the School open while he transitioned out of its management. Next, he said they requested the payments because they were due to them but he admitted the vacation payouts had not been sought in previous years when due. Then, he said that the board wanted to make the “records clear” since the CEO was leaving. The CEO stated he and his wife “[didn’t] need the money” before contradicting himself by saying that they “needed the money.” Finally, he said the word “advance” in the board minutes was used in error, because the CEO’s wife was “owed the funds.”

During the 2012-13 school year, the School’s teachers and staff signed a document titled “*Consent to Payroll Benefits Delay*.” That document stated, “The Undersigned hereby acknowledges that Kinston Charter Academy, in an effort to meet its cash flow needs and remain open, has experienced delays in payment of health insurance premiums and retirement contributions. This will acknowledge that I have been made aware of this issue...and consent to the same with the understanding the school will get this resolved by July 30, 2013.” Despite the employees signing those releases, the School had no authority to skip these required submissions of employee withholdings.

*North Carolina General Statute §115C-238.29F(e)(4)* requires that charter school employees “be deemed employees of the local school administrative unit for purposes of providing certain State-funded employee benefits, including membership in the Teachers’ and State Employees’ Retirement System and the State Health Plan for Teachers and State Employees.” *North Carolina General Statute §105-163.2* requires the submission of state payroll taxes. *IRS Publication 15 (Circular E)* requires that employers submit federal payroll taxes on a regular basis. *North Carolina General Statute §96-9.2* and *§96-9.6* require employers to submit contributions to the Unemployment Insurance Fund each calendar year.

## RECOMMENDATIONS

DPI should actively monitor whether charter schools are submitting payments on behalf of employees for unemployment, health insurance, federal and state payroll taxes, and retirement contributions, especially for schools on financial probationary or disciplinary status.

The State Board in conjunction with DPI should consider pursuing civil action to recover vacation payouts to the CEO and his wife.

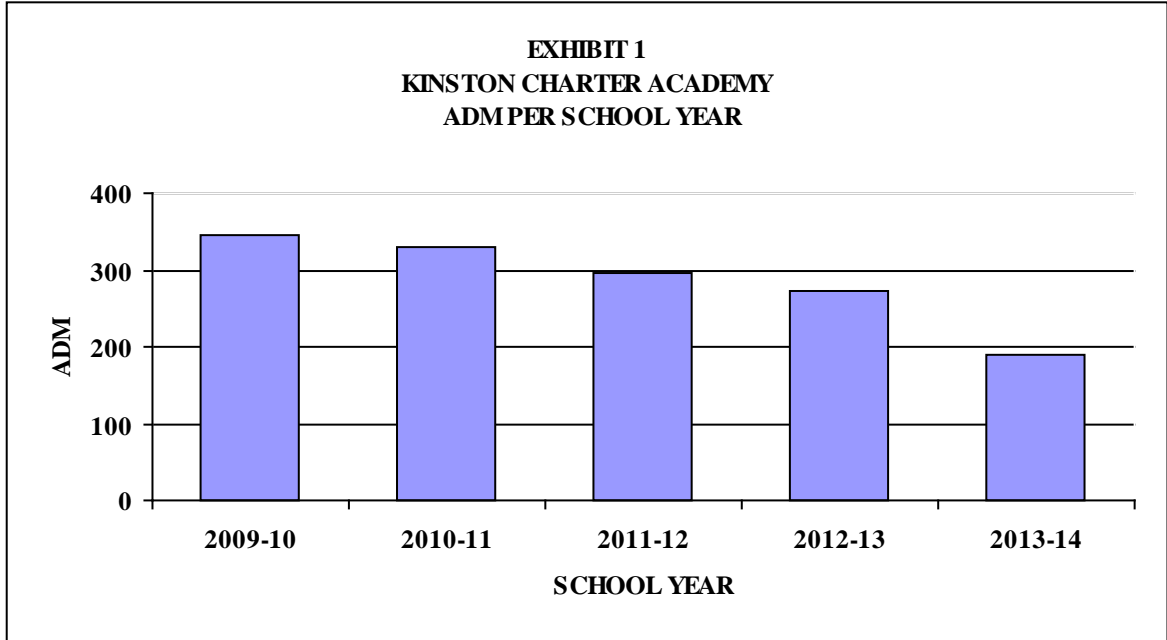
**Note:** This finding referred to the North Carolina Department of Commerce’s Division of Employment Security; North Carolina Department of State Treasurer’s State Retirement System; North Carolina Department of State Treasurer’s State Health Plan; North Carolina Department of Revenue; Internal Revenue Service; State Bureau of Investigation; and the District Attorney for Lenoir County.

**6. DECLINING STUDENT ATTENDANCE, UNREALIZED PRIVATE DONATIONS, AND HIGH OPERATING COSTS CONTRIBUTED TO SCHOOL’S INSOLVENCY**

Kinston Charter Academy’s (School) attendance declined 21% between 2009 and 2013 which reduced its annual state appropriations. In addition, the School never received promised private donations and incurred significant expenses that drove up its operating costs.

**Declining Student Attendance Resulted in Decreasing State Appropriations**

The School’s Average Daily Membership (ADM) decreased from a high of 346 in 2009-10 to 274 in 2012-13. (See Exhibit 1) Because state appropriations (allotments) are based on a per-student allocation, ADM decreases led to smaller allotments. As a result, the decreased allotments were inadequate to meet the budget given the high fixed costs the School needed to cover.



The CEO blamed the declining student attendance on public schools opening in the vicinity of the School, the retirement of experienced teachers in 2008 and 2009, a lack of extra-curricular activities, and an increase of students with disciplinary problems. North Carolina General Statute §115C-238.29E(d) states that attendance, staffing, budgeting, and operating issues are the responsibility of the School’s board and administrative leadership.

### **Greater Kinston Credit Union Failed to Honor Annual \$100,000 Commitment**

The Greater Kinston Credit Union (Credit Union) never honored its commitment to provide \$100,000 annually to the School. Review of bank statements and general ledger accounts confirmed the lack of any donations from the Credit Union to the School over the last seven years of operation.

Given the high administrative costs and unrealistic financial model, the unfulfilled donations placed the School's finances at higher risk. In the March 24, 2010 letter placing the School on financial disciplinary status, DPI officials warned the School's CEO not to depend on these unrealized donations when developing a "sound fiscal written plan to reduce [the School's] deficit."

The School's charter included a commitment for \$100,000 per year from the Credit Union. The School's founder was the president of the Credit Union prior to his death. After his death, the Credit Union's involvement with the School diminished.

### **Excessive Fees for Short-term Financing**

The School paid extremely high fees on two short-term loans obtained on **May 31, 2013** and **June 27, 2013**. These loans were paid in full on **July 22, 2013**, after the School received its initial installment for 2013-14. Because traditional financing was unavailable given the School's financial situation, the Chief Executive Officer/Principal (CEO) found financing through two companies that required \$15,000 "financial services fees" and \$15,000 "origination fees" on each \$100,000 loan.

The School actually received \$170,000 but paid back \$230,000. Given these fees and the short-term duration of the loans, the School ultimately paid interest rates of **515.29%** on one loan (25 days) and **247.74%** on the other loan (52 days).

The CEO said he chose to pay those fees because no other financing was available to keep the School open. The board gave the CEO approval to obtain financing at its May 6, 2013, meeting. DPI was unaware that the board gave the CEO approval to obtain these loans until July 29, 2013, after the loans had been repaid. Because charter school boards have ultimate authority over their finances and operations, no requirement exists to inform DPI that charter schools are incurring additional debt.

### **Transportation Costs Further Compromised the Budget**

The School's budget also had to accommodate transportation costs unlike many charter schools that do not provide transportation. The School purchased 12 buses to provide transportation to students from Lenoir, Pitt, and Greene counties. Transportation costs averaged more than \$57,000 per year over the last five years of operation. Because the School served a large percentage of students from economically-disadvantaged backgrounds, the School's board chose to provide transportation to those students. For the 2013-14 school year, only 37 of 126 charter schools provided student transportation.

### **Significant Maintenance Costs Contributed to Budget Problems**

Because the School's building was built in 1986, the School encountered significant maintenance costs that further strained its finances. During the last five years of operation, the School averaged more than \$50,000 per year in maintenance costs. For

example, replacement of the heating, ventilation, and air conditioning (HVAC) units totaled \$158,738 in school years 2007-08 and 2010-11.

The CEO said that the School's founders knew that the two HVAC units would need replacement. He said the School should have initially budgeted for the replacement costs. DPI officials noted that the School's board and administrative leadership were responsible for budgeting for all known or expected costs.

### **High Mortgage Interest Rate Contributed to Budget Problems**

The School's mortgage rate of 8.25% with Self-Help Credit Union resulted in higher mortgage payments. The School paid as much as \$286,232<sup>28</sup> annually on its 20-year mortgage for the school building.

The School could not refinance at a lower rate due to its financial situation. The CEO attempted to refinance the mortgage but could not find a willing lender as confirmed with a local bank and a local credit union.

## **RECOMMENDATIONS**

The State Board of Education (State Board) should closely review a school's projected financial solvency when approving the initial charter or renewing charters.

The State Board should require charter schools to immediately disclose any undertaking of debt, especially for schools on financial probationary or disciplinary status.

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<sup>28</sup> Mortgage payment through June 30, 2008, which decreased to \$229,846 after July 1, 2008. Two mortgages were payable to Self-Help Credit Union and the U.S. Department of Agriculture (USDA). The USDA mortgage was 20 years at 4.0%.

The Department of Public Instruction (DPI) identified academic performance issues at Kinston Charter Academy (School) but the School closed before the State Board of Education (State Board) could revoke its charter for “inadequate performance.” In September 2012, DPI notified the School of its academic inadequacies for the prior school year. DPI warned that the School was in danger of having its charter revoked contingent on the results of its 2012-13 test scores.

The School’s academic composite<sup>29</sup> for 2012-13 was 11.4% with only 18.1% of students scoring at or above grade level in reading and less than five percent of students scoring at or above grade level in math. However, the School met growth targets during its final year of operation which would have prevented charter revocation based on academic performance.

<b>School Year</b>	<b>Math</b>	<b>Reading</b>	<b>Performance Composite</b>	<b>Met Growth?<sup>31</sup></b>
2008-09	53.7%	48.6%	50.1%	Yes
2009-10	53.9%	48.5%	49.4%	Yes
2010-11	51.3%	50.9%	51.8%	Yes
2011-12	36.4%	38.1%	36.8%	No
2012-13	<5%	18.1%	11.4%	Yes

The State Board may terminate or not renew the charter for schools with “inadequate academic performance” defined as “no growth in student performance **and** [emphasis added]...annual performance composites below sixty percent (60%) in any two years in a three year period.”<sup>32</sup>

The closing of a charter school during the school year impacts the students, local public schools, and other charter schools. When a school closes, students are disrupted from their normal academic routine as their parents must find a different school to attend. The children may also lose some academic progress in the transition to a new school and new teachers. The closure also affects teachers and staff who lose their jobs and vendors who go unpaid.

Moreover, the public schools or charter schools to which the students ultimately transfer are impacted by the addition of students during the school year. Because the initial installment for Kinston Charter Academy was already spent, that \$666,818 was not available for the public schools and the charter school that ultimately taught Kinston Charter Academy’s former students during the 2013-14 school year.

<sup>29</sup> The State Board’s *Policy Manual* defines composite score as the number of proficient scores on all tests for the current year divided by the number of all scores on all tests for the current year.

<sup>30</sup> Data provided by DPI’s Office of Charter Schools

<sup>31</sup> <http://www.ncreportcards.org/src/schDetails.jsp?Page=2&pSchCode=000&pLEACode=54B&pYear=2011-2012>

<sup>32</sup> Senate Bill 8 of the 2011 Session (Session Law 2011-164), North Carolina General Statute § 115C-238-29G(a)(1)

<b>FINANCIAL AND GOVERNANCE DISCIPLINARY ACTION NOTIFICATIONS BY DEPARTMENT OF PUBLIC INSTRUCTION<sup>33</sup></b>		
<b>DATE</b>	<b>STATUS</b>	<b>REASON(S) FOR ACTION</b>
6/5/2008	Financial Probationary Status	(1) Failure to have fiscally sound budget and finances (General fund expenditures exceeded revenues by \$112, 853 in FY 2005-06 and \$335,130 in FY 2006-07) (2) Did not have proper fixed asset listings (3) Did not have the required "state language" in its contracts
5/5/2009	Financial Probationary Status	(1) Failure to have fiscally sound budget and finances (Deficit of \$283,825 assets to liabilities and fund balance improved only to \$156,370) (2) Did not have proper fixed asset listings (3) Did not have the required "state language in its contracts"
3/24/2010	Financial Disciplinary Status	(1) Net equity of (\$325,304) (2) FY 2004-05 Deficit of (\$18,901) (3) FY 2005-06 Deficit of (\$112,853) (4) FY 2006-07 Deficit of (\$310,997) (5) FY 2007-08 Deficit (\$156,370), short-term borrowing of \$195,000 (6) FY 2008-09 Deficit of (\$174,837)
3/8/2012	Financial Disciplinary Status-Modified Allotment Schedule	Remaining allotments as follows: (1) March 14, 2012 \$108,152 (\$177,038 less the \$68,886 advance) (2) April 11, 2012 \$108,152 (3) May 23, 2012 \$108,153
1/8/2013	Financial Disciplinary Status	Concerns remain over financial solvency due to (1) Delinquent reporting to State Treasurer Retirement System (2) Delinquent premium payments to State Health Plan (3) Unrestricted net assets deficit of (\$66,604) (4) Food Service Fund decreased net assets and borrowed from General Fund (5) Cash flow issues
6/5/2013	Governance Cautionary Status	Not meeting "reporting requirements" and failing to ensure that needs of teachers are met due to delinquent employee contributions to the NC Retirement System and State Health Plan
8/2/2013	Governance Cautionary Status	Failure to provide all reports and payments to the State Treasurer's Office
8/16/2013	Governance Noncompliance Status	Intent to recommend initiation of revocation of charter due to multiple years of negative fund balances and cash flow issues, delinquent payments to Retirement System and State Health Plan, and associated financial penalties

<sup>33</sup> Obtained from correspondence from DPI to the School.

<b>YEAR-END FUND BALANCES<sup>34</sup></b>	
<b>Fiscal Year</b>	<b>Fund Balance</b>
2006-07	(\$354,292)
2007-08	(156,370)
2008-09	(137,337)
2009-10	(45,639)
2010-11	(63,077)
2011-12	49,986
2012-13	(170,830)

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<sup>34</sup> Amounts obtained from audited financial statements.



**Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

**North Carolina State Board of Education - Kinston Charter Academy**

*Inadequate Charter School Performance Notification*

**September 26, 2012 – SBE Chairman copied on this letter**

The Office of Charter Schools sent a letter to Mr. Ozie Hall, Kinston Charter Academy CEO/Principal, as notification that State assessment results from the last two years have put the school in danger of receiving the designation of 'inadequate charter school performance'. Kinston Charter Academy was informed that EOG/EOC test results for 2012-2013 would determine the future status of its charter. A request was made to provide the Office of Charter Schools with an academic intervention plan describing the instructional changes to be implemented by the charter school in order to attain the required academic performance. Kinston Charter Academy was given 30 days to honor the request.

Senate Bill 8, which passed both chambers of the General Assembly and was signed by the Governor in June 2011, defined inadequate charter school performance as schools with "no growth in student performance and annual performance composites below sixty percent (60%) in any two years in a three year period." For schools that are deemed inadequate, "the State Board is authorized to terminate or not renew the charter." Further, in December 2009, the State Board of Education (SBE) modified policy TCS-U-010. This policy states: "The State Board of Education shall revoke the charter of any charter school when, for two of three consecutive school years, the charter school does not meet or exceed expected growth and has a Performance Composite below 60%." The policy also stipulated that test scores from the 2009-2010 school year would be the first year of consideration.

*Financial Noncompliance Notification*

**January 8, 2013 – Provided to SBE as Board materials for the September 2013 meeting**

The Division of School Business sent a letter to Mr. Ozie Hall, Kinston Charter Academy CEO/Principal, which detailed the criteria for financial noncompliance status. From the North Carolina State Board of Education policy for charter schools on financial and governance compliance (TCS-U-006), a charter school may be placed on financial noncompliance status if the school shows signs of financial insolvency or weakness. It was stated that the school has been on financial noncompliance status since March 2010 due to multiple years of negative fund balances and cash flow issues. Specifics of the school's financial situation were detailed in the letter.

Improvement was noted in several areas following a review of the June 30, 2012 financial statements; however, it was reiterated that the school still has severe financial instability. As concluded, Kinston Charter Academy should remain on Financial *Disciplinary* status. A detailed financial plan for the remainder of fiscal year 2013 as well as a preliminary plan for 2013-2014 was requested from the school.

*March 2013 Meeting*

**March 6, 2013 – SBE meeting**

Information was presented to the State Board as 'New Business' regarding the 3 charter schools that were on Disciplinary Financial Non Compliance financial: Kinston Charter Academy, Downtown

**Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

Middle/STEAM, and Children’s Village Academy. From the report presented, Kinston Charter Academy was cited for financial noncompliance due to issues with cash flow, negative equity, and academic status. The Board was also notified that the school was delinquent with their health and retirement payments. The school was not recommended for revocation due to the positive trend in the financial indicators over the last 3 years

Unavailability for On-Site Monitoring Visit

**April 4, 2013 – Provided to SBE as Board materials for the September 2013 meeting**

The NC Race to the Top Program and the Office of Charter Schools sent a joint letter to Ms. Demyra Hall, Kinston Charter Academy Board Chair, citing continuous delays with respect to Race to the Top’s on-site monitoring visit. Five instances of unsuccessful attempts to schedule the visit were detailed within the letter. The last attempt was described as follows: “On March 12, 2013, NCDPI staff called Kinston Charter Academy to confirm the formal monitoring visit for the following day. Mr. Hall said he was not ready for a visit, citing budgeting concerns and the possibility that the school would be closing.”

Kinston Charter Academy was reminded of its previous Level Two Race to the Top sanction from February 27, 2013. To avoid further sanctions, the school was instructed to participate in the on-site monitoring visit by April 17, 2013. Failure to meet this obligation would result in further sanctions which could include all Race to the Top funds being frozen for Kinston Charter Academy, the removal of the School from the Race to the Top program, and required payback of all expended Race to the Top funding.

NC Retirement System and State Health Plan Delinquency Notice

**June 5, 2013 – Provided to SBE as Board materials for the September 2013 meeting**

After being informed by the NC Treasurer’s Office that Kinston Charter Academy had not yet submitted its required March 2013 Employer and Employee contributions report to the NC Retirement System, the Office of Charter Schools sent a letter of notification to Mr. Ozie Hall, Kinston Charter Academy CEO/Principal. The school was informed of their delinquency status for March, April, and May 2013. The letter went on to explain that any delay in submitting contributions since March means that all participating members at the school will not have accurate service and contribution records. As such, employees seeking retirement benefits would be delayed, as well as any beneficiaries requesting benefits on behalf of a member. According to the NC Retirement System, Kinston Charter Academy had incurred a total of 19 penalties for late submissions.

The Office of Charter Schools was also contacted by the NC State Health Plan. According to its records, Kinston Charter Academy has not made contributions since March and has only made partial payments into the Plan since November 2012. As of May 30, 2013, Kinston Charter Academy was said to owe more than \$30,000 to the State Health Plan. The lack of payment by the charter school means that any employee health claims filed after November 1, 2012 are being held.

**Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

In following State Board of Education Policy TCS-U-006, Kinston Charter Academy was notified of its placement on Governance Cautionary Status for not meeting “reporting requirements” and failing to ensure that the needs of all teachers are being addressed. As explained, the school would remain on this status for 30 calendar days and must comply with necessary reporting requirements to the NC Retirement System.

Several critical questions were posed regarding the delinquent funds. A response was due to the Office of Charter Schools by June 17, 2013.

*Response to NC Retirement System and State Health Plan Delinquency Notice*

**June 17, 2013 – Provided to SBE as Board materials for the September 2013 meeting**

Mr. Ozie Hall, Kinston Charter Academy CEO/Principal, provided this letter in response to the request made by the Office of Charter Schools on June 5, 2013. To begin, Mr. Hall communicated that employees and the board are informed on matters of delinquency with regards to retirement and health insurance contributions. Employee consent was obtained in November 2012. Mr. Hall attached documents signed by employees consenting to a delay in health benefits.

It was explained that health insurance payments for November 2012 through February 2013 were paid in March. Due to unforeseen additional penalties, Kinston Charter Academy was informed that health insurance claims from November would be held barring proper payment. The school instructed Blue Cross and Blue Shield to deduct the required penalty from the funds already remitted so that claims could be honored through January or February. This action was not performed, and the health insurance program has not paid claims from November through February. The school is currently working on this issue and expects to pay the required additional interest before June 30, 2013.

Mr. Hall then discussed a change in School Business policy with respect to charter school allotment advances. According to Mr. Hall, the letter announcing this policy change was dated in September but not received by Kinston Charter Academy until mid-October. The policy change was disruptive to the school’s cash flow plan, resulted in impaired credit, and led to late retirement and health insurance payments. Cash flow troubles were also attributed to an erroneous non-compliant finding received from School Business that questioned approximately \$285,000 of State funds. Mr. Hall charged that because creditors were given copies of the erroneous non-compliance report, the school’s ability to draw down equity from its facilities was impaired.

It was anticipated that the school would be able to pay the health insurance and retirement payments through June from drawn down equity by June 30, 2013. As stated, the school is currently negotiating refinancing that will improve its cash position and resolve any financial crisis.

**Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

NC Retirement System and State Health Plan Delinquency Follow-up

**June 19, 2013 – Provided to SBE as Board materials for the September 2013 meeting**

This letter was sent by the Office of Charter Schools to Mr. Ozie Hall, Kinston Charter Academy CEO/Principal, in acknowledgement of Mr. Hall's June 17, 2013 correspondence. Because the response by Mr. Hall did not provide answers to specific questions posed in the June 5, 2013 letter, these questions were once again reiterated. Board minutes from October 2012 through June 2013 were requested as proof that the board was fully aware of the delinquent payments to the NC State Health Plan and NC Retirement System. Additionally, Mr. Hall was asked to provide evidence that employees were informed of the delinquency prior to November 2012.

Kinston Charter Academy was informed that they will remain on Governance Cautionary Status until the Office of Charter Schools receives verification from the charter school and the NC Treasurer's Office that all reports and payments have been properly submitted.

Response to NC Retirement System and State Health Plan Delinquency Follow-up

**July 29, 2013 – Provided to SBE as Board materials for the September 2013 meeting**

Mr. Ozie Hall, Kinston Charter Academy CEO/Principal, responded to requests made by the Office of Charter Schools in its June 19, 2013 letter. Mr. Hall set out to explain what was done with funds deducted from employee paychecks to cover costs under the State Retirement System and Health Plan. According to Mr. Hall, no such funds were ever deducted, as Kinston Charter Academy deferred payment until the necessary funds were available. Additionally, Mr. Hall confirmed that most communications with employees regarding the delinquent status of payments to the NC State Health Plan and NC Retirement System were verbal in nature. Board minutes were provided for the Office of Charter Schools to review.

It was noted that Kinston Charter Academy is working to stabilize finances and assure all obligations are met going forward. To achieve this goal, the school has attempted a refinance of its facilities. Mr. Hall concluded that if the refinance is successful, Kinston Charter Academy will continue operations. If unsuccessful, it will be recommended to the board that the school be closed. A final decision is expected within the next 15 days.

Intent to Refinance Inquiry

**August 2, 2013 – Provided to SBE as Board materials for the September 2013 meeting**

The Office of Charter Schools provided this letter in acknowledgment of the response received from Kinston Charter Academy on July 29, 2013. It confirmed that explanations regarding delinquent payments to the State Health Plan and NC Retirement System were sufficient. The Office of Charter Schools understands that the school deferred health and retirement payments until funds were available.

Because Kinston Charter Academy's continued existence is dependent on a refinancing decision to be received within 15 days, a formal update to the Office of Charter Schools was required no later

**Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

than August 15, 2013. Should the school relinquish its charter, an immediate announcement to parents, community, and The Office of Charter Schools was emphasized.

If operations continue, Kinston Charter Academy was reminded that it is up for renewal by the State Board of Education at the end of the academic year. The school was informed that its academically inadequate status will be assessed once test scores are received by The Office of Charter Schools. The letter concluded by informing Kinston Charter Academy that the Governance Warning from June 19, 2013 remains intact until all necessary reports and payments are provided to the NC Treasurer's Office.

*Notification of Intended Charter Revocation*

***August 16, 2013 – SBE attorneys were copied on this letter, and this was provided to SBE as Board materials for the September 2013 meeting.***

The Office of Charter Schools sent a letter to Ms. Demyra McDonald-Hall, Kinston Charter Academy Board Chair, as written notification of The Department of Public Instruction's intent to recommend the State Board of Education initiate revocation the school's charter. As explained, "G.S. 115C-238.29G grants the State Board of Education statutory authority to terminate a charter and enumerates those reasons." Due to continued financial difficulties, it was determined that Kinston Charter Academy has failed to meet generally accepted standards of fiscal management.

Several issues were detailed to illustrate inadequate fiscal management. These included multiple years of negative fund balances and cash flow issues; failure to report, as required, to the Retirement Division of the NC Treasurer's Office for much of the 2012-13 fiscal year; failure to forward the required premium payments to the State Health Plan in the NC Treasurer's Office for much of the 2012-13 fiscal year; and accrual of numerous financial penalties from the NC Treasurer's Office due to the delinquency in reporting and payments. The letter noted Kinston Charter Academy's placement on Financial Disciplinary Status in 2012 and 2013 and concluded that the aforementioned issues are inconsistent with effective operation of a public charter school.

Due to lack of any apparent corrective action by the nonprofit board that holds the charter, it was confirmed that the Department of Public Instruction intends to recommend to the State Board, at its September meeting, initiation of revocation in accordance with G.S. 115C-238.29G and the signed Charter Agreement.

*Response to Notification of Intended Charter Revocation*

***August 27, 2013 – Provided to SBE as Board materials for the September 2013 meeting***

In response to the letter sent by the Office of Charter Schools on August 16, 2013, the Kinston Charter Academy Board of Directors met in emergency session on Monday, August 26, 2013 to consider the recommendation that the board voluntarily relinquish the school's charter. It was requested that the Department of Public Instruction delay initiation of the revocation process until the November State Board meeting. If granted the extra time, it was the board's intent to

### **Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

complete its transition and corrective action plans. Financial, academic, and demographic reasons for delaying the initiation were detailed within nineteen bullet points.

A final plea was made to allow the Kinston Charter Academy Board time to complete its transition and corrective actions plans. The letter concluded with the determination that if a delay was not granted the board would voluntarily relinquish the charter and the Office of Charter Schools would still have the option to initiate revocation.

#### *Notification of Intended Charter Revocation Follow-up*

***August 29, 2013 – SBE attorneys were copied on the letter, and this was provided to SBE as Board materials for the September 2013 meeting.***

The Office of Charter Schools sent a letter to Ms. Demyra McDonald-Hall, Kinston Charter Academy Board Chair, acknowledging a letter received on August 27, 2013 which requested the Department of Public Instruction delay the recommendation of revocation to the State Board. The letter informed the Board of Kinston Charter Academy that the Department would proceed as planned with the item before the State Board of Education.

It was detailed that the Board would discuss the item at its September meeting and vote on the initiation of revocation in October. Once a vote was taken, a written notification of the decision would be sent by the Office of Charter Schools.

#### *Kinston Charter Academy to the State Board (Leadership for Innovation Committee)*

***September 4, 2013 – SBE meeting***

Mr. Ozie Hall, Kinston Charter Academy CEO/Principal, sent a letter to Ms. Rebecca Taylor, State Board of Education LIC Chair, dated September 4, 2013. In the letter, Mr. Hall made his case against the proposed revocation of the school's charter. Principally, Mr. Hall cited inadequate notification of changes to the State allotment policy for early drawdowns as the root cause of a "cash crisis" that led to delinquency with payments to the State Health Plan and Retirement System. Several additional complaints were leveled against the Department of Public Instruction related to an erroneous non-compliance finding, miscommunications when scheduling proposed monitoring visits, and intrusion in the selection process of a financial services vendor. The letter also touted unspecified academic measures implemented in 2012-2013 as well as necessary repairs made to facilities. A final plea was made for the State board to reject the proposed revocation, preserve teachers' jobs, and allow the school to continue its service to the community.

#### *September 2013 Meeting*

***September 4, 2013 – SBE meeting***

As the first order of business, Chairman Cobey asked Board member Taylor for a motion to accept Kinston Charter Academy's surrender of its charter. Ms. Taylor prefaced the motion by reporting that, as of 1:15 this afternoon, the State Board of Education received a voluntary surrender of the

**Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

charter for Kinston Charter Academy. The State Board of Education acknowledges this voluntary surrender signed by the Kinston Charter Academy Board Chair on behalf of the entire Board. Given this development, the following motion was made by Chair Taylor:

*Upon motion made by Ms. Rebecca Taylor, and seconded by Mr. Kevin Howell, the Board voted unanimously to accept the voluntary surrender of Kinston Charter Academy's charter dated September 4, 2013.*

**September 5, 2013 – SBE Meeting**

*Discussion:* Initiate Charter Revocation for Kinston Charter Academy

*Policy Implications:* General Statute § 115C-238.29; SBE Policy # TCS-U-006; Section 24 of the Signed Charter Agreement

*Presenter(s):* Mr. Philip Price (Chief Financial Officer, Financial and Business Services), Ms. Alexis Schauss (Director, Division of School Business), and Dr. Joel Medley (Director, Office of Charter Schools)

Details were provided that The Department of Public Instruction has been working with the NC Treasurer's Office related to Kinston Charter Academy's delinquency in payments to the State Health Plan and Retirement System for its employees. As explained, Kinston Charter Academy was still delinquent from the last fiscal year (2012-2013) and already behind in payments for this fiscal year (2013-2014). Due to their nonpayment for employee benefits, the charter school remains on Financial Disciplinary Status and Governance Cautionary Status for failing to ensure that needs of all teachers are being addressed.

It was also noted that in September 2012, the Office of Charter Schools notified Kinston Charter Academy about its significant dip in academic performance which could lead to its closure. The Office of Charter Schools is currently awaiting results from the most recent EOG/EOC results to notify Kinston Charter as to its status. If the charter school is deemed academically inadequate according to the statute, a recommendation will be forthcoming for termination.

Several delinquencies were cited with regard to Kinston Charter Academy's interaction with NCDPI. These included corrective actions not submitted for Race to the Top and Title I monitoring visits. In addition, the Academy was slow to provide documentation and submit grants or budget to The Exceptional Children division.

The cash flow problems and lack of payment to the NC Treasurer's Office for employee benefits are evidence that the charter school is not meeting generally accepted standards of fiscal management. The pattern of delinquency with the NC Treasurer's office has also been detected within the Department, and the lack of responsiveness is of significant concern.

**Summary of Communications between DPI and Kinston Charter Academy (September 2012 – September 2013)**

*Recommendation:* It is recommended that the State Board of Education accept the recommendations of the Department of Public Instruction by initiating revocation of the charter for this school.

*Discussion:*

LFI Committee Chair Rebecca Taylor explained that the Board accepted the voluntary surrender of the charter of Kinston Charter Academy during its Wednesday (September 4, 2013) Open Session.

*Notification of Board Decision*

September 5, 2013 – SBE attorneys were copied on the letter

The Office of Charter Schools sent a letter to Ms. Demyra McDonald-Hall, Kinston Charter Academy Board Chair, as notification of the Board's decision. As stated in the letter, "The State Board of Education (SBE) at its regularly scheduled meeting on September 4, 2013 unanimously voted to accept the voluntary relinquishment of your school's charter primarily due to financial concerns. At 1:11 pm on September 4, 2013, the Office of Charter Schools received your resolution indicating Kinston Charter Academy's board of directors had voted to surrender the charter. Kinston Charter Academy (KCA) will effectively close its doors to students on Friday, September 6, 2013."

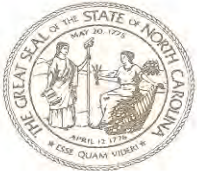
Close out procedures were then addressed. It was confirmed that the school had already received one-third of its State funding based on estimated average daily membership. This allotment totaled \$666,818 and was drawn down 100% less than two weeks into the school year. Due to this unusual occurrence, it was noted that careful attention would be paid when reviewing the school's current year expenditures. Reasonable current year expenditures incurred from July 1, 2013 to September 6, 2013 were permitted to be charged to this initial allotment and could include mortgage or rent payments, salary payments for the employees on staff for that time period, and other current year expenditures as deemed allowable by DPI. It was confirmed that all unused funds shall be returned to the Department. All payments after September 6, 2013 would be on a reimbursement basis, consistent with close out procedures.

The importance of closing procedures was stressed to ensure a smooth transition for students back to their assigned Local Education Agencies (LEA). Administrative and financial DPI contact information was provided to address any questions or concerns.



<b>KINSTON CHARTER ACADEMY USE OF 2013-14 INITIAL INSTALLMENT OF ALLOTMENT</b>	
Repayment of Loans <sup>35</sup>	\$221,990
Payroll	106,090
Federal Taxes	94,163
State Taxes	16,535
Contributions for Employees' Health Benefits to State Health Plan	80,731
Contributions for Employees' Retirement to State Retirement System	55,807
Utilities/Buildings/Grounds	26,643
Advertising/Web Design	24,075
Bookkeeping	12,000
HVAC Repairs	11,242
Purchase of School Buses	7,275
Annual Financial Statement Audit	6,712
Equipment Leasing Fees	2,000
Extracurricular Activities	1,418
Bank Fees	137
<b>TOTAL</b>	<b>\$666,818</b>

<sup>35</sup> Prior to the receipt of the first installment for 2013-14 from DPI, the School had \$8,010 in its bank account from other funds. A total of \$230,000 was made for loans repayment, but only \$221,990 was used from DPI funds.



**PUBLIC SCHOOLS OF NORTH CAROLINA**

DEPARTMENT OF PUBLIC INSTRUCTION | June St. Clair Atkinson, Ed.D., *State Superintendent*

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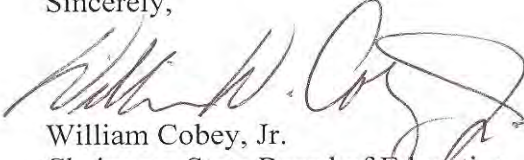
December 22, 2014

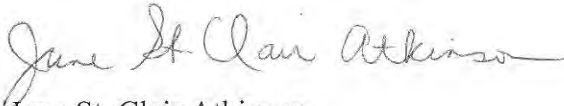
The Honorable Beth A. Wood, State Auditor  
Office of State Auditor  
2 South Salisbury Street  
20601 Mail Service Center  
Raleigh, North Carolina 27699-0601

Dear Auditor Wood:

The State Board of Education and Department of Public Instruction would like to thank the Office of State Auditor for responding to our request for an investigation of Kinston Charter Academy. We feel that the failure of this school is a direct result of mismanagement by the board and administration of Kinston Charter Academy. We do appreciate the recommendations in your report intended to improve our oversight processes and strengthen the ability to take disciplinary actions. The State Board of Education and Department of Public Instruction are working diligently to address the findings and recommendations noted in the audit report. Our response to the findings and recommendations in your report are attached.

Sincerely,

  
William Cobey, Jr.  
Chairman, State Board of Education

  
June St. Clair Atkinson  
State Superintendent

- c: State Board of Education Members
- Philip Price, Chief Financial Officer
- Alexis Schauss, Director School Business Administration
- Joel Medley, Director Office of Charter Schools
- Jeani Allen, Director of Internal Audit

**OFFICE OF THE STATE SUPERINTENDENT**

June St. Clair Atkinson, Ed.D., *State Superintendent* | [june.atkinson@dpi.nc.gov](mailto:june.atkinson@dpi.nc.gov)  
6301 Mail Service Center, Raleigh, North Carolina 27699-6301 | (919) 807-3430 | Fax (919) 807-3445

AN EQUAL OPPORTUNITY/AFFIRMATIVE ACTION EMPLOYER

**Request for Assistance**

The Division of School Business within the Department of Public Instruction (DPI) conducted a site visit to perform close out work at Kinston Charter Academy (KCA) in September 2013. The site visit was triggered due to the surrender of the charter as well as knowledge of financial issues. In conducting the visit, DPI monitors noted unusual transactions and requested supporting documentation for expenses. Ozie Hall, KCA Executive Director, refused to provide documentation and denied monitors access to financial records. Mr. Hall proceeded to threaten legal action against DPI staff and threatened to call law enforcement to have DPI staff removed from the property. These actions led DPI management to become suspicious of inappropriate spending. DPI determined it would be best to bring in expert investigators to provide an in-depth review of the school’s finances and use of public funds. The Director of the Division of School Business requested assistance from the Office of State Auditor (OSA) via email, which initiated this investigation. An excerpt of that email is below.

*The Department of Public Instruction has begun the close out procedures [of Kinston Charter Academy] and at this time has reason for concern regarding the expenditure of funds. The school has been delinquent in payments to the State Health Plan and Retirement System, has struggled with cash flow and as a result has been on Financial Disciplinary status for the fiscal year 2012 and 2013. I have attached the non-compliance report.*

*Per State Board of Education policy, Kinston Charter Academy received one third of their 2013-14 state funding based on an estimated average daily membership of 366. The total estimated allotment for 2013-14 was \$1,950,577 and the first installment equaled \$666,818. KCA drew down 100% of the cash related to that allotment.*

*Today, DPI received the expenditure records for this school as of August 31<sup>st</sup> and the records show that KCA expended \$88,770.19 in July 2013 and \$431,274.70 in August 2013 for a total of \$520,044.85. School was in session for only 10 instructional days before closing and the principal stated that there were only 230 students this year, approximately 37% less than the estimate. State Board policy provides the final funding based on actual student count in the first month, therefore their eligible funding would be \$743,169 less than the estimated amount. So in short KCA has expended 41% of its state allotment in two months.*

*DPI has access to the July and August expenditures and there are several items that look very unusual*

- *Principal Hall’s salary for July \$6,250, salary for August \$16,193*
- *Principal membership dues \$2,042*
- *Contracted service = \$23,003.51*
- *Debt Service Principle - \$170,000 in August (zero in July)*
- *Debt Service Interest - \$60,000 in August (zero in July)*
- *Looking at prior year financial statements attached- the entire FY debt service (P & I) was \$346,564*

*DPI had requested the check register from the vendor for July expenditures – the debt service was paid out of local funds on July 22 and 23. They were then moved to state funds in August.*

*I notified Mr. Hall through a telephone conversation that the DPI will allow reasonable current year expenditures incurred from July 1, 2013, to September 6, 2013, to be charged to the state 2013-14 allotment. Reasonable expenditures may include mortgage or rent payments for that period of time, salary payments for the employees on staff for that time period and other current year expenditures as deemed allowable by DPI. All unused funds shall be returned to the Department of Public Instruction. These funds will be reallocated to the school districts or charter schools that the students move to.*

*I believe that due to the above financial information and the history of KCA and specifically Ozie Hall’s delinquency in financial management, an audit by your office is merited.*

The Division of School Business communicated to OSA at a later time that checks were written to Glen Playa, Inc. and Structured Financial LLC for debt principal and interest payments (\$170,000 and \$60,000 noted above). These payments were not used to pay mortgages for KCA property, which were held by Wells Fargo, USDA, and Self Help.

**Financial Analysis**

The Division of School Business depends on data from the audited financial statements in order to perform annual financial review procedures for each charter school. The year end for schools is June 30, and audited financials for all schools and local governments are required to be submitted to the Local Government Commission (LGC) within the Department of State Treasurer by October 31 of each year. The LGC reviews each entity’s financial statements and forwards those of local education agencies and charter schools to DPI for review and analysis. The LGC reviews financials for a significant number of entities, therefore, the forwarding to DPI normally takes several months. It should be noted that the actions taken in Appendix A of the audit report are related to DPI analysis of the prior year audited financial statements. Over the past two years, the Division of School Business has started working closely with the LGC to expedite the review process for those schools known to be experiencing financial performance issues. A description of the annual financial review process completed by the Division of School Business is detailed below.

The Division of School Business performs the following review of financial data of the charter schools based on the annual independent audited financial statements.

1. Review all findings and perform an audit resolution, including ensuring that the school refunds questioned costs and provides a corrective action plan.
2. Analysis of all financial data as part of the Charter School Financial Performance Framework (see link on page 12). This framework analyzes financial data over a three- to five-year period to assess the current financial situation and the trends over time. Specific indicators that are used are:
  - Current ratio
  - Unrestricted days cash
  - Average daily membership
  - Default on debt
  - Revenue over expenditures
  - Total margin
  - Debt to Asset
  - Cash Flow
  - Debt Service Coverage Ratio
  - Fund Balance

Negative indicators are evaluated further and may result in the school being placed on financial noncompliance per State Board of Education policy #TCS-U-006 (see page 12 for link to SBE policies). The Division of School Business also performs monthly financial monitoring of schools that are considered high risk. This review involves review of monthly expenses for reasonableness. The Division of School Business notifies the Office of Charter Schools of any schools determined to be high risk.

3. Key Divisions within the DPI meet quarterly to discuss high-risk schools from all perspectives including financial, governance and academic.

The financial review of audited financials for fiscal years 2008 and 2009 showed KCA was having significant financial problems. DPI staff took appropriate action to put the school on Financial Probationary Status. The Division of School Business worked closely with Ozie Hall and Demyra Hall, KCA Board Chairman, related to compliance and financial issues. KCA leadership was insistent that the school's finances would improve. Mr. and Mrs. Hall presented DPI with a corrective action plan to improve the school's financial performance. It was determined that the school should be provided the opportunity to implement the new plan for improvement. KCA's financial statements did show improvement in fiscal year 2010 (see Appendix B in the audit report). A review of the fiscal year 2011 audited financial statements again showed financial problems, which led DPI to take action placing KCA on the highest level of noncompliance, Financial Disciplinary Status, and initiating a modified allotment schedule. In fiscal year 2012 the financial statements again showed improvements (see Appendix B in the audit report).

In January 2013, the Division of School Business received notification that KCA was delinquent in reporting and submitting payments for employee retirement and health insurance. DPI took action to again place KCA on Financial Disciplinary Status. At the March 2013 State Board of Education (SBE) meeting, DPI presented KCA along with two other schools that were on Financial Disciplinary Status. KCA was presented due to the history of financial problems and delinquency of payments related to employee retirement and health insurance. The other two schools presented had more significant financial problems in comparison at the time of the SBE meeting. The other schools were issued "Going Concern" opinions from their external auditors due to cash overdrafts and negative fund balances. A "Going Concern" opinion is issued by an external auditor when the auditor has substantial doubt regarding the entity's ability to financially survive. The SBE voted to revoke the charters of one of the schools with a "Going Concern" opinion. The SBE deferred the vote to revoke the other school and required the school to meet financial goals, as a condition to continue operating. The school worked closely with the DPI and has exceeded the financial goals set. The State Board of Education recognized that the KCA had made significant progress, improving the fund balance from a deficit of \$174,837 as of June 30, 2009, to a positive \$49,989 as of June 30, 2012. The week before the SBE meeting, Mr. Hall paid delinquent amounts due related to employee health insurance up to March 2013. Due to this payment and the financial progress shown in the 2012 financial statements, the SBE decided not to revoke the charter of KCA at this time.

The Division of School Business continued to perform monthly financial monitoring of KCA. KCA expenses recorded in July 2013 were received by DPI on August 5, 2013. At this time KCA had expended \$88,770 of state funds. These expenses were reviewed by DPI staff and appeared to be reasonable. The Division of School Business staff did notice a debt service payment expended from local funds on July 22, 2013, totaling \$170,000. On Thursday, August 29, 2013, Mr. Hall had the \$170,000 expense reclassified and accounted for the \$60,000 interest payment using state funds. KCA relinquished its charter the following week on Wednesday, September 4, 2013. The Division of School Business received the August expenditure detail on September 5, 2013, noting that the entire installment had been

expended. The Division of School Business attempted to pull back any cash available in the KCA bank account but received an insufficient funds notice from the bank.

**Charter Revocation/Relinquishment**

The charter revocation and school closing process is a time consuming process, which causes disruption to the lives of students and faculty at the charter school. The decision to initiate revocation is stressful and not taken lightly. Historically, revocation of a charter has resulted in several years of litigation. In the meantime, the students, teachers, and parents suffer. The State Board of Education did not intend to delay revocation of KCA’s charter. The school’s financial trend was not consistently negative throughout the timeframe. The school’s financial situation at times did appear to be progressing positively.

In August 2013 DPI took initiative to recommend that the SBE revoke the charter of KCA. Every opportunity had been provided to the charter school to create and implement corrective action plans; however, the school’s continued floundering revealed that the board was not governing the school. That termination intent was provided to the charter school, via certified letter, on August 16, 2013. A second letter, dated August 22, 2013, was also sent via certified letter offering additional details regarding the revocation. The Department rationale went beyond financial issues. The charter school board and leadership failed to submit required programmatic documentation for Race to the Top, Title I, and Exceptional Children.

DPI was prepared to recommend revocation for KCA during the SBE’s Leadership for Innovation committee meeting beginning at 1:00 pm on September 4, 2013. Prior to the presentation, an email arrived at 1:10 pm from the CEO indicating that the school would instead surrender its charter. The facts reveal that the Department and State Board were taking action; however, the charter school, in realizing the situation was at hand, decided to surrender instead.

Prior to the actual revocation presentation and surrender of the charter, a rather curious request was made by the Kinston Charter Academy board, on August 27, 2013, (the second day of school). The board, in writing, acknowledged the Department’s intent to revoke but asked to delay the revocation process until the November State Board meeting. This delay would have permitted the charter school to access its second allotment; however, the Department did not delay and moved forward.

The school, in the letter, asked for more time because they had not “exhausted corrective action options.” This admission of not having exhausted all options indicated further that something was awry. Four months earlier, the administration and board chair revealed that they may have to close the school; yet, they still wanted additional time to use state, federal, and local dollars to continue to find a way to perpetuate the existence of the school.

DPI’s decision to push forward with the revocation process instead of offering to delay as requested by Mr. Hall, kept KCA from having access to additional installments of state, federal, or local funding.

**Monthly Allotment Allocation**

In only a few instances, the Division of School Business has placed schools with a disciplinary noncompliance status on a monthly allotment schedule. This action is taken on a case by case basis, if it is thought that the monthly allotment schedule will instill budgetary discipline. The system used for allotments is not designed for monthly allotments, rendering this process labor intensive and time consuming. KCA was placed on monthly allotments during the 2011-12 year, as part of the corrective action plan to address the financial problems. By June 30, 2012, KCA had made significant gains ending the year with a positive fund balance and the school was removed from the monthly allotments. Keeping KCA on monthly installments would not have prevented the school from mismanaging the \$666,818. The school would have received the three monthly installments prior to closing, totaling the \$666,818. In this case, DPI would have had no notice of questionable expenditures until after the full installment was received.

**Average Daily Membership Funding**

Funding formulas for schools are set by NC General Statute (see link on page 12). The formulas utilize Average Daily Membership (ADM) for schools to determine funding. G.S. §115C-238.29D(d) states that a charter school may grow up to 20% above the prior year enrollment without State Board of Education approval. This provision in the law makes the budgeting for charter schools difficult and the impact on local education agencies material. The Division of School Business must ensure that growth is built in the budget and with 148 charter schools in varying stages of maturity and growth, the most accurate way to obtain the projected charter school enrollment is to request the information directly from the charter school. Therefore, DPI requests the projected student enrollment from each charter school in January for the following year. Many charter schools have experienced significant growth, and it is impossible to accurately differentiate between the schools that will meet their projected enrollment and those that will have actual enrollment materially below the projection. Between the 2014 and 2015 school years, 31 schools grew between 10 and 20% and the net increase in students, excluding the new charter schools was over 6,000 students accounting for approximately \$30,000,000. Over 80% of the schools were within 10% of the projected enrollment.

The “ADM” provided in Table I “Declining Average Daily Membership” is the final ADM, not the funded ADM. Final ADM is generally lower due to attrition during the year. The funded ADM is a more representative comparison for Initial ADM.

KCA ADM Comparison			
Fiscal Year	Funded ADM	Initial ADM	% difference
2009-10	359	362	6%
2010-11	343	387	13%
2011-12	305	413	35%
2012-13	302	372	23%
2013-14	230	366	59%

KCA responded with a projected student enrollment of 366, and even though they were currently at 305 ADM, they had met this level of enrollment in the past and had a facility that could hold 366 students. Per SBE policy, DPI provided the school with an initial allotment of one third of an annual

allotment for 366 students. The impact of a school over projecting the student count is that the school receives, in effect, an advance on state funds. The funds provided in the initial funding based on the projected ADM are adjusted upon receipt of the actual number of students. Division of School Business receives this information after 20 instructional days and recalculates the annual allotment based on the actual count. If the actual ADM is less than projected, the funding is reduced with the next allotment installment. The final annual appropriation is provided only on the actual number of students. In the case of KCA, Mr. and Mrs. Hall expended all the initial allocation and closed the school nine days in to the school year. This left DPI incapable of correcting the overstated projection of ADM.

The State Board of Education and Department of Public Instruction would like to implement a policy in which charter schools on financial or academic disciplinary status would not be automatically eligible for initial funding based on a projection 20% greater than prior year enrollment. A change in legislation is required in order to make this possible. The SBE and DPI plan to request legislation offering this flexibility from the General Assembly.

### **KCA Administrative Oversight**

The following language is included in every charter to show the clear legal obligation for the nonprofit board of directors of the charter to successfully operate a charter school.

*[T]he granting of a Charter in no way represents or implies endorsement by the SBE of any method of instruction, philosophy, practices, curriculum, or pedagogy used by the School or its agents; nor does the granting of [a] Charter constitute a guarantee by the SBE of the success of the Public Charter School in providing a learning environment that will improve student achievement.*

The fiduciary responsibility for the charter school resides with the nonprofit board of directors that holds the charter. The law, in G.S. §115C-238.29E(d), states that “the board of directors of the charter school shall decide matters related to the operation of the school, including budgeting, curriculum, and operating procedures.” Further, the statute is clear that these nonprofit boards “shall employ and contract with necessary teachers to perform the particular service” and that the “board may also employ necessary employees who are not required to hold teacher licenses to perform duties other than teaching.” Finally, according to G.S. §115C-238.29E(f), “Except as provided in this Part and pursuant the provisions of its charter, a charter school is exempt from the statutes and rules applicable to a local board of education or local school administrative unit.”

Thus, charter schools have, within the confines of the statute, autonomy over operations (budgetary and hiring) in exchange for performance accountability. It is incumbent upon the nonprofit board of directors to utilize that autonomy in a responsible fashion. Unfortunately, in this instance, the board and its administrative leadership did not do so. The nonprofit board acted to provide \$11,000 of vacation payments to the CEO/Principal and his wife (who was also the board chair) rather than dealing with payroll and other obligations. It is unclear why the board decided to pursue this action; however, they have the statutory autonomy in matters of budgeting. The nonprofit board also moved to employ relatives of the CEO/Principal. If the nonprofit board of directors failed to perform due diligence in properly vetting potential employees and their qualifications, then the nonprofit board did



not responsibly utilize the autonomy afforded to it under the law. Lack of internal controls and independent oversight from the KCA Board were major factors contributing to failure of the school.

**Financial Insolvency**

Mr. Hall repeatedly chose to provide excuses for financial issues. We would like to take the opportunity to provide factual information regarding a few of the excuses used by Mr. Hall. One excuse provided by Mr. Hall was related to declining ADM. KCA did see a decline in funded ADM from 359 students in 2009-10 to 305 students in 2011-12; however, the school also significantly increased their fund balance during the same timeframe. Another excuse was high facility costs for the school. An analysis of facility costs showed that KCA facility costs were consistent with other charter schools across the state. Mr. Hall regularly noted that an unrealized pledge was the reason for the school’s deficit. In March 2010, the Division of School Business requested that KCA leave the pledge out of the school’s financial plan since it was never received. Below is an excerpt from that letter.

*You are required to present a sound fiscal written plan to reduce Kinston Charter School deficit received by this office by April 7, 2010. Please be advised that this plan must not include the promise of \$300,000 from the credit union. If this money ever comes into the school, that will be great, but the school has not received any of the pledges.*

In reality the lack of internal controls and oversight allowed Mr. Hall to consistently mismanage finances of the school. Administrative mismanagement of funds and lack of responsibility for school performance were ultimately the cause of financial insolvency. Some of the mismanagement is detailed in the audit report. Another example of mismanagement and lack of oversight can be shown through the disbursement of bonuses despite financial concerns.

In July of 2011, Mr. Hall paid \$196,456 in bonuses to 30 employees including bus drivers, teacher assistants and the cafeteria manager. In 2012, Mr. Hall again paid bonuses to KCA employees totaling \$70,475. Some of these bonuses were more than double the employee’s monthly salary. The table below shows some examples of the most significant bonuses paid in July 2011. Bonus recipients included teachers who had worked in the prior year and had left the school prior to disbursement of the bonuses. Once again, the nonprofit board of directors failed to utilize their autonomy in a responsible fashion as approval of the bonuses contributed to the financial demise of the charter school.

KCA Bonuses Paid in July 2011		
<u>Name</u>	<u>Title</u>	<u>Bonus</u>
Mr. Ozie Hall	Exec Director	\$15,250
Ms. Sylvia Lanier	Teacher	\$10,056
Ms. Shirley Kornegay	Bus Driver	\$6,375
Stephen Maxwell	Teacher	\$10,264
Debra Williams	Bus Driver	\$4,824
Deborah Orr	Administrative Assistant	\$8,650
Melissa Grimes	Administrative Assistant	\$10,747
Calvin Holloway	Cafeteria Manager	\$7,067

### **State Health and Retirement Contributions**

The frequency of KCA's delinquency in submitting payment to the State Health Plan and State Retirement System were unprecedented issues for DPI. Prior to January 2013, DPI had limited interactions with the State Health Plan and State Retirement System regarding school payments.

In January 2013, the State Health Plan reached out to the Division of School Business because KCA stated that DPI was the reason for their delinquency in making required payments to the plan. This contact initiated a sequence of conversations between the Division of School Business, KCA, the Office of Charter Schools, the State Health Plan, and the State Retirement System. In accordance with State Board of Education Policy #TCS-U-006, KCA was placed upon Governance Cautionary Status for not meeting "reporting requirements" and failure to ensure the needs of all teachers were being addressed. This June 2013 notification launched a series of letters between the Department and charter school due to KCA's lack of response to certain matters. Ultimately, this series of communications culminated in the intent to revoke letter dated August 16, 2013, for, among other things, continued delinquency in State Health and Retirement contributions.

The Division of School Business has worked diligently to create relationships with both the State Health Plan and State Retirement System to set a process ensuring timely notification about delinquent payments regarding schools.

### **Academic Performance**

It is important to note that the statutory and policy requirement for adequate academic performance is 60% proficiency OR growth for two out of any three consecutive years. Proficiency measures a students' standing against a specific benchmark at a grade level; however, growth looks at the value added to the student by the school. If a charter school targets lower performing students, the school may not score well on proficiency, but they can "grow" that student academically. While Kinston Charter Academy's proficiency scores declined significantly during the tenure of the board and administration, the school missed making the growth standard only one year. Thus, the Department did not have an automatic closure case due to Kinston's meeting these minimum academic performance standards as provided in statute.

### **School Leader at a Current Charter**

During the time that Kinston Charter Academy was struggling, the CEO worked as a founding board member of a proposed charter school. It would seem that the leader's attention would have been better served on the school that was struggling financially and academically rather than diverting attention elsewhere. Mr. Hall was attending planning year sessions for the new charter school and completing documents for this new board.

The board chair of the new charter school was aware of the financial and academic situation at Kinston because of a phone call with the Office of Charter Schools in November 2013. On November 24, 2013, the board of the new school, however, did accept the resignation of Mr. Hall as a member of their board. This same board, although Kinston Charter Academy crumbled under the leadership of Mr. Hall, hired him instead to serve as the lead administrator of the new charter school, the very school that he assisted during the final months of Kinston Charter Academy's existence.

**State Board Strategic Plan**

The State Board of Education adopted a Strategic Plan in October 2013, and part of that plan included specific goals or objectives for charter schools. The State Board of Education directed the Department of Public Instruction to create and implement a Performance Framework that annually reviews each charter school in the following areas: Academics, Finances, and Operations. The 2014-15 school year is the baseline/implementation year for the Performance Framework.

The tabulation of the Framework findings for each area will be presented to all schools, and individual charter schools must submit a signature page back to the Department of Public Instruction. The signature page indicates that the board chair and the lead administrator have reviewed this documentation. These reports will also be housed on the Department website for the public to access.

**Remediation, Monitoring, and Termination of Charters**

The State Board of Education possesses the authority, both inherently and by statute, to impose consequences on a nonprofit board that holds a charter to operate a charter school in North Carolina. As with any grant, or license, the authority to award such a privilege carries with it the power to curtail or to completely terminate the privilege bestowed upon the recipient. In this case, the statutes are very clear that the State Board may terminate a charter, or not renew a charter based upon certain enumerated grounds, including a catchall ground “Other good cause identified” in G.S. §115C-238.29G(a).

While most licensing boards have the power also to “suspend” a license, obviously that is not a choice when it comes to charter schools, and thus the State Board is limited to three options when it comes to imposing consequences, or “discipline” on the holder of a charter:

1. The State Board may issue warnings, or “reprimands,” in an effort to hold the nonprofit accountable for specific deficits in management, fiscal matters, and other issues that may arise in connection with the operation of the charter. As has been explained, the SBE has adopted, and the Department routinely implements, the policy regarding financial and governance warnings, a very explicit policy detailing consequences for noncompliance in various areas. There are also times when the Department will place the school on a monthly allotment, closely monitoring the expenditure of funds.
2. The second option for the State Board arises when it is time to consider renewal of a charter. While the statute allows for a ten-year renewal, the SBE often limits the number of years for a renewal if the school has exhibited problems or issues in a particular area that indicate the school needs closer monitoring and does not warrant a full ten-year renewal period. If the school can demonstrate sufficient remediation during the abbreviated renewal period, it will often then be eligible for a longer renewal the following renewal cycle. (This option was not available in this case since KCA had not yet reached the term for renewal.)
3. The final option in dealing with a problematic charter school is termination of the charter, or “revocation.” The SBE is always hesitant to move in the direction of full revocation without first trying other means of remediation or “discipline.” A charter school is not a typical contractor simply carrying out the terms of a contract on behalf of the state. A charter school is not just a repository of state funds. A charter school is more often than not a community endeavor, a place where children and parents have placed their futures. It is also a place where teachers and other educators have come to work and impart their knowledge. Teachers

and children and parents have developed relationships. Children have become friends with other children and are not only learning within the walls, they are playing ball on the ball fields and participating in after-school clubs and field trips. In each and every case, the failings of the charter school have not been due to any wrongdoing on the part of children, parents, or teachers, but instead rest on the shoulders of the board of directors. Thus, the SBE must weigh all the various aspects of charter schools, including the ability to remediate the school versus the disruption of the education of children if the school were to shut down.

In the event the SBE determines that termination of the charter is the only realistic and fair option given the circumstances in a case, it proceeds with caution. It is rare that the SBE chooses to terminate a charter in mid-year, as the disruption to the students and parents and employees is rarely worth it. Thus, the SBE normally elects to revoke a charter effective at the end of the school year.

The Charter document, signed by the SBE and the charter school board of directors, outlines the process that will be followed in the event revocation becomes necessary. The SBE normally acts upon the recommendation of the State Superintendent, or upon the recommendation of the Charter School Advisory Board, and then only after every other possible remedial measure has been attempted.

The Charter provides that the first step is for the SBE to vote to initiate revocation. The charter school is then notified by certified mail of the intent to revoke and the charter board has 10 days in which to ask for a hearing before the SBE. The SBE Chair may appoint a panel of fewer than the full State Board to hear the appeal. That appeal hearing must occur before the next regularly scheduled SBE meeting.

After the appeals panel meets and hears from both the Department and the charter school, the appeals panel makes a written recommendation, which is then acted on immediately by the SBE. In numerous instances in the past, the SBE and the charter school have been able to reach resolution that will allow the school to remain open for a limited time, with conditions, to try once more to save the school. In many instances that has proved successful and the school has remedied its issues and many of those schools are operating successfully to this date. In other instances, the school simply was not capable of further remediation and the SBE had no choice but to revoke the charter.

Any final decision of the SBE to revoke a charter entitles the nonprofit board to Petition for a Contested Case Hearing pursuant to Chapter 150B of the General Statutes. That Chapter (The Administrative Procedures Act) allows any aggrieved person to seek review in the Office of Administrative Hearings. While that right to further review certainly helps to ensure that the charter school receives more than adequate due process, it also can cause even further disruption in the process since in many cases, the administrative law judge will enter a restraining order preventing the SBE from completing the revocation process (a process which normally strives to return students to their traditional public school assignment with the least possible disruption). The result is sometimes months of uncertainty for the school, the students, the parents, the employees and also the Department. Given the thoroughness with which the SBE approaches the serious decision to revoke a charter, given the very careful consideration by the SBE of all aspects associated with the operation of a charter school – from the use of public monies to the importance of stability and adequacy of educational opportunities for children – the second-guessing by the Office of Administrative Hearings is more disruptive than helpful. A better approach would be for the SBE’s decision to revoke,

following a very carefully executed procedure allowing for due process, to be a final decision appealable only to the Superior Court.

In the case of Kinston Academy, there might have been times when termination might have seemed the most expedient and responsible thing to do; however, the Department had to bear in mind that hundreds of children were attending school there, and that pulling the charter mid-year would not be worth the disruption. In many cases, remedial measures have saved schools in the past. It was entirely reasonable and prudent under the circumstances to work with the leadership of this school in an effort to restore the school to a more sound fiscal position. The Department did everything possible to save the school and in turn to save these students and their parents from displacement. As with any endeavor, the risk of failure competes with the very real possibility of success, and all the agency can do is have the safeguards in place and act in the best interests of the students, the parents and the public at every juncture of decision-making. The State Board contends and believes that all actions in this case were reasonable and were in the best interests of all involved.

**Links**

- Charter School Law - <http://www.ncpublicschools.org/charterschools/policy/legislation>
- SBE Policies - <http://sbepolicy.dpi.state.nc.us> (Most policies directly related to charter schools are included in the TCS-U series.)
- Guidance Documents - <http://www.ncpublicschools.org/charterschools/guidance>
- Charter Application
  - Training - <http://www.ncpublicschools.org/charterschools/training/application>
  - Resources - <http://www.ncpublicschools.org/charterschools/applications>
- Explanation of the Planning Year - <http://ocs.ncdpi.wikispaces.net/2014-15+Preliminary+Planning+Year>
- General Financial - <http://www.ncpublicschools.org/fbs/charterschools/>
- Financial Performance Framework - <http://www.ncpublicschools.org/docs/fbs/finance/reporting/guides/csfinancialframework.pdf>
- Federal Monitoring - <http://www.ncpublicschools.org/fbs/finance/federal/>
- Charter School Frequently Asked Questions - <http://www.ncpublicschools.org/charterschools/faqs>
- Attorney General's Opinions: <http://www.ncpublicschools.org/charterschools/manual/opinions>
- Resources on the website: <http://www.ncpublicschools.org/charterschools/resources>
- Charter School Leadership Institute Presentations (Performance Framework, Renewal, and Legal/Policy updates) - <http://ocs.ncdpi.wikispaces.net/Session+Documents>
- Useful information for administrators - <http://www.ncpublicschools.org/charterschools/manual/web>

**1. SCHOOL RECEIVED \$666,818 OF STATE APPROPRIATIONS IN JULY 2013 DESPITE MULTIPLE CITATIONS FOR FISCAL MISMANAGEMENT**

The State Board of Education and Department of Public Instruction concur with this finding and appreciate action taken to refer the finding to the agencies listed for further action. We will follow up with those agencies to ensure this matter is appropriately addressed.

The State Board of Education, through policy #TCS-U-006, has established protocol for the Department of Public Instruction to follow regarding financial and governance warnings. The State Board directed the creation and implementation of a Performance Framework that details, on an annual basis, a charter school's standing academically, operationally, and financially. The Department uses Charter School Financial Framework Guide, which was updated in February 2014, to provide guidelines regarding financial performance and compliance for charter schools. The operational portion of the Performance Framework focuses on legal compliance issues and performance of the charter school board. The State Board of Education plans to review charter school policies and procedures currently in place, revise or update any existing policies and procedures as needed, and implement any additional policies and procedures necessary to address the recommendations in the audit report. This action is expected to be complete no later than the end of the May 2015 State Board of Education meeting.

The State Board of Education and Department of Public Instruction will seek legal counsel immediately regarding civil action against Mr. Ozie Hall for mismanagement of the 2013-14 initial allotment installment of \$666,818.

**2. SCHOOL OVERSTATED ATTENDANCE ESTIMATE, WHICH INFLATED STATE FUNDS RECEIVED BY MORE THAN \$300,000**

The State Board of Education and Department of Public Instruction concur with this finding and appreciate action taken to refer the finding to the agencies listed for further action. We will follow up with those agencies to ensure this matter is appropriately addressed.

The State Board of Education plans to seek legislative changes to the annual funding model in order to address this recommendation. Action will be taken to seek this change during the upcoming legislative session scheduled to begin in mid-January 2015.

**3. INEXPERIENCE AND LIMITED PARTICIPATION LED TO INADEQUATE BOARD AND ADMINISTRATIVE OVERSIGHT OF SCHOOL**

The State Board of Education and Department of Public Instruction concur with this finding.

The State Board of Education and Department of Public Instruction have always required certain experience of charter school board members during the charter application process as well as the renewal process. The problem in this instance was that the board of Kinston Charter Academy changed significantly over the charter term. It should be noted that there are currently 148 charter schools operating in North Carolina. If the average number of board members is 7, that would total to

more than 1,000 positions required to be monitored. The State Board of Education will address reasonable requirements and expectations for charter school boards in the review procedures noted in our response to finding 1. This action is expected to be complete no later than the end of the May 2015 State Board of Education meeting.

**4. SCHOOL INCURRED UNNECESSARY EXPENSES DUE TO THE EMPLOYMENT OF CEO’S UNQUALIFIED RELATIVES**

The State Board of Education and Department of Public Instruction concur with this finding.

State Board of Education, through the Office of Charter Schools and the Charter School Advisory Board, deals with familial relationships when notified of such relationships. The application process as well as renewal process attempt to uncover and address any nepotism related to the school. These processes also look into the governance structure of the charter school. At its December 2014 meeting, the Charter School Advisory Board offered a favorable recommendation for a charter school renewal with the condition that board members should not be the spouse of senior administrators at the school. The Department of Public Instruction has also discovered another instance that is being handled. Each charter school, through its signed Charter Agreement, must meet the following conditions: “governing board members receive no compensation other than reimbursement of reasonable expenses incurred while fulfilling duties as a member of the board” and “that they will adhere to a duly adopted conflict of interest policy, including provisions related to nepotism.” Even though the SBE has placed these as conditions within the Charter Agreement, some boards fail to utilize their autonomy in a responsible manner by choosing not to abide by these terms.

The board of Kinston Charter Academy did have a conflict of interest policy contained in the entity’s bylaws. The policy did require board members to disclose any conflict and abstain from voting on a transaction in which there was a conflict. The State Board of Education and Department of Public Instruction will consider developing a policy regarding nepotism among charter school board members, senior administrators, and school staff. This action is expected to be complete no later than the end of the May 2015 State Board of Education meeting.

**5. DESPITE OWING MORE THAN \$370,000 IN PAYROLL OBLIGATIONS, QUESTIONABLE PAYMENTS MADE TO SCHOOL’S CEO AND HIS WIFE**

The State Board of Education and Department of Public Instruction concur with this finding and appreciate action taken to refer the finding to the agencies listed for further action. We will follow up with those agencies to ensure this matter is appropriately addressed.

The Department of Public Instruction has developed methods for receiving notification of untimely payments related to health insurance and retirement contributions. The Department will take action to communicate with the agencies responsible for unemployment and federal and state payroll taxes to discuss methods for monitoring. This action is expected to be complete by the end of January 2015.



The State Board of Education and Department of Public Instruction will pursue civil action as quickly as possible against Mr. Ozie Hall and Mrs. Demyra Hall to recover amounts paid for vacation.

**6. DECLINING STUDENT ATTENDANCE, UNREALIZED PRIVATE DONATIONS, AND HIGH OPERATING COSTS CONTRIBUTED TO SCHOOL'S INSOLVENCY**

The State Board of Education and Department of Public Instruction concur with this finding.

The State Board of Education and Department of Public Instruction perform significant financial analysis of each charter school's financial solvency when approving and renewing a charter. In this instance, Kinston Charter Academy had not yet reached the term for charter renewal. The State Board of Education will ensure the recommendations are addressed during review procedures noted in our response to finding 1. This action is expected to be complete no later than the end of the May 2015 State Board of Education meeting.

Kinston Charter Academy's (School) response to the report's findings and recommendations includes several statements or implications that are misleading or inaccurate. The School's response misinterprets the purpose of the investigative report, misrepresents the Office of the State Auditor's (OSA) work product, takes statements out of context, and reveals a misunderstanding of the nature of the findings and recommendations. Rather than responding to *all* the incorrect and misleading statements in the School's response, OSA offers clarification and corrections to several of the most significant incorrect and misleading statements.

The School's response takes issue with the term "fiscal mismanagement" and argues that the School was cited for "financial noncompliance." Fiscal mismanagement correctly describes the School's deficit fund balances over six of its last seven years of operation, poor budgeting process which repeatedly caused delayed employee salary and benefit payments, and the multiple citations by the Department of Public Instruction (DPI) over more than five years. The DPI notifications specifically cited lack of "a fiscally sound budget and finances," "continued serious financial problems," and "financial instability."

The School's response further alleges a conspiracy because a current DPI Division of School Business staff member formerly worked at OSA. That employee did not initiate the investigation, has not worked at OSA since July 2009, and has not worked in OSA's Investigative unit since 2006. Further, this employee worked at two other state agencies prior to joining DPI. More importantly, this employee had no ability to influence the work of OSA. The School's response takes the illogical position that no former OSA employee, who takes a position of employment elsewhere in state government, could report fraud, waste, or abuse without raising questions about a conflict of interest.

In several cases, the School's response notes that actions of the School cited in the report did not violate a law or procedure. The School's response fails to recognize that OSA intended its comments about the School's imprudent and questionable actions to help the State Board of Education (State Board) prevent other charter schools from experiencing similar financial problems or to prevent future loss of state funds.

For example, the report does not question whether the School's Chief Executive Officer (CEO) and his wife (the Board Chair) had a legal right to vacation payouts made less than a month before the School closed. Instead, the report questions whether it was prudent and ethical to receive those payments when the School did not meet all of its payroll obligations for other employees. The response also claims these payments "were ordinary course of business expenses" despite the CEO telling OSA investigators that he and his wife had never sought these payments in previous years.

Likewise, the report does not claim that the overstated attendance estimate violated a regulation. OSA recommends the State Board/DPI require documentation from all charter schools of increases in estimated attendance to prevent other charter schools in financial straits from receiving excessive funds that may not be collectible if a school closes. The School's response even attempts to portray the attendance estimate of 366 as realistic. However, during a September 2013 board meeting, the CEO acknowledged attendance of only 189 and said that "he was not optimistic that [the School] would be able to reach the desired 235 students to meet budget."

The report does not claim that board members or senior administrators "were required to have a background in education or administration" but rather notes that such backgrounds would benefit

the management of a charter school. Interestingly, the CEO told investigators that the School's initial financial struggles were due to board members lacking an appropriate background.

The School's response often leaves out key details in its attempts to deflect attention from its mismanagement. For example, the response notes that two board members had "eight years of experience serving as charter school board members" but neglects to mention that time was exclusively on the School's board. Further, the CEO again claims to have led a "private alternative school" but still has provided no information to verify its existence. Similarly, the CEO claims his wife and daughter were fully qualified to oversee academic programs at the School even though neither had ever worked in academics previously.

The response also claims the CEO's other daughter's work on the School's website was complete despite telling OSA investigators, "We were supposed to transition to the new site...but, of course, we never went all the way forward" and that the website was "never actually deployed." That daughter received \$2,500 from the School on August 12, 2013 via a cashier's check while internet archive research shows the School's last website re-design occurred between July 2011 and March 2012.

The School's response attempts to portray failure to pay employee benefits (retirement and health insurance) as a temporary problem that employees *chose*. The reality is that the School had an obligation to make those payments once they were withheld from employee paychecks, the School had no legal right to coerce employees to postpone those benefit payments, and those obligations remained outstanding when the School closed and still remain outstanding today.

**KINSTON CHARTER ACADEMY**  
**RESPONSE**  
**TO**  
**INVESTIGATIVE REPORT**  
**BY THE**  
**OFFICE OF THE STATE AUDITOR**  
**January 16, 2015**

### EXECUTIVE SUMMARY

Kinston Charter Academy operated from 2004 through 2013 and served many students. The school made expected growth each year except the one it was required to use the N.C. Department of Public Instruction's Supplemental Education Services (SES) program. The State Auditor's Report is full of false information, misleading statements and embellishments. Its key findings are based upon false information, misleading statements and embellishments.

- The school received multiple "financial noncompliance" findings associated with the schools' lack of financial resources. The school **did not** receive multiple citations for "fiscal mismanagement," and the characterization made by the State Auditor is purposely false and misleading.
- The school did not overstate its attendance estimates and such a characterization is false and misleading as the school complied with all existing rules related to student enrollment.
- The statement by the State Auditor that the school employed the Chief Executive Officer/Principal's (CEO) "unqualified relatives" is without a basis in any fact and is completely false and based upon the uninformed and racially biased opinions of DPI's staff. The school complied with the law regarding hiring of all employees and only qualified employees were hired especially since they were related to the CEO.
- The CEO and Dean of Students properly and legitimately received a vacation payout in the beginning of August 2013, and the statement by the State Auditor that more than \$370,000 in payroll obligations was due is false and misleading.
- The State Auditor's finding that declining student attendance, unrealized private donations, and high operating costs contributed to the School's insolvency is correct though incomplete.
- One of the major factors contributing to the school's closure are the cash flow problems created by the N.C. Department of Public Instruction's unilateral change in a long standing policy and procedure which allowed charter schools to draw funds from their State funds allotment as needed outside the generally published schedule. This unilateral action was not vetted through the Administrative Procedure Process. Kinston Charter Academy had more than \$600,000 in State funds which it was prohibited by DPI from using to pay current expenses.

- Another major contributing factor to the school’s closure was the school inability to refinance its mortgages and draw from the nearly \$2 million in equity that the school had in its real estate. Unilateral action by the N.C. Department of Public Instruction in creating an erroneous financial noncompliance, refusing to recall and correct the finding and making this finding available to the public thwarted the school’s refinancing efforts.

**BACKGROUND**

Kinston Charter Academy was founded in 2004 by a volunteer Board of Directors organized by a former Chairman of the Lenoir County Board of Education who organized the charter school because the local school district openly practiced racial discrimination against black students and under resourced schools attended by black students. Frustrated by his inability to get the majority of local school board members to change their policies and practices, Kinston Charter Academy was founded.

The Kinston Charter Academy’s board of directors included a racially diverse group of individuals with substantial financial experience, several former teachers and educators, and experienced school administrators. A local credit union pledged \$100,000 in annual operating support to the school for its first 5 years and an enthusiastic team set out to change the world.

The school featured small classroom sizes of 15 student, a 200 day school calendar, and a seasoned teaching staff. The school hired a Chief Executive Officer (CEO), a separate Principal, an Academic Director, a Technology Director, a Federal Programs Director, and other administrative personnel. The school secured financing in the amount of \$2.5 million to purchase a 52,000 square foot facility situated on a 14 acre site located in Lenoir County. The school retrofitted and created a state of the art facility.<sup>1</sup>

The school had mortgages with the U.S. Department of Agriculture at a 4 percent interest rate, and Self Help Ventures Fund in the amount of \$1.5 million<sup>2</sup> at the predatory rate of 8.25 percent. Both notes had a 20 year term. Self-Help’s mortgage was guaranteed by the USDA. The schools’ facility appraised for \$5.8 million in 2004.

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<sup>1</sup> Reportedly one of the most beautiful charter school facilities in the state, featuring a Science Lab, Media Center, and three Computer Labs.

<sup>2</sup> Self Help’s mortgage was guaranteed by the USDA.

Kinston Charter Academy immediately began to experience financial deficits in its first year of operation. By the third year of operation the school experienced a \$354,000 operating deficit. The schools' first CEO was a retired public school Superintendent, the second CEO was a former Assistant Superintendent, the school's third CEO was a retired public school Principal. The schools' fourth CEO was hired in 2008 and inherited a school that was in a substantial operating deficit, in need of hundreds of thousands of dollars of facilities repairs, and on the verge of closure due to the school's financial condition. The fourth CEO, along with major changes in board leadership, was able to keep the school open until the board finally surrender the schools' charter on September 3, 2013. During its life the school graduated seven eighth grade classes.

At the time the school closed, Kinston Charter Academy owned real estate valued at \$4 million with debt of about \$2.1 million. The school had \$1.9 million in equity in its facility. The school struggled to achieve a positive General Fund Balance which was a key to its ability to refinance its facilities. In November 2012, the Local Government Commission approved the schools' prior year audit report. Kinston Charter Academy had a positive General Fund Balance of \$49,000. The school had achieved a major financial goal. The school was now postured to refinance its mortgages. On December 14, 2012, the Division of School Business, within the N.C. Department of Public Instruction, knowing that the school was seeking refinancing for its mortgages, filed an erroneous financial noncompliance finding and then made the same available to lenders. [Exhibit 1]. Despite numerous communications requesting this finding be corrected and clear illustration that the same was unlawful it still took nearly five months for the Division to change the erroneous financial noncompliance finding. [Exhibit 3]. By then, the schools' ability to refinance had suffered a major setback.

To add insult to injury, the Division of School Business unilaterally changed a long standing policy which allowed charter schools to draw from its State funds allotment outside the published schedule. [Exhibit 2]. This unilateral policy change, which was not vetted through the required Administrative Procedure Act process and caused the school to experience damaging cash flow problems. The school was not able to timely pay state retirement and health benefits payments while the State held \$600,000 of funding allotted by the Legislature for the school. The Division used the school inability to pay the retirement and health benefit pays, which they caused, as a basis to seek revocation of the school's charter.

Kinston Charter Academy ended the 2012-2013 school year on June 30, 2013, and the Department of Public Instruction waited until just 10 days before classes were schedule to begin for the 2013-2014 school year to announce that it was seeking to revoke the schools charter. Kinston Charter Academy received actual notice of the Department’s intent to seek revocation on August 21, 2013, just five days before school was scheduled to begin on August 26, 2013. The Department was in contact with the CEO over the weeks between the school years and was made aware that the Board was working on a plan to reform and school’s administrative structure and hire a management team. The Department’s conduct in seeking revocation effectively thwarted the school’s continued effort to reform the school and refinance its real estate to use the equity captured in the facility. Without the ability to refinance, Kinston Charter Academy board of directors voted to voluntarily surrender the schools’ charter to the N.C. State Board of Education.

The individual within the Division of School Business which initiated the State Auditor’s investigation is a recent former employee of the Office of the State Auditor, and the direct supervisor of the Division employee who published the erroneous financial noncompliance finding that tanked the school’s refinance efforts in December 2012. This is the first time the Office of State Auditor has conducted an investigative audit of a charter school and issued an Investigative Report, according to State Auditor staff. The State Auditor Report is full of false information, misleading statements and unprofessional embellishments.

**STATE AUDITOR FINDING AND KINSTON CHARTER ACADEMY RESPONSES**

The State Auditor findings and Kinston Charter Academy’s responses are listed below:

**STATE AUDITOR FINDING #1: [SCHOOL RECEIVED \$666,818 OF STATE APPROPRIATIONS IN JULY 2013 DESPITE MULTIPLE CITATIONS FOR FISCAL MISMANAGEMENT]**

**RESPONSE TO STATE AUDITOR FINDING #1:**

The State Auditor, an elected official, has chosen to supplant the terms “financial noncompliance” with the terms “fiscal mismanagement.” The N.C. Department of Public Instruction has consistently used the terms “financial noncompliance” to characterize the financial deficiencies at Kinston Charter Academy. The schools financial issues revolved around **insufficient financial resources** to operate the school and the inheritance of a flawed financial



model. **To the extent the term “mismanagement” implies impropriety use of the term by the State Auditor is dishonest, unprofessional and not warranted by the facts.** In addition, the State Auditor’s politicizing Kinston Charter Academy’s closure by using inflammatory language violates the ethical duties of a licensed Certified Public Accountant and ethical and legal duties of the Office of the State Auditor is required to uphold.

The State Auditor claims that “the chief executive officer/principal (CEO) was able to spend state funds appropriated for the 2013-14 school year to pay expenses incurred during the prior school year” and sites an example of the school paying off two \$100,000 short-term loans from its initial installment of state funds in 2013-14. The State Auditor failed to mention that the school’s Board of Directors specifically authorized the borrowing of the funds at its March 22, 2013 board meeting in which a quorum was present, and specifically authorized the repayment of the funds in its July Board of Directors meeting. In addition to this significant material omission on the part of the State Auditor, it was also omitted that the school’s chief executive officer/principal did not sign the wire transfer which repaid the funds. Finally, the notes on the two loans were *due and payable on July 22, 2013*, and thus they were paid in the “current” fiscal year.

The State Auditor fails to mention that the entire amount of \$666,818 in state funds were **expended on the legitimate expenses of Kinston Charter Academy. Not a single dollar was expended frivolously or for an unlawful purpose.** Under the N.C. Charter School Act, charter schools are specifically exempt from other statutes that apply to traditional public schools except for those rules which are specifically enumerated in the statute. *NC. Gen. Stat. § 115C-238.29E(f) (2013)*. **No state law, State Board policy or regulation prohibits charter schools from paying the legitimate expenses incurred in the operation of the school.** Thus, the State Auditor’s characterization by use of the term “mismanagement” is false, unfair, unethical, and unwarranted.

Kinston Charter Academy, at the time of its closure, owned real estate with a fair market appraisal of \$4 million performed by a licensed, certified appraiser. The school had debts of approximately \$2.1 million. Had the school’s ability to borrow not been impaired by the actions of the North Carolina Department of Public Instruction, the school had the ability to refinance its mortgage and draw at least \$1 million from its equity for working capital. The school could have

continued to serve the students who were living under high poverty conditions in Lenoir County, North Carolina.

Kinston Charter Academy closed near the end of the first quarter of the school's fiscal year and legitimately expended funds through that date. The State Auditor characterizes \$666,818 as having been mismanaged yet they fail to mention the school's July and August payrolls, startup expenditures for the upcoming school year, and other cost to repair facilities, buses, and to purchase stock for the school's lunch program. The State Auditor also failed to take into account the fact that the school had not received local funding allocations or federal fund allocations as of the time the school surrendered its charter.

The State Auditor claims that the school withheld funds from employee paychecks and did not pay the funds over to the state health plan or retirement system. The school had a significant shortage of funds and only partially funded the payroll but subsequently funded the other payroll expenses as cash became available. The employee's themselves chose this option over the complete loss of their jobs in the sparse Lenoir County job market.

The State Auditor's statement that the CEO [mismanaged] the \$666,818 initial installment is a boldface fabrication that is not support by the facts.

**STATE AUDITOR FIND #2: [SCHOOL OVERSTATED ATTENDANCE ESTIMATE WHICH INFLATED STATE FUNDS RECEIVED BY MORE THAN \$300,000]**

**RESPONSE TO STATE AUDITOR FINDING #2:**

The State Auditor claims that "the CEO overstated ADM by 177 students." Under state law, currently enrolled charter school students are guaranteed a seat in the school in the next upcoming school year. The school had 225 students who were entitled to seats by law in the 2013-14 school year. In the previous school year, the school recruited approximately 100 new students, primarily from Pitt County. The school had a rigorous student recruitment plan an estimated a final enrollment which would include at least an additional 141 students. The school's actual estimate of enrollment for the 2013-14 school year was 366 students. **The estimate had a legitimate basis in fact and was made in accordance with the existing rules, policies, and procedures of the North Carolina Department of Public Instruction and the North Carolina State Board of Education.** The State Auditor's claim that the school provided no evidence supporting an estimated student attendance increase is a flat out false statement.

Average Daily Membership (ADM) is calculated based upon the number of students enrolled in the school each day for the first 20 days of the school year. The school surrendered its charter after six (6) actual school days. Unfortunately, because Kinston Charter Academy closed before the completion of the first 20 day count we can never know its' actual ADM. Unfortunately, the State Auditor has chosen to attempt to distort the facts by identifying 189 as the schools ADM, which it was not, and making an erroneous comparison to the estimated ADM of 366. The comparison by the State Auditor is mathematically unsound, unethical, distorted, and dishonest. The State Auditor claims the estimate was overstated. The estimate was an estimate with a proper basis. It would have been correct to state that the school's actual attendance fell short of the school's expectations. Any statement beyond the latter is politically motivated and false, and since this was brought to the State Auditor's attention prior to the publishing of its document the statement is purposefully misleading.

**STATE AUDITOR FINDING #3: [INEXPERIENCE AND LIMITED PARTICIPATION LED TO INADEQUATE BOARD AND ADMINISTRATIVE OVERSIGHT OF SCHOOL]**

**RESPONSE TO STATE AUDITOR FINDING #3:**

The State Auditor claims that the Charter school's Board membership did not include individuals with an education degree, prior experience in teaching, or school administration. The State Auditor claims that this purported "lack of experience" impaired the oversight of the school. Most local elected school boards throughout the United States did not have individuals with education degrees, and prior experience in teaching or school administration. Kinston Charter Academy did have two board members with eight years of experience serving as charter school board members, an individual with the Juris Doctor Degree, one with a Master Degree in Business Administration, one with a Master Degree in Public Administration, and with over 20 years of military experience (including one who managed millions of dollars in materials, equipment, and human resources for the United States Navy). The Board membership consisted of individuals with significant experience working with juveniles in the criminal justice system and individuals with significant experience in nonprofit organization management.

The State Auditor's opinions regarding board member experience and best management practices is not based upon actual facts and is misleading. Under state law, traditional public schools in North Carolina are managed by people with experience in school administration and

Kinston Charter Academy Response to State Auditor Investigative Report, Dated 1-16-2015. Page# 8

teaching. In 2013, only 14 percent of all Black students statewide passed both reading and math end of grade tests. If you control for poverty, and do an apples-to-apples comparison, Kinston Charter Academy outperformed the state and the local school district with the student population it served.

Despite its significant efforts, the school's Board was unable to raise sufficient funds to maintain operation of school. An additional unreasonable hurdle created by the misconduct of North Carolina Department of Public Instruction officials was their thwarting the school's refinance attempt and ultimately destroyed all of the Board and Administrative efforts to save the school.

At the time the schools' CEO was hired in 2008, he possessed a Bachelor Degree in Business Administration, a Master of Science Degree in Administration, had extensive experience in nonprofit organization administration, had over 10 years direct experience instructing at-risk students in a school classroom setting, and served as the executive director of a nonprofit organization which operated a private alternative school. The CEO's experience enabled the school to continue to operate from 2007 when it had a \$354,000 operating deficit until the school's closure in September 2013. The CEO also completed a Master Degree in Education, with emphasis on Curriculum and Instruction in 2010.

Kinston Charter Academy's board and administration did not lack adequate experience, they lacked adequate financial resources.

The State Auditor claims that limited board meeting attendance led to inadequate oversight. The State Auditor and her staff are apparently still living in the dinosaur age. In the modern world, many corporations' Board of Directors hold meetings while individual board members are at multiple locations on the globe. The use of modern technology enables humans to participate in meetings from virtually any location on the planet. It is well-established that their lack of physical presence is not a significant factor in their ability to carry out their board functions. Kinston Charter Academy's bylaws, approved in the school's charter by the State Board of Education, provided for board members to attend board meetings by electronic means. The Board of Directors also adopted specific resolutions allowing board members to participate in board meetings by electronic means. The board regularly had a quorum present in their board meetings and legitimately conducted its business with some members present on site and some

attending by agreed upon electronic means. The State Auditor's characterizations as to board attendance and participation are simply false and again purposefully misleading.

**STATE AUDITOR FINDING #4: [SCHOOL INCURRED UNNECESSARY EXPENSES DUE TO THE EMPLOYMENT OF CEO'S UNQUALIFIED RELATIVES]**

**RESPONSE TO STATE AUDITOR FINDING#4:**

The State Auditor attempts to create shock effect by claiming that the CEOs family members collected approximately \$92,500 in the school's final year of operation. The State Auditor claims that the individuals employed at the charter school that were related to the CEO were unqualified to perform the duties for the jobs they held. The State Auditor supplants her judgment for the judgment of the Kinston Charter Academy Board of Directors. The State Auditor, once again, misquotes the CEO and claims that the CEO said the board simply approved the hiring of all staff in one motion at a board meeting. The State Auditor staff never even asked or made any inquiry into the process of selecting any staff.

The CEOs wife<sup>3</sup> had eight years of experience as a nonprofit charter school board member. She held a Juris Doctor Degree and had over 15 years of experience working with at-risk juveniles and families in the court system. She was raised in the Kinston community and knew many of the families that the school served. Her primary job duties involved discipline and guidance for students in the middle school age group, grades 6-8. She was uniquely qualified to serve the high risk population that the school served which was over 95% African-American and about 98% in poverty. She also assisted the school in conducting a nationwide search for highly qualified teachers and engaged in the process of conducting extensive interviews to select the teaching staff that served the school in the 2012-13 school year. In the 2011-12 school year, the school did not make "expected growth" and was in danger of closure in the event the school failed to meet "expected growth" in two out of any three-years while the school's performance composite was below 60 percent. The State performance composite for African-American

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<sup>3</sup> The CEO and board chair were married after taking on the role of CEO and board chair at the school. The board chair tender her resignation but the board rejected it and asked her to remain chair. The board chair meticulously recused herself from any decisions involving compensation, financial remunerations, or other matters that gives the appearance of a conflict of interest. The chair, the CEO, and the board meticulously complied with conflict of interest policies and procedures.

students was well below 60 percent, therefore any charter school with a significant African-American population is always at risk of closure under this discriminatory policy.<sup>4</sup>

The board's decision to hire the CEO's wife as a Dean of Students was a sound and prudent business judgment. As the State Auditor noted, the school met "expected growth" for the 2012-13 academic school year and was not in danger of closure due to low academic performance as a consequence of the fine work performed by the Dean of Students.

The State Auditor claims that the board's decision to employ the CEO's daughter as an academic officer resulted in an unnecessary expense. The CEO's daughter was selected on her merit. She possessed a top rate education from Tufts University with a Bachelor Degree in American Studies. Tufts has one of the finest education programs in the world. The CEO's daughter's choice of American Students uniquely qualified her to work in a high poverty environment and with the student population that Kinston Charter Academy served. In addition, the CEO's daughter came with a plan to improve the school's academic standing and recruited teachers who graduated of Boston College, Tufts University, and New York University.<sup>5</sup>

The CEO's daughter's duties included assisting in recruiting staff, managing discipline in grades kindergarten to third grade, facilitating teacher planning, student recruitment, and use of data to drive instruction. All these were skills possessed. The result was that the school made expected growth in the 2012-13 academic school year.

**The State Auditor's assumption that these individuals were required to have a background in education or administration is contrary to the innovative nature of charter school operations.** As the State Auditor noted the school had relied upon someone with 20 years of experience in public schools with their most recent job as an assistant to the superintendent. Under the tenure of that individual, the school slumped into low performance status. As previously noted, *experienced teachers and school administrators have experienced little success with high poverty populations across the state.*

<sup>4</sup> In 2010, the CEO filed a complaint with the US Department of Justice office of civil rights claiming that the policy requiring schools that did not meet expected growth for two out of any three years with performance composite below 60% was racially discriminatory against schools serving significant Black, Latino, and Handicapped student populations since the state performance composite for these groups is well below 60% and black student tended to live in high poverty communities where historical data showed low performance when tested under a culturally inadequate testing system.

<sup>5</sup> Ironically, three of the teachers recruited from major colleges and universities were robbed in a home invasion in Kinston at the start of the school year. High crime in Kinston and Lenoir County make it difficult to recruit high quality staff in Kinston.

Finally, one of the CEO's daughter's successfully secured a contract for \$2500 to design a website and provide other technology services for which other vendors charged in excess of \$7500. The State Auditor misquotes the CEO and claims that the website never became operational. The website is operational today. The website was never fully used for the purpose for which it was developed since the school closed.

The State Auditor claims that the CEO's relatives were unqualified. The State Auditor's statement is without any basis in fact. In addition, the salaries and compensation received by said individuals was below fair market value.

**STATE AUDITOR FINDING #5: [DESPITE ULTIMATELY OWING MORE THAN \$370,000 IN PAYROLL OBLIGATIONS, QUESTIONABLE PAYMENTS MADE TO SCHOOL'S CEO AND HIS WIFE]**

**RESPONSE TO STATE AUDITOR FINDING #5:**

The State Auditor claims that despite the potential closing of the School and its financial problems, the School paid the CEO and the Dean of Students, employees of the Board of Directors, earned vacation pay to which they were entitled. The State Auditor failed to disclose that neither the CEO nor his wife signed any checks to make these payments, but suggest the CEO and the Dean of Students should not have accepted the payments. It is kind of like saying that the State Auditor and her staff should not take earned paid vacation time because the State runs a deficit.

The N.C. Department of Public Instruction did not initiate revocation of the school's charter in June, 2013 at the close of the school year. They waited until 10 days before students began to arrive, after teachers were hired<sup>6</sup>, summer professional development was complete, and significant expenses incurred to start the school year. The school did not receive actual notice of the Department's intention to initiate revocation until August 21, 2013, just 5 days before the first day of school. In an August 2, 2013 letter, the Office of Charter Schools acknowledges the school's choice to remain open. The school's board of directors agreed in July that it would move forward with opening and continue the effort to refinance its facility and draw working capital from equity stored in the schools facilities and real estate. Kinston Charter Academy was a going concern and the vacation payout to the CEO and Dean of Students were ordinary course of business expenses.

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<sup>6</sup> Some teachers have move from out of state to North Carolina just to teacher at Kinston Charter Academy.

Kinston Charter Academy Response to State Auditor Investigative Report, Dated 1-16-2015. Page# 12

The State Auditor argues that teachers and other administrators were not paid in September but failed to disclose that the CEO and Dean of Students were not paid in September either. The school paid the August payroll. If the school had not closed, it was due about \$60,000 in local funds and over \$200,000 in federal funds to use to support the September and October payroll. In addition, the school had a commitment for a \$300,000 bridge loan [Exhibit 5] to assist its cash flow needs and was negotiating the refinance of the school's facilities. The school did not get paid the local or federal funds because of the surrender of the charter. The school was not going to borrow the additional \$300,000 if the school was closing. In addition, the N.C. Department of Public Instruction specifically promised to cover the final expenses if the school surrendered its charter but then reneged on the promise. The Kinston Charter Academy board of directors decided to surrender the charter because the Department's efforts to revoke the charter at that time were fatal to the school's administrative reformation and real estate refinance efforts. [See: Exhibit 4 and 6].

The State Auditor fails to utilize the clear evidence presented to her staff in the characterization of these payments as the State Auditor mischaracterizes \$285,290 in reimbursements owed to the Unemployment Insurance Fund as unpaid payroll obligations.<sup>7</sup> These funds were not a "payroll obligation". The State Auditor also includes over \$30,261 in salaries which were not even incurred when the CEO and Dean of Students were paid for earned vacation time. Also, since the vacation pay outs occurred in August, most of the other payroll obligations claimed by the State Auditor as being owed were not incurred or were not yet due. The State Auditor takes statements made by the CEO out of context or outright distorts them in the Auditor Report creating misleading allegations and false innuendos.

The CEO is owed payroll for September and October 2013 and for other time spent on the close out of the school over more than one year. The total owed to the CEO for this close out and corporate wrap up is in excess of \$40,000.

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<sup>7</sup> The school operated under the legislative provision [N.C. Gen Stat. § 96-9.6] which allows non-profit organizations to pay 120 percent reimbursement to the Unemployment Insurance Fund in lieu of paying an unemployment contributions. The State Auditor erroneously inflated the amount of payroll obligations owed at the time vacation payouts were made to the CEO and the Dean of Students.



**STATE AUDITOR FINDING #6: [DECLINING STUDENT ATTENDANCE, UNREALIZED PRIVATE DONATIONS, AND HIGH OPERATING COST CONTRIBUTED TO THE SCHOOLS INSOLVENCY]**

**RESPONSE TO AUDITOR FINDING #6:**

Multiple factors contributed to Kinston Charter Academy’s insolvency as noted by the State Auditor. There are several additional factors not mentioned by the State Auditor as follows:

**Flawed Financial Model**

The school’s financial model was flawed from its inception. When the school was able to implement its academic model it demonstrated superior results. The original concept was small class sizes of 15 students, a 200 day academic calendar with extended day programming, and a high percentage of experienced (retired) teachers. The original budget planned about \$90,000 in mortgage or facilities rental expense. In reality, the annual facility cost was over \$240,000 plus expensive facilities maintenance. Teacher salaries were estimated at \$30,000 per year but the school hired about 11 retired teachers at a cost of about \$41,000 per year plus an 11% employer contribution toward a second retirement. The school also hired three seasoned teachers at a rate of over \$45,000 each plus benefits. The cost of insurance, utilities, transportation, building and grounds maintenance was all severely underestimated in the original plan. The school hired a CEO, a separate Principal, a separate Academic Officer, a Technology Director, and a Federal Programs Director. The school began incurring deficits in the first year of operation. By the third year, the school had a \$354,000 cumulative operating deficit.

The school’s closing CEO entered a school with a \$354,000 deficit and a flawed financial model where the marginal classroom income was insufficient to cover the school’s fixed expenses. Classroom sizes were increased and the school year was reduced from 200 days to 180 days as measures to control cost. In addition, the school experienced costly and major facilities issues such as having to replace two 50 ton HVAC units, and HVAC Control system with a combined cost of about \$250,000. The problems with the facility also contributed to lower enrollment as the facility air conditioning and heating problems caused a loss to student enrollment.

**Lenoir County Schools Dispute**

Lenoir County Public School (LCPS) board members and Superintendent publicly pledged to close Kinston Charter Academy. LCPS unlawfully withheld nearly \$1 million in local

Kinston Charter Academy Response to State Auditor Investigative Report, Dated 1-16-2015. Page# 14

funds from the charter school and placed the school under major financial stress. LCPS eventually paid Kinston Charter Academy about \$170,000 which the school accepted because it was under financial duress. LCPS constructed two new school facilities and placed those facilities in very close proximity to Kinston Charter Academy's facilities for the purpose of competing for students. LCPS openly recruited Kinston Charter Academy's teachers and used the teachers to solicit the school's students. Kinston Charter Academy operated in very hostile environment. LCPS's role on the Lenoir County Chamber of Commerce, Education Committee blocked any meaningful business community support for Kinston Charter Academy.

**Interference by N.C. Department of Public Instruction**

In the 2012-13 school year, the Division of School Business unilaterally changed its long standing policy and practice regarding cash advances from the State funding allotments without vetting it through the Administrative Procedures Act process. The result was that Kinston Charter Academy was late making payments to the state health plan and retirement system while at the same time the school had about \$600,000 in state funds that the new policy prevented the school from accessing to meet then current cash flow needs.

Division of School Business staff knew that Kinston Charter Academy was working to reduce its cumulative operating deficit and to refinance its mortgage to obtain a better interest rate and draw working capital from the school's equity to meet the school's cash needs. Refinance was the key to the school's survival. In November 2012, the Local Government Commission approved the school prior year final audit. In December 2012, the school had a \$49,000 positive fund balance and was positioned to refinance the school's mortgage. On December 14, 2012, the Division of School Business issued an erroneous financial noncompliance finding which claimed the school improperly used State funds to pay its mortgage and had a questioned cost of \$285,000. The Division never made such a finding before or since. The same employee of the Division involved was previously publically accused by Kinston Charter Academy of improperly attempting to force the school to use a certain financial services vendor.

It took the Division months to address the erroneous finding. They waited just long enough to ruin the schools' refinance efforts and to force the school into financial noncompliance in late paying of retirement and health benefits which the Division then used as a basis to seek revocation of the schools' charter. The deficiencies cited by the Department of Public

Instruction to seek charter revocation were caused by Department of Public Instruction employee conduct.

**Shift in Student Population Served**

Another contributing factor to low enrollment was that the student population shifted. Parents enrolled students in the school because LCPS encouraged its students with low performance and significant discipline problems to transfer to Kinston Charter Academy. The student population also shifted from 67 percent poverty to 98 percent poverty. As the population shifted it became increasingly difficult to recruit teachers capable of meeting the needs of the student population and more affluent parents did not choose to send their students to school with at-risk students. This major population shift had major cost implications for the operating budget. Also, transportation cost increased as the school had more and more Pitt County residents enroll their children in the school and less car riders.

**Race to the Top**

Kinston Charter Academy was induced to participate in the "Race to the Top" program by Department of Public Instruction officials. The school was required to perform about \$500,000 in mandates over a period of four years but received less than \$75,000 in "Race to the Top" funds during the same period. The program did not benefit the school and further strained the school's finances.

**Supplemental Education Services**

In 2011, Kinston Charter Academy was forced by Department of Public Instruction regulations to participate in a Supplemental Education Service program and use funding to pay outside service providers for remedial reading and math. The school did not make expected growth the year the school was required to participate in the State's Supplemental Education Services program. In all previous years, the school made expected growth. It conducted its own program with East Carolina University students as tutors and mentors to Kinston Charter Academy students. Kinston Charter Academy also had an East Carolina University Education Professor serving on its board of directors. The low performance year caused by the Department's interference in the school's academic program caused the school to experience subsequent cost in attempting to repair the damage caused by the Department of Public Instruction's action.

**Miscellaneous Issues**

N.C. Department of Public Instruction officials took a hostile position toward Kinston Charter Academy's CEO after the CEO's filed a complaint with the U.S. Department to Justice, Office of Civil Rights in response to the State Board of Education's adoption of a Department recommended policy which was discriminatory toward charter schools serving significant Black, Hispanic, and Handicapped student populations. In addition, the CEO reported misconduct by the Division of School Business staff. The Division subsequently engaged in conduct which impaired the school's cash flow such as unilaterally changing a long standing policy on cash advances from State fund allotments and by creating a fraudulent financial noncompliance finding to thwart the school refinancing efforts. These issues had a major adverse impact on the Kinston Charter Academy's financial condition.

**CONCLUSIONS**

The State Auditor's Report contains false information, purposefully misleading statements and unprofessional embellishments. Kinston Charter Academy's volunteer Board of Directors, Chief Executive Officers, Principals, Faculty and Staff members always worked tirelessly and in good faith throughout all of the years of the school's life. The school served hundreds of students and positively impacted many North Carolina children's lives.

[Exhibit 1]

Compliance Data Sheet

(For Charter Schools pending renewal in June, 2014)

Section 2: Department of Public Instruction Report

(DPI data required by the Charter Agreement or Otherwise Stated in the law)

Reporting Area: Finance/audits

School:Kinston Charter

School is Compliant

School is Non-Compliant

Description of Non-Compliance issues

07-1 The school has a deficit fund balance of \$354,292 as of June 30, 2007.

08-1 The school has a deficit fund balance of \$156,370 as of June 30, 2008.

09-1 The school has a deficit fund balance of \$174,837 as of June 30, 2009.

10-1 The School has a deficit fund balance of \$45,639 as of June 30, 2010.

11-1 The School has a deficit fund balance of \$63,077 as of June 30, 2011.

Deficit in the Proprietary Fund for FY 2011-12 of \$30,592.

The school used "state Fund" to pay their monthly mortgage payments on their building. This is a violation of G S 115C-238.29H(a1). This has a questioned cost of \$285,429.86.

ADM 2010 359, 2011 343, 2012 305.

Name of person completing report:Gene Bruton

12/14/2012

[Exhibit 2]



**PUBLIC SCHOOLS OF NORTH CAROLINA**

STATE BOARD OF EDUCATION William C. Harrison, Ed.D., *Chairman*  
 DEPARTMENT OF PUBLIC INSTRUCTION June St. Clair Atkinson, Ed.D., *State Superintendent*  
 WWW.NCPUBLICSCHOOLS.ORG

**MEMORANDUM**

**TO:** All Charter School Administrators  
**FROM:** Alexis Schauss *Alexis Schauss*  
 Division of School Business  
**DATE:** September 5, 2012  
**SUBJECT:** No Cash Advances or Changes in Timing of Allotments

Effective July 1, 2012, the Division of School Business **will no** longer provide **any** cash advances to charter schools.

To help the cash flow of charter schools that receive their allotments in three installments, the Division of School Business has modified the timing of the 3<sup>rd</sup> allotment installment. The allotments will be scheduled as described below.

1. 34% of the allotment after the General Assembly adjourns, based on initial ADM.
2. 34% of the allotment after the 1st month ADM is finalized and adjusted for actual ADM.
3. 32% of the allotment will be distributed prior to **the end of February** (previously the end of March).

Please ensure that you budget accordingly so that your school can cover necessary expenses.

AS/dkm

- c. Lydia Prude, School Allotments  
 Joel Medley, Office of Charter Schools

**OFFICE OF FINANCIAL AND BUSINESS SERVICES  
 DIVISION OF SCHOOL BUSINESS**

ALEXIS SCHAUSS, Director | [alexis.schauss@dpi.nc.gov](mailto:alexis.schauss@dpi.nc.gov)  
 6334 Mail Service Center | Raleigh, North Carolina 27699-6334 | (919) 807-3553 | Fax (919) 807-3704  
 An Equal Opportunity/Affirmative Action Employer

Read Message

EXHIBIT 3  
Page 1 of 1  
Exhibit 3

Compose Reply Option: Forward NC Department of Public Instruction Delete Print Save Addresses

Date: 6-Jan-2013 21:35:00 -0500  
From: "Ozie Lee Hall" <ozhall@kinstoncharteracademy.com>  
To: "Philip Price" <philip.price@dpi.nc.gov>, "Sarah Harris" <sarah.harris@dpi.nc.gov>, "Joel Medley" <JMedley@dpi.state.nc.us>, "Demyra Hall" <dhall@kinstoncharteracademy.com>  
Subject: Use of State Funds for payment on loans for facilities

Dear Dr. Price:

We recently sent you an email and letter regarding the application of GS 115C-238.29B(a1). I have attached two documents that may help clarify the issue. First, on June 17, 1997 The Attorney General's Office issued an opinion (attached) that specifically states that charter schools may not use state funds to repay loans used to purchase real property. However, subsequently the current version of GS 115C-238.29B(a1) (Session Law 1997-430) (attached) was adopted into law on August 22, 1997 that reversed the prior prohibition. Specifically, under the current version of the law state funds "may be used for payments on loans made to charter schools for facilities..." The very next sentence in the statute states that state funds shall not be used to obtain "any other" interest in real property." The phrase "any other interest in real property" specifically acknowledges that charter schools may obtain interest in real property with state funds for the stated purpose only. Finally, the last sentence in the section (a1) again acknowledges the authority of charter schools to use state funds with the words "also may own land and building it obtains through non-state sources." The words "also may" demonstrates that charter schools may use state funds for the limited purpose of payment on loans for facilities it uses to operate its school. Kinston Charter Academy used state funds only for payment on loans for facilities it uses to operate its school in accordance with the statute.

I trust this will help clarify the issue. Perhaps Mr. Bruton is confused because of the old version of the law. Nevertheless, this is an urgent matter for us because of the immediate impact it has on our operations. In the past, we have had major concerns about Mr. Bruton making threatening statements to us as a state official in an attempt to force us to contract a specific accounting vendor. We also have major concerns about Mr. Bruton's motivation in raising this issue. Therefore, we hereby make a public records request for any and all emails, letters, and records of any communications between Mr. Bruton and any official from Self Help Credit Union, and Acadia Northstar, LLC since January 1, 2012 to the present.

We further request your office and the State Board of Education forthwith issue a formal position regarding the application of GS 115C-238.29B(a1).

Very sincerely,

Ozie Lee Hall, CEO  
KINSTON CHARTER ACADEMY  
2000 Dr. Martin Luther King, Jr. Blvd.  
Kinston, NC 28501  
Telephone: (252)522-0210, Ext. 281  
Fax: (252) 522-2584  
Cellular: (252)520-3397

All attachments to this message are listed below.  
Click on the name of any of the attachments to download them.

Sessions Law 1997-430.pdf Size: 102368 bytes

AG Opinion 6-17-1997 Charter School Loans and Terms.pdf Size: 233118 bytes

[Exhibit 4]

KINSTON CHARTER ACADEMY  
 2000 Dr. Martin Luther King, Jr. Blvd.  
 Kinston, NC 28501  
 Telephone: (252) 522-0210  
 Fax: (252) 522-2584

September 4, 2013

VIA EMAIL

Ms. Rebecca Taylor, Chair  
 Leadership for Innovation Committee  
 N.C. State Board of Education  
 301 N. Wilmington Street  
 Raleigh, NC 27601-2825

**RE: PROPOSED CHARTER REVOCATION FOR KINSTON CHARTER ACADEMY**

Dear Ms. Taylor:

Certain staff at the Business and Financial section of the NCDPI have proposed the revocation of the school's charter. Kinston Charter Academy (KCA) has been in operation for since 2004. The current administration came in 2007 when the school had a (-\$354,000.00) operating deficit. Over several years the school reduced the annual operating deficit from (-\$354,000.00) in 2007 to a \$49,000.00 positive fund balance in 2012. The school owns its facilities which appraised for approximately \$4 million. The school owes approximately \$2 million in notes on the facility and therefore has equity of about \$2 million.

Last year (2012-2013) the school took certain measures to boost student performance and made necessary repairs to facilities. In the past the school has always been able to make early draws from its State allotment. Last year that policy/practice changed without adequate notice. In mid-October 2012 we learned for the very first time that Alexis Schauss, the new Director of the Division had issued a policy memorandum dated September 5, 2013 with a retroactive effect to July 1, 2012 which changed the allotment schedule. This new policy did not have Legislative or State Board approval. This policy placed the school in a cash crisis.

In November 2012, when we began to have problems paying the retirement and health insurance premiums Kinston Charter Academy had about \$600,000.00 in State funds that the new policy prevented the school from being able to draw State funds to pay these obligation. In addition, when the school sought to borrow funds from the equity in its facilities to address the temporary cash flow problems the Financial and Business section issued an erroneous non-compliance finding stating the school has \$285,000.00 in questioned cost and suggested it was illegal to use State funds to pay mortgage payments on the schools facilities which are used to educate children. It took the Financial and Business section until April 2013 to repudiate this erroneous non-compliance finding. What is most troubling is that the erroneous non-compliance finding was provided to several potential lenders which prevented the school from being able to borrow funds from the equity in the schools facilities at that time.

Thus, in March 2013, when the Financial and Business section presented to the State Board the delinquency in payments to the State Health Plan and the Retirement system the school cash flow problems existed in part because of the actions of the Financial and Business section of NCDPI that impaired our cash flow. [Note: It should also be noted that we have had continuing issues with Mr. Gene



Letter to N.C. State Board of Education, LFI Committee, dated 9-4-2013.

Page 2

Bruton of the Business and Financial section after we did not yield to a forced illegal attempt by him to cause us to choose a particular financial services vendor. We have also made a public records request to the Mr. Phillip Price which has been ignored.]

The school's deferred payments to the Health Plan and Retirement systems were all done with the consent of the school's employees who we have kept informed at all times. The employees collectively participated in a joint decision to preserve the school and their jobs. It is ludicrous for DPI staff to suggest that revoking the school's charter and causing the employees to lose their jobs will somehow help these employees.

In July 2013 the Retirement system payments were brought current and on Thursday, August 29, 2013 we made full payment to the health plan.

As to the other matter, we had scheduling issues last year because several units within NCDPI did not use the updated listserv for email addresses and sent notices to incorrect email address and the school did not receive several notices of proposed monitoring visit dates. We are gathering records and information for the federal monitoring at this time and anticipate full resolution of these matters within the next 15 business days.

Please also note that the Kinston Charter Academy Board of Directors has developed a reform plan that will expand and improve the skills sets on the Board of Directors and contract with a Charter School Management company with experienced operators to take over the day-to-day management of the school. The Board plans a management change at the school including board and administration to improve the school.

The Business and Financial section is well aware that the school has several facilities refinance options available to it which will allow the school to draw equity of about \$1 million which will enable the school to upgrade its facilities and provide needed working capital going forward.

If the State Board rejects the proposed charter revocation at this time it will preserve teachers' jobs and allow the school to complete its refinance option and allow this charter school to continue to serve this community.

Very sincerely,



Ozie Lee Hall, Jr.  
CEO/Principal

OH:

- c. Demyra R. McDonald-Hall
- Senator Don Davis
- Senator Louis Pate
- Dr. Joel Medley, OCS
- Lisa Swinson, OCS
- Superintendent Dr. June St. Clair Atkinson
- N.C. State Board of Education

[Exhibit 5]



16 W. Martin St., Ste 807, Raleigh, NC 27601 Ph: (919) 785-2902 Fax: (919) 573-0424  
email: [hheartleyjr@nc.rr.com](mailto:hheartleyjr@nc.rr.com) website: [www.hdhloans.com](http://www.hdhloans.com)

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August 21, 2013

Kinston Charter Academy  
C/O Ozie Lee Hall, CEO  
2000 Dr. Martin Luther King Jr. Blvd.  
Kinston, NC 28501

Dear Mr. Hall:

We have reviewed the financial statements of the Academy, completed business with the Academy in the past and look forward to doing business with you in the future.

Based upon our review and barring unforeseen changes in your financial affairs, we have prequalified in principal your loan request for a maximum of \$300,000.00 for the purpose of funding operating capital for the Academy.

At the time that a formal request is made, there will be execution of a commitment letter evidencing the loan approval and the understanding between the lender and the Academy. The terms and conditions will also be fully disclosed in this commitment letter.

We look forward to working with the Academy to help you meet your financial goals. Should there be questions or concerns, please advise.

Sincerely,

A handwritten signature in black ink that reads "Harvey D. Heartley, Jr." in a cursive script.

HDH Partners, Inc

Harvey D. Heartley, Jr

President / CEO

Resolution of Closure of Kinston Charter Academy

[Exhibit 6]

KINSTON CHARTER ACADEMY

BOARD OF DIRECTORS

RESOLUTION

This Resolution was adopted by the Kinston Charter Academy Board of Directors in open session with a quorum present during a duly called and noticed Special meeting of the Board held on Tuesday, September 3, 2013 at 6:30 p.m. at 2000 Dr. Martin Luther King, Jr. Blvd., Kinston, North Carolina 28501 as follows:

Recital

WHEREAS, in 2004, Kinston Charter Academy was granted a Charter by the North Carolina State Board of Education to operate a Kindergarten through 8<sup>th</sup> grade Charter school in Lenoir County, North Carolina under designated LEA number 54b for a period of 10 years ending in 2014; and

WHEREAS, said Kinston Charter Academy has operated the school and graduated nine (9) eighth (8<sup>th</sup>) grade classes, and made "expected growth" seven of eight years, and "high growth" four of eight years; and

WHEREAS, said Kinston Charter Academy students have made major accomplishments including being recognized as a 2007 National Charter School of the Year by the National Council on Educational Reform, and having a KCA student win the eastern North Carolina regional spelling bee in 2011 and go on to represent the school in the Scripps National Spelling Bee in Washington, D.C. thus ranking in the top 270 spellers in the nation; and

WHEREAS, said Kinston Charter Academy students, parents, and volunteers have made major accomplishments through the school's Marching Band, Martial Arts Team, Drama Group, Junior National Beta Club, Student Honor Societies, Student Government Association, and Parent Teacher Organization; and

WHEREAS, many stakeholders have made tremendous commitments and personal sacrifices to help the school succeed and provide a high quality educational experience for its students; and

Resolution of Closure of Kinston Charter Academy

WHEREAS, Charter Schools in North Carolina are designed to test innovative ideals and school design models; and

WHEREAS, many lessons can be learned from the nine years of operating experience of Kinston Charter Academy, and among other lessons is the fact that class size matters, serving disproportionate percentages of at-risk students requires additional financial resources, teacher licensure status does not automatically translate into high student performance, and optimum school operating conditions are impacted by an efficient and transparent regulatory environment; and

WHEREAS, the financial model upon which the school was structured required annual infusions of external financial supports from the local community, and cooperation from the local school districts in disbursing legislated funding to the charter school; and

WHEREAS, by 2007 the school experienced a \$354,000.00 operating deficit and has struggled to keep its doors open and reduce its annual operating deficit; and

WHEREAS, even though the school was able to reduce the deficit incrementally over the years to achieve a \$49,000 operating surplus in 2012, increased class sizes, referrals by the local school district of its students with chronic low performance and disciplinary challenges resulted in declining enrollment; and

WHEREAS, in a competitive act, the local school district has opened two new state of the art school facilities within a short distance from Kinston Charter Academy's school facilities with combined student enrollment capacity in excess of 1,300 Kindergarten through 8<sup>th</sup> grade students; and

WHEREAS, Kinston Charter Academy lacks the financial resources to compete with the local school district, was not successful in recovering nearly \$1 million in illegally withheld local current expense funds from the local school district; and

WHEREAS, Kinston Charter Academy is in need of making substantial repairs and upgrade to its facilities at a combined cost in excess of \$600,000.00 and is experiencing a shortfall of working capital; and

Resolution of Closure of Kinston Charter Academy

WHEREAS, erroneous compliance findings, changes and uncertainty in regulatory policies that impact cash flow, and rules that deter schools operating with large populations of at-risk minority students; and

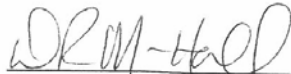
WHEREAS, Kinston Charter Academy does not have adequate financial working capital to complete the 2013-2014 academic school year and is experiencing regulatory issues that have arisen as a result of the school's financial condition; and


WHEREAS, the school has about \$2 million in equity in its school facilities but has been unable to refinance in the current regulatory environment; and

WHEREAS, it is in the best interest of Kinston Charter Academy students to make an early transition in the light of the schools lack of means to continue:

NOW, THEREFORE, it is hereby resolved that Kinston Charter Academy hereby surrenders its Charter to the North Carolina State Board of Education effective on Tuesday, September 10, 2013 at 5:00 p.m. The last day for students will be Friday, September 6, 2013. Students and Parents will be informed of the school's decision to close on Wednesday, September 4, 2013 and provided with transition options. The school will facilitate student transition beginning September 9, 2013 until all existing student records are transferred. The school will immediately appoint a transition team to carry out this resolution and work with the Office of Charter Schools to complete a final closeout.

This the 3<sup>rd</sup> day of September, 2013.

  
\_\_\_\_\_  
Demyra R. McDonald-Hall  
Chairman of the Board of Directors

Attest:   
\_\_\_\_\_  
Linda McKnight  
Board Secretary

# ORDERING INFORMATION

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For additional information contact:  
Bill Holmes  
Director of External Affairs  
**919-807-7513**



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This investigation required 1,629 hours at an approximate cost of \$117,288.