Office of the New York State Comptroller

Division of Local Government & School Accountability

True North Rochester Preparatory Charter School

Contract Management

Report of Examination

Period Covered:

July 1, 2011 — August 13, 2013

2014M-73

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

July 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 financial operations of the True North Rochester Preparatory Charter School, entitled Contract Management. This audit was conducted pursuant Article V, Section 1 of the State Constitution. The audit was commenced under the State Comptroller's authority as set forth in Section 2854 of the Education Law as amended by Chapter 101 of the Laws of 2010, and completed under the Comptroller's authority as set forth in section 2854 of such law as amended by Chapter 56 of the Law 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 taxpayers, students and their parents. 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 under Education Law Article 56. Charter schools have fewer legal operational requirements than traditional public schools. Most of the charter school's requirements are contained in its bylaws, charter agreement, the fiscal/financial management plans, and the *Financial Oversight Handbook* for those schools that are authorized by the State University of New York (SUNY).

The True North Rochester Preparatory Charter School (School), located in the City of Rochester, is governed by the Board of Trustees (Board) which comprises nine members. The School contracts with a charter management organization (CMO) for overall financial management and bookkeeping services. The Board appoints a Principal, who is responsible, along with the Director of Operations and other administrative staff, for the day-to-day management of the School under the direction of the Board.

The School was established in 2006 under SUNY authorization and provides education to approximately 670 students in kindergarten through third, and fifth through eighth grades. The School's total expenditures for the year ended June 30, 2013 were approximately $8.86 million.[1] These expenditures were funded primarily with revenues derived from billing area school districts for resident students and from certain State and Federal aid attributable to these students.

Objective

The objective of our audit was to review the Board's oversight of management contracts. Our audit addressed the following related question:

- Did School officials properly manage the School's management contract with the CMO?

Scope and Methodology

We reviewed the School's management of the CMO contract for the period July 1, 2011 through August 26, 2013.[2]

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such

[1] According to unaudited profit and loss statement provided by the CMO

[2] Because our audit of the CMO management contract included a review of building leases, we note that leases covering our audit period were entered into prior to our audit scope date. The Ames Street building lease was dated March 2, 2010 and the Brooks Avenue building lease was originally dated July 1, 2006.

standards and the methodology used in performing this audit are included in Appendix C 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 disagreed with certain findings in our report. Our comments on issues School officials raised in their response are included in Appendix B.

The Board has the responsibility to initiate corrective action. We encourage the Board to prepare a plan of action that addresses the findings and recommendations in this report, and to forward the plan to our office within 90 days. For more information on preparing and filing your Corrective Action Plan (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 Board Clerk's office.

Contract Management

Best practices for managing contracts include negotiating their terms and conditions (e.g., deliverables and consideration), ensuring compliance with the terms and conditions, and documenting any agreed upon changes that may arise during its implementation or execution. To effectively monitor a contract, officials must understand the contract, including the specific contract obligations.

The Board entered into a contract with a charter management organization (CMO) to provide management services through a memorandum of understanding (MOU). The MOU specifies the management fee that the School pays annually to the CMO; this fee for the 2012-13 fiscal year was $695,028. The School also reimbursed the CMO over $300,000 for expenses paid by the CMO that were in addition to the management fee. The School also paid $396,406[3] to a wholly-owned subsidiary of the CMO for the lease of its school facilities. We identified significant concerns with the lack of detail contained in the MOU. Without clear and concise contract language, the School does not have a firm agreement detailing what services are included. If the School is paying for expenditures that should be covered by the management services agreement, it will have fewer funds to improve operations, add schools or to spend on student education. The absence of a clear and unambiguous contract increases the likelihood that taxpayers have paid for goods and services that have not been received.

Included in the MOU is a listing of "Duties and Obligations" to be provided by the CMO in exchange for a service fee. This listing, contained on just over one page, outlines the services the CMO is to provide to the School. We found this listing to be vague and insufficient to provide a clear understanding of exactly what the CMO would be obligated to provide to the School in exchange for the management fee. For example, one item states "recruiting the Principal, teachers, and administrators" but does not define or give any detail as to what "recruiting" means. Similarly, other items state "providing professional development for teachers" and "providing payroll and bookkeeping services" but do not provide specifics on how the CMO will provide such services.

In addition, though the MOU does expand on some of the items outlined, in most cases we found this offered little clarification. For example, the MOU states that the CMO will conduct fundraising

[3] Rent expense incurred for the years ended June 30, 2013 and 2012 was $191,711 and $204,695, respectively.

activities and that the funds raised will be used to support the School. However, it does not provide details regarding specific fundraising activities that it will conduct or how much funds it anticipates raising through these activities. Because of the lack of details contained in the MOU, we also reviewed certain related contracts (such as leases), and spoke to senior CMO staff and School officials to determine what the CMO would provide the School for the fees charged.

We met with the Directors of Operations (DOs) of the two school buildings. The DOs are responsible for approving all School expenditures for their respective buildings which included reimbursements totaling $300,000 during the 2012-13 fiscal year for expenses determined not to be covered by the MOU. The MOU is the basis for determining what items should be included in the service fee and which items are additional expenses. While the DOs agreed that they felt confident concerning what is a School expense and what items should be paid for by the CMO, the DOs did not claim to base their knowledge on the MOU but instead based it on the training provided to them by the CMO. By basing their disbursement decisions on training provided by the very organization that will benefit from these disbursements – rather than on a detailed contract outlining agreed-upon expenses – the DOs are at risk of expending School funds unnecessarily.

We spoke to officials from the School and the CMO about specific contract terms that we believed were vague to determine if there was a consistent understanding of the terms. We found that understanding of the terms was inconsistent among School and CMO officials, as discussed in further detail below.

<u>Facility Maintenance, Repairs and Major Repairs</u> – The MOU does not contain specifics regarding facility maintenance and repairs; it simply states, "Finding and/or maintaining an adequate facility and coordinating financing and the completion of major repairs." Since this language appeared vague, we asked the DOs what "major repairs" meant to them; they told us that the School acts as owners of the leased buildings and the School is responsible for all repairs and improvements. However, one DO told us that the CMO may help to cover the cost for an unexpected major item that was not budgeted for. For example, she said that a few years ago, the CMO helped to cover the cost when the middle school roof needed to be repaired because it was unexpected, costly and not budgeted for. When we posed the same question to members of the Board, they told us that the CMO just manages the buildings' operations and does not pay for direct costs including those for maintenance or repair. If one of the buildings needed a new roof, the CMO would help with the decisions and with obtaining a contractor; however, the School would be responsible for

all costs associated with the repair or replacement of the roof. Board members further stated that, if the CMO did pay for any part of the repair, it was as a charitable contribution on the CMO's part and not because of a contractual obligation.

There was no additional guidance to define "major repairs" in the MOU. Therefore, we reviewed the lease contracts that the School entered into with the landlord, which is a wholly-owned subsidiary of the CMO. The lease contracts contain substantially more detail than the MOU. The lease for the middle school was originally entered into on July 1, 2006 and states, "Landlord shall maintain and make all necessary repairs and replacements to structure and exterior, including roof and walls. Landlord is responsible for capital repairs and replacements to common areas, parking lots, landscaped areas, utility systems and HVAC."[4] Based on the middle school lease, it appears that the landlord should have been solely responsible for the repair of a roof. We also found that the School made transfers to the CMO for maintenance and HVAC items that should have been covered by the landlord based upon the lease language. For example, the 2012-13 expense report shows that the middle school paid $19,486 for building repairs, $3,747 for plumbing and $2,349 for HVAC services.

Recruiting the Principal, Teachers and Administrators − Despite being listed as a CMO responsibility, the School spent $29,800 for "staff recruitment" during the 2012-13 fiscal year. School officials stated that the CMO does not pay for travel or advertising for candidates, and to fulfill the "recruiting" portion of the MOU, the CMO provides "name recognition" because it is a nationally known charter management company, which results in a supply of qualified applicants from all over the United States.

Training and Evaluating the Principal, and Providing Professional Development for Teachers − The DOs and CMO officials both stated that, early in their relationship, the CMO paid all costs associated with training principals. After principals were trained, the CMO decided it would be better to provide training to the teachers. However, since there are so many more teachers than principals, the travel costs associated with training would be paid for by the School. Officials from the CMO stated that the MOU is not a service level agreement and is just an outline for what services the school can expect to receive from the CMO. Each year, after receiving feedback from the DOs, the CMO issues written guidance providing clarification and changes as to which services will be covered that year. For example, CMO officials gave the DOs a memorandum related to professional

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[4] HVAC stands for Heating, Ventilation, and Air Conditioning.

development that noted changes to how the CMO will provide professional development. Included with the changes were bullets that the CMO "pays for the costs related to content development for teacher training." It also stated that "Schools pay all costs related to the delivery of teacher trainings, whether at the school, region or organizational level." The CMO would incorporate the changes included on these memorandums in the budgeting information given to the DOs which becomes the basis for the School's budget. CMO officials believe that the Board's approval of the budget is also considered to be approval for these changes to the MOU. This assumption lacks transparency and can lead to confusion because the MOU is not in agreement with actual practices.

<u>Providing Payroll and Bookkeeping Services</u> − Payroll processing services are provided to the School through a third party contractor selected by the CMO. The School paid $5,620 to a third party payroll processor for services provided for the fiscal year ended June 30, 2013 which should have been paid for by the CMO. The CMO's decision to assign its responsibility to provide these services to a third party should not have resulted in an additional cost burden to the School. CMO officials indicated that the MOU means that the CMO is responsible for selecting the third party vendor; however, the School is still responsible for paying for the service. This appears contrary to the MOU language. When we discussed this section of the MOU with Board members, they agreed that the MOU might not be as sufficiently detailed on this issue as it should be.

School officials entered into a MOU whereby the School will annually pay a CMO nearly $700,000 for services and an additional $300,000 for expenses. This vague contract does not clearly define each party's responsibilities and allows one party − the CMO − to train the DOs, who are responsible for overseeing the School's interests in the contract. The lack of clear contract language and independence between the parties does not ensure that the School is receiving the best value for the moneys paid.

Recommendations

1. The Board should negotiate written agreements that contain clear language and thoroughly detail each party's rights and responsibilities. Negotiated agreements also should include schedules that set timeframes for deliverables. Material changes to written agreements should be supported by addendums that have been properly authorized.

2. School officials should ensure that they are receiving all services and benefits stipulated in the contract and are paying only for those stipulated services.

APPENDIX A

RESPONSE FROM SCHOOL OFFICIALS

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

Uncommon Schools | ROCHESTER PREP

June 18th, 2014

[redacted]
Division of Local Government and School Accountability

Office of the State Comptroller
The Powers Building
16 West Main Street - Suite 522
Rochester, New York 14614

[redacted]

We have reviewed the Report of Examination issued at the conclusion of the Office of the State Comptroller's audit of True North Rochester Preparatory Charter School- Brooks and Jay Campuses (Rochester Prep), and are pleased to note that the audit found no deficiencies in controls in the areas of general governance, financial oversight and condition, cash receipts and disbursements, purchasing, payroll and information technology and that we have sufficient systems of controls to limit risk exposure in these areas.

The objective that the audit identifies is listed in the report as being: "Did school officials properly manage the School's management contract with the CMO?"

Rochester Prep contracts with Uncommon Schools, a non-profit CMO, to provide a wide variety of services instrumental to the day-to-day operations of the school. Uncommon Schools currently manages 36 other schools across New Jersey, New York and Massachusetts, including 2 others in Rochester. These schools are consistently recognized as being among the best public schools in their respective geographies, despite having student populations that are consistently among the most at-risk in their communities. Uncommon Schools was also recently awarded the Broad Prize in recognition of its success as a CMO, particularly in reversing the effects of poverty on student achievement.

Rochester Prep and Uncommon Schools take very seriously not only their commitment to student success but also to the highest-quality operations, including fiscal and other controls and procedures.

The SUNY Charter Schools Institute (CSI), which issues Rochester Prep's charter in 5-year terms, oversees and authorizes Rochester Prep's ongoing operations. A portion of this oversight includes review and approval of the Memorandum of Understanding (MOU) between Rochester Prep and Uncommon Schools. CSI has reviewed and approved this MOU, which is almost entirely identical to others in force between Uncommon Schools and other New York State charter schools. These other MOU's, each of which also has CSI approval, have been reviewed on at least two other occasions as part of other OSC audits and received no criticism.

See Note 1 Page 13

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Rochester Prep Middle School - West Campus
1020 Maple Street
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T: 585 368 5090
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www.rochesterprep.org

In addition, counsel for both Rochester Prep and Uncommon Schools has also reviewed and approve the MOU on multiple prior occasions.

The specific criticism from the Office of the State Comptroller seems to be that the MOU is not sufficiently specific in order to allow school officials to ensure that they are "getting what they pay for" when it comes to the contracted services provided by Uncommon Schools. It is important to note that no school official nor the Rochester Prep Board of Trustees has raised any concerns about the type, amount or quality of services provided by Uncommon Schools to Rochester Prep.

Further, the type and degree of detail suggested by the OSC audit team would require a "service level agreement" outlining in great detail each activity, sub-activity and responsibility of any service provided by the MOU. This level of detail is simply impractical because the MOU must be flexible enough to accommodate changing circumstances throughout the 5-year charter term. For example, Uncommon Schools provides fundraising support to Rochester Prep. Since Rochester Prep's inception, the need for fundraising support has varied, from zero to over $1M. Because our schools are self-sustaining on an operating basis, fundraising is primarily related to expansion activity. When our schools are growing, we need fundraising support. When they are mature, they require little if any. Identifying specific goals, activities, owners and timeline for each year of a five-year contract for such a varying need would be counterproductive, especially in light of the fact that there are over 20 separate areas in which Uncommon Schools provides support to Rochester Prep.

Notwithstanding the impracticability of creating a service-level agreement, concurrent with a pre-existing review and amendment of the MOU, Rochester Prep's Board of Trustees has approved and plans to adopt changes that are intended to address some of the lack of clarity identified by the OSC audit team:

- "Fundraising" has been changed to *"Fundraising support as needed"*
- "Providing payroll and bookkeeping services" has been changed to *"Coordinating payroll and providing bookkeeping services"*
- This additional language was also added to the MOU:

> *USI shall be responsible for any and all travel, travel-related and incidental expenditures incurred by USI employees in the delivery of the above noted services. Rochester Prep shall be responsible for all travel, travel-related and incidental expenditures incurred by Rochester Prep employees. Travel, travel-related and incidental expenditures incurred by prospective Rochester Prep employees during the interview process shall be the responsibility of the School once it has been established that said employees are primarily interested in employment in the Rochester NY region as opposed to elsewhere within the USI school network.*

The OSC audit team also made assertions relating to specific school activities which were used as evidence, we believe erroneously, to support a claim that school officials were not properly managing the contract with Uncommon Schools:

See Note 2 Page 13

- Facility maintenance and major repairs: The roof repair referenced in this section was necessitated by an unapproved addition to the building. The repair was paid for in full by the school in full alignment with the lease terms.
- Recruiting the Principal, teachers and administrators: Uncommon Schools provides a dedicated staff person, based in Rochester, whose salary is entirely paid for by Uncommon Schools, to provide recruitment support specifically for Rochester Prep schools. The funds cited as having been paid by the school actually pertained to candidate travel, an expense not related to recruitment but to hiring.

- Training and evaluating the principal and providing professional development for teachers: Uncommon Schools provides and pays for professional development for both Principals and Directors of Operations. It also offers centralized Professional Development opportunities for teachers at different points during the year and in different subject/content areas. These trainings are developed by Uncommon Schools at its own expense. When these sessions are offered in locations other than Rochester, Rochester Prep's staff and teachers need to travel in order to participate. Rochester Prep pays for their travel expense. However, Uncommon Schools assumes all expenses for the Professional Development content, materials and delivery. At no point, as the report states, did Uncommon decide that "After principals were trained... it would be better to provide training to the teachers. However, since there are so many more teachers than principals, the travel costs associated with training would be paid for by the School."

Uncommon Schools and Rochester Prep work in close partnership not only to ensure that students receive the highest-quality education, but also to guarantee that both parties are faithful stewards of public funds. This is especially important considering that Rochester Prep, like other charter schools, receives only a fraction of the public funding available to other public schools. This, combined with a commitment to the highest-quality operations and constant improvement, results in a significantly lower than average spending on administrative services and fees, including those fees paid to Uncommon Schools for support services governed by the MOU. Uncommon Schools' support allows Rochester Prep to not only spend less on "overhead" and "administration" but also to focus on teaching and learning. We strongly believe that the MOU is not only appropriate, as has been established by repeated review by both CSI and counsel, but appropriately implemented.

Sincerely,

Geoff Rosenberger
Chair, Board of Trustees
Rochester Prep

APPENDIX B

OSC COMMENTS ON THE SCHOOL'S RESPONSE

Note 1

OSC audits often focus on narrowly-defined audit objectives. Similar findings that were not discussed in previous audit reports should not be interpreted as an indication that the conditions did not exist, as they likely were not considered in the focus of other audits.

Note 2

Our audit findings were based on assertions made to us by School officials.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our examination was to assess the School's financial operations. 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: general governance, financial oversight and condition, cash receipts (including resident school district billing), cash disbursements, purchasing, inventory control, payroll and personal services and information technology.

During the initial assessment, we interviewed appropriate School officials, performed limited tests of transactions and reviewed pertinent documents, such as School policies, Board minutes and financial records and reports. After reviewing the information gathered during our initial assessment, we determined where weaknesses existed and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. Based on that evaluation, we determined that controls appeared to be adequate and that limited risk existed for most of the financial areas we reviewed. We then decided on the reported objective and scope by selecting for audit the area most at risk. We selected the Board's oversight and management of contracts for further audit testing. To accomplish the objective of this audit and obtain valid evidence, we included the following audit procedures:

- We reviewed the contract terms and conditions contained in the MOU.
- We interviewed key School, Board and CMO personnel to obtain an understanding of the procurement process and how the School negotiated, interpreted and monitored the MOU.
- We reviewed leases and other contracts as they related to the MOU.
- We reviewed intercompany transfers, profit statements and general ledgers provided to us by the CMO.
- We reviewed and recalculated the management fee paid to the CMO.

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.

APPENDIX D

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