

April 11, 2019

VIA ELECTRONIC MAIL

Governing Board, REALM Charter School
c/o Victor Diaz, Executive Director
1222 University Avenue
Berkeley, CA 94702

Dear Mr. Diaz,

This document constitutes a Notice of Intent to Revoke issued by the Berkeley Unified School District (the “District”) to REALM Charter School (“Charter School”) under Education Code § 47607(e). The District’s Board approved the Notice of Intent to Revoke on April 10, 2019. This Notice of Intent to Revoke arises out of the Notice of Violation previously issued to REALM on February 6, 2019, arising out of several instances of financial misconduct.

If the Board approves this Notice of Intent to Revoke, the Board shall hold a public hearing on the Notice of Intent to Revoke at its May 8, 2019 meeting, and will act on whether or not to revoke the charter at its May 29, 2019 meeting.

I. LEGAL BASIS FOR ACTION

A. Education Code Provisions

The revocation of a charter is governed by Education Code § 47607. Education Code § 47607(c) sets forth the grounds for revocation:

A charter may be revoked by the authority that granted the charter under this chapter if the authority finds, through a showing of substantial evidence, that the charter school did any of the following:

- (1) Committed a material violation of any of the conditions, standards, or procedures set forth in the charter;
- (2) Failed to meet or pursue any of the pupil outcomes identified in the charter;
- (3) Failed to meet generally-accepted accounting principles, or engaged in fiscal mismanagement; or
- (4) Violated any provision of law.

The charter-authorizing agency precedes revocation with a Notice of Violation and a reasonable opportunity to remedy the violation under Education Code § 47607(d):

Prior to revocation, the authority that granted the charter shall notify the charter public school of any violation of this section and give the school a reasonable opportunity to remedy the violation, unless the authority determines, in writing, that the violation constitutes a severe and imminent threat to the health or safety of the pupils.

Prior to revocation, the charter-authorizing agency provides the charter school with a Notice of Intent to Revoke, and conducts a public hearing on the potential revocation (Education Code § 47607(e)):

Prior to revoking a charter for failure to remedy a violation pursuant to subdivision (d), and after expiration of the school's reasonable opportunity to remedy, without successfully remedying the violation, the chartering authority shall provide a written notice of intent to revoke and notice of facts in support of revocation to the charter school. No later than 30 days after providing the notice of intent to revoke a charter, the chartering authority shall hold a public hearing, in the normal course of business, on the issue of whether evidence exists to revoke the charter. No later than 30 days after the public hearing, the chartering authority shall issue a final decision to revoke or decline to revoke the charter, unless the chartering authority and the charter school agree to extend the issuance of the decision by an additional 30 days. The chartering authority shall not revoke a charter, unless it makes written factual findings supported by substantial evidence, specific to the charter school, that support its findings.

The charter school may appeal the revocation to the County Board. (Education Code § 47607(f)(1).)

B. California Code of Regulations

Cal. Admin. Code tit. 5, § 11968.5.2, sets forth additional procedures for a school district's revocation of a charter. Subsection (a) of the regulation provides the charter school 72 hours' notice before the board considers issuing a Notice of Violation:

At least 72 hours prior to any board meeting in which a chartering authority will consider issuing a Notice of Violation, the chartering authority shall provide the charter school with notice and all relevant documents related to the proposed action.

Subsection (c) describes the charter school's obligations once a Notice of Violation is served:

Upon receipt of a Notice of Violation, the charter school's governing body as described in the school's charter, if it chooses to respond, shall take the following actions:

- (1) Submit to the chartering authority a detailed, written response addressing each identified violation which shall include the refutation, remedial action taken, or proposed remedial action by the charter school specific to each alleged violation.

The written response shall be due by the end of the Remedy Period identified in the Notice of Violation.

- (2) Attach to its written response supporting evidence of the refutation, remedial action, or proposed remedial action, if any, including written reports, statements, and other appropriate documentation.

Once the charter school responds to the Notice of Violation, the District will determine whether to proceed with the revocation process. As set forth in Cal. Admin. Code tit. 5, § 11968.5.2, sections (d) and (e):

- (d) After conclusion of the reasonable opportunity to remedy, the chartering authority shall evaluate the response of the charter school's governing body as described in the school's charter response to the Notice of Violation and any supporting evidence, if submitted, and shall take one of the following actions:
 - (1) If the chartering authority has substantial evidence that the charter school has failed to refute, to the chartering authority's satisfaction, or remedy a violation identified in the Notice of Violation, the district shall continue revocation of the school's charter by issuing a Notice of Intent to Revoke to the charter school's governing body as described in the school's charter; or
 - (2) Discontinue revocation of the school's charter and provide timely written notice of such action to the charter school's governing body as described in the school's charter.
- (e) If the chartering authority does not act, as specified in subdivision (d), within 60 calendar days of the conclusion of the Remedy Period specified in the Notice of Violation, the revocation process is terminated and the Notice of Violation is void.

If the Board approves this Notice of Intent to Revoke, the Board will hold a public hearing within 30 days, and take action on a Final Decision in open session within 30 days of the public hearing:

On the date and time specified in the Notice of Intent to Revoke, the chartering authority shall hold a public hearing concerning revocation. No more than 30 calendar days after the public hearing (or 60 calendar days by written mutual agreement with the charter school), the chartering authority shall issue a Final Decision.

If the Board approves this Notice of Intent to Revoke, the Board shall hold a public hearing on the Notice of Intent to Revoke at its May 8, 2019 meeting, and will advise the Charter School as to the hearing date on which the Board will take action on the Notice.

The charter school must file any appeal to the County Board within 30 days of Board action. (Cal. Admin. Code tit. 5, § 11968.5.4(a).)

II. HISTORY OF ENFORCEMENT MEASURES/NOTICES OF VIOLATIONS

The following section sets forth the history of the District's oversight and enforcement measures taken with respect to the Charter School.

A. December 9, 2015 Renewal Report

At its December 9, 2015 meeting, the Board approved the renewal of the REALM Middle School and REALM High School charters, upon the following conditions:

- Resubmission of multi-year projections for both charter schools.
- Reductions in expenditures to reduce REALM Middle School's deficit spending and negative fund balance.
- Submission of monthly budgets to the District, including updates and cash flow, until resolution of the negative fund balance and a 3% reserved was achieved.
- Response to District concerns and request for information expressed in prior fiscal oversight letters.
- No further advances on the payment of REALM's in lieu property taxes under Education Code section 47635.

B. January 26, 2017 (REALM Middle and High School) Grounds: Failure to Follow Generally Accepted Accounting Principles and Fiscal Mismanagement; Violation of terms of the Charter (Education Code section 47607(c)(1)(A), (C))

The Board approved the issuance of a Notice of Violation, dated January 26, 2017, based upon the following conduct by the Charter School:

- Negative ending fund balances
- Deficit spending
- Cash flow problems
- Excessive obligations under promissory note and line of credit
- Insufficient reserves

C. February 2, 2018 (REALM Middle and High School) Grounds: Failure to Follow Generally Accepted Accounting Principles and Fiscal Mismanagement; Violation of terms of the Charter (Education Code section 47607(c)(1)(A), (C))

The Board approved the issuance of a second Notice of Violation, dated February 2, 2018, based upon the following conduct by the Charter School:

- Negative ending fund balances
- Deficit spending
- Cash flow problems

- Excessive obligations under promissory note and line of credit
- Insufficient reserves

In response to the Notice of Violation, REALM submitted a Request for Material Revision to merge REALM Middle School and REALM High School under a single charter. The Board approved the material revision in February, 2018.

D. September 26, 2018 (El Cerrito Site)

The Board approved the issuance of a third Notice of Violation on September 26, 2018, based upon the Charter School's illegal establishment of a site in Contra Costa County, without requesting a material revision of its charter, in violation of Education Code 47605.1(d) and 47605(a)(4).

E. February 6, 2019 Notice of Violation
Grounds: Failure to Follow Generally Accepted Accounting Principles and Fiscal Mismanagement; Violation of terms of the Charter (Education Code section 47607(c)(1)(A), (C))

The Board approved the issuance of a fourth Notice of Violation, dated February 2, 2019, based upon the following conduct by the Charter School:

- Failed to submit its final audit report by December 15, 2018 for fiscal year 2017-2018.
- Failed to pay its employer contributions to the State Teachers' Retirement System (STRS) for the months of November (\$43,855.23) and December, 2018 (\$44,267.37).
- Failed to pay \$1.5 million dollars in financial obligations to vendors and other creditors.
- Failed to reflect the negative fund balance of REALM Middle School in the budget of the consolidated REALM Charter Schools after the Board granted a material revision to consolidate the REALM Middle School and REALM High School.
- Representing to the District that it had cured a previous Notice of Violation by moving from its Middle school facilities from outside Alameda County (in El Cerrito, Contra Costa County), to a new facility in Berkeley. However, the Charter School had not secured a final permit for its new site, and was therefore forced to cancel no less than 2 days of school last month.

Also included in the Notice of Violation were the following allegations contained in the January 29, 2019 letter:

1. "REALM has failed to pay its STRS obligations for its employees in a timely manner.
2. REALM does not have a maintenance or janitorial staff. This has led to unsafe working conditions for teachers and staff, and unsafe learning conditions for students.
3. REALM has not provided the necessary safety equipment to ensure student and teacher safety in the lab science classrooms.

4. REALM has not reimbursed teachers for approved expenditures and has no plan to do so.
5. REALM has not kept the Berkeley Unified School Board, the Chartering Authority, updated with regards to a possible merger and/or acquisition by Compass Charter Schools.
6. REALM has not conducted safety drills required by the Collective Bargaining Agreement. This creates unsafe conditions for students and staff.
7. It is our understanding that REALM did not follow required procedures with regard to the REALM school bus and/or cannot afford needed repairs, and now there are students who are not attending school due to a lack of transportation. This is a travesty for these students and families.
8. REALM has not held a meeting with teachers to discuss how the new REALM Online program will impact current teachers and students. This change was made without consultation with teachers.”

III. VIOLATIONS ON WHICH THIS NOTICE IS BASED

A. Failure to Follow Generally Accepted Accounting Principles and Fiscal Mismanagement (Education Code section 47607(c)(1)(C))
Violation of terms of the Charter (Education Code section 47607(c)(1)(A))

This Notice of Intent to Revoke is based upon the allegations of the February 6, 2019 Notice of Violation, as set forth above. After reviewing REALM’s response, staff recommends proceeding with the next step, which is approval of a Notice of Intent to Revoke, for the reasons set forth below.

B. REALM’s Response to Allegations in February 6, 2019 Notice of Violation

Violation	Status
1) Failed to submit its final audit report by December 15, 2018 for fiscal year 2017-2018.	REALM submitted audit response on March 4, 2019. The statutory deadline is December 15. (Education Code section 47605(m).)
2) Failed to pay its employer contributions to the State Teachers’ Retirement System (STRS) for the months of November (\$43,855.23) and December, 2018 (\$44,267.37).	REALM has made the November and December payments to STRS.
3) Failed to pay \$1.5 million dollars in financial obligations to vendors and other creditors.	Not remedied. REALM is still working on paying off its debts in full. REALM suggests that the Compass merger will result in satisfaction of its debts. See further analysis below.
4) Failed to reflect the negative fund balance of REALM Middle School in the budget of the consolidated REALM Charter Schools after the	Not remedied. REALM failed to follow Generally Accepted Accounting Principles in reflecting the negative ending fund balance in its budget.

Board granted a material revision to consolidate the REALM Middle School and REALM High School.	
5) Representing to the District that it had cured a previous Notice of Violation by moving from its Middle school facilities from outside Alameda County (in El Cerrito, Contra Costa County), to a new facility in Berkeley. However, the Charter School had not secured a final permit for its new site, and was therefore forced to cancel no less than 2 days of school last month.	Partially remedied. REALM began use of the building on Feb. 1, 2019, but was forced to cancel some instructional days as a result of the permitting issue.

C. District’s Evaluation of REALM’s Response to the February 6, 2019 Notice of Violation

Ever since the renewal of the REALM charters in December, 2015, the Charter School has been plagued by financial mismanagement. It has sustained chronic negative ending fund balances, deficit spending, incurred significant unpaid financial obligations, and failed to follow Generally Accepted Accounting Principles.

REALM is delinquent in approximately \$1.5 million in financial obligations. While it has described a plan to repay these obligations, the plan lacks specifics. REALM cites \$400,000 in “cash and technical resources” from Compass Charter Schools, this amount only represents just over 25% of the Charter School’s indebtedness.

After reviewing REALM’s response to the Notice of Violation, the District concludes that violations remain in two areas: excess unpaid financial obligations, and fiscal mismanagement/failure to follow Generally Accepted Accounting Principles. The District discusses below the factual basis for this conclusion.

1. Request for Material Revision: Proposed Merger with Compass Charter Schools.

On or about March 12, 2019, REALM submitted a Request for Material Revision which proposed an acquisition by Compass Charter Schools (“Compass”). Because the proposed acquisition by Compass interplays with REALM’s response to the Notice of Violation, the District has evaluated the Request for Material Revision and proposed acquisition as part of evaluating REALM’s response to the Notice of Violation.

The Request for Material Revision proposes to continue REALM’s classroom-based program, while introducing an independent study/non-classroom based program:

VOLUNTARY INDEPENDENT STUDY OPTION

While the Charter School will remain a classroom-based program, it will offer a voluntary independent study option for students. In this respect, the Charter School shall comply with

independent study laws and regulations including, but not limited to, Education Code Sections 51745 et seq., 47612.5, 47634.2; and Title 5, California Code of Regulations, Sections 11700-11705, as applicable. The Charter School will maintain written records that contemporaneously document all student attendance and make these records available for audit and inspection. (Request for Material Revision, p. 41.)

The Budget Summary submitted with the Request for Material Revision contains the following enrollment assumptions for the current school year, as well as the next five school years.

Enrollment By Grade

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Grade 6	14	60	63	66	69	73
Grade 7	44	60	63	66	69	73
Grade 8	54	60	63	66	69	73
Grade 9	70	80	84	88	93	97
Grade 10	79	80	84	88	93	97
Grade 11	72	80	84	88	93	97
Grade 12	65	80	84	88	93	97
Other Enrollment (Grade 12+, etc.)		100	105	110	116	122
Total Enrollment	398	600	630	662	695	729

(Budget Summary, p. 2.)

The Request for Material Revision and accompanying budget summary lack a supporting narrative of assumptions behind the budget and projected enrollment, thereby leaving some significant questions and disparities in the Charter School's financial plan for the next five school years. For example, the Request for Material Revision states that the Charter School "will offer a voluntary independent study option for students." (Request for Material Revision, p. 41.) It is assumed that the "Other Enrollment (Grade 12+ etc.)" row in the above chart refers to students enrolling in the independent study program, though this is not explained explicitly anywhere in the Budget Summary.

The Budget Summary's Certificated Salaries raise even more confusion. The Certificated Salaries appear to be commensurate with the projected enrollment growth of the Charter School for 2019-2020 through 2022-2023. However, between 2022-2023 and 2023-2024, teacher salaries drop from \$1,824,258 to \$16,000, causing Certificated Salaries as a whole to drop from \$2,625,481 to \$832,758. No explanation is given for this programmatically incompatible reduction in expenses:

	Certificated Salaries	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
1100	Teachers' Salaries	1,382,444	1,719,039	1,816,444	1,917,059	1,824,258	16,000
1105	Teachers' Stipends / Bonus	16,000	16,000	16,000	16,000	16,000	16,000
1120	Substitute Expense	35,000	35,700	36,414	37,142	37,885	38,643
1200	Certificated Pupil Support Salaries	127,173	129,716	132,310	134,957	137,656	140,409
1300	Certificated Supervisor and Administrator Salaries	345,400	464,508	473,798	483,274	492,940	502,798
1305	Certificated Sup. and Admin. Stipends / Bonus	8,500	8,500	8,500	8,500	8,500	8,500
1900	Other Certificated Salaries	100,000	102,000	104,040	106,121	108,243	110,408
1910	Other Certificated Overtime	-	-	-	-	-	-
1000	Subtotal	\$2,014,516	\$2,475,463	\$2,587,507	\$2,703,05	\$2,625,481	\$832,758

(Budget Summary, p. 6.)

Nor does the budget summary contain commensurate declines in expenses in the other areas of program operation, such as Classified Salaries, Employee Benefits, Books and Supplies, or Services and Other Operating Expenses. Therefore, the precipitous decline in teacher salaries cannot be explained by the integration of the non-classroom based program, which might result in a decline in teacher salaries, but not to the degree called for in the Budget Summary. Therefore, this sudden decline in teacher salaries constitutes a major area of confusion in the Charter School's budget summary. If it is in fact an error, then it has caused the Charter School's expenses for 2023-2024 to be significantly understated, and its projected ending fund balance to be significantly overstated.

The Budget Summary also depends on a significant and steady increase in enrollment through 2023-2024, which would require REALM to not only achieve, but to exceed by a significant margin, its historical enrollment peak. Following is a chart of the enrollment trajectory that would be required of REALM to sustain itself financially under its proposed budget:

Year	14-15	14-15	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
M.S.	310	302	249	187	112	180	186	198	207	219
H.S.	361	366	347	344	286	320	342	352	372	388
Add'l	N/A	N/A	N/A	N/A	N/A	100	105	110	116	122
Total	671	668	596	531	398	600	633	660	695	729

(Budget Summary, p. 2 (18-19 to 23-24; DataQuest (14-15 to 17-18).)

The Charter School's budget depends upon a 200-student increase between 2018-2019 and 2019-2020, and then increases of about 30 students in each year thereafter. This precipitous increase would contradict historical trends of significant declining enrollment across the board, but especially pronounced at REALM's middle school. Therefore, the 5-year budget is based upon tenuous and unsupported enrollment increases.

Also suspect is the Budget Summary's assumption that the Charter School would recover from a budget deficit of \$889,517 in FY 2018-2019 to achieve a surplus of \$1,135,589 in 2019-2020, with a corresponding swing in the ending fund balance of \$(1,680,705) in FY 2018-2019 to (\$545,116) in 2019-2020. Nowhere in the Budget Summary or Request for Material Revision does REALM explain how, with currently \$1.5 million in unpaid financial liabilities, the Charter School would make up such a deficit in such a short period of time, with Compass only committing \$400,000 in resources to REALM.

Both REALM and Compass were placed on notice that they would need to provide a *detailed* financial plan demonstrating how REALM would extricate itself out of its current dire financial circumstances. In a March 11, 2019 letter to REALM and Compass, the District stated that:

By now, the District expects that Compass recognizes REALM's dire financial condition, and the District's concerns about the Charter School's ability to sustain day-to-day operations. As the District's February 5, 2019 letter stated:

As you know, REALM has maintained significant negative ending fund balances for several fiscal years, and currently is delinquent in over \$1 million in payments to vendors and other creditors. Whether or not the request for material revision meets the requirements for approval will depend on whether it

contains a detailed financial plan for satisfying all of REALM's current financial delinquencies, and achieving financial solvency in future fiscal years.

As you also must be aware, the District has a current Notice of Violation pending against REALM related to its financial condition, and the Board of Education is slated to take action on a Notice of Intent to Revoke at its March 27, 2019 [now April 10, 2019] meeting. Please be aware that the District considers the timely submission of REALM's request for material revision, and response to the upcoming Notice of Intent to Revoke, to be the responsibility of REALM and Compass alone. We hope that you now understand the urgency that REALM and Compass take prompt action in light of REALM's precarious financial condition. (Emphasis Provided.)

The District concludes that REALM's response to the Notice of Violation, and its Request for Material Revision, fail to contain the required detail and assurances that the Charter School would be able to remedy its dire financial condition. The Budget Summary contains significant discrepancies and omissions, and is based upon unrealistic increases in enrollment. Instead of committing itself to reducing expenses and reconfiguring the scope of its program to improve its financial viability, the Charter School continues its pattern of attempting to sustain a financial model based upon unsustainable enrollment increases, excessive expenditures, and nonconforming budget practices.

2. Request for Material Revision: Charter School Employee's Right to Representation

The "Executive Summary" contained on p. 6 of the Request for Material Revision states that "Compass is not bound by the Collective Bargaining Agreement between Berkeley Federation of Teachers and REALM." This statement misstates the law. Education Code section 47611.5 provides

(a) Chapter 10.7 (commencing with Section 3540) of Division 4 of Title 1 of the Government Code [The Rodda Act] shall apply to charter schools.

(b) A charter school charter shall contain a declaration regarding whether or not the charter school shall be deemed the exclusive public school employer of the employees at the charter school for the purposes of Section 3540.1 of the Government Code. If the charter school is not so deemed a public school employer, the school district where the charter is located shall be deemed the public school employer for the purposes of Chapter 10.7 (commencing with Section 3540) of Division 4 of the Government Code.

The Request for Material Revision states that the Charter School shall be the exclusive employer of its employees under the Rodda Act. (Request for Material Revision, p. 3) ("The Charter School declares that it shall be deemed the exclusive public school employer of the employees of REALM Charter School for purposes of the Educational Employment Relations Act. [Ref. Education Code Section 47605(b)(6)].") Therefore, Compass cannot evade recognizing BFT as an exclusive representative, or the collectively negotiated contract between BFT and the Charter School.

V. CONCLUSION

After reviewing REALM's response to the Notice of Violation, the District concludes that violations remain in two areas: excess unpaid financial obligations, and fiscal mismanagement/failure to follow Generally Accepted Accounting Principles. Staff has concluded that the proposed Material Revision calling for Compass to acquire REALM does not remedy the remaining violations, for the reasons stated above.

The Board is asked to take action on whether to approve the Notice of Intent to Revoke. Should the Board do so, it shall hold a public hearing on the Notice of Intent to Revoke at its May 8, 2019 meeting, and will act on whether or not to revoke the charter at its May 29, 2019 meeting. If necessary, the Board would also take action on the Request for Material Revision on May 29, 2019. If the Board revokes the charter, the Charter School may appeal the revocation to the County Board of Education (Education Code § 47607(f)(1)), and either party may appeal the County Board's decision to the State Board of Education. (Education Code § 47607(f)(2).) Therefore, the Board's revocation of the charter does not necessarily mean that the Charter School would have to immediately cease operations.

Sincerely,

Pauline Follansbee

Assistant Superintendent of Business Services