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Review of the Financial Operations of the Village Learning Center Public Charter School

May 17, 2004

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May 17, 2004

Dr. Brenda L. Belton
Executive Director
District of Columbia Board of Education
Public Charter Schools Oversight Office
825 North Capitol Street, N.E.
Washington, D.C. 20002

Letter Report: Auditor's Review of the Financial Operations of the Village Learning Center Public Charter School

Dear Dr. Belton:

Pursuant to your November 6, 2003 request and section 455 of Pub.L.No. 93-198, D.C. Code, 2001 Ed. §1-204.55,[1] the District of Columbia Auditor examined the accounts and operations of The Village Learning Center Public Charter School (VLC) for fiscal years 1999 through 2004, as of November 30, 2003.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine whether the Board of Trustees and management conducted VLC's financial activities and operations consistent with applicable rules, regulations, laws, and sound financial management principles and practices during fiscal years 1999 through 2004, as of November 30, 2003.

The scope of the audit included a review of the accounts and operations of VLC for the period October 1, 1998 through November 30, 2003. To accomplish the objective, the Auditor reviewed the following statutes and regulations:

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[1] *See* the District of Columbia Home Rule Act, as amended, Pub. L. No. 93-198, Section 455 (b), D.C. Code, 2001 Ed. §1-204.55 (b): "The District of Columbia Auditor shall each year conduct a thorough audit of the accounts and operations of the government of the District in accordance with such principles and procedures and under such rules and regulations as he may prescribe." *See also,* D.C. Code, 2001 Ed. §1-204.55 (c): "The Auditor shall have access to all books, accounts, records, reports, findings and all other things, or property belonging to or in use by any department, agency, or other instrumentality of the District government and necessary to facilitate the audit."

the District of Columbia School Reform Act of 1995, Pub.L.No. 104-134, as amended, D.C. Code, 2001 Ed. § 38-1800.01 ("the School Reform Act") *et seq.*;
the Public Charter Schools Act of 1996, D.C. Law 11-135, effective May 28, 1996, D.C. Code, 2001 Ed. §38-1700.01 *et seq.*; and
5 D.C.M.R. §§900-937 (2004) (public charter school policies).

The Auditor also reviewed VLC's audited financial statements for the period under audit; management reports; Board minutes; monitoring reports; cash receipts and disbursement journals; and contracts and agreements. The audit team also reconciled deposits of public revenues that VLC received to a confirmation statement provided by the District of Columbia Office of the Chief Financial Officer. Additionally, the audit team reviewed working papers and schedules that were prepared by VLC's independent auditor. Furthermore, the Auditor interviewed key officials of VLC and the Public Charter Schools Oversight Office ("PCSOO"). The PCSOO is an agency within the District of Columbia Board of Education ("DCBOE").

The audit was performed in accordance with generally accepted governmental auditing standards and included such test of the accounting records as were deemed necessary under the circumstances.

BACKGROUND

VLC was established in 1998 to operate as a public charter school pursuant to D.C. Code, 2001 Ed. § 38-1802.01.[2] During school year 2004, VLC enrolled approximately 468 students in pre-kindergarten through the 12th grade. Based on this enrollment, VLC received total FY 2004 local appropriated funding of approximately $4,675,725 from the District of Columbia.

The mission of VLC is to enhance the cognitive, social, physical, emotional, and moral development of students. VLC offers services to children who are culturally and socioeconomically diverse. The curriculum includes reading, language arts, mathematics, science, social studies, art, music, computer lab, physical development, and foreign languages.

VLC's activities are primarily funded by local appropriations through the DCBOE under a 15 year charter agreement through June 30, 2013. Under the terms of the charter agreement, VLC is

[2] *See* the School Reform Act, Pub.L.No 104-134, §2201.

required to renew its charter application every five years beginning July 1, 2003.[3] Under the authority vested in DCBOE under section 38-1702.01 (b) (1) - (3) of the D.C. Code, the Board shall deny an application for renewal of a charter for the following reasons:

(1) The school has committed a material violation of the conditions, terms, standards, or procedures set forth in its charter;
(2) The school has failed to meet the goals and student academic achievement expectations set forth in its charter; and
(3) The renewal application fails to comply with the requirements of §§ 38-1702.02 and 38-1702.03.[4]

Furthermore, DCBOE's chartering authority also includes the power to revoke. DCBOE must revoke a school's charter if it determines that a school has "committed a violation of applicable law or a material violation of its charter,"[5] and the following:

(1) has engaged in a pattern of nonadherence to generally accepted accounting principles;
(2) has engaged in a pattern of fiscal mismanagement;
(3) is no longer economically viable;
(4) is not making satisfactory progress toward meeting student achievement expectations in the school's charter; and
(5) does not meet the minimum academic standards required for District of Columbia public schools.[6]

PCSOO officials indicated that they had received repeated reports of VLC being delinquent in making its lease, Washington Gas, and federal tax payments. As a result, the DCBOE took action in its board meeting on November 19, 2003 to place VLC on a 120 day probation. The action for placing VLC on probation was a unanimous decision. On January 30, 2004, the DCBOE issued a written notice to VLC's Board of Trustees informing it of the date of the probationary period which ended March 19, 2004. Further, the DCBOE stated that VLC must develop an incremental corrective

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[3] *See* D.C. Code, 2001 Ed. § 38-1702.01 (a) (1) which states: "Each charter shall be limited to a period of 5 years but may be renewed for an unlimited number of additional 5-year periods." *Note also* that VLC submitted its application for charter renewal in November of 2003 for fiscal year 2004. It has not been acted upon by the DCBOE as of the date of this report.

[4] These provisions discuss the Council of the District of Columbia's findings and purposes for enactment.

[5] *See* D.C. Code, 2001 Ed.§ 38-1702.10(a).

[6] *See* D.C. Code, 2001 Ed.§ 38-1702.10 (b) (1) - (5).

action plan, come into fiscal compliance, and take certain actions. Table I presents those actions that VLC must take and the date of submission.

TABLE I

**The Village Learning Center PCS:
Actions to be Taken and Date of Submission
Per DCBOE's January 30, 2004 Letter**

NUMBER	ACTION	DATE OF SUBMISSION
1	Submit corrective action plan developed as required by Board of Education resolution	February 15, 2004
2	Submit the following reports:	On or before March 31, 2004
	• SY 2002-2003 Annual Report	
	• FY 2003 Independent Audit Report	
	• Appointment of an audit or similar committee	
	• Proof that employees in financial functions are bonded	
	• Cash flow management plan	
	• Accounts payable schedule/report	
	• Background check on all employees in financial functions	
	• Proof that lease(s), Washington gas and Federal tax payments are current	
	• Proof that all reports required by the Board of Education are current	
3	Exit meeting with Charter School officers	March 19, 2004[7]

Source: Letter from President of DCBOE, dated January 30, 2004

The probationary period was extended twice. The first extension extended the probationary period to April 19, 2004, while the second extension extended the probationary period through May 19, 2004.

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[7] In Table I above, the March 19, 2004 scheduled date for the exit meeting was established by DCBOE officials.

FINDINGS

VLC'S ACCUMULATED DEFICIT TOTALED $895,567 AT SEPTEMBER 30, 2003

The Auditor's examination of financial data pertaining to VLC's operations revealed that expenditures exceeded operating revenues in each fiscal year during the period October 1, 1997 through September 30, 2002. During this period, VLC's accumulated deficit reached a high of $916,325. However, for FY 2003, VLC's operating revenues exceeded its expenditures by $20,758, reducing the accumulated deficit to $895,567. Table II presents VLC's operating revenues, expenditures, and accumulated deficit for fiscal years 1999 through 2003.

TABLE II

The Village Learning Center PCS:
Operating Revenues, Expenditures, and Accumulated Deficit for Fiscal Years 1999 Through 2003

FISCAL YEAR	OPERATING REVENUES[8]	EXPENDITURES	ACCUMULATED (DEFICIT)
Opening Deficit at October 1, 1998			($76,745)
1999	$1,003,813	$1,120,621	(193,553)
2000	2,218,121	2,561,288	(536,720)
2001	4,140,762	4,292,302	(688,260)
2002	4,510,538	4,738,603[9]	(916,325)
2003	4,784,572	4,763,814	(895,567)

Source: VLC's Audited Financial Statements

The audit team determined that the following factors contributed to VLC's deficit spending: (1) IRS levied interest and penalties totaling $265,729 for FY 2001; (2) VLC management leased certain properties during the audit period at a total cost of $245,318, but these properties were not

[8]See Appendix I for a Schedule of Revenue and Support for each fiscal year.

[9]See Appendix II for a Schedule of Functional Expenses for this fiscal year.

occupied; (3) VLC did not participate in the National School Lunch Program in prior years, thereby forfeiting approximately $200,000 in additional revenues; and (4) VLC incurred interest expense of approximately $87,647 on executing short-term loans for working capital.

<u>IRS Levied Interest and Penalties Totaling $265,729 for FY 2001</u>

During calendar year 2001, VLC filed its Form 941, Employer's Quarterly Federal Tax Returns and corresponding payments late. Due to late filing and payment of withholding taxes for the last three quarters of calendar year 2001, IRS assessed total penalties and interest of $265,729. This notice of levy was dated September 24, 2003. Persons designated by VLC management to handle the filing and payment of withholding taxes did not perform these assigned tasks timely. Additionally, VLC management did not perform the necessary monitoring and oversight to gain assurances that the filing of required tax returns and corresponding payments were performed in accordance with established regulations.

In September 2003, the IRS garnished VLC's bank accounts for a total of $124,081. Also, the District's Office of the Chief Financial Officer withheld $141,648 from VLC's quarterly per pupil allotment due October 15, 2003 to retire the balance owed IRS. Therefore, the IRS assessment of $265,729 has been paid.

<u>VLC Spent Approximately $245,318 for Leased Properties That It Did Not Occupy</u>

During the audit period, VLC incurred total occupancy costs of approximately $1,460,690 from leasing several properties in the District of Columbia to provide for the academic, social, physical, and cultural development of its students. See Table III for a summary of occupancy costs by lessor for each fiscal year.

Since VLC was able to lease adequate facilities from the District at 33 Riggs Road NE beginning in August 2002, it had no need to occupy properties and trailers leased from Second FSK Limited Partnership, New Covenant Faith Bible Church, St. Paul Christian Community Church, St. James Baptist Church, and Allied Trailers. Occupancy costs for these unoccupied leased properties and trailers totaled approximately $215,700. In addition to rental costs, VLC incurred costs for renovation, electric, and leasehold improvements of $29,618 for the unoccupied space that was leased from Second FSK Limited Partnership. Therefore, VLC incurred total costs of $245,318 for leased properties that were not occupied. Table III presents the lessor, location, lease term, expected use of property, and costs for unoccupied leased properties.

TABLE III

The Village Learning Center PCS:
Schedule of Unoccupied Leased Properties
FY 1999 through FY 2004, as of November 30, 2003

LESSOR	LOCATION	LEASE TERM	EXPECTED USE OF PROPERTY	COSTS
Second FSK Limited Partnership	1121 H Street, NE	September 20, 2001 to September 19, 2003	Middle School and High School	$156,960
New Covenant Faith Bible Church	1350 Maryland Avenue, NE	October 15, 2001 to September 30, 2002	6th through 8th Grades	30,774
St. Paul Christian Community Church	414 Tennessee Avenue, NE	August 1, 2002 to June 30, 2003	6th through 8th Grades	18,500
St. James Baptist Church	4024 Minnesota Avenue, NE	August 1, 2002 to January 31, 2003	High School	1,500
Allied Trailers	702 15th Street, NE	September 2001 and October 2001	Elementary School	7,966
Total Occupancy Costs				**215,700**
Leasehold Improvements and Utilities	1121 H Street, NE			29,618
TOTAL COSTS				$245,318

Source: Lease Agreements and VLC's Financial Records

Expended costs of approximately $245,318 for leased properties that were not occupied appear to have contributed to VLC's deficit spending. Furthermore, it is evident that the expenditure of these scarce public resources did not provide any measurable benefits to VLC's operations.

Lack of Participation in the National School Lunch Program

VLC officials indicated that the school has been eligible to participate in the National School Lunch Program since the beginning of school year 1999. For various reasons, VLC personnel did not complete the required applications or the school was not able to pass inspection. These failures resulted in the forfeiture of approximately $200,000 in additional revenues for lunches. VLC received approval to participate in the program for school year 2004.

VLC Incurred Interest Expense of Approximately $87,647

During FY 1999 through FY 2004, as of November 30, 2003, VLC borrowed approximately $1,125,000 from Branch Banking and Trust Company (BB&T) to obtain working capital for its operations. VLC incurred interest expense charges of $87,647 on executing these short-term promissory notes which were used to cover working capital deficits and payroll obligations. Table IV presents the date of note, lender, and amount.

TABLE IV

The Village Learning Center PCS:
Schedule of Short-Term Promissory Notes and Interest Expense with BB&T
FY 1999 through FY 2004, as of November 30, 2003

DATE OF NOTE	LENDER	AMOUNT
July 1999	BB&T	$250,000[10]
August 30, 2002	BB&T	250,000
October 2, 2002	BB&T	375,000
November 26, 2002	BB&T	250,000
Subtotal		$1,125,000
Interest Expense	BB&T	87,647
TOTAL		**$1,212,647**

Source: Loan Agreements and VLC's Audited Financial Statements

The borrowing of these funds is an indication that VLC officials did not manage the school's resources in a prudent and responsible manner. VLC's Board of Trustees did not fulfil their fiduciary responsibilities in assuring that VLC management developed and adhered to viable spending plan budgets during each fiscal year. Poor management decisions and improper financial management practices coupled with the fact that certain financial matters were not handled in a timely and cost effective manner helped to foster the creation of VLC's deficit.

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[10] VLC management did not provide a copy of the July 1999 loan agreement for review by the audit team. The Executive Director of VLC should provide a copy of the July 1999 loan agreement with BB&T to the District of Columbia Auditor immediately.

RECOMMENDATIONS

1 The Board of Trustees, in consultation with VLC management, develop a cash flow plan targeted toward: (A) operating in an economically viable position; (B) curtailing monthly operating expenditures so that they do not exceed realized monthly operating revenues; and (C) eliminating the accumulated deficit within a specified time period.

2. The Executive Director of VLC develop a system of checks and balances for assuring that tax returns and the payment of withholding taxes are filed timely to avoid the assessment of penalties and interest in the future.

3. The Board of Trustees and the Executive Director of VLC critically scrutinize, inspect, and examine future lease agreements so that the necessary terms and conditions can be implemented for protections and reimbursements in the event that the properties are not needed or certain specific conditions cannot be met in order to occupy the leased properties. The Board of Trustees and the Executive Director of VLC should have assurances that a certificate of occupancy for any desired space can be obtained before executing a bona fide lease agreement.

4. The Executive Director of VLC take immediate steps to operate and manage future funded programs, such as the National School Lunch Program, in a manner to optimize available revenues and resources for operations.

$156,424 IN LOAN REPAYMENTS LACKED LOAN AGREEMENTS AND OTHER RELEVANT SUPPORTING DOCUMENTATION

In reviewing VLC's financial records, the audit team noted payments to VLC's Executive Director and other family members, as well as a hired financial consultant (referred to as related parties). VLC's Executive Director indicated that these payments represented the repayment of loans made to the Village Learning Center PCS. The Auditor determined that these "loans" were generally not in the form of cash or cash equivalents and the value of what was provided to the school had not been established by an independent arms-length appraisal. Further, VLC's management and Board of Trustees could not provide any loan agreements or cash receipts records to document and support the legitimacy of the loans or loan repayments to VLC's Executive Director, other family members, and the financial consultant. Based on VLC's audited financial statements and financial records, the Auditor determined that these loan repayments totaled approximately $156,424. VLC officials indicated that these loans were interest-free. Table V presents loan repayments made to each of the parties.

TABLE V

The Village Learning Center PCS:
Loans Executed with Related Parties
FY 1998 through FY 2004, as of November 30, 2003

FISCAL YEAR	RELATED PARTY	LOAN AMOUNT
1998	Executive Director of VLC	$112,100
1998	Executive Director of VLC	12,050
1998-1999	Spouse of Executive Director of VLC	16,060
1998	Financial Consultant	8,000
2003	Son of Executive Director of VLC	8,214
TOTAL		**$156,424**

Source: VLC's Audited Financial Statements and Financial Records

RECOMMENDATIONS

1 Executive Director of VLC immediately provide to the District of Columbia Auditor copies of all executed loan agreements with related parties. In the future, VLC management maintain all loan agreements in an orderly and professional manner.

2. The Executive Director of VLC and all parties receiving loan repayments in the absence of a valid written loan agreement repay these funds to the Village Learning Center PCS within 90 days of the date of this report. Any failure on the part of the parties to repay these funds as recommended herein will be referred to the District's Office of the Corporation Counsel for the appropriate civil action.

3. The Office of the Inspector General investigate the legitimacy of loan repayments made to the VLC Executive Director, her family members, and a hired financial consultant.

VLC PAID APPROXIMATELY $256,849 FOR CREDIT CARD EXPENDITURES THAT COULD NOT BE SUPPORTED BY DOCUMENTATION

During fiscal years 1999 through 2004, as of November 25, 2003, the VLC paid approximately $349,383 in credit card charges for 1,067 transactions. Of the total $349,383 in credit card payments identified by the Auditor, VLC management could not provide documentation to support approximately 882 or approximately 83% of transactions totaling $256,849 or 73.5% of total credit card payments.

VLC Management Failed to Adopt Policies and Procedures Governing the Use of Credit Cards

The Auditor found that VLC's Executive Director and board of trustees failed to adopt, implement, and enforce policies and procedures governing accountability for the use of credit cards issued to VLC's Executive Director, Administrative Assistant, and 7/8 Grade Instructor. This is an example of poor internal accounting and management controls and ineffective management practices and governance that exposed VLC's finances to misuse and waste.

Table VI presents expenditures that were charged to credit cards assigned to VLC officials during fiscal years 1999 to 2004, as of November 25, 2003.

TABLE VI

The Village Learning Center PCS:
Credit Card Expenditures
FY 1999 through 2004, as of November 25, 2003

CREDIT CARD CHARGES	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	TOTAL
Airfare	$1,987	$3,912	$1,229	$3,120	$4,112	$0	$14,360
Apparel	555	3,252	1334.58	1,776	5,924	243	13,085
Books	638	2,419	8940.58	4,910	1,864	1,840	20,611
Building Materials	926	181	0.00	0	0	0	1,107
Car Rental	0	1,350	2,788	2,198	332	0	6,668
Computer & Comp. Accessories	6,722	808	26,346	6,058	21,017	0	60,951
Conference & Seminar Fees	668	298	179	2,522	564	0	4,231
Educational Supplies	666	3,258	8,290	13,443	7,175	0	32,832
Flowers	326	257	3,161	1,803	664	0	6,212
Food & Beverage	924	617	2,471	3,273	1,468	1,022	9,775
Furniture and Appliances	0	11,408	737	0	1,878	0	14,023
Gift Items	116	1,976	10,441	3,158	6,357	3,101	25,149
Hotel	1,349	8,826	3,304	10,023	3,162	396	27,059
Membership & Subscriptions	1,433	719	830	1,461	1,299	313	6,055
Office Supplies	1,692	1,047	0	4,971	9,684	2,046	19,440
Party Supplies	0	7,096	2,430	0	397	0	9,923
Printing & Publications	1,203	3,414	3,467	3,156	1,967	70	13,276
Sporting Goods	470	1,083	711	1,095	389	526	4,274

Stamps	594	1,406	1,953	416	4,879	0	9,247
Toys & Games	845	172	0.00	0	617	0	1,633
Trophies & Awards	732	984	$1,550	0	115	0	3,382
Miscellaneous	$1,133	$4,808	$6,501	$20,543	$8,498	$4,608	$46,092
TOTAL	**$22,980**	**$59,290**	**$86,662**	**$83,924**	**$82,362**	**$14,164**	**$349,383**

Source: VLC Credit Card Statements

VLC Paid Approximately $256,849 for Credit Card Transactions That Lacked Proper Supporting Documentation

The General Accounting Office's Standards for Internal Control in the Federal Government, dated November 1999, sets forth the importance of obtaining and maintaining appropriate documentation to support transactions in an effective internal control system. The GAO's Standards for Internal Control state that: "All transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. All documentation and records should be properly managed and maintained." Also, good internal control practices require each transaction to be supported by an original invoice or receipt from the vendor.

The Auditor found that during fiscal years 1999 through 2004, as of November 25, 2003, VLC management failed to establish and adhere to credit card policies and procedures, as well as effective internal control procedures, by paying outstanding credit card invoices even though the invoices lacked supporting documentation such as receipts. Of the total credit card payments of $349,383 made during fiscal years 1999 through 2004, as of November 25, 2003, the Auditor identified approximately $256,849, or 73.5%, in payments for which there were no vendor invoices, receipts, or any other supporting documentation. Because there was no supporting documentation such as invoices or receipts available to support credit card expenditures, the Auditor could not determine whether these expenditures were for legally permissible VLC business.

Table VII presents credit card payments made without supporting documents during fiscal years 1999 to 2004, as of November 25th.

TABLE VII
The Village Learning Center PCS:
Credit Card Payments Without Supporting Documents
FY 1999 through 2004, as of November 25, 2003

Fiscal Year	Number of Transactions Without Supporting Documents	Amount
FY 1999	88	$13,245
FY 2000	165	$57,290
FY 2001	138	$48,958
FY 2002	285	$78,857
FY 2003	179	$47,424
FY 2004 through 11/30/03	27	$11,075
TOTAL	882	$256,849

Source: VLC's Credit Card Expenditure Records

Payments made in the absence of supporting documentation exposed VLC's finances to a significant risk of potential fraud, waste, and abuse. Without supporting documentation, it was impossible for the Auditor or accountable VLC managers to substantiate the legitimacy of these transactions. Moreover, without vendor sales receipts or invoices it was impossible to determine whether items purchased were for official VLC business or for the cardholder's personal use. The practice of making payments without supporting documents may have resulted in the use of public funds to support fraudulent, improper, or personal transactions. Further, payments in the absence of supporting documentation exhibited poor business judgment, undermined the integrity of transactions processed by VLC, and indicated a weak internal control system and environment.

RECOMMENDATIONS

1. VLC's Executive Director immediately cancel all corporate credit cards issued to VLC employees and provide the Auditor with evidence of the cancellation within 15 days of the date of this report.

2. The VLC Board of Trustees establish a specific policy and procedures regarding the criteria that must be used to determine the necessity for corporate credit cards to be issued in VLC's name, in addition to the criteria that will be used to determine: (A) which VLC employees will be assigned credit cards; (B) expenditure limits for each card; (C) the types of purchases that cards my be used to make; (D) regular specific report that must be filed with the Board concerning expenditures made with each credit card issued to VLC employees including the Executive Director; (E) a requirement that the Executive Director develop and implement policies and procedures regarding credit card usage that must be adhered to by VLC employees under his/her management control; and (F) and specific accountability measures that will be applied by the Board for any failure of the Executive Director or VLC employee to comply with the Board's or school's policy and procedures regarding credit card usage and accountability.

3. VLC's management ensure that credit card invoices are supported by adequate and appropriate documentation before making payments, and that all records of credit card transactions are retained for a minimum of five years and made available when needed.

4. The Inspector General of the District of Columbia investigate all of VLC's credit card expenditures that are not supported by adequate or any documentation.

VLC ISSUED 234 CHECKS MADE PAYABLE TO "CASH" TOTALING $216,572 DURING FISCAL YEARS 1999 THROUGH 2004 AS OF NOVEMBER 30, 2003

Effective internal control procedures over cash disbursements to reduce the risk of possible fraud include: prohibitions against signing blank checks or checks made payable to the order of "Cash" or "Bearer."

The Auditor found that during fiscal years 1999 through 2004, as of November 30, 2003, VLC issued 234 checks made payable to "Cash" totaling $216,572. VLC management could not provide the audit team with supporting documents for these checks. Table VIII presents the total number of checks made payable to cash during FY 1999 through 2004, as of November 30, 2003.

TABLE VIII
The Village Learning Center PCS:
Checks Made Payable to Cash
FY 1999 through 2004, as of November 25, 2003

FISCAL YEAR	NUMBER OF CHECKS	AMOUNT
FY 1999	3	$980
FY 2000	23	$17,495
FY 2001	58	$46,071
FY 2002	136	$107,708
FY 2003	12	$19,655
FY 2004 through 11/30/03	2	$24,663
TOTAL	**234**	**$216,572**

Source: VLC's Financial Records

The Auditor found that VLC's management failed to adopt, implement, and enforce clear and precise policies and procedures governing cash disbursements. Additionally, the Auditor's analysis of checks made payable to cash revealed that VLC management failed to exercise sound business judgment by assuring, at a minimum, if it had to be done under exigent circumstances, checks made payable to cash were supported by adequate documentation. Lack of clear policies and procedures, poor internal controls, and a weak internal control environment in addition to poor business judgment contributed to this improper practice. The practice of issuing checks made payable to "Cash" can result in the use of public funds to support fraudulent, improper, wasteful, or abusive transactions.

RECOMMENDATIONS

1. Village Learning Center immediately cease issuing checks made payable to cash.

2. Village Learning Center management be held accountable for reimbursing the District all funds disbursed by checks made payable to "Cash" that lacked supporting documentation.

3. The Inspector General of the District of Columbia investigate all checks issued by VLC that were made payable to "Cash."

UNPAID IRS PENALTIES AND INTEREST TOTAL $81,491

On November 30, 2003, IRS issued a levy of $50,000 because VLC filed its FY 2001 Form 990, Return of Organization Exempt from Income Tax, during April 2003, approximately one year late. As a result, IRS assessed a penalty of $50,000. On May 3, 2004, IRS notified VLC management of penalties and interest totaling $31,491 because payroll withholding taxes for the fourth quarter of calendar year 2003 were paid late.

VLC management has retained legal counsel to appeal the assessment of these penalties and interest amounting to $81,491.

Additionally, the audit team requested copies of VLC's Form 990 for fiscal years 1999, 2000, and 2003. These records have not been provided for review.

RECOMMENDATIONS:

1 The Executive Director of VLC implement a follow-up system of checks and balances to assure that:

   (a) required IRS tax forms are prepared in accordance with applicable rules and regulations and filed timely;

   (b) corresponding payment of payroll withholding taxes to the IRS be made timely.

2. The Executive Director of VLC provide copies of VLC's Form 990, Return of Organization Exempt from Income Tax for fiscal years 1999, 2000, and 2003 to the District of Columbia Auditor immediately.

VLC FAILED TO STRUCTURE AND STAFF A SUFFICIENT, EFFICIENT, AND COMPETENT FINANCE OFFICE

The audit team noted that VLC management has hired expensive consultants to handle the day-to-day operations of its finance office. These consultants were paid $65 and $75 per hour to provide management and accounting services for ongoing school financial activities. During the audit period, VLC incurred total accounting and financial management consulting costs of approximately

$149,149. VLC management lacked the experience to adequately review and appraise the work performed by the financial consultants. The payment of excessive fees to these financial consultants appears to have contributed to VLC's deficit spending.

Additionally, the audit team noted that VLC's general ledger lacked proper reviews, reconciliations, and adjustments. Transactions were posted to incorrect accounts or they had not been properly entered into the general ledger accounting system. Furthermore, it was observed that recordkeeping practices were insufficient. VLC's revenue files, credit card records, disbursement records, tax files, and various other documentation supporting procurement, travel, and other operational expenses were incomplete. Key information was not maintained in a logical order, and documentation was missing or inadequate.

VLC's Executive Director indicated that an experienced Chief Financial Officer was recently hired to manage and operate the finance office.

RECOMMENDATION

The Board of Trustees and management develop a plan to address the infrastructure for the Finance Office and related offices and departments. The infrastructure should provide for an adequate and sufficient segregation of duties and responsibilities.

BACKGROUND CHECKS WERE NOT CONDUCTED FOR 12 EMPLOYEES

The contractual agreement between the DC Board of Education and Board of Trustees of the Village Learning Center Public Charter School section IX (A) states: the school shall ensure the conduct of background checks/clearances for all employees.

The Auditor's review of 81 VLC employees' records revealed that background checks were not conducted for 12 employees during School Year 2004. The Auditor found that these 12 employees did not submit both police clearances and FBI fingerprints. Additionally, 14 employees' background records were incomplete: either FBI fingerprints or police clearances were missing from the file. VLC's personnel officer indicated that two of the employees that did not submit fingerprint and police clearances are part-time employees.

Category	Number of Employees
Background Check Not Conducted	12
Incomplete Background Checks[11]	14

Source: VLC's Employee Files

RECOMMENDATION

VLC management must insure that complete criminal background checks are conducted on all employees.

INTERNAL CONTROL DEFICIENCIES

In performing the audit of VLC's financial activities and operations, the Auditor noted several matters that should be addressed to strengthen internal controls and operating efficiency.

1. Discontinue the practice of issuing checks made payable to "Cash" immediately.
2. Develop and implement policies and procedures to govern the use of corporate credit cards.
3. File tax returns and payments to the IRS timely.
4. Maintain invoices, receipts, loan agreements, tax returns, canceled checks and other supporting documents in an orderly and professional manner.
5. Discontinue paying sales taxes on exempt purchases.

CONTINGENCIES

The Auditor noted the following contingencies that when ultimately resolved, may have an adverse affect on VLC's current financial position:

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[11] Finger print or police criminal history is missing

Claim with former landlord amounting to $111,635;[12]

2. Amount due Washington Gas at April 28, 2004, totaling $82,243;

3. IRS assessed penalties and interest totaling $81,491; and

4. Pending employee lawsuit on discrimination.

CONCLUSION

The Auditor's examination of the financial operations of the Village Learning Center Public Charter School revealed that expenditures exceeded operating revenues in each fiscal year during the period October 1, 1997 through September 30, 2002. During this period, VLC's accumulated deficit reached a high of $916,325. However, in FY 2003, VLC's operating revenues exceeded its expenditures by $20,758, reducing the accumulated deficit to $895,567.

The Auditor determined that the following factors contributed to VLC's deficit spending or adversely effected VLC's financial operations: (1) IRS levied interest and penalties totaling $265,729 for FY 2001; (2) VLC's management leased certain properties during the audit period at a total cost of $245,318, but these properties were never occupied; (3) VLC did not participate in the National School Lunch Program during the majority of the audit period, thereby forfeiting approximately $200,000 in additional revenues; (4) VLC incurred interest expenses of approximately $87,647 on executing short-term loans for working capital; (5) VLC management made $156,424 in loan repayments to the Executive Director and related parties as well as a financial consultant that lacked loan agreements and other relevant supporting documentation; (6) VLC management authorized the payment of approximately $256,849 for credit card transactions that lacked proper supporting documentation. Payments made in the absence of supporting documentation exposed VLC's finances to a significant risk of potential fraud, waste, and abuse; and (7) VLC issued 234 checks made payable to "cash" totaling $216,572 during fiscal years 1999 through 2004 as of November 30, 2003 that lacked any or adequate supporting documentation. Making checks payable to cash revealed that VLC management failed to exercise sound business judgment, established poor internal management and accounting controls, and conducted its financial operations in a weak internal control environment. The practice of issuing checks made payable to "Cash" can result in the misuse of public funds to support fraudulent, improper, wasteful, or abusive transactions.

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[12]During November 2003, Second FSK Limited Partnership executed a claim against VLC alleging defaulted payment of rent, common area maintenance charges, real estate taxes, late charges, water and sewer charges and administrative fees in the amount of $111,365.22.

Overall, VLC's financial operations and practices did not support a successful public charter school business operations model from its inception; VLC was in continuing violation of the terms and conditions of its charter. Further, VLC was not provided the kind of sustained support, guidance, and oversight by the District that was needed to assure that it operated on a sound financial footing, within clearly defined financial and operational guidelines that more fully supported its success. The Board of Trustees of a public charter school has a fiduciary responsibility to the school and is ultimately responsible for the overall policy as well as for making final decisions that are consistent with the school's charter.

Respectfully submitted,

Deborah K. Nichols

Deborah K. Nichols
District of Columbia Auditor

APPENDICES

Appendix I

The Village Learning Center PCS
Schedule of Revenue and Support
FY 1999 through FY 2003

Captions	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	TOTALS
Pupil Allocations[13]	$813,928	$1,699,397	$3,417,401	$3,741,897	$3,579,651	$13,252,274
Grants	158,688	364,062	706,130	729,147	950,038	2,908,065
Contributions	0	0	0	0	229,059	229,059
Interest Income	0	0	0	2,094	679	2,773
Other	31,197	154,662	17,231	37,400	25,145	265,635
TOTALS	**$1,003,813**	**$2,218,121**	**$4,140,762**	**$4,510,538**	**$4,784,572**	**$16,657,806**

Source: VLC's Audited Financial Statements

[13]District of Columbia appropriated funds based on enrollment for each school year.

Appendix II

The Village Learning Center PCS:
Schedule of Functional Expenses for Fiscal Years 2002 and 2003

Description	FY 2002	FY 2003
Salaries, Wages and Benefits	$2,890,867	$2,439,927
Payroll Taxes	246,300	195,086
Fringe Benefits	122,207	84,414
Consultants	25,697	12,482
Occupancy	326,531	612,502
Dietary	112,670	85,085
Accounting	80,878	58,738
Legal	4,048	7,135
Student Supplies	216,509	198,262
Staff Development	45,385	53,216
Contracted Instructionals	100,160	259,206
Repairs and Maintenance	40,008	46,696
Leasehold Improvements	0	128,727
Depreciation and Amortization	147,444	134,598
Insurance	10,309	49,827
Office Supplies	106,500	94,352
Utilities	70,067	165,071
Storage and Rentals	15,992	0
Telephone and Communications	13,935	50,612
Interest	9,810	18,605
License and Fees	27,165	1,385
Bank Fees	9,352	5,737
Penalties and Interest	50,050	0
Planning	14,291	13,063
Dues and Subscriptions	4,021	1,334
Administrative Fee	17,789	16,871
Printing and Copying	10,280	5,545
Advertising	2,038	7,267
Transportation	8,641	2,798
Miscellaneous	9,659	15,273
Total Expenses	**$4,738,603**	**$4,763,814**

Source: VLC's Audited Financial Statements