



Alliance College-Ready Public Schools

The Nonprofit Did Not Spend Public Funds or Divert Classroom Resources in Response to Unionization Efforts

Report 2016-117

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April 13, 2017

2016-117

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning our review of the Alliance College-Ready Public Schools' (Alliance) management organization and the charter schools under its operational jurisdiction.

In March 2015, a group of teachers and counselors working at Alliance charter schools announced their decision to organize a union and join the United Teachers Los Angeles (UTLA). In that same month, the Alliance home office—a private nonprofit corporation—began to take action in response to these unionization efforts and created a special account to track private donations and expenditures related to these purposes. Although the Alliance home office spent nearly \$1 million from this account on consulting, legal expenses, and flyers and letters to parents and teachers, it did not use public funds for these activities. Further, we noted that Alliance did not divert funds from classroom activities to pay for its response to unionization efforts. In addition, the Alliance home office used private funds to reimburse its schools for any time principals or school personnel spent in response to the unionization effort—such as time spent distributing informational materials or attending training on how to respond appropriately to UTLA organizers.

As part of its response to the unionization efforts, the Alliance home office shared alumni data with the California Charter Schools Association, which then used this information to conduct outreach. The Alliance home office maintained that a provision in federal law related to the use of contractors allowed it to disclose these records without prior consent. However, we found that federal requirements would not permit Alliance to rely on this provision because, prior to correcting this problem for the 2016–17 school year, Alliance had failed to provide students and parents with annual notifications of their rights associated with their confidential information. Moreover, although Alliance had a process for parents to opt out of having their student's directory information shared with third parties, it only recently began requiring the retention of those opt-out letters; therefore, we could not determine whether Alliance honored all opt-out requests. Finally, we found that Alliance did not always follow its policies and procedures, did not establish adequate segregation of duties in its procurement process, and did not require retention of vendor conflict-of-interest disclosure forms.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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SUMMARY

Alliance College-Ready Public Schools (Alliance) is a private nonprofit corporation that supports the operation of a network of 25 charter schools throughout the Los Angeles area and serves nearly 12,000 students. Charter schools are public schools and are subject to the Educational Employment Relations Act (EERA), the State's collective bargaining laws pertaining to teachers and other school employees. Under the EERA, charter school employees are free to unionize, and charter schools must refrain from unlawfully interfering with union activities. In March 2015, a group of 67 teachers and counselors working at Alliance charter schools announced their decision to organize a union and join the United Teachers Los Angeles (UTLA).¹ In that same month, Alliance began to take action in response to these unionization efforts, and by June 2016, Alliance had spent roughly \$1 million on its response. For this audit, we reviewed whether Alliance used public funds to finance its response to the unionization efforts and whether its response decreased classroom spending. This report draws the following conclusions:

Although the Alliance Home Office Spent Nearly \$1 Million in Response to Unionization Efforts, It Did Not Use Public Funds for This Purpose

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Alliance created a special account to track donations and expenditures related to its response to the unionization efforts at its charter schools. This account is supported entirely by private contributions, and the Alliance home office did not spend any public funds as part of its response. As of June 2016, it had spent \$915,000 from this special account—including \$426,000 in consulting fees for public relations and other services—in response to the unionization efforts at its charter schools.

Alliance Did Not Divert Funds From Classroom Activities to Pay for Its Response to Unionization Efforts

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Because Alliance raised private funds specifically to respond to the unionization effort, these funds were not otherwise slated to go to the schools to pay for classroom expenses. In addition, the Alliance home office used private funds to reimburse its charter schools for any time principals or school personnel spent in response to the

¹ As of February 2017, UTLA representatives confirmed that Alliance charter schools are not represented by a union and there is currently no vote pending regarding unionization at the Alliance charter schools. Nevertheless, an active committee of teachers and counselors at Alliance charter schools is continuing to work to form a union with UTLA.

unionization effort, such as time spent distributing informational materials or attending training on how to respond appropriately to UTLA organizers.

Moreover, we found that per-pupil classroom expenditures at the three Alliance charter schools we reviewed increased between fiscal years 2013–14 and 2015–16.² Specifically, the Alliance home office provided more private funds to its schools in fiscal years 2014–15 and 2015–16 than it had in fiscal year 2013–14, before the unionization effort began.

Alliance Did Not Fully Comply With Federal Requirements Before It Shared Confidential Student, Parent, and Alumni Information With Third Parties

Before the 2016–17 school year, Alliance was not meeting all federal requirements that restrict the manner in which confidential student data can be shared with third parties. Specifically, Alliance did not annually inform parents and students about their rights under federal law. Further, until the 2016–17 school year, Alliance did not require the retention of all letters from parents who choose to opt out of having their students' directory information shared with third parties; therefore, we could not determine whether Alliance honored all opt-out requests received during the period we reviewed.

Alliance has agreements with numerous third-party entities requiring it to share confidential data for a variety of reasons, including analyzing student achievement data. One such agreement is with the California Charter Schools Association (CCSA). CCSA used confidential alumni contact information to conduct outreach in response to the unionization effort. Alliance maintains that a provision in federal law related to the use of contractors allows them to disclose these records without prior consent. However, according to federal guidance, Alliance cannot rely on that provision because it failed to provide annual notification of rights as federal regulations require.

² As discussed in the Introduction, the Alliance home office response to the unionization efforts at its charter schools began in March 2015 and extended through fiscal year 2015–16.

In addition, we reviewed the Alliance home office's contracting and procurement policies and procedures. State law grants charter schools broad discretion in how they spend public funds, and federal regulations place only a few requirements on how charter schools procure certain goods and services. For the 80 Alliance home office and charter school expenditures we tested, Alliance had adequate support and the expenses appeared to be for an allowable schoolwide or charterwide purpose. However, we could not determine that the expenditures we tested were reasonable because Alliance did not generally require its staff to document how they determined that a particular vendor's costs were reasonable. We also found that it did not always follow its contracting policies and procedures and it did not establish adequate segregation of duties in its procurement process. Further, the Alliance home office did not require retention of vendor conflict-of-interest disclosure forms.

Summary of Recommendations

To ensure that it complies with federal laws regarding student privacy, Alliance should document its revised process for collecting, tracking, and monitoring the list of Alliance students and families who have opted out of sharing their directory information with third parties.

The Alliance home office should fully implement its revised procurement policies and procedures, including retention of vendor conflict-of-interest forms, and provide adequate training to ensure that appropriate staff members at both the Alliance home office and Alliance schools comply with the new policies and procedures.

Agency Comments

In its response to the audit, Alliance agreed with our report's conclusions and indicated that it has already implemented, or has begun to implement, our recommendations.

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INTRODUCTION

Background

In 1992 the Legislature enacted the Charter Schools Act, which authorizes the establishment of charter schools that receive public funding but that operate independently from the school district structure and are generally not subject to most laws governing school districts. According to the California Department of Education (Education), for the 2015–16 school year, nearly 573,000 students—about 9 percent of California students in public schools—were enrolled in 1,222 charter schools throughout the State. According to Education, groups of teachers, parents, and community leaders or community-based organizations can create charter schools to provide instruction to students from kindergarten through grade 12. Generally, local public school boards, county boards of education, or in some instances, Education authorize charter schools, and the agreements (or charters) between the authorizing boards and the charter organizers detail the charter schools' specific goals.

State law also allows nonprofit public-benefit corporations, formed pursuant to applicable state law, to operate charter schools. When a nonprofit operates multiple charter schools, it is commonly referred to as a *charter management organization* (CMO). CMOs typically provide functions for charter schools such as hiring, professional development, data analysis, public relations, and advocacy, and in return they receive a management fee from the charter schools. Charter schools are public schools and are subject to the EERA, the State's collective bargaining laws pertaining to teachers and other school employees. Under the EERA, charter school employees are free to unionize, and charter schools must refrain from unlawfully interfering with union activities.

Alliance College-Ready Public Schools

Alliance is a private nonprofit corporation that currently supports the operation of a network of 25 charter schools throughout the Los Angeles area. The Los Angeles Unified School District authorizes the Alliance charter schools. Alliance's mission is to open and operate a network of small, high-performing high schools and middle schools in low-income communities with historically underperforming schools. For the 2015–16 school year, Alliance charter schools served nearly 12,000 students, 94 percent of whom were eligible for free or reduced-cost lunches. As evidence of its focus on preparing students for college, 99 percent of the 1,631 Alliance charter school graduates from the 2015–16 school year completed all the courses required for entrance into the University of California and California State University systems.

Services That the Alliance Home Office Provides to the Charter Schools

The home office provides the following services:

- Finance and accounting services.
- Human resources and employee relations.
- Teacher support, including professional development.
- Educator effectiveness, including teacher evaluation support.
- Recruitment and selection support.
- Student assessment support.
- Research and data analysis.
- Student and technology information services.
- School operations and facilities support.
- Curriculum development and research.
- English language learners and special education support.
- Communication and fundraising support.
- Counseling, college success, and alumni support.
- School development and district liaison.
- Parent and community engagement.

Sources: Administrative service agreements between the Alliance home office and the 25 Alliance charter schools.

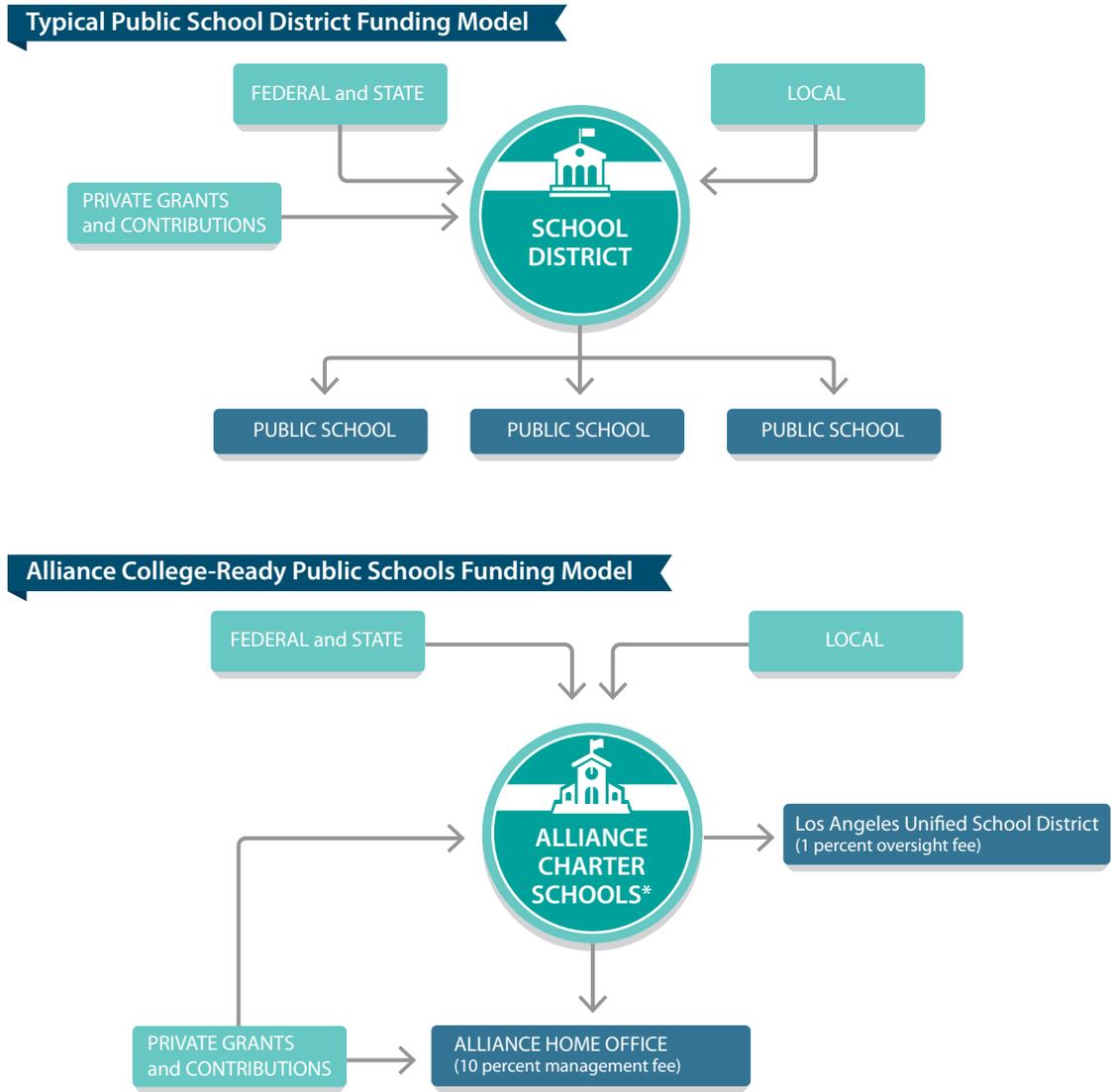
The Alliance home office, acting as the CMO, provides accounting and contracting services, including payroll, as well as the other services shown in the text box. According to the administrative service agreement between the Alliance home office and the charter schools, the home office functions as an independent contractor to the schools, and it currently charges each school a 10 percent management fee, based on the school's gross revenue, for these services.

The typical public school district is a local educational agency (LEA) that receives public funds from Education and other public and private funding sources and then distributes those funds to the schools within its district. In contrast, each of the 25 Alliance charter schools is a separate LEA that receives public funds directly from Education and other public funding sources. Alliance charter schools use these funds to pay the Alliance home office's management fee, among other expenses. Figure 1 illustrates these two funding models.

As Table 1 on page 8 shows, Alliance charter schools received \$157 million in public funding from state, federal, and local sources in fiscal year 2015–16, representing 94 percent of their total revenue. For that same fiscal year, the schools' expenditures included \$84 million in salaries and benefits and nearly \$20 million in professional and consulting services, which included the management fees paid to the home office.

Also in the same fiscal year, as shown in Table 2 on page 8, the Alliance home office received more than \$29 million in private grants and contributions, accounting for approximately 56 percent of its revenue, and nearly \$12 million, or 22 percent of its revenue, in management fees from the charter schools. Because the Alliance home office functions as an independent contractor for Alliance charter schools, it recognizes the management fees it receives from the Alliance charter schools as private revenue.

Figure 1
Comparison of Funding Models for Public School Districts and Alliance College-Ready Public Schools



Sources: California State Auditor generated based on state law and Alliance accounting records.

* There are currently 25 Alliance charter schools, and each school receives funding directly from the California Department of Education and other public funding sources.

Table 1
Alliance Schools Revenue and Expenses
Fiscal Years 2014–15 and 2015–16

	FISCAL YEAR		
	2014–15	2015–16	
Revenue			
State revenue	\$86,084,274	\$119,336,657	PUBLIC FUNDING Fiscal year 2015–16 \$157,181,159
Local revenue	17,663,488	21,948,280	
Federal revenue	15,188,798	15,896,222	
Private grants and contributions	9,626,740	7,742,888	
Other revenue*	1,312,900	1,741,034	
Total revenue	\$129,876,200	\$166,665,081	
Expenses			
Salaries and benefits	\$62,421,666	\$84,173,850	
Professional/consulting services	14,059,794	19,593,888	
Operations	4,705,063	8,352,396	
Facilities, repairs, and other leases	14,733,094	18,152,280	
Other expenses†	21,282,117	25,840,408	
Total expenses	\$117,201,733	\$156,112,822	

Sources: Alliance audited financial statements for fiscal years 2014–15 and 2015–16 and Alliance accounting records.

* Other revenue includes interest and other income.

† Other expenses include books and supplies, subagreement services, depreciation expenses, and interest.

Table 2
Alliance Home Office Revenue and Expenses
Fiscal Years 2014–15 and 2015–16

	FISCAL YEAR	
	2014–15	2015–16
Revenue		
Private grants and contributions	\$16,958,133	\$29,357,409
Management fees	9,077,837	11,757,097
Federal revenue	2,970,227	4,299,003
State revenue	3,289,032	–
Other revenue*	157,612	7,139,546
Total revenue	\$32,452,841	\$52,553,055
Expenses		
Operations	\$16,350,440	\$30,118,639
Salaries and benefits	9,151,182	9,909,200
Professional/consulting services	1,733,967	4,803,708
Facilities, repairs, and other leases	998,563	801,145
Other expenses†	843,128	840,622
Total expenses	\$29,077,280	\$46,473,314

Sources: Alliance audited financial statements for fiscal years 2014–15 and 2015–16 and Alliance accounting records.

* Other revenue includes interest, rental income, and investment gain in subsidiaries.

† Other expenses include books and supplies, subagreement services, depreciation expenses, interest, and facility development costs.

Unionization Efforts by United Teachers Los Angeles

Currently, employees of Alliance charter schools are not represented by a union. In March 2015, a group of 67 teachers and counselors working at Alliance charter schools announced their decision to unionize and join UTLA. In that same month, Alliance began to take actions in response to these unionization efforts, some of which UTLA would later claim violated the EERA. In April 2015, UTLA filed unfair labor practice charges with the Public Employment Relations Board (PERB) against Alliance and three of its charter schools, alleging that they violated provisions of the EERA, as summarized in the text box.

In his June 2016 proposed decision, the PERB judge dismissed many of the charges against Alliance but did find that Alliance violated the EERA by blocking UTLA emails, by interfering with UTLA organizers' access to two of the charter school campuses, and because a principal made threatening statements to an Alliance teacher. The PERB judge ordered Alliance to desist from these unfair practices and to take proposed affirmative actions, but he dismissed the other UTLA allegations against Alliance related to its communications with teachers and the public. As shown in Figure 2 on the following page, UTLA appealed the PERB judge's proposed decision, Alliance responded and these appeals were still pending.³ In addition to the unfair labor practice charges addressed in the PERB judge's proposed decision and pending appeals, UTLA has alleged other unfair labor practices, but as of March 2017 no proposed or final decision has been issued on the allegations.

United Teachers Los Angeles' Unfair Labor Practice Allegations Against Alliance

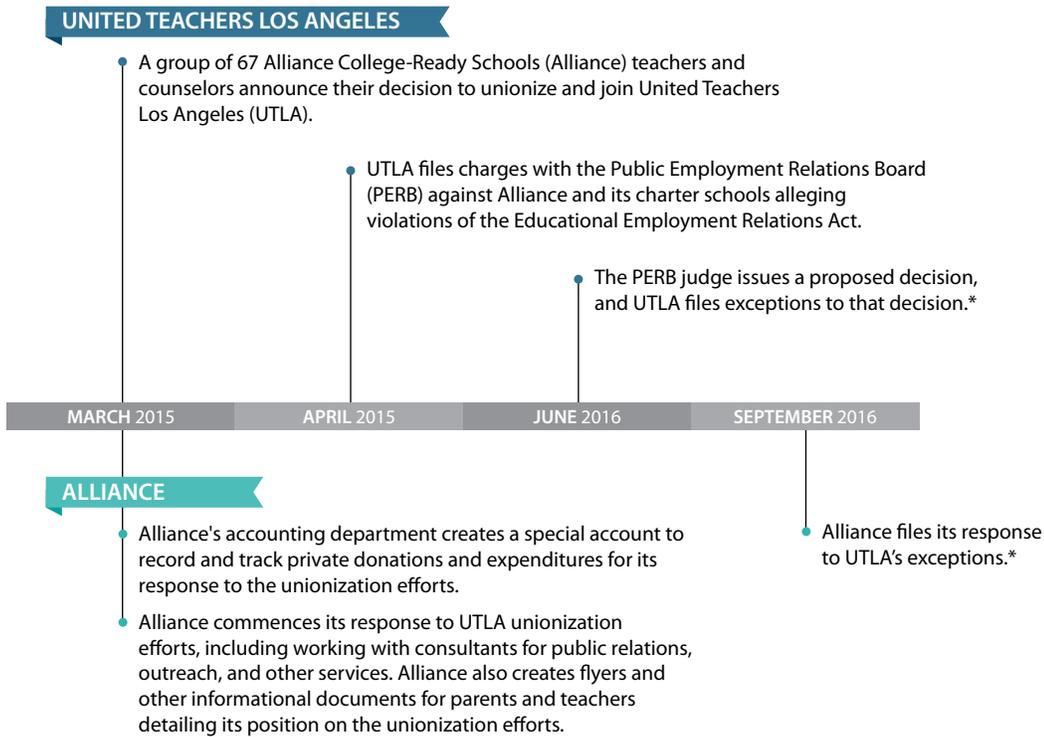
UTLA filed unfair labor practice charges against Alliance and three of its charter schools, alleging that they did the following:

- Issued four separate communications to teachers and the public regarding UTLA's campaign.
- Terminated a teachers' meeting with a UTLA organizer.
- Denied UTLA access to two Alliance campuses and blocked emails from UTLA.
- Removed a teacher from a meeting and instructed her to stop distributing union-related flyers.

Source: PERB judge's June 2016 proposed decision.

³ An appeal of an administrative law judge's proposed decision in this circumstance is called a *statement of exceptions*.

Figure 2
Timeline of Recent Unionization Efforts at Alliance College-Ready Public Schools



Sources: California State Auditor's review of UTLA and Alliance documents regarding unionization efforts at the Alliance charter schools and the PERB judge's 2016 proposed decision.

* An appeal of an administrative law judge's proposed decision in this circumstance is called a *statement of exceptions*.

Although the Alliance Home Office Spent Nearly \$1 Million in Response to Unionization Efforts, It Did Not Use Public Funds for This Purpose

Key Points

- Alliance accounts for charter school expenditures and revenues separately from its home office. Although Alliance charter schools receive mainly public funding, its home office is a private nonprofit corporation and its revenue consists mostly of private grants and contributions and other private revenue.
- The Alliance home office did not spend public funds on its response to unionization efforts at the charter schools.
- In March 2015, the Alliance home office created a special account to track donations and expenditures for its response to the unionization efforts at its charter schools. This special account is supported entirely by private contributions. As of June 2016, the Alliance home office had spent roughly \$915,000 from this fund on consulting, legal expenses, and flyers and letters to parents and teachers.

The Alliance Home Office Does Not Comingle Public and Private Funds

A critical reason that Alliance was able to avoid using public funds to pay for its response to the unionization efforts is that it tracks revenue and expense accounts separately for the home office and the charter schools using distinct resource codes with public and private designations. Alliance charter schools receive nearly all of their funding from public sources and, according to our review of the Alliance accounting records, those funds are held in separate accounts for the charter schools. The Alliance home office is a private nonprofit corporation and receives most of its revenue from private contributions and management fees from the Alliance charter schools. These management fees are considered private revenue because, under the administrative service agreement with each of the charter schools, the Alliance home office functions as an independent contractor and charges a management fee for services provided. Any private donations that the home office receives are designated as such and are not comingled with the charter schools' public funds.

The Alliance Home Office Separately Tracked Expenditures Related to Its Response to Unionization

Within the existing accounting structure just described, Alliance took further steps to ensure that no public funds were spent on its response to the unionization efforts. Specifically, in March 2015, shortly after a group of Alliance teachers and counselors announced their intention to unionize and join UTLA, Alliance created a special account to separately track any expenses related to its unionization response. We found that the Alliance home office either paid all such expenditures directly from the special account or reimbursed entities from that fund for expenditures related to the unionization response.

Although the Alliance home office's revenue is derived mainly from private grants and contributions and the management fees that its charter schools pay, Alliance created a separate revenue stream for its special account. Beginning in March 2015, the home office solicited and received private donations for the special account and through its network of private donors, it raised more than \$1.7 million—sufficient to cover all expenses related to its response to the unionization efforts at its charter schools. As a result, the Alliance home office did not spend public funds on its response.

As of June 2016, Alliance had spent approximately \$915,000—including \$426,000 in consulting fees and \$31,000 for flyers and letters to parents and teachers—in response to the unionization efforts at its charter schools. As shown in Figure 3, the special account's largest expenditure category was for consulting services, which included payments to communications consultants for messaging, public relations, and outreach.⁴ Alliance also used the fund to track legal and litigation-related expenditures. In total, Alliance had spent nearly \$107,000 on legal costs by June 2016, but it also received more than \$2 million in pro bono legal services to assist in its response to the unionization efforts and subsequent legal proceedings.

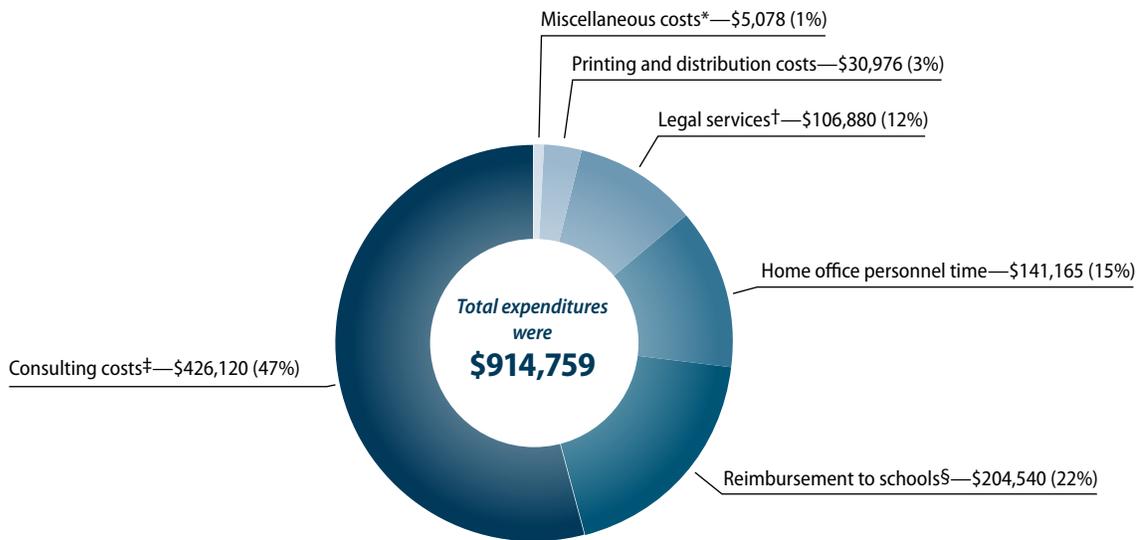
As of June 2016, Alliance had spent approximately \$915,000 in response to the unionization efforts at its charter schools.

The Alliance chief executive officer (Alliance CEO) explained that the special account's funds were spent, in part, responding to UTLA statements that Alliance deemed incorrect or misleading. For example, Alliance published on its public website a “frequently asked questions” document that gave background on UTLA and described why it believed UTLA was trying to unionize Alliance charter schools. Specifically, Alliance expressed its opinion that UTLA has been funding and supporting efforts to interfere with the freedom and flexibility that charter schools like Alliance have in tailoring programs for the needs of their students. Alliance also produced a document stating the benefits of its charter

⁴ We noted that not all of the consulting costs reported in the special account were related to unionization efforts. Specifically, we identified that some of the consulting contracts existed before the unionization efforts and we excluded invoices for which the consultant's summary of work did not include unionization efforts.

schools remaining independent and nonunionized to ensure that students receive a high-quality college preparatory education. The PERB judge ruled in his June 2016 proposed decision that those communications were permissible, although UTLA has appealed that decision.

Figure 3
Alliance Home Office Unionization Expenditures
Fiscal Years 2014–15 and 2015–16 (Combined)



Source: Alliance College-Ready Charter Schools (Alliance) accounting records.

* Miscellaneous costs include travel expenses, bank charges, and office expenses, among others.

† Legal services does not include \$2.2 million Alliance received in pro bono legal services.

‡ We noted that not all of the consulting costs reported in the special account were related to unionization efforts. Specifically, we identified that some of the consulting contracts existed before the unionization efforts and we excluded invoices for which the consultant’s summary of work did not include unionization efforts.

§ Reimbursement to schools are payments to the school accounts for expenses related to the time spent by school personnel in response to the unionization effort and a \$3,000 grant to each school for any future response to unionization efforts.

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Alliance Did Not Divert Funds From Classroom Activities to Pay for Its Response to Unionization Efforts

Key Points

- The Alliance home office reimbursed its schools for any time principals or school personnel spent related to responding to the unionization efforts, such as training or distributing informational materials.
- Because Alliance raised private funds specifically for the unionization response, these were not funds that were otherwise slated to go to the schools for classroom expenses. In fact, per-pupil classroom expenditures at the three Alliance charter schools we reviewed increased between fiscal years 2013–14 and 2015–16.
- The Alliance home office donated more funds to its charter schools in fiscal years 2014–15 and 2015–16 than it had in fiscal year 2013–14, the year before the unionization efforts began.

The Alliance Home Office Used Private Funds to Reimburse Its Schools for the Time Principals and Other Staff Spent on Unionization-Related Activities

The Alliance home office reimbursed its charter schools for time spent by school personnel related to the unionization response with private funds from the special account it created for that response. According to the Alliance CEO, the Alliance home office organized a number of conference calls with school principals, during which it provided training to the principals and answered questions regarding the unionization efforts at the schools. Further, he told us that to prevent them from affecting the principals' workday, the Alliance home office scheduled these telephone conference calls in the morning and again in the afternoon. This allowed principals to participate when it was most convenient.

We spoke with principals who participated in these conference calls, and they informed us that these were optional conference calls during which the home office answered questions and offered advice regarding the UTLA unionization efforts. Specifically, the principal from the Alliance Susan and Eric Smidt Technology High School (Smidt Technology High School) explained that as part of these conference calls, the home office informed them that they were not allowed to track or interfere with UTLA members and advised them to maintain a distance of at least 100 feet from UTLA members who were on a school campus.

The Alliance CEO explained that to ensure that the schools were not bearing the costs of these conference calls, the Alliance home office prorated the time principals spent participating in these calls and reimbursed the schools' accounts from the special account. Specifically, the Alliance home office created a spreadsheet to track the date and length of all conference calls. Then it identified all principals and their pay rates and reimbursed the schools for the principals' time, regardless of whether the principal actually participated in the conference call. Similarly, the Alliance home office used this spreadsheet to prorate the time of other school personnel who spent time on responding to the unionization effort, such as the time spent by staff posting fliers and bulletins the Alliance home office created. Finally, to ensure

that the reimbursements to the charter schools were accurate, the Alliance home office required the charter schools to confirm that the reimbursements they received were correct and that they accounted for the time principals and school staff spent in response to the unionization effort. We reviewed a selection of these reimbursements and found that the Alliance home office accurately calculated the rates for reimbursement to the charter schools.

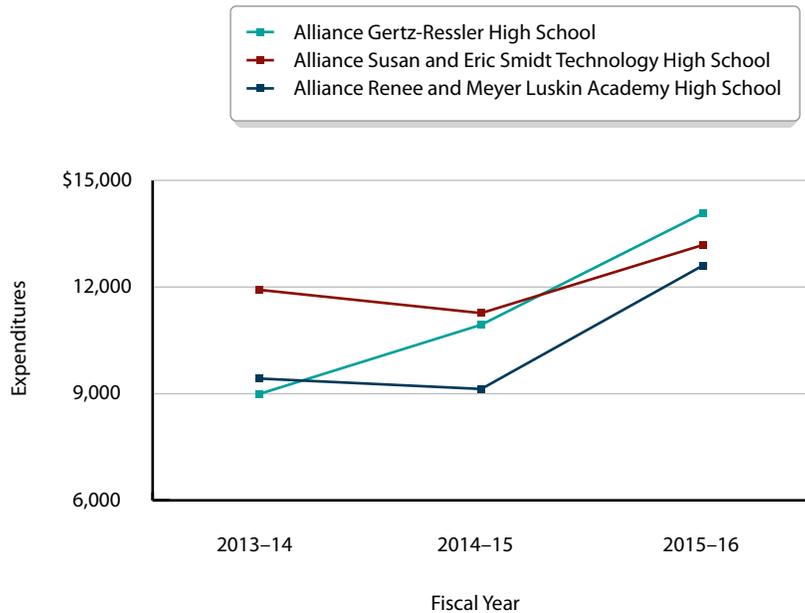
Beginning in fiscal year 2015–16, the Alliance home office provided each school a grant of \$3,000 instead of continuing to rely on the reimbursement model. According to the grant agreement letter, Alliance schools are to use these grants to cover the time each school's principal, assistant principal, office manager, and other school personnel spend responding to unionization efforts. Once a school's \$3,000 advance is depleted, the Alliance CEO indicated that Alliance will make additional privately raised funds available as necessary.

Classroom Expenditures Did Not Decline as a Result of Alliance's Response to the Unionization Efforts

Because the Alliance home office raised private funds specifically for its response to the unionization efforts, these were not funds that were otherwise slated to go to the schools for classroom expenditures. Moreover, Alliance charter school classroom expenditures did not decline as a result of the unionization response, which began in fiscal year 2014–15. Specifically, we reviewed the per-pupil classroom expenditures at three Alliance charter schools—Alliance Gertz-Ressler High School (Gertz-Ressler High School), Alliance Renee and Meyer Luskin Academy High School (Luskin High School), and Smidt Technology High School—for the past three fiscal years (including fiscal year 2013–14) and found that classroom expenditures increased at these three schools.

As Figure 4 shows, in fiscal year 2013–14—the year before the unionization efforts—per-pupil classroom expenditures at the three schools were between about \$9,000 and \$11,900. Although per-pupil classroom expenditures decreased slightly at Luskin High School and Smidt Technology High School during fiscal year 2014–15, the year unionization began, they increased at Gertz-Ressler High School. Further, in fiscal year 2015–16, per-pupil classroom expenditures rose at all three schools to between \$12,600 and \$14,100.

Figure 4
Alliance College-Ready Public Schools' Classroom Expenditures per Pupil
Fiscal Years 2013–14 Through 2015–16



Source: California State Auditor generated based on Alliance College-Ready Public Schools accounting records.

Home Office Funding to the Schools Did Not Decrease as a Result of the Response to Unionization Efforts

Although the Alliance charter schools receive the majority of their funding from public sources, the Alliance home office does provide them with some private funding to help supplement their revenues. In fiscal year 2013–14, one year before the start of the unionization effort, the Alliance home office distributed nearly \$2 million in private funding among the Alliance charter schools for events such as principal and teacher of the year awards and parents as partners achievement awards. In fiscal years 2014–15 and 2015–16, while the response to unionization efforts were ongoing, the Alliance home office's private funding to the charter schools was \$9 million and \$7 million, respectively. This included nearly \$6 million given to the Alliance Morgan McKinzie High School in fiscal year 2014–15 for purposes that included the purchase of a building and parking lot. Because the Alliance home office increased the amount of private funds it donated to the charter schools after the start of the unionization effort, there is no indication that it diverted funds it would normally have given to charter schools to respond to the unionization effort.

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Alliance Did Not Fully Comply With Federal Requirements Before It Shared Confidential Student, Parent, and Alumni Information With Third Parties

Key Points

- Although Alliance is now in compliance with federal requirements that restrict how confidential student data can be shared with third parties, Alliance did not meet all of these requirements in the past. Specifically, before the 2016–17 school year, Alliance did not annually inform parents and students about their rights under federal law.
- Although Alliance had a process for parents to opt out of having their student’s directory information shared with third parties, it only recently began requiring the retention of those opt-out letters; therefore, we could not determine whether Alliance honored all opt-out requests during the period we reviewed.
- Alliance enters into service agreements with numerous third-party entities that necessitate sharing of confidential student data. Although Alliance included data security and confidentiality provisions in each of the agreements we reviewed, it should standardize these provisions so that each agreement is equally robust and specific.
- Alliance shared alumni data with the CCSA, which then used this information to conduct outreach in response to the unionization effort. Alliance maintains that a provision in federal law related to the use of contractors allows it to disclose these records without prior consent. However, federal requirements would not permit Alliance to rely on that provision because it failed to provide annual notifications as applicable federal regulations require.

Alliance Shared Student, Parent, and Alumni Data With Third-Party Entities But Did Not Comply With All Federal Requirements

The Alliance home office currently shares parent, student, and alumni information with numerous third-party entities for a variety of reasons, such as providing analyses of student achievement data and grades or attendance, tracking information relating to free and reduced-cost meals, and advocating for charter schools. The Family Education Rights and Privacy Act (FERPA), a federal law that protects the privacy of student education records, allows schools to disclose student information, including directory information such as a student’s name, address, telephone number, and date and place of birth under certain circumstances, but it also requires that the schools first annually inform parents and students about their FERPA rights and allow them a reasonable amount of time to opt out of the sharing of directory information. FERPA also permits educational agencies and institutions to disclose directory information about former students as long as the agency or institution respects any opt-out requests that alumni previously submitted.

Although FERPA requires schools to inform parents and students annually about their FERPA rights, Alliance has not historically provided those notices. According to Alliance’s vice president of operations (operations vice president), before the 2016–17 school year, Alliance did not provide these annual notifications as FERPA requires. After we inquired about Alliance’s practices regarding FERPA notifications, the operations vice president informed us that Alliance would create and disseminate notifications on an ongoing basis. We confirmed that Alliance created new notifications based on guidance from the U.S. Department of Education, and sent them in fall 2016. These notifications—if sent annually—will comply with current federal requirements.

FERPA also requires schools to provide students and parents a reasonable amount of time to opt out of sharing their directory information. To comply with FERPA requirements, at the beginning of each school year Alliance charter schools provide parents with opt-out letters so that they may request that student directory information be withheld and the schools are then responsible for collecting the opt-out notices from Alliance parents and creating the opt-out list for the home office. However, the Alliance chief of staff confirmed that before the 2016–17 school year, there was no expectation that schools would retain opt-out requests or that the home office would validate that the lists the schools created of those opting out were complete. As a result, we were unable to determine whether the lists of parents who had opted out earlier than the 2016–17 school year were complete and accurate. Therefore, we could not determine whether Alliance honored all opt-out requests parents and students had submitted during the period we reviewed.

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The Alliance chief of staff confirmed that before the 2016–17 school year, there was no expectation that schools would retain opt-out requests.

.....

To address this concern, the Alliance chief of staff told us that, beginning in the 2016–17 school year, the Alliance home office is requiring its charter schools to scan copies of all opt-out letters to a shared drive and generate a list of opt-out notices to ensure that the lists are complete and that directory information is not shared inappropriately.

Alliance Enters Into Data-Sharing Agreements With Numerous Third-Party Entities, Including Advocacy Groups, to Share Confidential Information

The Alliance home office currently shares parent, student, and alumni information with 19 third-party entities for reasons described earlier. We reviewed five data-sharing agreements between Alliance and third-party entities and found that these agreements include provisions regarding security of the confidential information that is shared. For example, the Alliance home office entered into a data-sharing agreement with the American Institutes for Research (AIR) to measure the impacts of teacher initiatives and provide feedback on those initiatives. The agreement between Alliance and AIR requires researchers to maintain data in compliance with federal and state laws, as well as to adhere to best practices in the information security field. However, we found that Alliance could benefit from standardizing the provisions of these agreements. For example, although the data-sharing agreement between Alliance and The Boston Consulting Group, Inc. (Boston Consulting) calls for Boston Consulting to keep the shared data confidential and to use these data only for the intended purposes, it does not explicitly refer to federal and state data security or confidentiality laws. As a result, this agreement is not as robust and specific as other Alliance agreements we reviewed.

Alliance also shared directory information with the CCSA, a membership organization that represents the interests of charter schools, performs state and local advocacy directly affecting charter schools, and offers its members financial and legal services, as well as other support and services shown in the text box. Alliance charter schools have been members of CCSA since 2003, and for 2015 they paid an annual membership fee of \$5 per student (totaling about \$45,600). Alliance charter schools paid for the membership out of their unrestricted fund account that includes both public and private funds. State law grants schools authority to use their funding for membership in organizations that promote and advance public education and the improvement of educational opportunities for California's children.

CCSA Member Services

CCSA provides services and support to its members including the following:

- Regional and statewide advocacy for charter schools.
- Technical assistance and tools for strategic planning and charter renewal.
- Financial and legal services, including incorporation services and litigation support.
- Training and professional development.

Source: CCSA's public website.

In addition to CCSA's regular membership services, CCSA and Alliance entered into an agreement in April 2015 under which Alliance shared alumni data with CCSA. The purpose was to provide charter school alumni with information and guidance about charter school issues and to conduct research and evaluation for the benefit of charter schools. According to CCSA's chief of staff,

CCSA used the information Alliance provided to contact alumni who may have been interested in conducting outreach to Alliance parents and other Alliance alumni. Additionally, CCSA set aside funds to pay Alliance alumni to call parents and inform them of the unionization effort. According to the script CCSA created, the alumni informed parents that UTLA has a track record of opposing charter schools and gauged their support for Alliance charter schools without UTLA involvement.

FERPA allows schools to provide personally identifiable information from an education record to school officials without consent or an opt-out process if the relationship between the school and school officials meets certain provisions. Specifically, schools may release information to school officials—defined by the U.S. Department of Education as professors, administrators, or contractors, among others—who have a legitimate educational interest in the information, provided the school official is under the direct control of the school with respect to the use and maintenance of the educational records.

The Alliance chief of staff and legal counsel stated that the data-sharing agreement between Alliance and CCSA met the requirement of the school official exception, and that as a result Alliance was not required to obtain consent to release records. Alliance maintains that the agreement involves a legitimate educational interest because it allows CCSA to host trainings on public speaking and community relations and to provide information on charter school policy and programs. Additionally, the data-sharing agreement has provisions requiring CCSA to comply with FERPA and maintain the confidentiality of any data it receives from Alliance.

However, although FERPA and FERPA-related guidance only broadly define *legitimate educational interest* and *school official*, federal guidance requires educational institutions—if they intend to use the school official exception to provide confidential data to a contractor—to define these terms in their annual notifications to parents. As indicated earlier, Alliance has only recently begun sending these required notifications. In relevant regulations, Education has stated that educational institutions must provide in their annual notification the criteria they use to define these terms before they disclose protected information under this provision of law. Because Alliance failed to provide proper annual parental notice before providing alumni data to CCSA, Alliance's reliance on this FERPA exception appears to be misplaced. In addition, as described earlier, Alliance only recently began requiring schools to retain copies of all opt-out letters from parents. Without the ability

to independently verify that Alliance honored all opt-out requests, we have no assurance that Alliance has fully complied with FERPA in its sharing of directory data with CCSA.

Recommendations

To ensure that it complies with federal laws regarding student privacy, Alliance should document its revised process for collecting, tracking, and monitoring the list of Alliance students and families who have opted out of sharing their directory information with third parties.

Alliance should standardize its data-sharing agreements so that each agreement contains robust and specific language regarding data security and the confidentiality of the data being shared.

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OTHER AREAS WE REVIEWED

To address the audit objectives approved by the Joint Legislative Audit Committee (Audit Committee), we also reviewed the Alliance home office contracting and procurement policies and procedures.

Alliance's Contracting and Procurement Policies and Procedures

State law grants charter schools broad discretion in how they spend public funds. Specifically, state law authorizes charter schools to use funds for schoolwide and charterwide purposes, and federal regulations place only a few requirements on how charter schools procure certain goods and services, such as the provision of school meals from certain food service management companies and electronic telecommunications services. Under its administrative service agreements with each of its 25 charter schools, the Alliance home office provides contracting and procurement services for its schools. To meet this obligation, the Alliance home office developed approval policies to indicate who is authorized to sign contracts for the home office and the Alliance schools. Similarly, it established procurement policies and procedures that specify who can approve invoices and entries into the Alliance's accounting system. The policies also include a vendor approval process, requiring Alliance vendors to submit certain documents, such as a background check and insurance certification forms.

We reviewed a total of 80 transactions from fiscal years 2014–15 and 2015–16 at the Alliance home office and three of its charter schools—Gertz-Ressler High School, Luskin High School, and Smidt Technology High School. This included a review of 22 transactions from the special account used specifically in response to the unionization efforts.

Alliance Expenditures We Reviewed Were Allowable, but We Could Not Always Verify That They Were Reasonable

- Of the 80 transactions we reviewed, we found that all expenditures had adequate support and appeared to be for a schoolwide or charterwide purpose.
- As indicated earlier, state law imposes few restrictions on how charter schools procure goods and services and therefore few requirements on how they determine whether the cost of goods and services is reasonable. Further, the Alliance operations vice president indicated that Alliance does not generally require its staff to document how they determined that a particular

vendor's costs were reasonable. Consequently, other than the three expenditures described below, Alliance staff had no obligation to, and did not, document how they determined that costs were reasonable. However, in a draft of its revised policies and procedures manual, Alliance indicates that for purchases greater than \$10,000, staff will begin documenting three price quotes and for purchases greater than \$100,000, schools will conduct a competitive selection process if the purchase does not meet the sole source or non-competitive justification requirements.

- For the three expenditures in our selection that had competitive bid requirements—all of which relate to electronic telecommunications services—we found that the Alliance charter schools conducted a competitive bid process as required.

Alliance Did Not Always Follow Its Contracting Policies and Procedures

- According to the Alliance home office's approval policy, only the Alliance CEO and chief financial officer have the authority to enter into home office contracts. Alliance's procedures also authorize school principals and school officers to enter into charter school contracts. However, three of the 80 contracts we reviewed were out of compliance because an unauthorized signatory entered into the contract.
- We noted that Alliance could not locate five of the contracts or agreements we attempted to review. In one instance, the operations vice president confirmed that the home office entered into a service transaction without a formal contract because of time constraints. She was unable to explain what had happened to the other four contracts due to staff transitions and departures.
- Alliance is in the process of formalizing its procurement policies and procedures to require both the home office and the charter schools to retain records of contracts for at least five years.

Alliance Did Not Establish Consistent Segregation of Duties

- Alliance's policies and procedures did not establish adequate segregation of duties over the Alliance charter schools' procurement process to mitigate the chance of fraud and abuse. Specifically, its procurement policies state that the Alliance school principal can enter into charter school contracts;

however, the principal can also sign and date subsequent invoices to indicate approval. Thus, the principal is approving both the initial agreement and the subsequent invoices.

- Although we did not identify instances of fraud, we noted four instances in which a charter school's principal entered into a contract and also approved subsequent invoices—two instances at Gertz-Ressler High School and two at Luskin High School.
- According to the operations vice president, the Alliance home office is also in the process of revising its policies and procedures to implement approval thresholds, which will require both a charter school principal and the Alliance home office vice president or chief of the applicable department to sign contracts greater than \$10,000.

Alliance Did Not Require Retention of Vendor Conflict-of-Interest Disclosure Forms

Alliance procurement training indicates that its vendors must complete conflict-of-interest disclosure forms to be eligible for a contract. The disclosure form states that a vendor must disclose any relationship with any Alliance home office or Alliance charter school official or employee to prevent any potential or existing conflict of interest. However, the operations vice president confirmed that the Alliance home office did not require the retention of vendor conflict-of-interest disclosure forms until the beginning of fiscal year 2016–17.

Recommendations

The Alliance home office should update and formalize its procurement policies and procedures manual, and it should provide adequate training to appropriate staff before the start of the 2017–18 school year—including the following:

- Establish competitive bidding thresholds for the procurement of goods and services.
- Require both the Alliance home office and charter schools to retain contract records for at least five years.
- Establish adequate segregation of duties for procurements to mitigate the risk of fraud and abuse.
- Obtain and retain vendor conflict-of-interest forms.

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SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee directed the California State Auditor to review the Alliance management organization and the charter schools under its operational jurisdiction. The audit scope includes eight audit objectives. Table 3 lists the audit objectives and the methods we used to address them.

Table 3
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	We reviewed state laws outlining the procedures for establishing and managing California charter schools, such as the requirements found in the Charter Schools Act and the Educational Employment Relations Act, the State's collective bargaining laws regarding teachers and other school employees. We also reviewed the Family Education Rights and Privacy Act, a federal law that protects the privacy of student education records.
2 For the charter schools overseen by Alliance, identify the source and amount of funding received and, to the extent possible, determine whether public and private funds are comingled.	<ul style="list-style-type: none"> • To identify the source and amount of funding received by the Alliance home office and the Alliance charter schools from fiscal years 2014–15 through 2015–16, we interviewed key officials within Alliance's accounting division and reviewed revenue and expenditure data for the Alliance home office and its charter schools, including audited financial statements. • To determine whether public and private funds were comingled, we reviewed Alliance's accounting system and confirmed that the system tracks revenue and expense accounts for the home office and the charter schools using distinct resource codes with public and private designations.
3 For the charter schools overseen by Alliance, identify the major categories of spending, including, but not limited to, salary, wages, and benefits for teachers, administrative costs, contract costs, and legal fees. Further, identify the percentage of funding spent on classroom instruction.	<ul style="list-style-type: none"> • To identify major categories of spending from fiscal years 2014–15 through 2015–16, we interviewed key officials in Alliance's accounting department and obtained the financial data for the Alliance home office and its charter schools. • We reviewed per-pupil expenditures at three Alliance charter schools: Gertz-Ressler High School, Luskin High School, and Smidt Technology High School.
4 Determine whether a selection of expenditures of funds were allowable and reasonable.	<ul style="list-style-type: none"> • We obtained and reviewed Alliance procurement policies and procedures and interviewed key management and procurement personnel. • We reviewed a selection of 80 transactions occurring from fiscal years 2014–15 through 2015–16 at the Alliance home office and three of its charter schools—Gertz-Ressler High School, Luskin High School, and Smidt Technology High School. This included review of 22 transactions from the special account used specifically in response to the unionization efforts. • To gain assurance that we selected transactions from the complete population of expenditures, we traced 29 disbursements to the data and found no errors.

continued on next page...

AUDIT OBJECTIVE	METHOD
<p>5 Determine the following expenditures relating to teacher unionization:</p> <p>a. The amount of money Alliance spent to write, develop, print, duplicate, and distribute communications, paper or electronic, to Alliance educators, parents, and alumni referencing teacher unionization efforts.</p> <p>b. The amount of money Alliance spent to hire consultants who have assisted in developing communications, planning documents, and strategies relating to teacher unionization efforts.</p> <p>c. The cost of all legal services, including, but not limited to, the costs to respond to any complaints issued by PERB and to respond to and litigate the injunction issued by the Los Angeles County Superior Court against Alliance.</p> <p>d. Whether the schools' individual boards of directors and the Alliance board of directors were involved in deciding how, when, and to what extent to allocate resources relating to teacher unionization efforts, rather than to the classroom.</p>	<p>To address this objective, we performed the tasks described below at the Alliance home office:</p> <ul style="list-style-type: none"> • Interviewed key Alliance personnel. • Reviewed expenditures from the special account and other funds to identify funds Alliance spent in response to the unionization efforts. • Obtained financial reports on funds expended in response to the unionization effort. • Reviewed expenditure reports to identify and categorize expenditures from the special account Alliance created to track expenditures related to the unionization efforts. • Reviewed the Alliance home office's allocation formula for schools' personnel time spent on unionization efforts. • Interviewed charter school personnel to verify that the time allocated to them was accurate and to determine the extent of their involvement in the unionization efforts. • Obtained and reviewed Alliance board minutes that discussed creating a fund to track the costs of responding to the unionization effort.
<p>6 Examine the policies, procedures, and practices by which Alliance, on behalf of the charter schools it manages, shared parent, student, and alumni information with third-party organizations, including, but not limited to, the CCSA.</p>	<p>We interviewed CCSA personnel regarding data they received from Alliance and how that information was used to conduct outreach in response to the unionization efforts.</p>
<p>7 Determine whether parent, student, and alumni information was shared by Alliance or its charter schools in conflict with confidentiality laws, policies, or practices.</p>	<ul style="list-style-type: none"> • We reviewed relevant laws and regulations governing confidentiality of parent, student, and alumni data. • We interviewed key management and procurement personnel. • We also reviewed data-sharing agreements between Alliance and third-party organizations where Alliance shared parent, student, or alumni information.
<p>8 Review and assess any other issues that are significant to the audit.</p>	<ul style="list-style-type: none"> • We evaluated the results of the PERB judge's 2016 proposed decision and UTLA and Alliance responses to that decision. • We also interviewed officials at Alliance and UTLA regarding the status of the unionization efforts at the Alliance charter schools.

Sources: California State Auditor's analysis of Joint Legislative Audit Committee audit request number 2016-117, and information and documentation identified in the table column titled *Method*.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: April 13, 2017

Staff: Benjamin M. Belnap, CIA, Deputy State Auditor
Ralph M. Flynn, JD
Christopher P. Bellows
Ashley Yan

Legal Counsel: Stephanie Ramirez-Ridgeway, Assistant Chief Counsel

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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March 27, 2017

Dear Ms. Howle:*

Thank you for the opportunity to respond to the draft audit report. We appreciate the professional and positive engagement from your team and believe the audit process was fair and objective. Alliance is dedicated to providing our students with a top-level education that prepares them for college and beyond. We therefore appreciate your acknowledgement of Alliance's success in educating minority students in the lowest-income communities in Los Angeles. Additionally, we have taken a close look at the areas that you reviewed during the audit and have rapidly taken steps to improve the particular processes and procedures contained in your two recommendations.

The audit confirms that Alliance College-Ready Public Schools did not misuse or misappropriate ANY public funds and that NO funds were diverted from the classroom or elsewhere from where they belonged.

Alliance College-Ready Public Schools fully understands the responsibility that comes with being the steward of public funds and has been extremely diligent in ensuring that every public dollar we receive is spent in an appropriate manner in service of our mission to provide low-income students throughout Los Angeles with a rigorous college-preparatory education.

Alliance College-Ready Public Schools had an internal process to withhold student data upon parent request.

Alliance annually offered families an opportunity to opt-out of sharing student data with external parties. Based on these opt-out requests, Alliance removed student data sent to third parties; however, the auditor identified a need for additional disclosures as part of this process. As the auditor noted in its report, as of December 2016, Alliance has made and will continue to make these additional disclosures.

①

The new management at Alliance College-Ready Public Schools has either corrected or has begun to address the two recommendations made by auditors.

The audit's two recommendations have been extremely helpful in bringing to our attention areas that need strengthening and improvement. Our action steps in response to the recommendations are shared below. We firmly believe that upon additional review by the California State Auditor, these issues will be considered fully implemented.

Recommendation 1: To ensure that it complies with federal laws regarding student privacy, Alliance should document its revised process for collecting, tracking, and monitoring the list of Alliance students and families who have opted-out of sharing their directory information with third parties.

In March 2017, Alliance College-Ready Public Schools revised its process for collecting, tracking and monitoring directory and opt-out information. The Alliance believes that this revised process fully implements the State Auditor's recommendation.

②

Recommendation 2: The Alliance Home Office should fully implement its revised procurement policies and procedures, including the retention of vendor conflict-of-interest forms, and provide adequate training to ensure that appropriate staff members at both the Alliance Home Office and Alliance schools comply with the new policies and procedures.

- ③ The audit report uncovered policy and procedural inconsistencies related to contracting and procurement. None of these inconsistencies violated any law or statute. In January and March 2017, Alliance shared drafts of its revised policies with the auditors. By June 2017, Alliance will have implemented its revised procurement policies and procedures and the associated training per the audit's recommendations.

Sincerely,

A handwritten signature in black ink that reads "Dan Katzir". The signature is written in a cursive style and is placed on a light gray rectangular background.

Dan Katzir, CEO
Alliance College-Ready Public Schools

COMMENTS

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM ALLIANCE

To provide clarity and perspective, we are commenting on the Alliance response to our audit. The numbers below correspond to the numbers we have placed in the margin of Alliance's response.

Alliance's comments indicate that it removed student data sent to third parties based on opt-out requests. However on page 20 we note that, although Alliance provided parents with opt-out letters, it confirmed to us that before the 2016–17 school year it did not have an expectation that schools would retain letters submitted by parents requesting to opt-out of having student directory information shared and it did not have a process to verify the completeness of charter schools' lists of opt-out requests. As a result, we were unable to determine whether Alliance's lists of parents who opted out were complete, or verify that Alliance had honored all opt-out requests during the period we reviewed.

①

As part of its response to this report, Alliance submitted its revised process for collecting, tracking, and monitoring opt-out information. If Alliance implements this revised process, we believe it will have fully implemented our recommendation.

②

Alliance is putting undue emphasis on the fact that the deficiencies we found related to its management processes do not violate specific provisions of law. Strong management processes, sometimes referred to as internal controls, help ensure that entities do not misuse public funds or otherwise violate the law. Our recommendations, which Alliance accepts, will help Alliance strengthen its internal controls.

③