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October 6, 2020

## **Via Electronic Mail**

Oceanside Collegiate Academy  
Marvin Arnsdorff, Chairman  
E-Mail: drarnsdorff@gmail.com

Re: Notice of Concerns & Enactment of Fraud Prevention Policy

Dear Mr. Arnsdorff,

The Charter Institute at Erskine College (the “Institute”) is the charter school sponsor of your school, Oceanside Collegiate Academy (the “School”). To fulfill this role and comply with the South Carolina Charter Schools Act, S.C. Code §§ 59-40-10 et seq. (the “Act”), the Institute has a responsibility to regularly monitor the performance and legal and fiscal compliance of the School. This specifically includes conducting oversight activities, notifying a school of perceived problems, and taking appropriate corrective actions in response to identified deficiencies (S.C. Code Ann. § 59-40-55(A)).

The Institute received an anonymous report of suspected corrupt or fraudulent conduct by Pinnacle Charter Schools Management Group, LLC, the vendor/EMO of the School (the “EMO” or “Pinnacle”). Upon initial review and investigation of the report and the financial operations of the School, specific concerns were identified that relate to the transactions, agreements, and roles that exist between the School and the EMO.

These concerns, which are addressed in greater detail below, include suspected corrupt or fraudulent conduct and/or self-dealing related to:

- the scope of services and fee structure in the management agreement compared with the financial records of the School;
- a pattern of excessive fees charged by Pinnacle for bond issuance for non-profit charter schools and related fees;
- the EMO independently procuring contractors and/or subcontractors, including businesses owned by EMO principals and their family members, on behalf of the school without board action or compliance with board-adopted policies and related deficiency in board oversight; and
- the EMO independently procuring contractors and/or subcontractors that duplicate services already provided under the EMO agreement and/or charter.

The Charter Institute team has worked in alignment with our review procedures to monitor key areas of school programming and operations that would assess school compliance with local, state, and federal requirements, as well as ensure that the needs of students served are being adequately met. One of the key components of operational review is ensuring compliance with board-adopted policies and contracts that rise to the level of being a material term to your charter and/or the contract held between the Charter Institute and the School.

On May 28, 2020, the Institute met with School board leadership during an in person meeting at the Institute office where the Institute presented its concerns to the School regarding suspected corrupt or fraudulent conduct by the School's EMO Pinnacle. On June 16, 2020, the Institute team met with the full School Board during a regular scheduled School board meeting and presented its concerns of suspected corrupt or fraudulent conduct by Pinnacle, provided a draft letter outlining same, and requesting that the School board join the Institute in conducting a third party audit of the School's EMO. At the June 16<sup>th</sup> board meeting, the School Board unanimously voted to partner with the Institute and conduct a third party audit of Pinnacle.

The Institute was subsequently informed that during the July 28<sup>th</sup> Board meeting, the School board met with Pinnacle and decided to separate from the Institute and conduct its own more limited financial audit of Pinnacle, which ignores essentially all of the areas of concern identified by the Institute, the School's authorizer. We question whether the auditing firm's proposal adequately addresses any of the majority of concerns that the Institute discussed with the School.

As an autonomous school, Oceanside Collegiate Academy can move forward with its own audit. However, in light of the School Board's limited financial audit, lack of urgency, potential lack of capacity, and poor oversight of the fiscal management of the school, the Institute will be enacting the Fraud Prevention Policy and proceeding with its investigation of these concerns, and conducting a full third-party audit that will investigate all identified areas of concern. Attached is the Scope of Services that will be included in the Institute's RFP for the third-party audit of the School's EMO/vendor Pinnacle.

As a public charter school that receives state and federal dollars, the Board is ultimately responsible for oversight of those dollars. The School Board has failed to take a stance to investigate all of the allegations brought to their attention by their authorizer. The School Board appears to have considered the school annual financial audit report as the trademark for financial compliance. The annual financial audit is one test for compliance.

The Institute hopes that the results of the forensic audit will contain minor or no non-compliance items. However, with the initial evidence identified by the Institute, the Institute, as the authorizer and Local Education Agency, must proceed with the investigation in accordance with its legal and ethical responsibilities.

As the Institute has previously shared with you, based on the report and preliminary evidence reviewed, the Institute has identified several areas of concern regarding the School and its vendor/EMO Pinnacle. These areas of concern will be part of the Institute's investigation and third-party audit, and the School will be expected to work with Pinnacle and provide all relevant

and/or requested documentation to the auditor<sup>1</sup>. We would appreciate the School proactively working with Pinnacle to assemble the information.

## 1. Management Fee Concerns

The Institute has raised serious concerns related to the operationalization of the School's agreement for management services with Pinnacle. In order to ensure fidelity to the program as approved, the auditing firm will be reviewing evidence of alignment with board policy, the school's charter, and the management agreement as they relate to the scope of services, the division of roles, the delegation of responsibilities, and the fulfillment of agreed upon terms and services negotiated between the school board and the Education Management Organization (EMO).

During a review of the School's financials and budget, the Institute noticed that the School has expenditures relating to School Management Services, Fiscal Services, and Human Resources Services. See attached **Appendix** for a breakdown of the expenditures and the percentage of the expenditures comparing to the school's revenue for the fiscal year 2017-2018 and 2018-2019.

The contract between the School and EMO indicates that the EMO will provide Financial, Budget, and Human Resource services to the School. According to the financial entries, the School is paying an additional fee for services relating to the Fiscal and HR management of the School. These combined amounts exceed the 15% fee provided in the contract between the School and EMO.

The School board has shared with the Institute that the school would not have opened without the Pinnacle's down payments during the inception of the schools. This causes concern on several levels, as addressed further below. Most importantly, such a statement is indicative of a lack of capacity and implies that the School Board is not supervising, fulfilling its fiduciary duty, or willing to investigate its EMO, because it believes it would not be in existence without the EMO's investment and therefore, is unwilling to challenge the EMO's conduct.

**Pause on EMO Fees:** Both the Pinnacle and the School Board have shared that Pinnacle did not charge the school 15% in their first few years of the school opening. This would constitute a breach of contract. Any material change to the charter or contracts must be approved by the Institute board, which was not done. If this is true, the school board must provide the evidence concerning same. If the EMO did withhold charging 15%, the board must provide the terms for the repayment of the 15% and the agreed-upon timeline to pay the funds back to Pinnacle.

**Planning and Implementation Funds:** The auditing firm will be reviewing all the Planning and Implementation funds for the School to ensure that these federal funds were not paid to Pinnacle as part of its fee. If the School paid Pinnacle out of P&I, the auditing firm will also need to review whether the funds were part of the initial 15% or an additional fee. The School board must also provide an executed contract on this matter.

**Bond fees:** The auditing firm will be reviewing the bond fees paid to Pinnacle. If the School paid Pinnacle out of the bond, the auditing firm will need to determine whether the funds were part of

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<sup>1</sup> Per the charter contract the School is are required to provide financial information to the Institute.

the initial 15% or an additional fee. The School Board must also provide an executed contract on this matter.

**Contracts and Payments Made to Public Relations Firm, Lobbyist, Legal Fees, Finance Auditors and other vendors:** The auditing firm will review all contracts and payments made by Pinnacle using School funds and evaluate any evidence on whether the board had knowledge of and/or authorized these payments.

## **2. Inequitable Percentages for schools within the portfolio**

The Institute noticed that the EMO provides consistent/similar services for other schools in South Carolina. Based on the Institute records, the EMO is charging different fees from different funding sources between the Institute schools. While this inequity in fee structure between schools is not in itself an issue of Institute compliance, the lack of clarity in the scope of services that would warrant the variation is inconsistent with EMO messaging and suggests a lack of due diligence on the part of the board in fulfilling statutorily required fiduciary responsibilities.

## **3. Finance and Human Resources Subcontracts**

The Institute discovered that the EMO has a contract for Finance services and human resources services that are being additionally charged to the School. Based on records filed with the Institute, these services are a part of the existing management agreement and should not warrant additional fees. Even if these contracts are reflective of an increase in scope or service, these contracts should have been procured by the School board in alignment with existing policies and procedures, and should be implemented by the Chief Executive Officer/Principal of the school as delegated by the board. Currently these contracts have been awarded to immediate family members of the EMO.

## **4. Principal Oversight, Employee Hiring and Reporting**

Currently, the school's charter specifies that the Principal will be responsible for the operations of the school, and will oversee the hiring, evaluating, and supervising of staff (pg. 33). The Principal, although hired by the EMO, is also responsible for primary communication with and reporting to the Board and will be reviewed by the Board (pg. 33). The charter further states that it is the Principal's responsibility to ensure that the school meets its stated educational goals and objectives and it is the Board's responsibility to hold him/her accountable for such (pg. 36).

Further, the charter references staff being classified as at-will employees of OCA (pg. 44) and references a grievance procedure for staff and administration that includes only the OCA Board (pg. 45). These language discrepancies make it unclear what the governing board's responsibilities are in employing, hiring, and/or evaluating school leadership and staff. This is further convoluted when compared in structure to the founding documents of the sister schools, which vary in reporting of the Principal to the Board. Again, the charter highlights only the comparability between the three EMO-managed schools, so the distinction in purpose and structure is unclear.

Contrary to the School's charter, Pinnacle has been hiring, evaluating, and supervising the Principal, employees, and staff. The auditing firm will review the process and any contracts in relation to the School and School board responsibilities under its charter.

## **5. Payment to Lobbyist**

Public records reveal that the EMO is paying \$4,000 per year for lobbying services. A separate contract was produced with the same lobbyist for accountability and compliance responsibilities, which also references lobbying services, for the School, where the lobbyist charged the School \$4,000 per month, and was executed by the President of the EMO. Similar \$4,000 per month contracts with the lobbyist were signed by the President of the EMO on behalf of Gray Collegiate Academy and Legion Collegiate Academy.

The Institute is concerned that the EMO is potentially defraying its lobbying expenses or substituting payments for lobbying through these ambiguous school-level contracts for accountability and compliance support. No evidence has been found where the school board approved this contract. Moreover, the Institute is very concerned about the President of the EMO signing on behalf of the schools for contracts with large payments.

**Board Governance:** With all the comprehensive list of non-compliance issues mentioned above, it is very clear that the board has delegated responsibilities to the EMO that must be preserved and retained by the School Board. Evidence suggests the EMO controls the School budget, strategic planning, board meetings, contracts with vendors, and day-to-day operations including oversight and evaluation of the principal. Evidence also suggests that the EMO assesses its own performance annually through the production of an annual marketing report.

The School Board has therefore, not fulfilled its responsibilities to evaluate and establish the salary of the School leader, execute contracts and subcontracts, assess the effectiveness of management services, develop and implement board policies, and ultimately, fulfill the school’s mission and vision.

**Conclusion:**

The Institute is disappointed that the School Board decided to separate from the Institute’s investigation and conduct a more limited investigation that ignores serious concerns of potential fraudulent or corrupt activity by the EMO presented by the Institute, without further discussion with the Institute, its authorizer.

Nevertheless, the Institute also has a fiduciary and legal obligation and responsibility to monitor the performance and legal and fiscal compliance of the School, including its EMO. In light of the significant concerns of suspected fraudulent and/or corrupt conduct by the School’s EMO, the Institute is enacting the Fraud Prevention Policy and will proceed with the full third-party audit outlined in the attached Scope of Services.

Thank you in advance for your cooperation in this matter. Should you have any questions, please do not hesitate to contact me at sarah@thetimmonsfirm.com or call 864-906-0289.

Very truly yours,

  
Sarah A. Timmons

Enclosure

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