INVESTIGATIVE REPORT
Hmong College Prep Academy
PUBLIC VERSION

Executive Summary

The Office of the State Auditor (OSA) received concerns about a 2019 investment of $5,000,000 by the Hmong College Prep Academy (Charter School).

The OSA obtained from the Charter School certain documents relevant to the investment. Based on a review of the documents provided by the Charter School, the OSA concludes that:

(1) the Charter School’s $5,000,000 investment did not comply with Minnesota law regarding permissible investments of public funds,
(2) the Charter School had failed to recover $4,315,238 of these public funds during the review period (September of 2019 through April of 2021), and
(3) the investment appears to be inconsistent with the Charter School’s investment policy.

Additionally, the OSA notes that the recent recommendations and Corrective Action Plan of Bethel University as the Charter School’s authorizer appear reasonable and appropriate in light of the Charter School’s actions with respect to the Woodstock investment.1

Investigative Report

Background

The Charter School is a K-12 charter school subject to Minn. Stat. ch. 124E and certain statutes cited therein. As required by Minn. Stat. § 124E.06, subd. 2, the Charter School is organized as a nonprofit corporation.2 The Charter School is governed by the HCPA Board of Directors (Board of Directors).3

The Charter School was chartered by and operates under a charter contract with its authorizer, Bethel University (Bethel).4 The authorizer provides charter school oversight under Minnesota law. For example, Minn. Stat. § 124E.10, subd. 3(b), states “[a]n authorizer shall monitor and evaluate the

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1 This Investigative Report covers certain issues reviewed by the OSA. Nothing herein should be interpreted to imply the absence of other issues or approval of any act or transaction not mentioned.
2 According to the Minnesota Secretary of State’s Office, the Charter School first filed as a nonprofit corporation on February 7, 2003.
3 See e. g. Minn. Stat. §§ 124E.07, 317A.201 – 317A.257.
4 See Minn. Stat. §§ 124E.05, 124E.06, and 124E.10. See also, Charter School Contracts between Bethel University and Hmong College Prep Academy dated July 18, 2018, and June 17, 2020.
academic, financial, operational, and student performance of the school, and may assess a charter school a fee ....”5 The agreed-upon fee structure must be stated in the charter school contract.6

Minnesota law requires each charter school to have its financial statements audited annually; and the annual audits must be submitted to the Minnesota Department of Education, the charter school’s authorizer, and the OSA by December 31.7 In addition, “[t]he commissioner [of the Minnesota Department of Education], state auditor, legislative auditor, or authorizer may conduct financial, program, or compliance audits.”8

The Charter School’s Cash, Investments, and Revenue Sources

According to its audited financial statements, the Charter School’s cash and investments have grown over time from $5,498,585 at fiscal year-end 2015 to $12,163,187 at fiscal year-end 2019.9 The Charter School reports that the vast majority of its revenue (95% to 98%) comes from “State Sources” and “Federal Sources.”10

According to the Charter School’s response to information requests, it entered into a Limited Partnership Agreement with Woodstock Capital Partners, LP (the Partnership); and on September 10, 2019, the Charter School disbursed $5,000,000 as a capital contribution to the Partnership, per the capital contribution requirement of the Partnership Agreement.11

5 Bethel’s oversight responsibilities are described in the Charter Contract as follows: “Bethel shall monitor and evaluate the School’s academic, financial, operational, and student performance, including the School’s compliance with this Contract and Applicable Law.” For its part, “[t]he School agrees that, in the spirit of continuous improvement, Bethel may monitor and evaluate any indicator of academic, financial, operational, and student performance, including indicators not expressly set forth in this Contract, which shall inform Bethel’s evaluation of the School and the School’s continuous improvement plan.”
6 See Minn. Stat. §§ 124E.10, subd. 3(c); see also Minn. Stat. §§ 124E.05, subds. 3(a) and subd. 4(a), 124E.06, subds. 3(h) and 4(a). The charter contract between Bethel and the Charter School provides that, “[t]he School shall pay Bethel a fee for Bethel execution [sic] of its oversight responsibilities. The fee shall be the maximum fee provided by the Charter School Act...” See 2018 and 2020 Charter Contracts, Article III, section 3.2.
7 See Minn. Stat. §§ 124E.16, 123B.77.
8 Minn. Stat. § 124E.16, subd. 1.
9 See HMONG COLLEGE PREP ACADEMY CHARTER SCHOOL NO. 4103 FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION YEAR ENDED JUNE 30, 2015, 2016, 2017, 2018, and 2019. This does not include cash and investments held by trustee that, according to the Charter School’s notes to the financial statements, “consist of funds held by an escrow agent for the purpose of providing debt service payments on the Revenue Bonds used to obtain the site for the school as well as the construction and improvement of the school site.” The Charter School’s annual audit has been performed by a CPA firm.
11 Subscription Agreement, p. 1.
Delayed 2020 Audit Due to Investment

The Board of Directors meeting minutes dated December 16, 2020, document a discussion regarding “the status of the financial audit and Woodstock Capital Investment.” These minutes also note that the audit “progressed normally with the exception of documentation from Woodstock Capital Investments” and that the auditor requested certain documents and that “Woodstock Capital has not provided the requested documentation.”

The Board of Directors meeting minutes dated December 28, 2020, document that the Charter School’s auditors “will issue a delay of issuance...regarding the audit....”

Subsequent Board of Directors meeting minutes indicate some Charter School efforts to seek the return of funds from Woodstock Capital.12

The Charter School’s 2020 audited financial statements were filed with the OSA on June 1, 2021.13

Charter School Lawsuit Against Woodstock Capital, LLC, and its CEO

In June, 2021, the Charter School initiated a lawsuit against Woodstock Capital, LLC, and its CEO (the Defendants). In its Complaint, the Charter School states: “Defendants fraudulently induced HCPA into purchasing a limited partnership interest in the Woodstock Partnership in September 2019.”14

OSA Review and Findings

The OSA requested all Charter School documentation for the Woodstock Capital Investment referred to in the Charter School’s meeting minutes. The documents provided to the OSA by the Charter School included (1) a Limited Partnership Agreement of Woodstock Capital Partners, LP (the Partnership), dated July 27, 2018, (Partnership Agreement); (2) Subscription Documents, including a Subscription Agreement

12 The January 27, 2021, Board of Directors meeting minutes allege that documents were in the process of being drafted “to complete the transfer of funds” from “the Woodstock Capital Investment” and that “[t]he 2020 audit is complete pending the return of funds from Woodstock Capital.”
13 The Charter School’s auditors reported a material weakness in internal controls over investments and a Minnesota legal compliance finding for a disallowed type of investment for the year ended June 30, 2020, reporting that “the School has experienced significant...losses and wrote the investment down to the amount subsequently received...” See HMONG COLLEGE PREP ACADEMY CHARTER SCHOOL NO. 4103 SCHEDULE OF FINDINGS AND RESPONSES YEAR ENDED JUNE 30, 2020, as included in the HMONG COLLEGE PREP ACADEMY CHARTER SCHOOL NO. 4103 FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION YEAR ENDED JUNE 30, 2020, pp. 68 - 69.
14 Although we note this litigation, we will not comment further, as its substance and prospects are outside the scope of our review, and the litigation issues, regardless of how they are resolved, are unlikely to impact our findings in this report.
that sets forth a required contribution amount for HCPA as a limited partner, signed by the HCPA Board Chair; (3) a Confidential Private Placement Memorandum dated February of 2019 (Memorandum); and (4) communication between the CEO of the Partnership and the Charter School Superintendent.15

The OSA reviewed this documentation and other publically available documents, including the Partnership’s 2019 United States Securities and Exchange Commission Form D (Form D), used “by companies that have sold securities without registration under the Securities Act of 1933” to file the notice required by the federal securities laws.16

1. The Charter School’s $5,000,000 Investment did not Comply with Minnesota Law.

The Charter School disbursed $5,000,000 on September 10, 2019, to the Partnership, per the capital contribution requirement of the Partnership Agreement, which states, “Upon admission to the Partnership, each Limited Partner shall contribute Cash...in the amount set forth in such Partner’s Subscription Agreement.” The Subscription Agreement specified that the Charter School agreed to make a capital contribution of $5,000,000.17

Minnesota law permits the investment of public funds, such as funds of a charter school, only in securities that are generally considered to be among the safest available. The types of permissible investments for charter schools are specified in Minnesota Statutes. Minnesota Statutes, Section 124E.16, specifies that each charter school “is subject to and must comply with” specified Minnesota statutes “governing government property and financial investments,” including Minn. Stat. §§ 118A.04 and 118A.05 which pertain to investment restrictions for local government entities.18

Minnesota Statutes, Section 118A.04, limits the investment of public funds to a small list of safe debt securities, including those issued by the federal, state, and local governments, as well as highly rated commercial paper, fully insured certificates of deposit, and banker’s acceptances issued by U.S. Banks. Minnesota Statutes, Section 118A.05 provides additional investment options including money market mutual funds, repurchase agreements, and guaranteed investment contracts.19

Minnesota law does not authorize investment in limited partnership subscriptions, private equity placements, or hedge funds.

15 The Charter School Superintendent is listed in the Subscription Documents’ Investor Questionnaire as the Charter School’s Authorized Representative/Agent and as the individual “making the investment decision on behalf of the entity,” Investor Questionnaire, p. 3.
16 See https://www.sec.gov/smallbusiness/exemptofferings/formd.
17 Subscription Agreement, p. 1.
18 See Minn. Stat. § 124E.16, subd. 1. Officials are not personally liable for any loss sustained from funds invested according to Minn. Stat. §§ 118A.04 and 118A.05. See Minn. Stat. § 118A.02, subd. 2(b).
19 In contrast to these limited choices for local government entities, Minnesota law regulating public pension plan investments allows certain public pension plans to make equity, debt, and resource investments through limited partnerships and private placements. However, even a public pension plan’s use of these types of investments is highly restricted. See, Minn. Stat. §§ 11A.24, subd. 6, and 356A.06, subd. 7(h).
According to the Memorandum, “[t]he Partnership was organized as a Delaware limited partnership on July 27, 2018, to operate as a private investment partnership.” Woodstock Capital, LLC, a New Jersey limited liability company, is the general partner of the Partnership.

The Partnership Agreement states:

The Partnership is organized for the purpose of (i) investing substantially all of its assets in Woodstock Master Capital, Ltd., a Cayman exempted company limited by shares (the “Master Fund”) which will subsequently invest in Securities and (ii) engaging in all activities and transactions as the GP may deem necessary or advisable in connection therewith and doing such other lawful acts as the GP may deem necessary or advisable in connection with the maintenance and administration of the Partnership....

The Memorandum identifies the risks associated with the Partnerships’ investments and strategies, which include equity securities, options, derivatives, foreign securities, other private funds, leverage and margin transactions, short selling, and highly volatile instruments.

In its Form D, the Partnership characterized itself as a “Hedge Fund” that was not “registered as an investment company under the Investment Company Act of 1940” and its securities offered as “Pooled Investment Fund Interests.”

These characterizations of the investment further show that this investment in Woodstock Capital Partners, LP, was not in compliance with Minnesota law governing permissible charter school investments.

In a letter to Superintendent Hang dated September 6, 2019, the CEO of Woodstock stated:

The Fund will invest in US Government Bonds and Short-Term interest rate debt securities, which are very liquid. The fund may also, if opportune, invest in European government bonds with an equivalent, or higher rating than US Government bonds. The Fund will concentrate on benchmark 10-year US bonds as well as Short-Term Notes and interest rate products with the aim of diversification towards lower risk and consistent returns. The Fund will focus on buying these debt securities at discounts through regulated markets and identify, purchase, and hold positions that will reap consistent profits throughout the year. These securities can be held, or sold, for optimal risk management.

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20 Partnership Agreement, § 1.05.
21 Memorandum, pp. 19–25.
The fund, through its affiliations with liquidity providers, will also extend and provide liquidity to banks and Broker Dealers and earn a percentage of the liquidity that it provides for this service.22

Minnesota law does not permit a charter school to invest in “European government bonds” or “interest rate products.” Further, although a Minnesota charter school may invest in some short-term debt instruments, the broad category of “Short-Term notes” without further restriction would include many notes not permitted as investments for a Minnesota charter school.

2. The Charter School Has Not Been Able to Recover Invested Public Funds.

a. Partnership Statements

The Charter School provided the OSA copies of statements relevant to the Partnership that appear to have been provided to the Charter School by third-party administrators, Circle Partners and SS&C GlobeOp.23 Because these statements do not provide any information about the underlying investments, the OSA makes no representations regarding the reliability or accuracy of these statements. Nevertheless, the OSA observed that the statements provided by Circle Partners reported beginning and ending capital balances, contributions and withdrawals, certain fees, and a line item called “Income Allocation.” The OSA observed that the statements provided by SS&C GlobeOp reported Opening and Closing Market Value of an Account, Subscriptions, Redemptions, Transfers to Capital, and an “Increase/(Decrease) in Market Value.” The following chart shows the alleged capital balance or market value of this investment according to these statements.

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22 There is also a Confidential Side Letter Agreement, dated October 21, 2019. The October 21, 2019, Confidential Side Letter Agreement states that it “modifies the Performance Allocation attributable to [the Charter School’s] capital Account under Section 3.02(b)” of the [Partnership Agreement].”

23 According to its web site, Circle Partners is an independent fund administrator. The Charter School provided the OSA copies of a statement from Circle Partners for February and March of 2021, and November and December of 2020. According to its web site, SS&C GlobeOp is a hedge fund and private equity administrator. The Charter School provided the OSA copies of SS&C GlobeOp statements for each month beginning September of 2019 through October of 2020.
According to these documents, as of March 31, 2021, the Charter School’s ending capital in the Partnership totaled $705,291.

b. Requested withdrawals and amounts returned

As a “Partner in the Partnership and, pursuant to Section 4.01(a) of the Partnership Agreement,” the Charter School requested to withdraw $50,000 and $722,205.36 on November 13, 2019, and April 8, 2021, respectively.24

The Charter School’s 2020 audited financial statements indicate that the investment was valued at the amount that was ultimately returned to the Charter School.25 Upon request, the Charter School informed the OSA that it received a total of $684,762 from Woodstock; $50,000 in November of 2019 and $634,762 in April of 2021.26 The Charter School recognized a loss in 2020. The OSA finds that during the review period (September of 2019 through April of 2021), the Charter School has not been able to recover $4,315,238 ($5,000,000 - $684,762) of the public funds disbursed to the Partnership.

24 See APPENDIX A – FORM OF REQUEST FOR WITHDRAWAL signed November 13, 2019, and April 8, 2021.
25 The Charter School disclosed, in its notes to the financial statements that, “The School entered into a $5,000,000 unallowed investment in a hedge fund during the year. The hedge fund managers did not provide sufficient information from which to value the investment at year end...This was not a rated investment and no required disclosure information is available. For financial statement purposes the fair value was measured at the amount that was ultimately returned to the School since there was insufficient information available with which to estimate the value other than the ultimate amount returned...subsequent to year end.” See HMONG COLLEGE PREP ACADEMY CHARTER SCHOOL NO. 4103 FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION YEAR ENDED JUNE 30, 2020. The OSA does not attest to the accuracy of this information.
26 In an email to its attorney, the Charter School explained the amount returned as follows: “Woodstock returned $634,762 (which was 90% of $705,290.83 – per the March 30, 2021 Statement from Circle Partner). Circle Partner said after the Woodstock Audit for FY20 is completed, they would release the other 10% hold back.”
3. The Investment in the Partnership Appears to be Inconsistent with the Charter School’s Investment Policy.

The Charter School provided the OSA a copy of its investment policy. The first objective of the Charter School’s Investment Policy is stated as follows:

Safety of Principal - Investments shall be undertaken in a manner that seeks to ensure the preservation of principal in the overall portfolio. To attain this objective only appropriate investment instruments will be purchased and insurance or collateral may be required to ensure the return of principal.

In contrast, “The Partnership’s investment practices, by their nature, involve a substantial degree of risk,” according to the second paragraph of the Memorandum.

Further, as noted above, the Memorandum identifies the risks associated with the Partnership’s investments and strategies which include equity securities, options, derivatives, foreign securities, other private funds, leverage and margin transactions, short selling, and highly volatile instruments.27

The Memorandum goes on to state: “The Partnership is a recently formed entity and has no operating history upon which prospective investors can evaluate its likely performance,” and “[a] Limited Partner could incur substantial, or even total, losses on an investment in the Partnership. An investment in the Partnership is only suitable for persons willing to accept this high level of risk.” (Emphasis added.)28

In addition, the Subscription Agreement contains representations and warranties by the Charter School including, “[t]he undersigned has evaluated the risk of investing in the Partnership and is acquiring the Interest based only upon its independent examination and judgment as to the prospects of the Partnership as determined from information obtained directly by the undersigned from the Partnership or its authorized representatives. The undersigned understands that an investment into the Partnership may result in a substantial or total loss of capital” and “[t]he Partnership is an investment that involves a high degree of risk and the undersigned can sustain a substantial loss of this investment in the Partnership. The undersigned is willing to bear the economic risk of investment in the Interest for the period of time stipulated in the withdrawal provisions of the Partnership Agreement.” (Emphasis added.)

Given the high level of risk associated with the Partnership, it is not an investment consistent with the Charter School’s policy objective of ensuring preservation of principal nor is it an appropriate investment for public funds.

27 Memorandum, pp. 19 – 25.
28 Memorandum, p. 28.
4. Authorizer’s Oversight Actions.

After reviewing the Woodstock investment and other issues, the Charter School’s Authorizer, Bethel University, provided to the Charter School (1) the Final 2020-2021 HCPA Annual Assessment Rubric and Summary, (2) a timeline related to the Woodstock investment, (3) a Corrective Action Plan, and (4) an August 30, 2021, letter.

The letter summarizes the Authorizer’s conclusions and directives as follows:

   - The HCPA Board be led by a board member who is not a HCPA employee.
   - The HCPA Board terminate the current superintendent and fill the position with a highly qualified candidate with no prior connection to the HCPA,
   - The HCPA Board hire an outside board consultant, whose qualifications are reviewed and approved by Bethel as authorizer, to fulfill the roles outlined in the corrective action plan.

The letter notes that HCPA has qualified for Authorization Level 3, which according to Bethel’s Charter School Handbook, indicates “Notice of Probationary Status,” the metric for which is described as:

   - Continued failure to meet performance targets; and failure to meet objectives of School Improvement and Corrective Action Plan.
   - Continued failure to comply with applicable law or with the charter.31

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29 Bethel University | Education Department 2020-2021 HCPA ANNUAL ASSESSMENT RUBRICKS Final 2021.8.24.
31 Bethel University Education Department CHARTER SCHOOL HANDBOOK (Revised 2020.2), p. 15.
The Corrective Action Plan includes the three recommendations quoted above. It sets forth the following actions in the area of Fiscal Management – Budget and Finances:

- Create a new and separate finance/CFO job to remove direct finance responsibilities from the superintendent position (to be completed within 90 days of notice);
- Hire a financial consultant that reports directly to Bethel, as authorizer, to review all HCPA finances and provide monthly reports to the Bethel Charter Oversight Committee for the next 12 months (monthly, to begin within 30 days of notice);
- Provide monthly updates to Bethel Charter Oversight Committee regarding progress on implementing the Corrective Action Plan mentioned in Single Audit Report/UFARS (monthly, to begin within 15 days of notice);
- Implement two-person authorization at financial institutions for electronic transfers such as wires and ACH transfers (to be completed within 30 days of notice);
- Require auditor to include Bethel, as authorizer, on any board communications (to be completed within 30 days of notice); and
- Conduct an independent audit of financials and recommendations for improvements [implement audit FY22, and improvements in FY23 (to begin within 90 days of notice).

These recommendations and Corrective Action Plan appear reasonable and appropriate in light of the Charter School’s actions with respect to the Woodstock investment.

**Conclusion**

Based on a review of the documents provided by the Charter School, the OSA concludes that (1) the Charter School’s $5,000,000 investment did not comply with Minnesota law regarding permissible investments of public funds, (2) the Charter School has not been able to recover $4,315,238 of these public funds during the review period (September of 2019 through April of 2021), and (3) it appears the Investment is not consistent with the Charter School’s investment policy. The OSA also views the recommendations and Corrective Action Plan of Bethel University as authorizer to be reasonable and appropriate measures for the Charter School to implement in order to address the issues noted in our review.

Because the Woodstock investment did not comply with Minnesota law regarding permissible investments of public funds, this Investigative Report has been filed with the County Attorney pursuant to Minn. Stat. § 6.51, which states, in part, “[i]f such report disclose malfeasance, misfeasance, or nonfeasance in office, the state auditor shall file such copy with the county attorney of the county in which the administrative offices of the political subdivision are located, and the county attorney shall institute such proceedings as the law and the public interest require.”