



Dave Yost • Auditor of State

August 8, 2017

Dear :

I am writing to you because as a community school in Ohio, you are a public school. [See *Cordray v. Internatl. Preparatory Sch.*, 128 Ohio St. 3d 50, 50, 941 N.E.2d 1170, 1171 (2010)] This means you have certain duties that do not arise for private, parochial or proprietary schools.

It is common and legal in Ohio for a community school to contract with a private company to provide management and educational services. Frequently, these contracts call for compensation to be based on a percentage of revenue received by the school.

Last year, the Ohio Department of Education (ODE) began using a more robust look-back process regarding the number of full-time-equivalent students funded in a given school (the FTE review.) That process has not been without controversy and has been the subject of court challenges. As of this writing, ODE has made at least two final determinations and has reached settlement agreements with various schools it reviewed in 2016. Some of these have resulted in a claw back of state funding.

While the court challenges have not yet run their course, all courts considering the controversy have upheld the position of ODE. Based upon the record to date, it seems prudent to provide cautionary guidance to community schools on a very serious matter which will come up in your audits if your school is at some point subject to an ODE claw back.

If your management contract, educational service contract -- or, for that matter, your sponsor contract -- is based on a percentage of funding, and ODE determines a claw back is appropriate, this also may mean you must seek a refund of overpayments under those contracts.

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Please seek legal counsel on this matter. Each individual situation will be driven by the express terms of the parties' contract. However, please note that your school's interest is necessarily adverse to the interest of your management company, educational service company and sponsor. Please assure that any legal counsel is independent of your management company, educational service contractor or sponsor.

A community school is a *public* school. Your school has a fiduciary duty to its students and to the State of Ohio to seek these repayments.

During this office's normal audits, we will look at the terms of the applicable contracts, and if warranted will issue a finding for recovery if an ODE claw back resulted in reduced funding without a corresponding recovery from the management company or sponsor in favor of the community school.

A finding for recovery may be avoided if the money has been repaid, or is in the process of being repaid under the terms of a reasonable and enforceable repayment agreement. Please note that the reasonableness of the agreement will turn on many factors, and depending on the financial stability of the management company, educational service contractor or sponsor, may require collateralization or other assurances of future payments.

I understand that this may produce significant difficulty for some community schools, and for their management companies and sponsors. But if a school was overfunded, it must not result in a windfall profit for a private company, while the school itself suffers with reduced funding.

My office is currently drafting additional procedures to incorporate in our regular audits, and these procedures will also be incorporated in our contracts with Independent Public Auditors where an audit engagement is contracted out. We will hold a supplemental training in the near future in Columbus to provide information about our audit approach for community school fiscal officers and board members.

For those whose contracts do not provide compensation based on a percentage of funding, or for those whose FTE review by ODE does not find overpayments, these procedures may not be applicable. For questions please contact, Kristen Martin, Assistant Chief Legal Counsel at (614)466-5407.

Sincerely,

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Cc: Treasurer