

**Investigative Report:
Misuse of Public Monies by
a Charter School Owner**



March
1997

Douglas R. Norton
Auditor General



DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
DEPUTY AUDITOR GENERAL

March 7, 1997

Members of the Arizona Legislature

The Honorable Grant Woods
Attorney General

The Honorable Lisa Graham Keegan
State Superintendent of Public Instruction

In conjunction with the Office of the Attorney General, we have conducted a special investigation of the Arizona charter school, Citizen 2000, for the period April 1995 through June 1996. Our investigation was performed to determine if Citizen 2000's internal control structure and its operation were adequate to prevent the misuse of public monies; and if not, the extent to which these monies had been misused.

Our investigation consisted primarily of inquiries and the examination of selected financial records and other documentation. Therefore, our investigation was substantially less in scope than an audit conducted in accordance with generally accepted auditing standards. Accordingly, we do not express an opinion on the financial records or internal control structure of Citizen 2000, nor do we ensure that all matters involving the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants or other conditions that require correction or improvement were disclosed.

The accompanying report describes our findings and conclusion as a result of this special investigation.

After this report is distributed to the members of the Arizona State Legislature, the Attorney General, and the State Superintendent of Public Instruction, it becomes public record.

A handwritten signature in cursive script that reads "Douglas R. Norton".

Douglas R. Norton
Auditor General

Attachment

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Summary

— ◆ —
Investigation Highlights:

- A charter school owner caused the misuse of \$126,843 of public monies.*
 - The owner used the school accounts to repay personal debts.*
- ◆ —

In January 1996, the Arizona Department of Education requested that the Office of the Auditor General review certain allegations related to potential misuse of public monies by Dr. Lawndia Venerable, owner/principal of charter school Citizen 2000. As a result of that request, we conducted an investigation of those allegations and have submitted these findings to the Office of the Attorney General.

Our investigation revealed that from April 1995 through June 1996, Dr. Lawndia Venerable caused the misuse of public monies totaling \$126,843 by giving public money to herself and a family member, repaying personal debts, and authorizing personal purchases. Identified below are some of the improper transactions carried out in Citizen 2000's first year of operation:

- Dr. Venerable authorized a \$99,297 school check for a down payment on her mother's home.
- Dr. Venerable approved \$25,786 of school checks to repay her personal bank debts.

In addition, we discovered numerous transactions that did not comply with Arizona statutory requirements.

We determined that these findings occurred primarily because of the Citizen 2000 owner/principal's disregard for appropriate spending of public monies, lack of oversight by an independent governing board, and weak internal control structure policies and procedures used in administering public monies.

Background

Charter School Background

Charter schools were developed to provide alternative academic choices for parents and pupils. Charter schools are exempt from many statutes and rules relating to school districts and governing boards, particularly those dealing with curriculum and personnel. However, as stated in Attorney General opinion I95-10 (R95-015), this “. . . is not a sweeping exception from all non-Title 15 (Education Code) statutes and rules that schools must obey, such as criminal laws. . .” and, “. . . charter schools are a newly added component of the public education system in Arizona.”

◆

Citizen 2000 received \$2,488,106 from the Department of Education in fiscal year 1995-96.

◆

Charter schools are subject to the same financial requirements as school districts.

Charter schools are not allowed to charge tuition, levy taxes, or issue bonds. They are financed primarily by state monies and must be accountable to Arizona taxpayers and state officials for the way that money is spent. Therefore, in matters of fiscal responsibility and financial accountability, charter schools are subject to the same financial requirements, procurement rules, and audit requirements specified in the statutes for school districts unless the charter includes specific exemptions. Citizen 2000 requested no such exemptions. At the time these public monies were misused, April 1995 through June 1996, charter schools were required to follow the *Uniform System of Financial Records (USFR)*¹, jointly developed by the Arizona Department of Education and the Auditor General’s Office, which sets forth the required policies and procedures developed to help schools maintain proper controls over assets and financial records.

Citizen 2000 received \$2,488,106 of state aid from May 1995 through June 1996, the school’s first year of operation.

¹The *Uniform System of Financial Records for Arizona Charter Schools* was developed in August 1996, pursuant to legislative amendments by Laws 1996, Chapter 356.

Finding I

Citizen 2000 Owner Misused Public Monies

◆

In Citizen 2000's first year of operation, Dr. Venerable misused \$126,843 of public monies.

◆

From April 1995 through June 1996, Dr. Lawndia Venerable, owner/principal of Citizen 2000, caused the misuse of public monies and theft totaling \$126,843 by giving public money to herself and a family member, repaying personal debts, and authorizing personal purchases. During our investigation we noted the following possible violations of Arizona Revised Statute (A.R.S.) §35-301, which states “A public officer or other person, . . . charged with the receipt, safekeeping, transfer or disbursement of public money is guilty of a class 4 felony who: (1) without authority of law, appropriates it, or any portion thereof, to his own use, or to the use of another,” and A.R.S. §13-1802 (A), which states “A person commits theft if, without lawful authority, such person knowingly: (2) converts for an unauthorized term or use services or property of another entrusted to the defendant or placed in the defendant’s possession for a limited, authorized term or use.”

Exhibit 1

Summary of Misuses of Public Monies April 1995 through June 1996

Description	Amount
Gifts of public monies and repayment of personal debts	\$114,027
Personal purchases	<u>12,816</u>
Total public monies misused by Dr. Venerable	<u>\$126,843</u>

Source: Records of Citizen 2000, Transamerica Title Co., Bank One, Norwest Bank, and investigation reports.

Gifts of Public Monies and Repayment of Personal Debts

From July 1995 through January 1996, Dr. Venerable caused \$114,027 of public monies to be misused by directing or authorizing and allowing the use of Citizen 2000 monies as gifts to a family member and personal payments to herself and her creditors. See Exhibit 2 on page 5 for a listing of these transactions. All of these transactions were paid without the governing board's prior approval and many of them were falsely categorized as "loan payments" in the Citizen 2000 check register, as Dr. Venerable repaid herself more money than she had loaned to the school.

Beginning in July 1995, weeks before the first day of classes at Citizen 2000, Dr. Venerable directed or authorized and allowed the use of the school's monies totaling \$102,562 for the down payment and related expenditures for her mother's home in the Biltmore Estates. On July 5, Dr. Venerable prepared and signed a \$365 Citizen 2000 check to Pacific American Mortgage for an appraisal that was necessary to secure financing on the home. Then, on July 31, 1995, Dr. Venerable prepared and signed a \$99,297 Citizen 2000 check payable to Transamerica Title Company for the down payment. This disbursement was categorized in the Citizen 2000 check register as a "loan payment;" however, bank records indicated that Citizen 2000 owed Dr. Venerable only \$24,321. In December 1995, Dr. Venerable's sister and Citizen 2000 Associate Principal, Loretha Johnson, prepared and signed two Citizen 2000 checks totaling \$2,400 for home construction improvements. And in January 1996, Dr. Venerable prepared and signed a \$500 Citizen 2000 check for more home construction improvements.

◆
*Weeks before the first day of
attendance at Citizen 2000, Dr.
Venerable allocated \$103,000 of
school monies as a gift to her
mother.*

As part of the mortgage agreement, Dr. Venerable signed a Gift Affidavit on July 18, 1995, stating that the source of a \$103,000 gift to her mother was the Citizen 2000 checking account, and that no repayment was expected or implied.

Dr. Venerable and Loretha Johnson had previously attempted to purchase this home, signing a contract and counteroffer on July 13, 1995. This agreement was contingent upon the first mortgage holder receiving its discounted payoff by July 31, 1995.

◆

Dr. Venerable paid herself and her creditors \$35,786 without authorization of the school's governing board.

◆

In addition, on August 17 and 18, 1995, Dr. Venerable prepared and signed four Citizen 2000 checks totaling \$25,786 payable to banks for payments on her personal credit cards and a line of credit. On September 1, 1995, Dr. Venerable prepared and signed a \$10,000 Citizen 2000 check payable to herself. These disbursements were categorized in the check register as "loan payments"; however, bank records indicated that Dr. Venerable had taken more in "loan payments" than she had provided to the school.

Exhibit 2

**Gifts of Public Monies and
Repayment of Personal Debts
July 1995 through January 1996**

Date	Description	Amount
	Biltmore home expenses:	
07/05/95	Pacific American Mortgage	\$365
07/31/95	Transamerica Title Co.	99,297
12/13 & 23/95	Ernest Hasan, Contractor	2,400
01/08/96	Ernest Hasan, Contractor	<u>500</u>
	Total gifts of public monies	<u>102,562</u>
	Excess "loan payments":	
08/17 & 18/95	MBNA and Norwest Banks	25,786
09/01/95	Lawndia White Venerable	<u>10,000</u>
	Total repayment of personal debts	<u>35,786</u>
	Subtotal	138,348
07/31/95	Due to Dr. Venerable	<u>(24,321)</u>
	Net unauthorized disbursements	<u>\$114,027</u>

Source: Records of Citizen 2000, Transamerica Title Company, Bank One, Norwest Bank, and investigation reports.

Personal Purchases

Dr. Venerable authorized use of the Citizen 2000 checking account and American Express corporate cards for personal purchases that totaled \$12,816 from April through December 1995. See Exhibit 3 on page 7 for a listing of these transactions. None of these expenditures were first approved by the governing board.

◆
Payments for personal purchases were accounted for in school records the same way as school purchases.

Dr. Venerable authorized \$2,675 of Citizen 2000 checks for payments to her personal attorneys. These expenditures were classified on the Citizen 2000 check register as “operations”, the same category used for school attorneys. In addition, Dr. Venerable prepared and signed a \$2,445 Citizen 2000 check for construction performed on her own home also located in the Biltmore Estates. This personal expenditure was classified on the Citizen 2000 check register as “building expense,” the same category used for construction performed on the school. Dr. Venerable also used the Citizen 2000 American Express corporate card, as well as the school’s checking account, to pay \$2,228 for jewelry. In addition, Dr. Venerable used Citizen 2000 monies to pay \$1,300 of her personal income taxes, \$823 for her home’s electric service, and \$318 for her September 4, 1995, travel expenses in Flagstaff. Dr. Venerable also used \$515 of Citizen 2000 monies on seven occasions to dine out or go to the movies. Other personal purchases by Dr. Venerable included \$27 for flowers and swimming pool supplies. The total amount of Dr. Venerable’s personal purchases was \$10,331.

In addition, Dr. Venerable authorized her sister, Loretha Johnson, brother-in-law, Allison Johnson, brother, Hobert White, fiancé (presently her husband), Derek Gabourel, and mother, Rosie Taylor, to use a total of \$2,485 of Citizen 2000 monies for personal purchases. These purchases included family members’ reimbursement or use of the American Express corporate card for airline flights and vehicle rentals to make more than a dozen trips between California and Arizona, totaling \$1,917. In addition, family members used \$475 of Citizen 2000 monies for dining out and family picnics, as well as \$93 for flowers and car washes.

Exhibit 3

**Personal Purchases Authorized by Dr. Venerable
April through December 1995**

Description	Dr. Venerable	Family	Total
Personal attorneys	\$2,675		\$2,675
Home construction	\$2,445		\$2,445
Personal trips	318	\$1,917	2,235
Jewelry	2,228		2,228
Personal taxes	1,300		1,300
Dining out/picnics/movies	515	475	990
Home utilities	823		823
Flowers/car washes/ swimming pool supplies	27	93	120
	<u>\$10,331</u>	<u>\$2,485</u>	<u>\$12,816</u>

Source: Records of Citizen 2000, Bank One, and investigation reports.

Finding II

Numerous Transactions Did Not Comply with Statutory Requirements

◆

Citizen 2000 had virtually no internal controls to protect \$2,488,106 of state aid from misappropriation.

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Charter schools are subject to the same financial requirements, procurement rules, and audit requirements specified in the statutes for school districts. Therefore, Citizen 2000 was required to comply with the *Uniform System of Financial Records* (USFR), developed jointly by the Office of the Auditor General and the Arizona Department of Education. In January 1996, the Office of the Auditor General performed a procedural review of Citizen 2000 to determine whether the school had substantially complied with the requirements of the USFR. In that report, we concluded that the school's internal control structure was virtually nonexistent at that time and detailed the many internal control deficiencies. In general, we found a complete lack of segregation of duties since one individual was responsible for virtually all accounting functions. Controls over cash and expenditures were extremely weak and provided an environment susceptible to undetected errors and theft.

In accordance with A.R.S. §15-271, if the school did not correct the deficiencies within 90 days, the State Board of Education could withhold the school's state aid. In June 1996 the Auditor General issued a status review report that indicated the school had not attained an acceptable degree of compliance with the requirements of the USFR and requested the State Board of Education to take appropriate action.

Additional deficiencies detected during this investigation are grouped in three categories of noncompliance: transactions that do not comply with the Arizona Constitution, with school district procurement rules, and with USFR requirements.

Citizen 2000 Violated the Arizona Constitution

The school repeatedly loaned public money totaling \$2,950 to employees and allowed the employees to repay the money over several months. Further, one employee received additional loans from the school while prior loans were still outstanding. As of June 30, 1996, that employee still had not repaid \$625. In addition, school personnel did not retain documentation to verify that \$660 was repaid by several other employees.

Article IX, Section 7 of the Arizona Constitution provides: "neither the State, nor any county, city, town, municipality, or other political subdivision of the State shall ever give or loan its credit in the aid of. . . any individual, association, or corporation. . ." Arizona Attorney General Opinion 185-051 allows that "while public funds may not be loaned or given to private individuals or entities, an incidental private benefit is not prohibited by Article IX as long as there is a public purpose served by the expenditure or loan of funds and the value to be received by the public is not far exceeded by the consideration being paid." However, Citizen 2000 could not provide documentation to support any public purpose for loaning these monies.

Citizen 2000 Did Not Comply with School District Procurement Rules

Citizen 2000 did not comply with the competitive bidding procedures prescribed by the State Board of Education in the *Arizona Administrative Code*. The school did not issue an invitation for bids for the following construction contracts:

1. A contract awarded on August 1, 1995, to paint and repair bathrooms for \$16,600. Payments to this contractor totaled \$16,392 during fiscal year 1995-96.
2. A contract awarded on August 3, 1995, to install electrical service for \$21,452. Payments for the installation totaled \$29,498.

In addition to not obtaining competitive bids, the school awarded all of the first contract and a portion of the second to unlicensed contractors. By using unlicensed contractors, the school accepted unnecessary risk. When using licensed contractors, there is an appeal process with the Registrar of Contractors and possible compensation for unfinished or unacceptable work. There is no such recourse with unlicensed contractors.

◆
By using unlicensed contractors,
the school accepted unnecessary
financial risks.
◆

Citizen 2000 Did Not Comply with the *Uniform System of Financial Records*

The school did not comply with requirements of the *Uniform System of Financial Records*, developed to help schools maintain proper controls and record financial data that is comparable to that of other state-supported schools.

1. The following revenue and expenditure transactions were misclassified in the Citizen 2000 check register:
 - a. Monies collected for student lunches and fund-raising activities were recorded as “personal loan” revenue.
 - b. Monies expended for construction on Dr. Venerable’s home and her mother’s home were recorded as “building expense.”
 - c. Personal charges on the American Express Corporate credit card were not separated from Citizen 2000 charges and were recorded as “credit” expense.
 - d. Money Dr. Venerable expended for a personal appraisal was recorded as “services,” but represented to be reimbursed that same day with Dr. Venerable’s personal monies. However, the deposit recorded as repayment of the appraisal expenditure consisted entirely of monies collected from parents for a field trip and did not include Dr. Venerable’s personal monies.

2. Citizen 2000 did not maintain adequate documentation to properly support the following expenditures:
 - a. Payments to individuals who had reportedly loaned money to the school were inadequately supported. Loan agreements specifying terms of repayment were not prepared, or were prepared months after the loan was received.
 - b. From June through December 1995, Citizen 2000 employees charged \$43,318 on American Express corporate credit cards and did not maintain receipts or invoices for charges totaling \$27,843. The statements indicated that employees made purchases at restaurants such as Planet Hollywood, Coyote Springs Brewery, Chang's China Bistro, Hard Rock Cafe, and the Phoenician. They also made purchases at gas stations in California, movie theaters, car washes, and flower shops. In addition, Citizen 2000 paid \$1,285 in delinquency charges.
 - c. Receipts and invoices were not maintained for checks payable to cash, or payable to Dr. Venerable's family members who then cashed the checks.

Conclusion

Citizen 2000 Had No Controls To Prevent Inappropriate Spending of Public Monies

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The Citizen 2000 charter school contract states "the school shall organize and manage a charter school as a public school with public monies. . ."

◆

Charter schools must adhere to their charter school contract, which states that "the school shall organize and manage a charter school as a public school with public monies in a manner consistent in all respects with and as fully represented in the school's application."

Dr. Venerable, as owner/principal of Citizen 2000, had no independent board or person monitoring her use of public monies on a regular basis. Dr. Venerable was not prohibited from appointing relatives to the school's original governing board and key administrative staff because charter schools are exempt from many of the statutory and regulatory requirements that apply to school districts and governing boards. Even after the original governing board members were replaced with more independent individuals, the board did not review individual transactions on a routine basis. Likewise, the school's sponsor, the State Board of Education, provided general oversight, but no direct monitoring of financial transactions. Arizona Revised Statutes §15-183.S. states "The sponsoring entity of a charter school shall have oversight and administrative responsibility for the charter schools which they sponsor."

In substance, only one person controlled virtually all of Citizen 2000's assets and monetary transactions with little or no direct accountability to anyone. This lack of accountability and independent review created a climate that invited misuse of public monies.

Bankruptcy and Revocation Closes Citizen 2000

As mentioned earlier in this report, the Auditor General requested the State Board of Education (Board) to take appropriate action in June 1996, since Citizen 2000 had not attained an acceptable degree of compliance with the requirements of the USFR. In particular, the school had serious deficiencies in their student count process. The student count determines the amount of state aid paid to the school. In October 1996, the Department of Education reported to the Board that, based on Citizen 2000's inaccurate enrollment figures for fiscal year 1996-97, the school had received an overpayment of approximately \$250,439. On November 18, 1996, the Board revoked Citizen 2000's charter.

◆
*All of the school's assets
purchased with public monies
have been retained by the
bankruptcy trustee.*

Also on November 18, Dr. Venerable filed a voluntary petition for Individual Chapter 7 bankruptcy, and closed Citizen 2000. All of Citizen 2000's students had to enroll in other schools midterm, and the cost of their education was absorbed by those schools and ultimately by the State. On November 19, Dr. Venerable filed a voluntary petition for Corporate Chapter 7 bankruptcy. The Arizona Department of Education and the Arizona State Board of Education were identified as creditors in the Individual and Corporate bankruptcy filings. Dr. Venerable declared that Citizen 2000 had \$284,925 in assets, and \$178,577 in liabilities. Dr. Venerable did not include her mother's home in the Biltmore Estates as school property, even though \$99,297 of Citizen 2000 monies were used for the down payment, approximately 31 percent of the appraised value.

Furthermore, A.R.S. §15-183 was amended in 1996 to include "Any and all property accumulated by a charter school shall remain the property of the charter school." Therefore, the bankruptcy trustee holds legal title to all of the school's remaining assets.