Office of the New York State Comptroller

Division of Local Government
& School Accountability

PUC Achieve Charter School

Board Oversight

Report of Examination

Period Covered:

July 1, 2014 – March 30, 2016

2016M-316

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

May 2017

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 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 PUC Achieve Charter School, entitled Board Oversight. 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, 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

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

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. Charter schools generally have fewer legal operational requirements than traditional public schools. Most of the operational requirements for a charter school are contained in New York State Education Law Article 56; the school's bylaws, charter agreement and fiscal/financial management plans; and the *Financial Oversight Handbook* (handbook).[1]

The PUC Achieve Charter School (School), located in the City of Rochester in Monroe County, was granted a provisional charter by the Board of Trustees of the State University of New York (SUNY) in November 2013. The School is one of 17 charter schools, 16 of which are located in California, that exist under PUC National, a nonprofit organization that replicates its charter school model established in California in other communities. The School is governed by a Board of Trustees (Board) that is composed of seven members: five local members, and two from California who are also the original founders of the School's management company (Company).[2] The Board is responsible for the general management and control of the School's financial and educational affairs. Currently, the Principal, Assistant Principal and Office Manager are responsible for the day-to-day operations of the School.

The School's 2014-15 fiscal year operating expenditures totaled $2.24 million. These expenditures were funded primarily with revenues derived from billing the area school districts for resident pupil tuition and from certain State and federal aid attributable to these pupils. During the 2014-15 school year, the School provided education to approximately 85 students in grade five.

Scope and Objectives

The objective of our audit was to review the Board's oversight of the School's financial operations and potential conflicts of interest for the period July 1, 2014 through March 30, 2016. Our audit addressed the following related question:

- Did the Board adequately monitor the School's financial operations and potential conflicts of interest?

[1] The Charter Schools Institute of the State University of New York (SUNY) publishes the *Financial Oversight Handbook* to provide SUNY-authorized charter schools assistance with navigating financial accountability. The Charter Schools Institute was created by the SUNY Board of Trustees to assist them in carrying out their responsibilities of granting public school charters under the New York State Charter Schools Act of 1998. SUNY is in the process of updating its handbook. In the interim, it is sharing the handbook published by the New York State Education Department, entitled *Fiscal Oversight Guidebook*.

[2] One of the California Board members is the Company's CEO. The Company is a nonprofit corporation located in California.

Audit Results

The local Board members did not provide adequate oversight of the Company's work, actively direct and monitor the School's financial operations or monitor the School's potential conflicts of interest. We found that the Company performed all aspects of the School's financial transactions, which School officials could not monitor because they did not have access to the accounting records and bank accounts. As a result, local Board members were unaware that the School's budgets were insufficient to adequately support ongoing operations and financial records and reports were inaccurate and incomplete.

Additionally, the School has suffered from a poor financial position since its inception. During the first year of operations, revenues fell short of estimates by approximately $221,000 (17 percent), due to a 32 percent decline in anticipated enrollment. This situation was compounded by higher-than-expected expenditures of more than $326,000 (17 percent), which led to a year-end loss of approximately $470,000. To help bridge this financial gap, the School obtained a $100,000 loan from the Company, but was unable to pay the Company's annual management fee totaling $162,785 and had to defer other payments totaling $236,000.

Furthermore, we found that one of the School's Trustees appears to have a prohibited interest in the School's transactions with a local limited liability company (LLC). The Trustee was a manager of an LLC, and personally invested in the LLC, that held the assignment and mortgage on the property leased by the School. Therefore, this Trustee receives an indirect monetary benefit as a result of the lease agreement and other subsequent agreements related to a $2.3 million loan associated with the assignment and mortgage.

Furthermore, we found that the School's contract with the Company was signed by a School Board member who also was a Company Board member at the time. In addition, we found that the two California-based Board members who wrote School checks were also the Company's founders. In both cases, these are not legally based conflicts of interest because nonprofit organizations are exempt from General Municipal Law's conflict of interest requirements. While not prohibited by law, these situations create a conflict of interest because when the Company/School Board member signed the School's contract or the founders sign the School's checks, they must simultaneously represent the Company's and School's interests.

Comments of School Officials

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. Except as specified in Appendix A, School officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comments on the issues raised in the School's response letter.

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. Charter schools generally have fewer legal operational requirements than traditional public schools. Most of the operational requirements for a charter school are contained in New York State Education Law Article 56; the school's bylaws, charter agreement and fiscal/financial management plans; and the *Financial Oversight Handbook* (handbook).[3] Charter schools are required to set both financial and academic goals, and a school's renewal of its charter is dependent on meeting these goals.

The PUC Achieve Charter School (School),[4] located in the City of Rochester in Monroe County, was granted a provisional charter by the Board of Trustees of the State University of New York (SUNY) in November 2013. The School is governed by a Board of Trustees (Board) that is composed of seven members: five local members, and two from California who are also the original founders of the School's management company (Company).[5] The Board is responsible for the general management and control of the School's financial and educational affairs. Currently, the Principal, Assistant Principal and Office Manager are responsible for the day-to-day operations of the School.

The Board entered into an administrative services agreement (services agreement) with the Company in 2014. The Company agreed to perform and provide school management services in connection with governance, financial administration and reporting, subject to the Board's and its own control, supervision, direction and policies.

The School's 2014-15 fiscal year operating expenditures totaled $2.24 million. These expenditures were funded primarily with revenues derived from billing the area school districts for resident pupil tuition

[3] The Charter Schools Institute of the State University of New York (SUNY) publishes the *Financial Oversight Handbook* to provide SUNY-authorized charter schools assistance with navigating financial accountability. The Charter Schools Institute was created by the SUNY Board of Trustees to assist them in carrying out their responsibilities of granting public school charters under the New York State Charter Schools Act of 1998. SUNY is in the process of updating its handbook. In the interim, it is sharing the handbook published by the New York State Education Department, entitled *Fiscal Oversight Guidebook*.

[4] The School is one of 17 charter schools, 16 of which are located in California, that exist under PUC National, a nonprofit organization that replicates its charter school model established in California in other communities. (see www.pucschools.org)

[5] One of the California Board members is the Company's CEO. The Company is a nonprofit corporation located in California.

and from certain State and federal aid attributable to these pupils. During the 2014-15 school year, the School provided education to approximately 85 students in grade five.

When the School began operations, the Company provided the School with a Director of Operations, Director of Business Development and School Principal, who were all Company employees and from California. These individuals were responsible for recruiting students and implementing Company practices for educational instruction and business operations. The School has experienced significant administrative turnover since its inception. During our audit period, the School had four Directors and three Principals. Three Directors and one Principal were Company employees.

Objective

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

- Did the Board adequately monitor the School's financial operations and potential conflict of interests?

Scope and Methodology

We examined the financial operations of the School for the period July 1, 2014 through March 30, 2016.

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 are included in Appendix C of this report. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

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. Except as specified in Appendix A, School officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comments on the issues raised in the School's response letter.

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

Board Oversight

The Board is responsible for safeguarding public funds intended for educational purposes. A School's financial condition is a primary factor in determining its ability to continue providing public educational services. The Board and School officials are accountable for the use of School resources and are responsible for effectively planning and managing financial operations.

To make sound financial decisions, the Board must receive accurate financial information. One of the basic objectives of accounting and financial reporting is to provide managers with financial information useful for determining and forecasting financial condition. The Board must have accurate financial information to develop proper budgets and multiyear financial plans.

The School's bylaws stipulate that the Board may delegate the management of activities to others, so long as the affairs of the School are managed and its powers are exercised under the Board's ultimate jurisdiction. Because two of the seven Board members are affiliated with the Company, involvement by the local Board members takes on added importance. To accomplish their responsibilities, the local Board members must be informed and vigilant overseers of the School's financial operations.

The local Board members did not provide adequate oversight of the Company's work or actively direct and monitor the School's financial operations. The Company performed all aspects of the School's financial transactions, which School officials could not monitor because they did not have access to the accounting records and bank accounts. Further, the local Board members did not regularly receive monthly financial reports from the Company, and reports submitted since August 2015 were insufficient and lacked information, such as a detailed budget-to-actual report and cash flow statement. As a result, the School's budgets were insufficient to adequately support ongoing operations, financial records and reports were inaccurate and incomplete and the local Board members' ability to carry out their oversight responsibilities was severely limited. Consequently, the Board was not fully aware of the School's financial problems and was not in a position to take timely, effective corrective steps.

We also found that one School Trustee may have a prohibited interest in a School contract. Because the Board has conceded management of the School to the Company with limited oversight, School officials and taxpayers cannot be assured that the School's financial transactions are appropriate and in the best interests of the School rather than the Company.

Financial Condition

A school is considered to have sound financial health when it can consistently generate sufficient revenues to finance anticipated expenditures and maintain sufficient cash flow to pay bills and other obligations when due, without relying on short-term borrowings. Conversely, a school in poor financial condition may experience recurring unplanned operating deficits, which can impede its ability to carry out its educational mission. Persistent unplanned operating deficits are usually indicative of ineffective budgeting and can result in cash flow problems. Although not-for-profit charter schools are not required to have balanced budgets,[6] the SUNY handbook recommends that they should. Most importantly, the budget should be the school's financial plan for the year and used as a management tool to track actual results. When results differ significantly from the plan, the Board should take action to address the unexpected outcomes.

The School has suffered from a poor financial position since its inception. Its initial plan was to open for the 2014-15 school year with 120 fifth grade students and add a grade level each year until the students reached eighth grade.[7] However, enrollment fell to 82 students for the 2014-15 school year, which represented a 32 percent decline in anticipated enrollment and resulted in district-per-pupil aid being $221,000 (17 percent) less than projected. The effect of the revenue shortfall was magnified by expenditures that exceeded budget estimates by more than $326,000 (17 percent). Higher-than-expected expenditures included personnel costs and student services, even though enrollment was less than planned. Also contributing to the shortfall were costs that exceeded estimates, including facility rents and leases. Therefore, instead of a planned gain of approximately $6,300, results from operations caused an actual loss of approximately $470,000.

As a result of this loss, the School's operations did not provide it with the cash flow necessary to fund ongoing expenditures. The adverse effect of operations on cash flow was demonstrated in several ways.

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[6] As a nonbusiness entity, not-for-profit organizations must use any surplus revenues to further achieve their purpose or mission, rather than distributing surplus income to shareholders as profit or dividends. As a result, they do not need to have balanced budgets. However, they must have legitimate long-term plans to indicate how they intend to make a profit to ensure their sustainability.

[7] Because the grade five enrollment was insufficient to support the School during its first year of operation, the Board decided to add a grade six class before the first school year began. However, enrollment dropped significantly during the first months of operation, from 129 students to 82. With sixth grade enrollment down to seven students, the school chose not to add grade seven during the 2015-16 year and instead found placements for those students.

For example, the School:

- Obtained a $100,000 loan from the Company in September 2014.

- Was unable to pay the Company its contracted management fee (10 percent of operating revenue) for the 2014-15 fiscal year totaling $162,785.[8]

- Deferred other payments of about $236,000.

Our concerns regarding the School's financial condition extend beyond its initial year's poor results. As of the end of our fieldwork, the School had not started paying back any of the liabilities incurred in 2014-15. Additionally, the School deferred other payments totaling approximately $400,000 for the 2015-16 year. Notwithstanding the School's inability to pay existing ongoing costs, its rent is scheduled to increase by $120,000 per year from 2014-15 through 2017-18.[9]

Not only did the School incur substantial losses during its first year of operations, the Board also failed to develop a plan to improve financial operations in future years. Instead, the local Board members remained unaware of the extent of the situation, as a result of their failure to monitor the School's finances. Also, the Company took actions and made management decisions to continue the School's operations without the knowledge of the local Board members who should have been managing the finances.

After we completed our fieldwork, we obtained the School's audited 2015-16 financial statements and its 2016-17 budget. For the 2015-16 fiscal year, the audited financial statements reported net income of about $90,000, which resulted in a year-end net deficit position of about $377,000. The School's 2016-17 budget includes a reasonable estimate in district per pupil aid,[10] the full 10 percent management fee, increased rent payments and the repayment of the $100,000 loan

[8] The amount of this liability is unclear. The Company recorded an accrued liability for the management fee in the School's financial records based on only 7 percent of operating revenue ($114,000), which resulted in an apparent understated liability of approximately $49,000. The services agreement stated that the contracted management fee should be 10 percent of operating revenue, and the Company CEO told us the entire 10 percent fee should have been recorded as a liability. However, the Company CFO told us that the liability was 7 percent of operating revenue.

[9] In 2015-16, the $120,000 increase in rent was a 100 percent increase from the previous year; in 2016-17, it will be a 50 percent increase; and in 2017-18, it will reflect a 33 percent increase. The rent is scheduled to remain at $480,000 per year from 2017-18 through 2020-21.

[10] Based on the number of students enrolled in September 2016

from the Company with interest. The budget includes approximately $400,000 of other revenues such as State and federal aid and fundraising, which also appears to be a reasonable estimate based on past performance. However, the budget does not address the payment of the previous years' outstanding liabilities for deferred payments and management fees. If these budget estimates are met, the School could have a gain of approximately $131,000 to further reduce the accumulated deficit.

Board Involvement

The Board is responsible for safeguarding public funds intended for educational purposes, even when it contracts with a management corporation to operate the School. The Board should fulfill this responsibility by providing adequate oversight of the Company to ensure that all transactions are accounted for and that public funds are used effectively and efficiently for educational purposes.

Although neither of the California Board members have a prohibited interest in the service agreement, they have been in many situations in which they must simultaneously represent the Company's and School's interests.[11] This conflict must be offset by local Board members fully exercising their oversight duties.

The local Board members did not provide adequate oversight of the Company's work or actively direct and monitor the School's financial operations. The Company performed all aspects of the School's financial transactions. The local Board members did not require that they be given routine financial information or have access to the accounting records or bank accounts. As a result, the local Board members did not have an understanding of the School's financial position and could not effectively monitor the budget and actual results of operations.

<u>Budget Process</u> — The budget is a key tool that shows the Board's spending priorities and revenue sources and allows School management and the Board to monitor actual results against the planned activity. Given the School's financial condition, the Board should monitor budget-to-actual results in a close and timely manner. According to the services agreement, the Company was responsible for preparing the annual School budget for the Board's consideration, review and approval.

Although the Company prepared the budgets, the Board did not ensure that the budgets were realistic and structurally balanced. The Board's involvement in the budget process was limited because it relied on the Company to develop and monitor the budget, with little

[11] Refer to the Potential Conflicts of Interest section for further information.

to no input from the local Board members. As a result, the Board was unaware that the Company had created structurally imbalanced budgets that contained inaccurate and unrealistic information.

Budget Monitoring — The Company is responsible for maintaining annual budget information, including actual and projected expenses and preparing financial statements on a monthly basis. The Board is responsible for ensuring that its agreement with the Company clearly identifies the information that the monthly reports must contain and monitoring the monthly reports to determine whether all necessary information is being communicated.

The Board did not receive monthly financial reports from the Company. It was not until August 2015, over a year after the School's opening, that the Board started to regularly receive monthly financial reports. However, the services agreement was vague and did not clearly identify the information that the monthly reports should have contained. As a result, the reports that the Board received[12] contained inaccuracies and were insufficient to allow the Board to adequately monitor the School's financial operations. For example, the October 26, 2015 balance sheet excluded a liability for start-up costs totaling approximately $94,000 that was owed to the Company and deferred rent totaling approximately $236,000 that was included in the 2014-15 financial statements.[13] The Board failed to address the lack of accurate and complete financial information even after the School incurred a substantial unplanned deficit in the first year.

Furthermore, the October 26, 2015 statement of revenues and expenditures included year-to-date actual figures and reported budget figures that did not match the original, revised or adopted budgets and did not include the current month's activity, modified budget figures or budget-to-actual variances. Because the Board did not demand current and accurate financial information, it was unaware of the large budget variances and unable to take necessary steps to reduce spending and avoid additional cash flow issues.

Although the School's initial charter application required a five-year financial plan, the Board did not update the plan to account for the first year's poor operating results. As a result, the multiyear plan lost its value as a monitoring tool.

[12] A balance sheet and statement of revenues and expenditures

[13] When we spoke to Company officials regarding this error, they told us it had been corrected. However, the Company did not provide us with an updated and corrected report until February 3, 2016, even though we requested it on December 3, 2015.

The Board's ability to carry out its oversight responsibilities was severely limited because it did not require sufficient financial information on a monthly basis from the Company. Without detailed interim financial reports, the Board was unable to monitor the School's financial operations and unaware of the substantial revenue shortage and cost overruns and, therefore, did not take any action to address short-term cash flow needs or long-term plans.

Financial Administration — The Company's financial administration responsibilities include maintaining the School's budgeting and financial records. The services agreement provides that the Company establish and maintain a chart of accounts using the Company's computerized accounting system, subject to the Board's direction. The service agreement indicates that the Company is to provide purchasing services for supplies and cash management services using Board-approved banking institutions. Finally, the Company was charged with monitoring and supervising the School's vendors and executing agreements whose aggregate contracts were less than $50,000.

The Company handled all aspects of the School's financial transactions without any oversight by the local Board members or School officials. Specifically, the Company directly received bills, entered them into its computerized financial software, made bank transfers and wrote checks that were signed by the two California-based Board members. All cash receipts, except for School lunch money,[14] were directly deposited into the School's bank accounts that were maintained by the Company.

Furthermore, the Company received the School's bank statements and prepared untimely reconciliations for the bank accounts[15] several months after receiving the statements. During the 2014-15 school year, the Company performed bank reconciliations on average 108 days after the bank statement date. When bank reconciliations are performed in a timely manner, they provide officials with an opportunity to detect and correct errors and irregularities on a timely basis.

We selected two months[16] of receipt and disbursement transactions — 101 individual transactions totaling $527,790 — from the School's bank statements to determine whether they were accurately recorded and appropriate. We found that all transactions were accurately recorded and appeared to be appropriate.

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[14] School officials deposited lunch money into a local account and submitted it by check to the Company once per month.

[15] Except for the local account for lunch payments

[16] We judgmentally selected November 2014 and April 2015 due to the bank statement activity.

We also reviewed a judgmentally selected sample of 17 individual transactions[17] totaling $252,556 to determine whether they were appropriate School expenditures. Two transactions totaling $251,459 were paid to the Company for start-up costs for the salaries of a Principal, Director of Business Development and Director of School Development, and for travel costs.[18] The invoices for these start-up costs were generated by the Company and entered into the School's accounting system by the Company. The Company also initiated the bank transfers to pay these invoices without receiving approval from the Board or School officials.

We found that these payments appeared to be for appropriate School expenditures and within the authority given to the Company. However, because the Board allowed the Company to have unlimited access to the School's bank accounts without any oversight, the Board has limited assurance that School resources are safeguarded and used for appropriate purposes.

Potential Conflicts of Interest

As of May 28, 2010, Education Law provides that charter schools are subject to the provisions of Sections 800 through 806 of Article 18 of General Municipal Law (GML) to the same extent that these sections apply to school districts.

In general, the provisions of GML Article 18 limit the ability of municipal officers and employees, including school district officers and employees, to enter into contracts in which both their personal financial interests and their public powers and duties conflict. Specifically, unless a statutory exception applies, Article 18 prohibits municipal officers and employees from having an interest in contracts with the municipality for which they serve when they also have the power or duty, either individually or as a board member, to negotiate, prepare, authorize, or approve the contract;[19] to authorize or approve payment under the contract; to audit bills or claims under the contract; or to appoint an officer or employee with any of those powers or duties.

As a rule, interests in actual or proposed contracts on the part of an officer or employee, or his or her spouse, must be publicly disclosed in writing to the officer or employee's immediate supervisor and to the governing board. However, disclosure, abstention or recusal do not cure an interest in a contract otherwise prohibited by GML Article 18.

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[17] We judgmentally selected these 17 transactions based on the payee name and dollar value.

[18] These costs were covered by grant funds. During the 2014-15 fiscal year, the School recorded grant revenue from two different sources totaling $834,620.

[19] For this purpose, a contract includes any claim, account, demand against or agreement with a municipality, expressed or implied.

Lease Agreement — We found that a Board member appears to have a prohibited interest in the School's transactions pursuant to GML. This may have occurred as a result of the School not having clear guidance as to the applicability of GML Sections 800 through 806.

The School is currently leasing the building (property) it presently uses from a local limited liability company (LLC 1). According to the lease agreement (dated January 21, 2014) and an amendment to the lease agreement (dated May 21, 2014), the School makes monthly rental payments to LLC 1. Subsequent to entering into the lease agreement and amendment, LLC 1 entered into an assignment and mortgage agreement with a separate LLC (LLC 2). The assignment and mortgage agreement suggest that LLC 2 agreed to loan $2.3 million to LLC 1 in exchange for the assignment and mortgage on the property.

The Board President told us that LLC 2 is comprised of 27 individuals and/or charitable entities (investors). Each investor loaned $100,000 to LLC 2.[20] In exchange, the investors would receive either a 2 or 6 percent annual return for the duration of the loan (seven years). We found that one of the School Trustees was a manager of LLC 2 and also one of the investors. For purposes of Article 18, the lease agreement and amendments are "contracts" between the School and LLC 1.

This Trustee would have an "interest" in the contracts if, as appears to be the case, this individual received an indirect monetary benefit as a result of the lease agreement and its amendment.[21] As a Board member, the Trustee also possesses one or more powers or duties that could give rise to a prohibited interest.

We did find that the Trustee disclosed, in writing, the potential conflict of interest to the Board. However, disclosure does not cure an otherwise prohibited interest in a contract. Therefore, it appears the Trustee has a prohibited interest in the School's contracts.

Service Agreement — For purposes of GML, the service agreement between the School and the Company is a contract. As officers or employees of the not-for-profit corporation during this time, each California Board member would be deemed to have an interest in the

[20] According to the Trustee's OSC disclosure form, it appears the purpose of the loans were to finance the purchase and rehabilitation of the property used by the School.

[21] It is our understanding that LLC 1 uses the rental payments to pay debt service on its loan from LLC 2 which, in turn, uses those monies to make regular distributions to the Trustee, which includes interest on the Trustee's loan to LLC 2. In this case, it appears that the Trustee receives an indirect pecuniary benefit as the result of the leases between the School and LLC 1.

contract. However, each Board member's interest in the contract is not prohibited, because there is a statutory exception for interests in contracts with a voluntary nonprofit corporation or association.

Both individuals were required to disclose their interests, in writing, to the Board with the written disclosure being made part of the record of the Board's proceedings. Although the California-based Board members completed OSC-requested conflict of interest forms, the School did not obtain written disclosures. Also, the disclosures were not provided as part of the School's annual New York State Education Department (SED) filing.[22]

Furthermore, we found that the service agreement was signed on behalf of the Company by a School Board member[23] who also was a Company officer or Board member at the time. Although the Board member abstained from voting on the contract, under such circumstances the Board member should not have been involved in matters pertaining directly to the service agreement with the Company, including signing the contract.

School officials are accountable to the public, especially when the expenditure of taxpayer money is involved. When School officials act in their capacities as Company Board members and conduct business with the School in which they serve, the public may question the appropriateness of the transactions. Such transactions create the appearance of impropriety and may result in the improper enrichment of the Company at taxpayer expense.

Recommendations

The Board should:

1. Actively monitor the School's financial condition and develop a plan to improve its current condition.

2. Ensure that the School has sound budgets that are clearly adopted and included in the minutes.

3. Actively monitor the adopted budget and approve all budget transfers and modifications as necessary.

4. Require adequate monthly financial reports, including a balance sheet, statement of revenues and expenditures, cash flow statement and budget to actual information. The Board

[22] Charter schools are required to submit an annual report to SED. One of its components includes a requirement that trustees disclose their financial interests in the School's contracts and transactions.

[23] The School Board President also signed the services agreement.

should regularly and carefully review these reports to help ensure fiscal issues are discovered and addressed appropriately.

5. Consider updating its contract for services to clearly identify the information that the monthly reports should contain.

6. Ensure that its service provider responds to the Board's information requests and to those directed by the Board, in a timely and accurate manner.

7. Ensure that the Board minutes include all appropriate Board resolutions and actions and are on file at the School.

8. Ensure that School officials approve financial transactions, especially payments to any provider of financial services.

9. Ensure that School officials have access to the School's computerized accounting records and bank accounts to allow them to routinely review and monitor Company-recorded activity and bank reconciliations.

10. Familiarize itself with the provisions of GML Sections 800-806 and, if necessary, consult with legal counsel to address any potential conflicts of interest.

APPENDIX A

RESPONSE FROM SCHOOL OFFICIALS

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

Partnerships to Uplift Communities

PUC Achieve Charter School

ROBERT ZIMMERLI
Executive Director
MICHAEL SAMUEL
Assistant Principal
SHADI KAFI
Assistant Principal

DR. JACQUELINE ELLIOT
Co-Founder
DR. REF RODRIGUEZ
Co-Founder

March 31, 2017

State of New York
Office of the State Comptroller
Division of Local Government and School Accountability
Albany, New York 12205

RE: Response to Report of Examination (2016M-316) – PUC Achieve Charter School

Dear Sir or Madam:

Thank you for the opportunity to respond to the recommendations contained in the Report of Examinations with respect to the Financial Operations of PUC Achieve Charter School ("School") conducted by the State of New York Office of the State Comptroller ("OSC") covering the period beginning July 1, 2014 and ending March 30, 2016 (the "Audit Period"). Provided below are the School's responses to the OSC's Recommendations contained in the Audit Report.

1. The Board should actively monitor the School's financial condition and develop a plan to improve its current condition.

The School acknowledges that it operated at a deficit during the 2014-2015 school year, which primarily occurred as a result of lower than anticipated enrollment and higher than anticipated expenses related to transportation, personnel and the School's facility. However, the Board of Trustees of the School (the "Board") disagrees with OSC's position that the Board did not carry out its oversight responsibilities or monitoring functions. The Board also disagrees with OSC'S statement that the Board did not take any action to address short-term cash flow needs or long-term plans.

See Note 1 Page 23

Since the School's inception in 2014, all decisions made and any financial costs associated with such decisions have been incurred by the School with the School's ultimate success and financial viability in mind. Because a charter school's revenue stream in New York is so closely tied to enrollment, lower than anticipated enrollment can unfortunately have a material impact on a school's financial condition. The Board, School leadership and the School's charter management organization, PUC National, worked cooperatively with one another to address the deficit caused by the initial low enrollment and consistently communicated with the School's authorizer, SUNY, their joint plans to address any financial issues. PUC National was in a position to help ease the financial burdens experienced by the School during the first several years of operations and took certain actions to assist the School at the request of the Board, including providing a $100,000.00 loan to the School and accepting a deferral of the payment of the charter management fee and certain other payments due from the School.

14 Mark St. • Rochester, New York 14605 • 585.471.6219 • FAX 585.471.6220 • www.pucschools.org

Partnerships to Uplift Communities
PUC Achieve Charter School

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DR. REF RODRIGUEZ
Co-Founder

Now in its third year of operation, the School's enrollment has stabilized and the School's financial position has improved. Over the past three (3) years, the School has dramatically reduced the deficit and is currently forecasting to the end of the year with a reduction of liabilities of approximately $236,000.00 and net income of $130k. In the year ended June 30, 2016, the School's net income was $90,240. The Board plans to continue to exercise its oversight function by actively monitoring the School's financial condition and responding accordingly to the School's financial needs.

2. ***The Board should ensure that the School has sound budgets that are clearly adopted and included in the minutes.***

Since the School's inception, the Board has reviewed and actively monitored the School's budget. While the minutes of the Board do not accurately reflect that the Board adopted the proposed budget for 2015-2016 fiscal year, the minutes do clearly reflect that the Board adopted the proposed budget for the 2014-2015 and 2016-2017 fiscal year. The Board will continue to ensure that a sound budget is proposed and adopted for future fiscal and that such adoption is reflected in the minutes.

See Note 2 Page 23

3. ***The Board should actively monitor the adopted budget and approve transfers and modifications as necessary.***

As previously discussed in more detail in the School's responses to Recommendations 1 and 2 above, the School has reviewed and actively monitored the School's budget since the School's inception in 2014. The Board will continue to ensure that a sound budget is proposed and adopted for the School and that if modifications are needed to the budget mid-school year, such modifications shall be reviewed and approved by the Board. The fiscal policies and procedures adopted by the Board set forth the approval process and signature requirements for checks, transfers, purchases and cash disbursements made by the School. The School plans to continue to adhere to these fiscal policies and procedures, which are revised from time to time. Notwithstanding the foregoing, in line with best practices, the Board is changing its protocol to require that at least one Board member who is not affiliated with PUC National reviews and approves any checks, transfers or other disbursements to PUC National.

4. ***The Board should require adequate monthly financial reports, including a balance sheet, statement of revenues and expenditures, cash flow statement and budget to actual information. The Board should regularly and carefully review these reports to help ensure fiscal issues are discovered and addressed appropriately.***

At each Board meeting, PUC National, in conjunction with the Treasurer, present the Board with financial statements for their review, including a balance sheet and statement of revenues and expenditures. Moving forward, based on OSC's recommendation and best practices, PUC National, in conjunction with the Treasurer, also shall present the Board with a cash flow statement and budget to actual information. The Board has historically, and will continue in the future, to monitor the financial reports received to help ensure that any fiscal issues are discovered and addressed appropriately.

5. ***The Board should consider updating its contract for services to clearly identify the information that the monthly reports should contain.***

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Partnerships to Uplift Communities

PUC Achieve Charter School

ROBERT ZIMMERLI
Executive Director
MICHAEL SAMUEL
Assistant Principal
SHADI KAFI
Assistant Principal

DR. JACQUELINE ELLIOT
Co-Founder
DR. REF RODRIGUEZ
Co-Founder

PUC National and the Board are committed to working cooperatively with one another to provide the Board with access to any information needed to allow the Board to prudently monitor the financial condition of the School. To date, when the Board has a question or requires information from PUC National, PUC National responds to such request in a timely and accurate manner. While the Board is considering whether to update its service agreement with PUC National to identify the information that the monthly reports should contain, Board members are confident that they will receive the financial reports requested on a monthly basis, including, but not limited to, cash flow statements and budget to actual information, which have not before been requested by the Board.

6. The Board should ensure that its service provider responds to the Board's information requests, and to those directed by the Board, in a timely and accurate manner.

To date when the Board of Trustees of the School has a question or requires information from its charter management organization, PUC National, the service provider responds to such request in a timely and accurate manner. The Board shall ensure that PUC National continues to respond to requests in a timely and accurate manner as recommended by OSC.

7. The Board should ensure that the Board minutes include all appropriate Board resolutions and actions and are on file at the School.

At the Board's monthly meetings, the Board reviews and approves the minutes from the last Board meeting, which minutes include any resolutions or actions taken at such previous meeting. The School acknowledges that the Board minutes are currently stored on the PUC Intranet for convenience and are also kept by one Board meeting in hard copy format at his office. The Board of Trustees is working with PUC National to set up both an electronic minute book that be accessible too all Board members and School Leadership for reference and a physical minute book stored at the School.

8. The Board should ensure that School officials approve financial transactions, especially payments to any provider of financial services.

The Board has adopted fiscal policies and procedures, which have been reviewed by its independent auditor and submitted to its authorizer, SUNY. The Board, School leaders and PUC National will continue to follow such fiscal policies and procedures when dealing with financial matters and conducting financial transactions. As noted above in the School's response to Recommendation 3, the Board is changing its protocol to require that at least one Board member who is not affiliated with PUC National reviews and approves any checks, transfers or disbursements to PUC National.

9. The Board should ensure that School officials have access to the School's computerized accounting records and bank accounts to allow them to routinely review and monitor Company-recorded activity and bank reconciliations.

The School recognizes that at the time of the Audit, School leaders did not have direct access to accounting records and bank accounts; however, School leaders have always been provided with detailed reports to provide them with the ability to review and monitor the School's financial activity and any bank

See Note 3 Page 23

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reconciliations. As of October 20, 2015, monthly income statements, year-to date general ledger activity and balance sheets are available on the PUC Intranet. Also available are monthly bank reconciliation statements for the School's main accounts and fundraising accounts. It is also important to note that the Board has adopted fiscal policies and procedures, which have been reviewed by the School's independent auditor and submitted to the School's authorizer, SUNY, as required by the charter agreement. The School operates in accordance with these fiscal policies and procedures, balancing proper financial controls with the need for transparency into the School's financial condition. It is the School's position that different levels of access to reports should be provided based on an individual School leader's role at the School, with the Board receiving full access so it can fulfill its oversight responsibility. In addition, in the event financial information or a financial report is not accessible immediately on the PUC Intranet, School personnel or a Board member can immediately request and receive such information from the appropriate personnel at PUC National.

10. The Board should familiarize itself with the provisions of GML Section 800-806 and, if necessary, consult with legal counsel to address any potential conflict of interest.

The Audit Report incorrectly suggests that one of the School's Trustees has a prohibited interest in the School's transaction with a local limited liability company. As described in the Audit Report, the School leases its school facility from a limited liability company (the "Landlord") pursuant to a Lease Agreement dated January 21, 2014, as amended pursuant to that certain Amendment to Lease Agreement dated May 21, 2014 (as amended, the "Lease"). After entering the Lease, a separate limited liability company ("LLC 2) loaned the Landlord $2,300,000 secured by an assignment and mortgage on the School facility (the "Loan"). LLC 2 has 27 members (individuals and organizations), each of which loaned $100,000.00 to LLC 2. In exchange for such investment, the investors anticipate receiving between a 2.0% and 6.0% annual return for the duration of the Loan. One of the Trustees of the School is a managing member of LLC 2, having invested $100,000.00 in LLC 2.

The School understands that it is subject to the conflict of interest requirements set forth in the General Municipal Law. Specifically, the School understand that Section 801 of the General Municipal Law, prohibits its trustees, officers and employees, subject to certain limited exceptions, from having any interest in any contract with the School.

However, the transaction highlighted in the Audit Report is not a conflict prohibited by Section 801 of the General Municipal Law because an exception to the Section 801 of the General Municipal Law applies. Subdivision 2(a) of Section 802 of the General Municipal Law provides that the provisions of Section 801 do not apply to a "contract with a corporation in which a municipal officer or employee has an interest by reason of stockholdings when less than five percent of the outstanding stock of the corporation is owned or controlled directly or indirectly by such officer or employee." In the transaction raised by OSC in the Audit Report, the trustee in question lent $100,000.00 to LLC 2. The total amount lent to LLC 2 by all investors was $2,700,000.00. Accordingly, the trustee's ownership in LLC 2 is approximately 3.7%, which is under the 5.0% threshold, and therefore, the exception set forth in Section 802 2(a) of the Municipal Law applies. In addition, while the trustee is also listed as a managing member of LLC 2, he receives no remuneration for taking on such a role and such role does not give the trustee the power or authority to control more than 3.7% of LLC 2. Lastly, despite this transaction not being prohibited by the General Municipal Law, the trustee properly

See Note 4 Page 23

See Note 5 Page 24

disclosed his interest in LLC 2 in writing and abstained from voting on such transaction as required by New York's Not-For-Profit Corporation Law. **For the reasons stated above, it is the School's position that OSC should remove the section of the Report dealing with this matter since the 3.7% interest in LLC 2 is not a Prohibited Interest as defined by the GML.**

The Audit Report also raises issues with the fact that two of the School's Trustees are affiliated with PUC National, the School's contracted not-for-profit educational services provider; provided, however, OSC does acknowledge that such Board service is not prohibited by law. The School's charter agreement with its authorizer, SUNY, contains detailed restrictions on who may serve on the Board if the School has engaged a not-for-profit educational service provider. Specifically, the Agreement provides the following:

See Note 6 Page 24

"no more than two (2) Corporate Trustees may be affiliated with such not-for-profit entity, or have immediate family members so affiliated, and one (1) such Corporate Trustee's affiliation is limited to serving as director of such entity; provided, however, that in such case the following restrictions shall apply:

(1) termination of the contract with the not-for-profit educational service provider or other entity shall constitute cause for removal of such person(s) from the Education Corporation Board, and upon such termination such person(s) may be removed from the Education Corporation Board by vote of the Education Corporation Board provided there is a quorum of at least a majority of the entire Education Corporation Board present at the meeting; and

(2) such person(s) shall not hold the offices of chair or treasurer of the Education Corporation Board; and

(3) when the Education Corporation Board has proper grounds to go into executive session pursuant to the New York Open Meetings Law (as defined herein), and the Education Corporation Board is to discuss or vote upon an issue related to the not-for-profit management company or entity, the personnel of such company or entity, or such person(s), the Education Corporation Board may, after such person(s) has had an opportunity to fully address the Education Corporation Board, continue such executive session outside of the presence of such person(s); and

(4) the number of Corporate Trustees on the Education Corporation Board shall not be less than seven (7) where two (2) Corporate Trustees are affiliated with the not-for-profit entity and not less than six (6) where one (1) Corporate Trustee is affiliated with the not-for-profit entity."

The School abides by the restrictions contained in its charter agreement. SUNY also reviewed and approved the School's educational services agreement with the School prior to the Agreement being implemented. The School is operating within the requirements of the law and its contractual commitments to SUNY with respect to its relationship PUC National.

Other Comments:

In addition to the School's responses to the recommendations set forth in OSC's audit report, the School has the following comments on contents of the report:

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A. The School being operated in New York is based on a very successful model that has been developed and implemented over the years in California by PUC National. The Board is confident in PUC National's management of the day-to-day operations of the School, under the Board's ultimate oversight authority, which has not and will not be delegated.

See Note 1 Page 23

B. The legal name of the management company is PUC National (not Partnerships to Uplift Communities).

C. The SUNY Financial Oversight Handbook is currently unavailable as it is being updated by the Charter Schools Institute. The School has requested that such handbook be provided to the School once updated.

See Note 7 Page 24

We trust that this response shall satisfy all of the recommendations set forth in the Report. Should you wish to discuss this matter further, please contact us.

Very truly yours,

PUC ACHIEVE CHARTER SCHOOL

By: ________________________
Joseph Klein
Board Chair

APPENDIX B

OSC COMMENTS ON THE SCHOOL'S RESPONSE

Note 1

The Board conceded management of the School to the Company with limited oversight. The Company performed all aspects of the School's financial transactions, which School officials could not monitor. They did not have access to the accounting records and bank accounts and did not regularly receive adequate monthly financial reports from the Company that accurately detailed the School's revenue shortages, cost overruns and cash flow issues.

Note 2

While the adoption of the budget was identified in the Board minutes, no identifying information was included. When we requested the 2015-16 adopted budget, the Company gave us four different versions of the Board's adopted budget, each including slightly different figures.

Note 3

The Board did not receive adequate monthly financial reports, and the Company did not complete bank reconciliations in a timely manner. In addition, because the Board only had access to reports prepared by the Company, but not the computerized accounting records, the Board was limited in its ability to ensure that the information provided was complete and accurate.

Note 4

The exception in GML Section 802(2)(a) does not apply in this instance because the Board member did not have an "interest" in the lease agreement "by reason of stockholdings." As indicated in the report, it is our understanding that LLC 1 uses the rental payments to pay debt service on its loan from LLC 2 which, in turn, uses those monies to make regular distributions to the Trustee, including interest (either a 2 or 6 percent annual return) on the Trustee's loan to LLC 2. In this case, the Trustee's interest in the contract would occur because of an apparent indirect monetary benefit as a result of the lease between the School and LLC 1, and not "by reason of stockholdings."[24]

Furthermore, the exception in GML Section 802(2)(a) applies to "[a] contract with a corporation in which a municipal officer or employee has an interest *by reason of stockholdings* when less than five per centum of the outstanding *stock* of the corporation is owned or controlled directly or indirectly by such officer or employee" (emphasis added). In this case, the transaction involved a limited liability company, not a corporation. Also, even though the Trustee, as a member of LLC 2, may have an ownership interest in LLC 1 of approximately 3.7 percent, there is no analogous exception in GML for interest by reason of an ownership interest of less than 5 percent in an entity other than a corporation.

[24] Refer to GML Section 800[3] for further information.

If the Trustee were to decide not to receive interest on the loan made to LLC 2, the Trustee would not receive an indirect monetary benefit as a result of the lease between the School and LLC 1. Under such circumstances, the Trustee would not have an interest in the contract prohibited by GML Article 18.

Note 5

Although the Trustee disclosed, in writing, the potential conflict of interest to the Board, that disclosure does not cure an otherwise prohibited interest in a contract.[25]

Note 6

As indicated in the report, each Board member does not have a prohibited interest in the contract because a statutory exception applies.[26] However, GML still requires each Board member to disclose to the Board, in writing, his or her “interest” in the service agreement. Also, the written disclosure should have been included in the minutes of the Board’s proceeding.[27] However, we did not find any indication that either Board member made such written disclosure to the Board. In addition, written disclosures were not included as part of the School’s annual SED filing.

Note 7

As indicated in the report, SUNY recommends that charter schools use the *Fiscal Oversight Guidebook*, published by SED, while its handbook is updated.

[25] Refer to the Opinions of the State Comptroller Nos. 83-168, 2000-7 for further information.
[26] Refer to GML Section 802[1][f] for further information.
[27] Refer to GML Section 803 for further information.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed School officials and employees to gain an understanding of the School's financial operations.
- We reviewed Board minutes, Board policies, documented procedures and the manual and guide.
- We reviewed financial information for July 1, 2014 through October 2015.
- We reviewed the 2015-16 budget.
- We compared budget-to-actual figures on the Company's October 2015 report to the Board.
- We reviewed expenditures that cleared the bank statements during November 2014 and April 2015. We judgmentally selected these months due to the bank statement activity. We tested the transactions for compliance with School policy, proper support, approvals and appropriateness.
- We reviewed a judgmental sample of 17 transactions totaling $252,556 for compliance with School policy, proper support, approvals and appropriateness. Our judgmental sample was based on the payee and dollar value of the transactions.
- We communicated with the Company to obtain financial reports, invoices, bank statements, and reconciliations and canceled checks and to ask various financial questions.
- We recalculated the management fees and reviewed other related-party transactions (such as Board member and other nonprofit relationships).

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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