

Harmony Public Schools Complaint Review

October 14, 2016

Amsterdam & Partners, LLP
Attn: Mr. Robert R. Amsterdam & Mr. John Martin
The Homer Building
601 Thirteenth Street, NW
Eleventh Floor South
Washington, DC 20005

Subject: TEA Complaint Number: INV2016-05-101

Dear Mr. Amsterdam and Mr. Martin:

The purpose of this report is to notify you that the Texas Education Agency's (TEA) Special Investigations Unit (SIU) has conducted a complaint review regarding allegations that Harmony Public Schools (HPS) violated Tex. Educ. Code §12.1053; §12.128; Chap. 44, Subch. B; and 19 Tex. Admin. Code Chapters 100 and 109.

The complaint alleges the following violations (verbatim), which pertain to the 2014-2015 school year, and may have continued through the 2015-2016 school years:

1. **Over 75% of Harmony's vendors are Turkish-owned/operated and many have significant ties to Harmony's leadership due to previous employment at Harmony. Over the past 15 years, Harmony has paid affiliated Turkish-owned/operated vendors over \$150M. This is circumstantial evidence indicating that Harmony/Cosmos prefers affiliated vendors of the same national origin as the majority of Harmony/Cosmos's governing board, in violation of open/competitive bidding.**
2. **Harmony guaranteed a \$7M bond debt of a Turkish-operated/governed charter network in Arkansas, which is squarely violative of the Texas Public Investment Funds Act which Harmony cannot waive as a charter holder.**

This report addresses only the allegations described above and excludes allegations that are outside the jurisdiction of TEA.

During the complaint review, SIU requested documentation from HPS¹. The documentation was received on August 19, 2016, and analyzed as part of TEA's complaint review procedures.

Allegations

1. Over 75% of Harmony's vendors are Turkish-owned/operated and many have significant ties to Harmony's leadership due to previous employment at Harmony. Over the past 15 years, Harmony has paid affiliated Turkish-owned/operated vendors over \$150M. This is circumstantial evidence indicating that Harmony/Cosmos prefers affiliated vendors of the same national origin as the majority of Harmony/Cosmos's governing board, in violation of open/competitive bidding.

The complaint alleged that since 2001, HPS has paid affiliated Turkish-owned/operated vendors over \$150M, and that HPS prefers Turkish-owned/operated vendors of the same national origin as the majority of HPS Governing Board. For the purposes of this Complaint Review, SIU only reviewed HPS vendor records from July 2014 through July 2016.

The allegation does not identify any specific contracts that were awarded to a Turkish-owned/operated vendor over a more qualified non-Turkish owned/operated applicant. Therefore, the analysis was limited to whether HPS's contracting procedures conform to Texas law governing charter school procurement, or whether the information reviewed indicates that HPS failed to follow its contracting procedures. Even if it were the case that more Turkish vendors received contracts, this alone would not necessarily constitute a violation because more Turkish vendors may have submitted proposals to be considered than non-Turkish vendors.

A review of HPS' Purchasing Procedures was conducted with particular attention to Page 4, Section 2.1: Procurement Procedures. Pursuant to Tex. Admin. Code §100.1006, as an open-enrollment charter school, HPS is not required to competitively procure purchases or contracts for goods that are not public works or professional services contracts when using state and/or local funds.

On March 26, 2015, HPS implemented a competitive sealed proposal procurement process for goods and services contracts valued at \$50,000 or more in the aggregate for each HPS fiscal year reviewed by the SUI investigator (July 2014 through July 2016).

May 2016, HPS requested the adoption of the provisions of the Texas Education Code (TEC) Chapter 44, Subchapter B as the charter holder's process for awarding a contract for the construction, repair, or renovation of a structure, road, highway, or other improvement or addition to real property. This amendment to HPS' charter was approved by the Commissioner of Education on July 19, 2016.

A review of HPS' purchasing procedures showed that on November 11, 2014, HPS entered into an interlocal agreement with the Harris County Department of Education (HCDE), to provide procurement consulting services. HPS coordinates their competitive sealed procurement process with HCDE's review, input, and joint approval.

¹ Harmony Public Schools - Requested Documents (Thumbdrive)

SIU also reviewed HPS' Finance Committee Meeting minutes from July 2014 to May 2016. The minutes indicate that meetings were held to evaluate the needs of HPS at the various campuses; vendor involvement in the competitive sealed procurement process and to vote on contracts that would be awarded to vendors.

The minutes also noted a scoring system that was set up to evaluate each vendor on such factors as price, quality, and the extent to which the goods and/or services met the needs of HPS. These factors were assigned a value and the points were added up for an aggregate score. Although some of the vendors scored higher in some areas and may have had a higher aggregate score, certain factors like price and past performance was considered.

On projects over \$50,000, HCDE's presence at the Finance Committee was noted in the meeting minutes, and HCDE was consulted to assist in the procurement process per their interlocal contract with HPS.

SIU reviewed and analyzed one hundred-nineteen (119) awarded non-construction contracts approved by the Finance Committee during the time period from July 2014 to July 2016. When compared to the Texas Secretary of State's registry, seventeen (17) companies were registered with what appeared to have Turkish surnames based on the listing of the registered agent for that company. This is approximately 14% of the companies that were offered non-construction contracts during the timeframe of the complaint review. The remaining 86% did not appear to be owned by Turkish companies or had no registered name with the Texas Secretary of State² (See Chart 1). Collectively, the non-construction contracts amount to approximately \$35M, with awarded dollars to companies owned by Turkish surnames amounting to approximately \$14.7M, 42% of the total amount awarded (See Chart 2).

Additionally, SIU reviewed information provided by HPS for vendor awarded contracts for major construction projects from July 2014 to July 2016. Of the thirty-seven (37) reported contracts, four (4) contracts were awarded to Turkish-owned companies, representing 11% of all major construction projects (See Chart 3). The total dollar amount for these contracts was approximately \$23M, with \$4M awarded to Turkish-owned companies, representing 17% of the dollars awarded for construction contracts (See Chart 4).

Therefore, during the complaint review, SIU found the allegation that Harmony Public Schools (HPS) violated Tex. Educ. Code §12.1053; §12.128; Chap. 44, Subch. B; and 19 Tex. Admin. Code Chapters 100 and 109, to be unfounded.

² Based on the limited information available, the TEA cannot determine with absolute certainty whether or not the owners are of Turkish descent. For example, the existence of a surname that may be Turkish does not necessarily denote a Turkish owner. Also, a person of Turkish descent may have a non-Turkish surname. Regardless, TEA has reviewed no information that would lead to the conclusion that a less-qualified Turkish vendor was selected over a more-qualified non-Turkish vendor.

2. Harmony guaranteed a \$7M bond debt of a Turkish-operated/governed charter network in Arkansas, which is squarely violative of the Texas Public Investment Funds Act which Harmony cannot waive as a charter holder.

HPS provided the documents SIU requested regarding the issuance of the bond guaranty involving LISA Academy in Arkansas.

A review of these documents yielded the following information:

- The charter bond guaranty involves Series 2010Y and Series 2010Z bonds.
- The LISA Academy is, indeed, located in Arkansas and is owned by Little Scholars of Arkansas Foundation, a limited liability corporation (LLC).
- The Lien Note was issued by Regions Bank on December 15, 2010.
- The amount for the bond guaranty was found to be \$1.9M, not \$7M (the bond attorney for HPS confirmed the amount of the LISA bond guaranty).

On November 8, 1983, Article 7, Section 9(b), of the Texas Constitution, which provides for the guarantee of school district bonds by the Permanent School Fund (PSF), was approved (since renumbered to Article 7, Sections 5(d)-(e)). In 2011, the Texas Legislature added charter schools to the program. TEC §12.135. The Bond Guarantee Program (BGP) allows for bonds that are properly issued by a school district or a charter school to be fully guaranteed by the corpus of the PSF with the approval of the Commissioner of Education. The guarantee has received "AAA" ratings from the major bond rating services and replaces the need for private bond insurance.

The first time that HPS requested entrance into the BGP was July 2014, in the amount of approximately \$101.5M.

On September 15, 2016, SIU contacted the bond attorney for HPS. For the bond issuance in question, HPS utilized experienced and reputable bond counsel who regularly serves as bond counsel for several cities, counties, and school districts, as well as special utility districts. HPS bond counsel represented that the bond guarantee agreement specifically excluded any State funds as a source of funds that would be available for payment under the guaranty agreement.

SIU reviewed the bond documentation (including the guaranty agreement), and has determined that the agreement specifically excludes funds received from the State of Texas as a source for any guaranty payments, unless that is a use that is allowed by Texas Law and the rules and regulations of the Texas Education Agency. Section 1.02(b) of the guaranty agreement states that "The Corporation agrees to tender payments from allocable funds, not to exceed the Guaranty Coverage, to the Trustee for further disbursement to the Lender pursuant to the terms and procedures set forth in the Guaranty." (Emphasis added). Section 1.01(a) of the guaranty agreement defines "allocable funds" as "... Revenues of the Corporation [Cosmos Foundation Inc.] ... provided that, State Revenues (as defined by the Cosmos Master Indenture) are only available to the extent permitted by the laws of the State of Texas and the Rules and Regulations promulgated by the Texas Education Agency."

HPS also provided SIU with financial documentation regarding the funding of the LISA guaranty, which is held in HPS's 499 fund. According to TEA's Financial Accountability System Resource Guide (FASRG), Fund Code 499 is designed for locally funded temporarily restricted net assets. Since these funds are local, the charter school may use the funds as it sees necessary for the benefit of the school.

The funds are designated "Locally Funded Temp Restricted" funds, which are segregated donation funds that HPS collects and expends under fee revenue from its support agreements with various schools across the United States. This fund includes gifts, bequests, and miscellaneous local revenue. The fund does not include any revenue HPS receives from state or federal funding sources. At the time of this report, HPS 499 fund balance contains sufficient funds to satisfy the LISA guaranty. SIU also confirmed the source and use of the 499 funds with TEA's Division of Financial Compliance, which obtains annual "Actual Financial Receipts and Disbursements" and "Statements of Activities" from schools, including HPS.

The complaint also alleged that the guarantee violated the Texas Public Funds Investment Act. However, it does not appear that public funds were used or promised to be used in the event of a default. Therefore, since there are neither public funds nor investments involved in the agreement, this transaction is not subject to the provisions of the Texas Public Funds Investment Act.

SIU has found that the allegation with regards to the violation of the Texas Public Funds Investment Act is unfounded.

Summary

Harmony Public Schools provided TEA with the requested documentation, which was reviewed by the Special Investigations Unit. With regards to the aforementioned allegations that pertain to TEA's jurisdiction, the complaint review does not warrant a TEA investigation. Therefore, this report concludes this matter.

Sincerely,



Brenda Meyers, Director
Special Investigations Unit

Enclosure (1)

Harmony Public Schools: Complaint Review

Report Period: July 2014 to July 2016

Total Number of Awarded Non Construction Contracts (119)

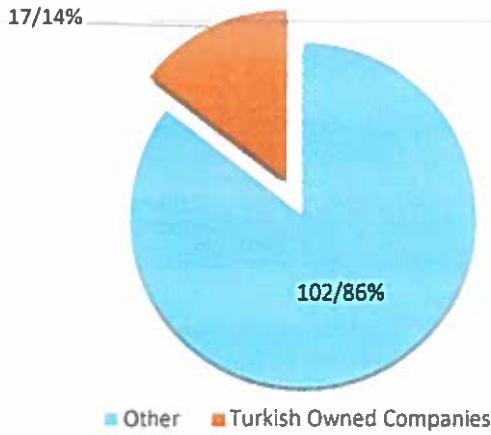


Chart 1

Dollars Awarded to Non Construction Contracts (\$35M)

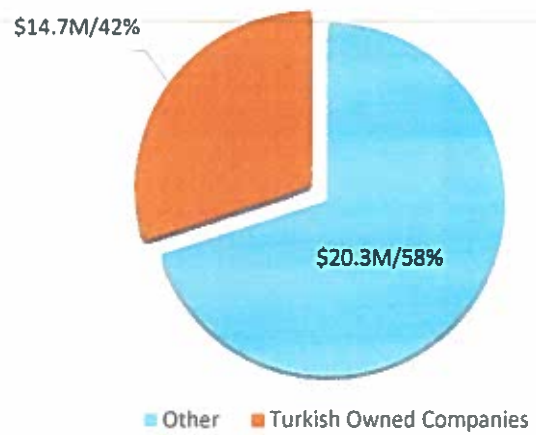


Chart 2

Total Number of Awarded Construction Contracts (37)

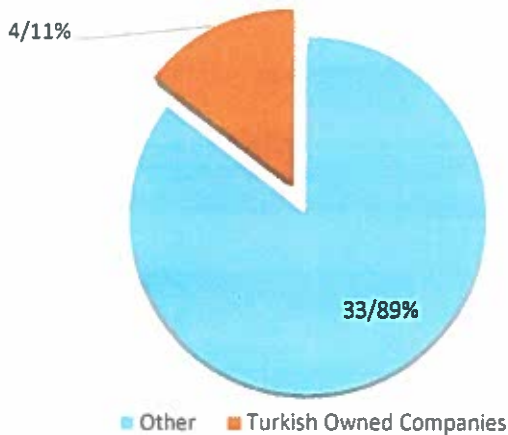


Chart 3

Dollars Awarded to Construction Contracts (\$23M)

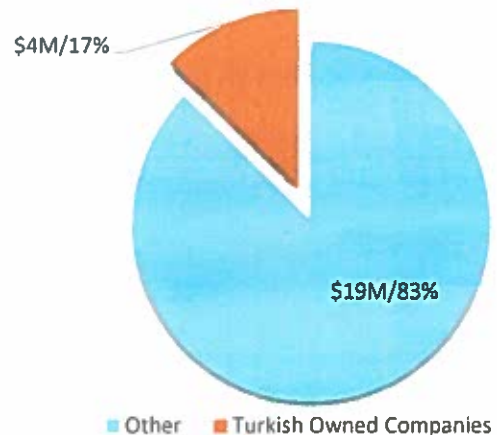


Chart 4