Office of the New York State Comptroller

Division of Local Government
& School Accountability

Child Development Center of the Hamptons Charter School

Financial Management

Report of Examination

Period Covered:

July 1, 2011 — February 27, 2013

2013M-98

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

July 2013

Dear School Officials:

A top priority of the Office of the State Comptroller is to help school officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support school operations. The Comptroller oversees the fiscal affairs of schools statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and School 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 Child Development Center of the Hamptons Charter School, entitled Financial Management. 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 Education Law.

This audit's results and recommendations are resources for School officials to use in effectively managing operations and in meeting the expectations of their constituents. 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. The Child Development Center of the Hamptons Charter School (School) is governed by a seven member Board of Trustees (Board), which is responsible for the general management and control of the School's financial and educational affairs. The Board has entered into an Administrative Services Agreement (Agreement) with Family Residences and Essential Enterprises, Inc. (FREE), a not-for-profit corporation located in Old Bethpage, New York. The Board has been using FREE to operate the School since the October 2010.

The School offers two educational programs including the ten-month traditional program from September through June and an extended two-month summer program from July through August. The School's revenues for the 2011-12 fiscal year were approximately $3.2 million. These revenues were derived from billing area school districts for resident pupils, and from certain State and Federal aid attributable to these pupils.

Objective

The objective of our audit was to examine the School's relationship with FREE to address the following related question:

- Did the Board properly monitor the management corporation operating the School to ensure School funds are effectively and efficiently used?

Scope and Methodology

Our overall goal was to assess the School's financial operations. Since financial operations were handled by the management corporation, we evaluated the relationship between the School and the management corporation for the period July 1, 2011 to February 27, 2013.

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.

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 are taking corrective action. Appendix B includes our comment on an issue 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 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 Secretary's office.

Financial Management

The Board is ultimately 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 corporation to ensure that all transactions are accounted for and that public funds are used effectively and efficiently for educational purposes. Complete and accurate monthly reports provide essential financial information that the Board can use to monitor the School's financial operations and the management corporation providing these services.

The Board has appointed FREE to serve as the designated representative for the Treasurer[1] of the School. FREE performs virtually all aspects of the School's financial operations, making monitoring even more essential. We found that the Board needs to improve its monitoring of the management corporation to ensure School funds are used effectively and efficiently.

The Agreement between the management corporation and the School states that FREE will provide the Board with financial reports including quarterly and annual balance sheets, monthly statements of revenue and expenses, and monthly banking transaction reports. FREE receives cash compensation from the School for services provided.

We found the Board did not receive quarterly and annual balance sheets and monthly banking transaction reports, as required by the Agreement. Instead, the financial reports provided to the Board contained only budget-to-actual revenue and expenditure reports for, on average,[2] a two-month period. Additionally, the management corporation did not present the Board with bank statements or cancelled checks and a list of all moneys received and paid each month –documentation that supports information in the financial reports. The Board's failure to rigorously review the School's finances, particularly in view of the management corporation's complete control of its

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[1] Through its contract with the management corporation, the School has, in effect, assigned most of the financial duties to FREE including preparing and approving bills, signing checks, recording financial activity, and providing financial reports to the Board. Many of these duties would typically be the responsibility of a Treasurer.

[2] The management corporation did not present the Board with two-month reports on all occasions. At times, the Board was presented with monthly reports and other times with two-month reports. On one occasion, they were presented with a three-month report.

financial activities, significantly increases the risk that School assets could be lost or misappropriated.

We also found that the two-month budget-to-actual revenue and expenditure reports that FREE presented to the Board did not contain information to ensure School funds are effectively and efficiently used. The budget-to-actual reports did not show separate financial information for the 10-month educational program and the two-month extended summer program.[3] As a result, the financial reports did not show that the extended summer program had operated at a deficit for both the 2011-12 and 2012-13 fiscal years. Actual revenues and expenses for the extended summer program show that the program incurred a $46,541 loss in 2011-12 and a $53,507 loss in 2012-13. The ten-month program operated at a surplus therefore masking the loss incurred by the extended summer program. The lack of this critical information precludes the Board from properly monitoring the School's finances.

We also reviewed the total compensation issued to the management corporation[4] during the audit period to determine whether it was compensated in accordance with the Agreement. We found that FREE did not receive cash compensation from the School for all services provided. The School accrued a liability of $185,138 for these services, which is 6 percent of the School's total expenditures for the year (as outlined in the Agreement), that is expected to be paid at a future date. The School accrues the liability rather than paying cash compensation to FREE due to lack of cash flow. The School's cash flow is affected because it does not always receive billed fees from area school districts in a timely manner. FREE does not have an anticipated date in which it expects to receive cash compensation from the School. However, FREE officials indicated that it anticipates a long term gain from the School by promoting[5] greater student enrollment. As a result of increased student enrollment, revenue will increase, therefore increasing cash flow and fees to FREE. Although we found only minor deficiencies, which we discussed with School officials, when the Board is not provided with adequate and detailed financial information, it diminishes the Board's ability to monitor and

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[3] Although these programs are operated in a similar fashion, it is important for proper monitoring and transparency purposes for theses revenues and expenditures to be presented to the Board in a separate manner.

[4] The management corporation performs virtually all aspects of the School's financial operations including preparing bills and signing checks; therefore, compensation to the management corporation would be performed by the management corporation. Due to this, we considered payments to the management corporation to have the highest risk.

[5] Although not stated in the Agreement, FREE also assists the Board in promoting student enrollment, but there are no "specific" costs to the School.

manage the School's fiscal operations and increases the risk that errors and irregularities may occur and go undetected and uncorrected.

In March 2013, the management corporation updated the budget-to-actual reports to indicate the separation between the ten-month educational program and the two-month extended summer program. This update was made prior to the completion of our fieldwork.

Recommendations

1. The Board and management corporation should follow the Agreement between the management corporation and the School as it relates to financial reporting.

2. The management corporation should prepare and the Board should review quarterly and annual balance sheets, monthly statements of revenue and expenses and monthly reports of banking transactions, as required by the Agreement.

APPENDIX A

RESPONSE FROM SCHOOL OFFICIALS

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

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CHARTER SCHOOL
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June 21, 2013

Ira McCracken, Chief Examiner
Hauppauge Regional Office
NYS Office Building, Room 3A10
Veterans Memorial Highway Hauppauge, NY 11788-5533

Re: Financial Management, Report of Examination 2013M-98

The Child Development Center of the Hamptons Charter School (the "School") Board of Trustees and Family Residences and Essential Enterprises, Inc. ("FREE") the management company are committed to safeguarding the public funds that are received by the School intended for educational purposes. The board views the responsibility of providing appropriate oversight and support to the School as its top priority.

The School and FREE have a management agreement in place which specifically highlights the full scope of services to be provided by FREE as the sole member of the School. This includes various responsibilities for the administrative oversight and day to day operations of the School as well as the financial management and reporting. FREE has consistently responded to the requirements outlined in the agreement and consistently fulfilled its responsibilities for the financial management, including preparing of all fiscal documentation that confirms all essential financial activity. However, the agreement does not highlight the specific documents that will be shared directly with the Board of Directors. FREE and the board have worked collaboratively and mutually agreed to the financial reports that would be prepared and shared with the board to assure the board was equipped with the all essential fiscal information to fulfill its fiduciary responsibility of oversight and review of the Schools revenue, expenditures, assets and essential fiscal activity.

See
Note 1
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FREE has consistently provided the statement of activities at every board meeting accompanied by a robust discussion of the budget versus actual revenue/expenditures.. Furthermore, FREE has recently refined its fiscal reporting by preparing two separate reports which will distinguish the financial data and activity for the 2 month Extended School Year (ESY)program from the 10 month school year program. Also, each year FREE prepares a detailed annual school year budget for the board's review and approval. Subsequently, this budget is submitted to the SUNY Charter School Institute for final review. Moreover, FREE has also provided the results of the annual financial statement audit in conjunction with the external audit firm which includes the statement of financial position, statement of activities, cash flow and the footnotes relating to pertinent fiscal activity.

The two recommendations that have been presented by the Office of the State Comptroller directly relate to more specifically delineating the reports that will be shared with the board of directors to assure compliance with the management agreement as it relates to financial reporting - review of the balance sheets quarterly, monthly statements of revenues and expenses, and monthly banking transactions. Management will provide all recommended materials to the board at its regular meetings.

Respectfully submitted,

Eugenia AuKim
Board of Trustees President

The CDCH Charter School is a public school and a 501(c)(3) organization.

APPENDIX B

OSC COMMENT ON THE SCHOOL'S RESPONSE

Note 1

The agreement specifically states "FREE shall prepare for each Affiliate regular financial reports of the Affiliate's activities, including (i) quarterly and annual balance sheets, (ii) monthly statements of revenues and expenses, (iii) monthly reports of banking transactions and (iv) other financial reports required by government agencies having jurisdiction over the Affiliate."

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our examination was to assess the financial operations of the School. Since financial operations were handled by a management corporation (FREE), we evaluated the School's relationship with FREE.

We examined the School's management agreement for the period July 1, 2011 to February 27, 2013. Our audit included various procedures to gather relevant evidence concerning our stated objective, as follows:

- We reviewed the School Charter, by-laws, and Board meeting minutes to understand the School's operations.
- We reviewed the School's audited financial statements for the 2011-12 fiscal year.
- We interviewed FREE personnel, the Board Vice President, and the Board Treasurer.
- We reviewed the "Administrative Services Agreement" to ensure that the management company is being paid in accordance with the agreement.
- We reviewed reports to the Board to ensure they are in compliance with the "Administrative Services Agreement" and to determine the summer program's results of operations.

We conducted this performance audit in accordance with generally accepted government auditing standards (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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Andrew A. SanFilippo, Executive Deputy Comptroller
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