



Henry Johnson Charter School Financial Operations

Report of Examination

Period Covered:

July 1, 2012 — April 30, 2014

2014M-214



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2014

Dear School Officials:

A top priority of the Office of the State Comptroller is to help charter school officials manage school financial operations efficiently and effectively and, by so doing, provide accountability for moneys spent to support school operations. The Comptroller audits the financial operations of charter schools outside of New York City to promote compliance with relevant statutes and observance of good business practices. This oversight identifies opportunities for improving school financial operations and Board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard school assets.

Following is a report of our audit of the Henry Johnson Charter School, entitled Financial Operations. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Section 2854 of the New York State Education Law, as amended by Chapter 56 of the Laws of 2014.

This audit's results and recommendations are resources for school officials to use in effectively managing financial operations and in meeting the expectations of the taxpayers. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

A charter school is a public school, financed by local, State and federal resources, that is not under the control of the local school board and is governed by New York State Education Law Article 56. Charter schools have fewer legal operational requirements than traditional public schools. Many of a charter school's operational requirements are contained in the entity's by-laws, charter agreement and financial management plans, which are part of the charter school application. The Henry Johnson Charter School's (School) current charter was issued in January 2012.

The School is located in the City of Albany and is governed by a Board of Trustees (Board), which comprises eight members. The Board is responsible for the general management and control of the School's financial and educational affairs. The Principal of the School (Principal) is the School's chief executive officer and is responsible, along with other administrative staff, for the School's day-to-day management under the Board's direction. The Business and Operations Manager is the chief accounting officer and is responsible for maintaining custody of, depositing and disbursing School funds; maintaining financial records; and preparing monthly and annual financial reports.

During the 2013-14 school year, the School had 365 students in kindergarten through fourth grade and 59 employees. The School's 2013-14 fiscal year budgeted expenses were approximately \$5.7 million, funded primarily with revenues derived from resident pupil tuition billings¹ and State and federal aid. The School contracts with a not-for-profit foundation (Foundation) for various services. The Foundation provides start-up grants, School facilities, a revolving loan fund and technical assistance to a number of charter schools.

Objective

The objective of our audit was to evaluate the effectiveness of the School's compact² contract with the Foundation. Our audit addressed the following related question:

- Did the School receive all the services from the Foundation as outlined in the compact agreement and is the fee structure of the compact agreement reasonable?

¹ The School bills local school districts tuition charges to provide educational services to students residing in the respective districts.

² An official contract or formal agreement between two or more parties

**Scope and
Methodology**

We reviewed the School's relationship and contracts with the Foundation for the period July 1, 2012 through April 30, 2014.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix B of this report.

**Comments of
School Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with School officials and their comments, which appear in Appendix A, have been considered in preparing this report. School officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Secretary's office.

Compact Contract

Charter schools require a number of services to adequately conduct business. A school can choose to obtain these services by having an employee perform the service or contracting with an independent service provider. Ultimately, it is the responsibility of a charter school's board of trustees to choose a method that provides the school with the required services in the most efficient manner possible. When contracting for services, a school should enter into a written agreement before the services are rendered. The agreement should provide both parties with a clear understanding of the nature and extent of the services to be rendered, provide for a means to measure and monitor service quality and establish a reasonable level of compensation for those services.

The School signed a compact agreement with the Foundation in December 2012 and then entered into a revised three-year compact agreement with the Foundation in June 2013, which is still current. The revised compact does not describe in detail the services that the Foundation will provide. For example, according to the compact, the Foundation "may" provide professional development services, teacher evaluations, external marketing assistance and financial consulting services. When asked to describe the specific services being provided to the School, the Board Chairman stated that the School receives access to educational software, recruiting services, management services, website design development services and other services.

The fee for these services is one percent of total pupil revenue for the 2012-13 fiscal year, one and a half percent of total pupil revenue for the following year, and two percent for the contract's final year. The Business and Operations Manager stated that the Foundation provided services to the School for the entire 2012-13 fiscal year, which started before the original compact agreement was entered into. The total fees due to the Foundation for the 2012-13 and 2013-14 fiscal years were \$52,631 and \$80,645, and at the current rate,³ the fee may be more than \$107,000 for the final year. The increase in the fee percentage over the course of the compact places an increasing financial burden on the School.

As a result of the insufficient detail about the exact services provided, we reviewed the School's expenses to determine if there were services to which the School was entitled to receive from the Foundation that were being provided by another contractor. We found that the

³ The current rate refers to 2 percent of the total pupil revenue for the contract's final fiscal year (2014-15).

School contracted with a consultant to provide recruiting services for the hiring of a Principal and three teachers during the Spring and Summer of 2013. The Board Chairman stated that, if the Board believes another vendor can better provide certain services, the Board has the flexibility to receive those services through that vendor. The School incurred \$14,305 in additional costs by paying the consultant for services that the Board Chairman told us were available from the Foundation.

We reviewed the compact agreement and could not determine how the quality of the services provided would be measured because the compact was insufficiently detailed. Therefore, School officials do not have a means to determine whether the School received an adequate level of services to justify the fees it paid to the Foundation. The fee structure, based on a percentage of per pupil revenue, does not appear to be reasonable, as the services being provided do not have any relationship to the number of students at the School or the Charter School Basic Tuition rate.⁴ The fee structure was established by the Foundation and increases as a means to expand the services provided to the members of the network.⁵

When the School enters into contracts that do not provide sufficient detail about the services being provided, and do not have a reasonable fee structure, the School is susceptible to incurring costs that are greater than necessary for the services it receives.

Recommendations

The Board should:

1. Ensure that contracts with the Foundation are signed prior to the start of the contract period covered and contain adequately detailed descriptions of the nature and extent of the services to be rendered and the means of measuring and monitoring service quality.
2. Ensure that contracts with the Foundation have reasonable fee structures based on the measurable value of the services provided.
3. Determine if there is a more cost-effective means to receive the desired services currently available from the Foundation.

⁴ The amount that a school district is required by law to pay to a charter school for each student enrolled in the charter school who resides in the district

⁵ The Foundation has established a network of charter schools, located in the City of Albany, to facilitate various activities on behalf of the members of the network who have entered into the compact.

APPENDIX A
RESPONSE FROM SCHOOL OFFICIALS

The School officials' response to this audit can be found on the following pages.



Building Character...Achieving Excellence

October 21, 2014

Office of the State Comptroller
Andrew A. SanFilippo, Executive Deputy Comptroller
Division of Local Government and School Accountability
110 State Street, 12th Floor
Albany, NY 12236

Dear Mr. SanFilippo:

The Board of Directors has reviewed the draft report of your examination of the financial operations of Henry Johnson Charter School. We embrace the need for academic and financial accountability as a key element of a successful charter school. The Board therefore takes seriously the responsibility of managing a budget in excess of \$5 million. We appreciated your very thorough review of our fiscal operations and are encouraged that it yielded such limited recommendations.

The audit addressed the compact agreement with the Brighter Choice Foundation to achieve high-quality instruction and operations at our school. It is commonplace for school districts, private schools and charter schools alike to utilize educational service providers in the areas of curriculum design and consulting, student benchmarking and performance, staff professional development, legal services and board governance training, financial management, accounting, human resources, strategic planning and regulatory affairs. As noted in the report, it is the responsibility of the Board to choose a method of delivery that provides the school with the required services in the most efficient manner possible and we believe that our relationship with the Foundation has met that standard.

The Foundation has supported the school since it's inception, managing the real estate development process to renovate and ready the school building for occupancy. In the years following, the Foundation would add legal support as well as state and local advocacy. By 2011, the school and Foundation recognized the mutual benefits of a more formal arrangement for on-going services to ensure the long-term success of the school. The spirit of the relationship was not intended to be purely transactional, as with an attorney or consultant. Rather, it was intended to be a partnership where both parties are pursuing the same goal of academic and operational excellence on behalf of the capital region's students and their families.

As the school matured, we recognized the need for additional services such as professional development for teachers, business managers, principals and board members. With this information, the Board signed an amended and expanded compact agreement in 2013 to provide more clarity to the relationship. This document outlined numerous goals and objectives under this arrangement, with specific activity areas for the Foundation to pursue on behalf of the school. The current agreement expires at the end of the 2014-2015 school year, and we are working with the Foundation to develop an updated agreement to continue this relationship.

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The new agreement will include additional detail about responsibilities of both the school and the Foundation to ensure effective academic and financial operations. The Board will ensure the Foundation documents the impact of their support to more effectively monitor the quality of services provided.

In the past two years, the Foundation has more than doubled the size of their staff and scope of services available to our school. For example, recruiting services were not available from the Foundation in the summer of 2013 so the Board engaged an external consultant for support. In the summer of 2014, the Foundation was staffed to provide recruiting services and conducted a nation-wide search to find our current Principal. This growth in Foundation service offerings was designed to correspond with the gradual increase in fees, which allowed the school to better afford the cost of these services.

The Board also recognized that the need for support services increases with every new student the school enrolls, as does the relative need for classrooms, teachers, administrative staff, etc. We determined that acquiring these services from individual providers (attorneys, educational consultants, assessment services, marketing consultants, etc.) was not the most efficient and cost-effective solution. A review of more comprehensive charter school educational service providers showed a standard fee structure based upon per-pupil revenues, at a range of 1% to 12% depending on the level of service and degree of management provided. Given these comparisons, the Board determined that the Foundation's 1% to 2% per-pupil revenue fee structure was the most reasonable method of obtaining these services on a gradually increasing scale. This arrangement also allows the school some relief should enrollment and revenues decline.

The Board has carefully monitored the level of service provided by the Foundation and believes that the school has benefited greatly from this partnership. We are satisfied that the Foundation has complied with the terms and the spirit of the contract to strengthen our school. We also determined that this was a relatively cost-effective method of acquiring the necessary support services for the school.

Thank you for this opportunity to participate in this review process and respond to your recommendations.

Michael Strianese
Board Chair

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard School assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services.

During the initial assessment, we interviewed appropriate School officials, performed limited tests of transactions and reviewed pertinent documents such as the School's charter, financial policies and procedures manuals, Board minutes and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the School's financial transactions as recorded in its databases. Further, we reviewed the School's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We then decided upon the reported objective and scope by selecting for audit areas that appeared to have weak controls in place. We selected compact contracts for further audit testing.

To accomplish our audit objective and obtain valid audit evidence, our procedures included the following steps:

- We reviewed compact contracts, Board minutes and invoices, and we interviewed School officials to determine the contract terms.
- We judgmentally selected expense codes where services outlined in the compact contract would be recorded. Next, we reviewed all claims for the expenses for the selected codes to determine what services were provided and whether the services should be provided by the Foundation as part of the compact contract. The codes selected were recruitment/marketing, advertising, accounting-outsourcing, consultants, Board expenses, and legal and attorney fees. Next, we totaled all payments to a consultant who provided recruitment services.
- We reviewed Board minutes to determine when the Board approved the compact contract and which Board members were present at the Board meeting when the compact contract was approved.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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