



Charter School for Applied Technologies

Payments to Affiliated Entities

Report of Examination

Period Covered:

July 1, 2010 — January 11, 2013

2013M-300



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 2014

Dear School Officials:

A top priority of the Office of the State Comptroller is to help school officials manage their schools efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support school operations. The Comptroller oversees the fiscal affairs of charter 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 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 Charter School for Applied Technologies, entitled Payments to Affiliated Entities. 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[1][c] of the Education Law, as amended by Chapter 101 of the Laws of 2010.

This audit's results and recommendations are resources for school officials to use in effectively managing 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

The Charter School for Applied Technologies (School) was established in 2001 by the Board of Regents under Article 56 of Education Law (Article 56). The Board of Regents is the “charter entity” for the School and, as such, is required to oversee the School to ensure compliance with all applicable laws, regulations and charter provisions.

Under Article 56, the School is an “education corporation” and regarded for most purposes as an independent and autonomous public school. Thus, the School is not under the control of the board of education of the school district in which it is located. Instead, the School is governed by a Board of Trustees (Board) which is presently comprised of nine members, including one parent representative. The Board is responsible for the general management and control of the School’s financial and educational affairs.

The School’s 2011-12 fiscal year operating expenses totaled approximately \$21 million. These expenses were funded primarily with revenues received from school districts for resident pupils (90 percent) and from State and Federal aid attributable to these pupils (10 percent). As of January 2013, the School had approximately 1,600 enrolled students and approximately 235 employees. Most of the School’s students are from the City of Buffalo.

The School’s consolidated financial statements include the accounts of two affiliated entities, a limited liability company (LLC) and a business corporation (Corporation), of which the School is the sole member. School officials indicated to us that these entities were expected to generate revenue by selling student assessment software developed by the School to other schools and by providing consulting services to other charter schools. The operating surpluses from these activities would then be remitted to the School to support its educational program.

Because the School’s consolidated financial statements do not present sufficiently detailed information for each of the affiliates, we requested access to the financial records of both affiliates. School officials declined to fully comply with our request, providing only limited documentation relating to certain aspects of the financial relationship between the School and its affiliates. Without complete access to the affiliates’ financial records, we could not determine if the School’s financial interests are adequately safeguarded.

By letter dated May 17, 2007, the School advised the State Education Department (SED) of its intention to establish an affiliated service group that would provide services related to but outside of the School's core mission, in order to generate revenues for the School.¹ The School advised SED that it planned to initially have the School fund its subsidiaries in exchange for a 100 percent interest in the securities of its for-profit subsidiaries. According to Board minutes dated June 5, 2007, less than a month after the School advised SED of its intention to establish the affiliated service group, and without having received a written response from SED, the Board voted to proceed with the establishment of the affiliates.

The LLC was formed on June 17, 2007. According to its articles of organization, the LLC was formed to carry on any lawful act or activity for which limited liability companies may be organized. On July 1, 2007, the School Board President executed an operating agreement on behalf of the School as the sole member of the LLC. Under the operating agreement, the School was required to make a capital contribution of \$175,000 to the LLC. The agreement also provides for the LLC's net profits and losses to be allocated to the School, with the timing and amount of distributions to be determined by the School. The operating agreement provides for management of the LLC to be vested in a manager appointed by the School.

At the same time the operating agreement was executed, the School's Superintendent, and the School's Director of Student Achievement who later became the School's Assistant Superintendent, were removed from the School's payroll and began working for the LLC. It also appears that the School appointed the Superintendent as manager of the LLC. Both of these individuals, however, retained their managerial roles at the School.

On July 1, 2007, the School and the LLC also entered into a management and consulting services agreement. The agreement was executed on behalf of the LLC by the Superintendent in his capacity as the LLC's president. Under the agreement, the School retained the LLC as an independent contractor to provide management and consulting services, including direct oversight of School operations. The services were to be provided on behalf of the LLC by three individuals, including the School's Superintendent and Assistant Superintendent. The term of the agreement was for one year with

¹ In a submission to SED several years later, the School broadened its rationale for forming the LLC to include saving money on tax-exempt bond financing covenants and responding to multiple requests for services from other charter schools, many of which were referred by SED, further indicating that the LLC was formed to provide consulting and management services to charter schools.

automatic renewals for consecutive one-year terms. The agreement requires the School to pay the LLC \$300,000 annually, plus reasonable expenses. We estimate that more than 90 percent of the LLC's revenues are generated from the School through the management agreement, and from other fees paid by the Corporation.

The Corporation was formed on February 10, 2010 to engage in any lawful act or activity for which the corporation may be organized under the Business Corporation Law. The certificate of incorporation authorizes the Corporation to issue 200 shares of common stock. On February 27, 2010, the Board approved a motion authorizing the School to make a one-time capital infusion of \$250,000 to the Corporation in exchange for all of its stock. According to School officials, the Corporation's board of directors is comprised of three members, one of whom is a member of the School's Board. It also appears that the School Superintendent served as the Corporation's president for a period of time. Subsequently the School's Assistant Superintendent assumed that position.

Objective

The objective of our audit was to examine the School's relationship with its affiliated entities and any related payments. Our audit addressed the following related question:

- Did the Board ensure that payments to affiliated entities were proper, accurate and supported?

Scope and Methodology

While our audit was for the period July 1, 2010 through January 11, 2013, we reviewed other documents that dated back to May 2007.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix 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 disagreed with the findings but indicated that they would consider the recommendations to improve operations. Appendix B includes our comments on issues raised in the School's response.

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 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 Secretary's office.

Payments to Affiliated Entities

The Board is responsible for safeguarding School resources. Accordingly, the Board is obligated to ensure that all financial decisions are in the School's best interests and that all financial transactions are documented, supported and legally permissible. Payments for professional services should be based on properly approved and executed written agreements that stipulate, among other things, the services to be provided and related rates of compensation. The Board should ensure that the School's operations are in compliance with applicable laws, as well as SED's rules, guidelines and recommendations. The overarching principle in spending school resources is to directly support the education of its students.

We found that the Board approved transfers of School funds totaling \$425,000 to capitalize two wholly-owned private entities which the Board caused to be established for the purpose of enabling the School to engage in what are essentially commercial ventures. We question whether the Board had authority to approve the transfers. Even if the Board had authority to approve the transfers, we were not able to assess the level of risk involved with the School's participation in these ventures because School officials refused to provide us access to either entity's financial records. We also note that the School made payments for services to one of the entities without a written contractual obligation to do so.

Authority to Capitalize Affiliates

As a threshold matter, we question whether the School had authority to capitalize the LLC and the Corporation. There is no express authority in Article 56 for a charter school to engage in any commercial venture or to form and capitalize a private entity. An education corporation organized to operate a charter school, however, is vested with all corporate powers "necessary and desirable for carrying out a charter school program" including, among other powers, those granted under the Not-For-Profit Corporation Law (NFPCL) that are made applicable to charter schools by Education Law. As relevant here, Education Law makes applicable to "education corporations" power under the NFPCL to "invest and reinvest" their funds, as well as the power to acquire and dispose of "shares ... or other securities ... issued by others, whether engaged in similar or different business, governmental or other activities." To the extent that these provisions may be construed as providing authority to "education corporations" to engage in a commercial venture, or to form and capitalize a private entity, we question whether they may be properly applied to charter schools.

In the first place, Article 56 expressly restricts a charter school's powers under the NFPCL to those that are "necessary and desirable for carrying out a charter school program," that is, the education of the charter school's own students. As recognized by the School in this instance, however, its participation in a commercial venture is outside of its core mission. Moreover, while Article 56 expressly authorizes a charter school to supplement its public funding by accepting gifts, donations and grants, there is nothing in Article 56 suggesting any intention whatsoever to permit a charter school to supplement its public funding by placing those moneys at risk in a commercial venture. Therefore, even if provisions of the NFPCL can be read as authorizing other types of "education corporations" to engage in commercial ventures, we are skeptical that these provisions can be properly applied to charter schools.

Further, Education Law provides that in the event of a conflict between Education Law and the NFPCL, Education Law controls. To the extent that the NFPCL can be construed as authorizing "education corporations" to acquire a controlling interest in a private entity, we believe the NFPCL would compromise significantly the provisions of Article 56 which mandate accountability and transparency in charter school financial operations. Under Article 56, charter schools are subject to oversight by the Board of Regents, the school's "charter entity" and, in certain instances, the school district in which the charter school is located.

In addition, charter schools are subject to audit by the State Comptroller at his or her discretion, are required to obtain an annual independent audit and are subject to both the Freedom of Information Law and the Open Meetings Law. If, as a legal matter, the School was correct in denying our request to review the financial records of its affiliates because the affiliates are separate "private business entities," then none of these safeguards apply to a private entity controlled by a charter school, leaving open opportunities for a form of undisclosed and unchecked self-dealing with public funds which may or may not produce results in a charter school's best interest. Therefore, while provisions of the NFPCL may authorize other types of "education corporations" to form and capitalize private entities, we question whether these provisions can be properly applied to charter schools.

Risk

In June and December 2007, the Board transferred amounts totaling \$175,000 as start up moneys for the LLC, and an additional \$250,000 in July 2010 as start up moneys for the Corporation. According to School officials, the two affiliated entities were expected to generate revenue by selling student assessment software developed by the School to other schools and by providing consulting services to other charter schools. The operating surpluses from these activities

would be remitted to the School to support the School's educational program. However, as of January 12, 2013, no such payments had been made to the School.

According to the forecast presented to and approved by the Board in September 2010, the LLC was expected to generate revenues of \$942,220 and \$875,000, and operating surpluses of \$15,260 and \$8,480, for the 2010-11 and 2011-12 fiscal years, respectively. We reviewed the consolidating schedules in the audited financial statements and found that the LLC had an operating surplus of \$168,073 for the 2010-11 fiscal year and an operating loss of (\$54,105) for the 2011-12 fiscal year. This resulted in the negative net asset balance of the LLC increasing² from (\$92,056) to (\$146,161) at June 30, 2012.

The possibility exists that the affiliated entities may continue to operate at a loss. Further losses might necessitate additional capitalization, thus diverting more resources from educating the School's students or, conceivably, the complete loss of the School's financial stake in the affiliated entities.

Other Payments to Affiliated Entities

From July 2007 to December 2012, the School has paid more than \$3 million in fees to the affiliated entities for management consulting services. We reviewed all such payments and found that the payments to the LLC were generally accurate, supported and in accordance with the management and consulting services agreement.

Effective July 1, 2010, the annual fee paid by the School to the LLC was increased from \$300,000 to \$750,000 to account for four employees from the School being transferred from the School's payroll to the LLC's payroll. The management and consulting services agreement between the School and the LLC, however, was not amended to reflect the change in services provided to the School or the associated increase in fees. Instead, the Board merely increased the budget appropriation against which payments to the LLC were charged. Because the School and the LLC are legally two separate entities, prudent business practices require that an amended agreement be prepared, approved and executed.³

For the period of January 2010 through December 2012, payments by the School to the Corporation for staff development amounted to slightly more than \$50,000. Although the payments to the

² This represents an actual decrease in net assets.

³ To the extent that the School's Superintendent and any other individual is regarded as an employee of both the School and the LLC, an amendment to the management and consulting services agreement would raise potential conflicts of interest and/or disclosure issues under article 18 of General Municipal Law.

Corporation were not made pursuant to a written contract, we found that the payments were adequately documented. Because the School and the Corporation are separate legal entities, the School should have entered into a written contract with the corporation detailing the services to be provided to the School and the payments to be made to the Corporation.⁴

We are referring this report to SED for its consideration.

Recommendations

1. The Board should confer with SED as to the propriety of its relationship with the LLC and the Corporation.
2. The Board should only spend School resources for activities that clearly and directly benefit its students.
3. The Board should ensure that contractual agreements and/or amendments are properly approved and executed.

⁴ Assuming that such an agreement is permissible under article 18 of General Municipal Law

APPENDIX A
RESPONSE FROM SCHOOL OFFICIALS

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



Charter School for Applied Technologies

J. Efraín Martínez, Superintendent
Andrew J. Lyle, Principal K-8
Ann Morgante, Principal 9-12
Phone: 716.876.7505
Fax: 716.876.9758

December 12, 2013

Via Hand-Delivery and First Class Mail

Mr. Robert E. Meller
Chief Examiner of Local Government and
School Accountability
Office of the State Comptroller
Buffalo Regional Office
295 Main Street, Suite 1032
Buffalo, New York 14203-2510

Dear Mr. Meller:

Re: Charter School for Applied Technologies
Response to Audit Entitled "Payments to Affiliated Entities"

This correspondence is submitted as a response to the Comptroller's draft audit report entitled "Payments to Affiliated Entities" ("Audit Report" or "Report") provided to the Charter School for Applied Technologies ("CSAT" or "School") on or about November 12, 2013. We have been asked by the Board of Trustees of CSAT ("Board" or "Trustees") to assist the School in the preparation of this letter to ensure that it is accurate and complete.

Preliminary Statement

CSAT is appreciative of the Comptroller's input and recommendations and enjoyed the opportunity to visit with you for an exit interview on November 18, 2013. The School recognizes its ongoing duty to examine and evaluate its internal policies and procedures, including its financial controls, and always strives to make the school as fiscally and responsibly efficient as possible in order to deliver an outstanding educational experience to our students. To that end, CSAT constantly is evaluating all aspects of its operations.

CSAT is pleased and proud that the Audit Report did not identify any operational or system-related deficiencies at the school. It also is proud that the Report did not identify any need for corrective action related to any of CSAT's internal or operational policies or procedures. The absence of any of these types of deficiencies in the Report validates the hard

work everyone at CSAT has invested in achieving its core goal of creating a vibrant and successful educational institution for its students. CSAT is proud of the learning environment it provides and is proud of its students' accomplishments.

A. Factual Inaccuracies in the Report:

Your letter of November 12, 2013 stated that the purpose of the November 18, 2013 exit discussion between the Comptroller's office and CSAT officials was to help ensure that the facts upon which your office relied in preparing the Report were accurate and complete. During the exit discussion, CSAT officials raised a number of concerns and identified certain factual inaccuracies that exist in the draft Report. It was CSAT's understanding that the inaccuracies would be addressed and a new draft Report would be provided prior to the time that this response letter was due to be submitted. To date, no such amended report has been received.

See
Note 1
Page 18

Regardless, CSAT always endeavors to cooperate to the fullest extent possible and required. To that end, below is a brief list of items in the draft Report that CSAT believes represent factual inaccuracies and that it hopes will be addressed when the final Report is released:

- a. Page 4, ¶ 1 – CSAT was established in 2001, not 2000. It is the largest charter school in New York State with more than 1600 students.
- b. Page 8, ¶ 1, last sentence – to clarify, CSAT is not subject to oversight by the Board of Education of the Buffalo Public School District – as the Report states on page 4, ¶ 2. The School is governed and controlled by its Board of Trustees and is subject to oversight by the Board of Regents and the State Education Department (“SED”).
- c. Page 9, ¶ 2 – the four employees identified were not all from its “finance office.” Those employees included the CFO, an Operations Manager, a PR Director, and a teacher.

See
Note 2
Page 18

See
Note 3
Page 18

See
Note 2
Page 18

B. Access to the Financial Records of EST, LLC and eDoctrina:

This request has been made previously by your office on multiple occasions. We addressed this request most recently by letter of this firm on October 4, 2012, a copy of which is attached as Exhibit A for ease of reference. However, CSAT is happy to cooperate and respond once again.

EST, LLC (“EST”) is a private, for-profit, limited liability company organized lawfully under the laws of the State of New York. eDoctrina is a private lawfully-organized New York corporation. We remain unaware of any authority – and the Report fails to identify any – that provides the Office of the State Comptroller the power to require CSAT to produce the financial records of private business entities. The School has asked the Comptroller for its authority on prior occasions, but no such authority has been provided.

See
Note 4
Page 18

Nonetheless, CSAT prides itself on being an “open book,” and seeks to cooperate to the best of its ability and to provide you with all the information it is required to provide that is

relevant to its finances. As a result, it has in the past provided your office with CSAT's complete consolidated financial statements. As you no doubt recall, CSAT's consolidated financial statements incorporate the financial statements of EST and eDoctrina, a common accounting practice performed by CSAT's independent auditors and a fact recognized by the Comptroller in the Report.¹ Therefore, while CSAT maintains its position that it is under no obligation to provide access to the financial records of EST or eDoctrina, substantively, the Comptroller already is in possession of the detailed financial information requested.

C. Findings:

1. Authority to Capitalize Affiliates

The Report questions whether the School had the authority to form and capitalize EST and eDoctrina, and questions whether the New York Not-for-Profit Corporation Law ("NFPCL") properly can be applied to charter schools. We believe the answer is yes.

Respectfully, CSAT has been open, honest, and cooperative since before EST and eDoctrina were created. In May of 2007, CSAT provided SED with an enterprise development plan for SED's analysis and comment – but received no formal response. As constructed, the plan lawfully allowed CSAT to create subsidiary and/or affiliated entities to share its educational and operational expertise with other charter schools and comply with its bond financing requirements. On multiple occasions since their formation, CSAT has provided further explanation and details about EST and eDoctrina to SED.

The Board's decisions to authorize the formation of EST, and later eDoctrina, were made cognizant of its obligation and vested oversight authority to make business and financial decisions in the best interest of the School and its students. They carefully were thought through and considered, with the Board exercising its best business judgment, fiduciary duty, duty of care, duty of loyalty and duty and commitment to serving the needs of the School, and most importantly its students and families. To that end the Board carefully examined many alternatives, and carefully considered the applicable law, with the help of outside counsel, and proceeded in the manner that it has.

The Report relies on a statement that Article 56 of the Education Law provides no express authority for a charter school to "engage in any commercial venture, or to form and capitalize a private entity." Even if true, for which this letter provides no opinion, the converse also is true. Neither the Education Law nor the NFPCL (which the Education Law makes applicable to charter schools) expressly prohibit a charter school from forming and capitalizing entities like EST and/or eDoctrina. A close examination of the NFPCL suggests the School has such authority and that no exceptions exist that would change the analysis. In fact, the absence of any direct statement in the law regarding whether a charter school properly may capitalize a for-profit entity likely is sufficient evidence of an intent on behalf of the legislature to allow the law to properly be applied to charter schools. While questioning the Board's authority, the Report provides no authority of its own suggesting a contrary conclusion is mandated.

CSAT remains ready, willing and able to work with the Board of Regents, SED, and the Comptroller to improve the educational experience at CSAT and achieve the core mission of the School. The School believes EST and eDoctrina assist it in achieving that goal.

¹ See Introduction, p. 4, ¶ 4.

2. Risk

As referenced above, CSAT's Board has an obligation, and is vested with the ultimate oversight authority, to make business and financial decisions in the best interest of the School and its students. The decisions to form and capitalize EST and eDoctrina exhaustively were thought through and considered, and the Trustees exercised their best business judgment, satisfying their fiduciary duties, duty of care and duty of loyalty with a level of commitment to serving the needs of the School and its students that should be commended in today's educational climate. Their dedication to the School's core mission and the best interests of its students is unquestioned.

As the Report points out, the NFPCL authorizes a school like CSAT to "invest and reinvest" their funds and to "acquire and dispose of shares . . . or other securities . . . issued by others, whether engaged in similar or different business." In compliance with its duties, the Board assessed properly the risk of forming and capitalizing EST and eDoctrina and, using their best business judgment, decided the benefits to the School and ultimately to its students far outweigh the potential risks of investing funds blindly in other more unknown, speculative securities.

See
Note 7
Page 19

It should be noted that the creation of EST alone saves the School considerable sums of money that otherwise necessarily would be spent on a management organization. As you recall, CSAT obtained bond financing after terminating Edison School, Inc. as its management organization. However, the bond financing still required CSAT to have a management agreement in place, despite the fact that CSAT had already been handling its own core management functions. To comply with its obligations, rather than continue spending money on Victory School, Inc., which it retained only for one year, EST was created, in part, to provide the management consulting services that were needed. By subsequently moving some key personnel from CSAT to EST, CSAT saved significant sums of money that otherwise would have been spent on a management organization that would have provided minimal value.

See
Note 8
Page 19

3. Other Payments to Affiliated Entities

CSAT is pleased by the Report's confirmation that the management consulting fees paid to EST and eDoctrina between July of 2007 and December of 2012 were accurate, supported, and in accordance with the management and consulting services agreement.

See
Note 9
Page 19

D. Recommendations:

1. **The Board should confer with SED as to the propriety of its relationship with [EST] and [eDoctrina].**

As set forth above, CSAT has been open and honest with SED even prior to implementing its enterprise development plan. CSAT sought comment and input from SED, by letter on May 17, 2007, in advance of proceeding with its plan. Having not received any communication from SED discouraging its plan, CSAT lawfully proceeded with the creation and capitalization of EST and eDoctrina. To date, no authority exists or has been provided that prohibits the School's activities in this regard.

See
Note 6
Page 18

CSAT is appreciative of the Comptroller's guidance and recommendation, however, and will continue to operate within the law and seek guidance from SED where appropriate.

2. The Board should only spend School resources for activities that clearly and directly benefit its students.

Using the considerable collective abilities of the Trustees, the Board, in its best business judgment, has made decisions to invest unrestricted School resources in EST and eDoctrina – wholly separate private entities created not only to share its educational and operational expertise with other charter schools and comply with its bond financing requirements, but also to enable CSAT to diversify activities and ultimately create additional sources of revenue for the School, which undoubtedly clearly and directly will benefit CSAT's students.

See
Note 10
Page 19

The School remains committed to continuing its policy of progressive evaluation of its financial controls over School resources and using them in a way that will better the educational experience for its students. CSAT appreciates the recommendation of the Comptroller in this respect.

3. The Board should ensure that contractual agreements and/or amendments are properly approved and executed.

The School is pleased that the Comptroller has recognized that the payments made to EST and eDoctrina since 2007 are well-documented and supported in accordance with all applicable agreements. Nevertheless, CSAT is committed to assessing whether any additional contractual agreements or amendments are advisable or necessary, and if so, is willing to make any necessary adjustments. The School is appreciative of the Comptroller for the recommendation.

See
Note 9
Page 19

Conclusion

Thank you for your thoughtful consideration of these issues and of CSAT's response to the Audit Report. If you have any additional questions, concerns, or comments, please contact me at your convenience.

Very truly yours,

J. Efrain Martinez

cc: Mr. Robert Mikulec, Sr.
President, Board of Trustees
Charter School for Applied Technologies
6156 Highgrove Park
East Amherst, New York 14051

Mr. Matthew D. Miller
Ms. Lisa Coppola
Rupp, Baase, Pfalzgraf, Cunningham & Coppola LLC
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Halim Omerhodzic
Tanya Moore
Laura Willard

KIMBERLY A. GEORGER
georger@ruppbaase.com

October 4, 2012

[REDACTED]
Office of the State Comptroller
295 Main Street, Room 1032
Buffalo, New York 14203

Dear [REDACTED]

Re: Audit of Charter School for Applied Technologies

I write in connection with your current audit of Charter School for Applied Technologies ("CSAT"). Specifically, you have requested that CSAT provide you with full disclosure of the financial documents of EST, LLC and eDoctrina, Inc. While CSAT desires to cooperate with you in your review of its financial documents, EST, LLC and eDoctrina, Inc. are private business entities, namely a limited liability corporation and a corporation, and we are unaware of any authority that permits the Office of the State Comptroller to compel this production. If such authority exists, however, please provide it, and we will reconsider our position which, for clarity, is that CSAT is not obligated to provide you with access to EST, LLC's and eDoctrina's financial records.

As you know, CSAT's independent auditors consolidated CSAT's financial statements with those of EST, LLC and eDoctrina, Inc., which is a common accounting practice. As a result, in complying with your request for CSAT's financial statements, CSAT produced the consolidated financials. It did this because it recognizes its obligation to provide you with all information relevant to CSAT's finances not because you are entitled to eDoctrina's or EST's records. Our position remains that the financial records of private entities are not subject to your review.

If you wish to discuss this matter further, or if you have legal authority which you believe entitles you to the information you seek, please contact me at 854-3400 or georger@ruppbaase.com. Thank you.

Very truly yours,

Kimberly A. Georger

OFFICES

APPENDIX B

OSC COMMENTS ON THE SCHOOL'S RESPONSE

Note 1

At the exit discussion, School officials indicated they would be providing additional documentation. However, no such information subsequently was provided. As such, there was no need to significantly modify the draft report and submit another version to the School. In fact, the significant issue in dispute was when the School first contacted SED about forming the affiliated entities. We note that the School's response letter confirms that the School contacted SED in May of 2007, which agrees with what we stated in our report.

Note 2

The report was changed to reflect the information provided.

Note 3

Section 2853[2-a] of the Education Law provides that, for charter schools approved by either SUNY or the Board of Regents, the school district in which the charter school is located shall have the right to visit, examine into and inspect the charter school for the purpose of ensuring that the school is in compliance with all applicable laws, regulations and charter provisions.

Note 4

The Comptroller's authority to audit a charter school includes authority to examine the School's financial relationships with private entities. As part of such examination, the Comptroller is entitled to review pertinent documents relating to that relationship regardless of whether the documents are financial records of the private entity or the charter school.

Note 5

As noted in the report, the School's consolidated financial statements do not present sufficiently detailed information to determine whether the School's financial interest in its affiliates is adequately protected.

Note 6

As indicated in the report, Section 2853[1][b] of the Education Law restricts a charter school's powers under the Not-For-Profit Corporation Law to those that are "necessary and desirable for carrying out a charter school program," that is, the education of the School's own students. Therefore, the issue is not whether a charter school is expressly prohibited from operating a commercial enterprise but whether the operation of a commercial enterprise is "necessary and desirable for carrying out a charter school program." For the reasons set forth in the report, we remain skeptical that a charter school may capitalize a private entity to engage in a commercial venture.

Note 7

The School's alternative investment options were not limited to "unknown, speculative securities." For example, the School always had the option of investing moneys not needed for immediate expenditure in the types of investments that can be made by local governments (see General Municipal Law section 11). Moreover, in this instance, such an investment would have resulted in a positive return with minimal risk.

Note 8

Although the School's compliance with its bond covenants was beyond the scope of our audit, we note that the practical effect of its management consulting services agreement with the LLC (i.e., EST) is for the School to have in place a management agreement with itself because the LLC is wholly-owned and controlled by the School.

Note 9

As noted in the report, effective July 1, 2010, the annual fee paid by the School to the LLC was increased from \$300,000 to \$750,000 without a corresponding amendment to the management consulting services agreement. Similarly, the report notes that for the period January 2010 through December 2012, the School paid the Corporation (i.e., eDoctrina) slightly more than \$50,000 without any written contract.

Note 10

Section 2850 of the Education Law provides that charter schools are established for the sole purpose of providing teachers, parents and community members with the opportunity to establish and maintain schools that operate independently of existing schools and school districts in order to accomplish certain educational and school management objectives. To accomplish this purpose, charter schools are provided with public funding and are authorized to supplement that funding by accepting gifts, donations and grants. In light of this purpose and statutory funding scheme, we doubt that the State Legislature ever envisioned that a charter school would "diversify" its activities by placing public funds at risk to engage in a commercial enterprise having as its purpose additional sources of revenue for the school. The School's confidence that the LLC and the Corporation will generate revenues for the benefit of its students is not warranted by its experience to date and is purely speculative.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our examination was to assess the financial operations of the School. 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 and disbursements, purchasing, payroll and information technology.

During the initial assessment, we interviewed appropriate School officials, performed limited tests of transactions, and reviewed pertinent documents, such as contractual agreements, School policies and procedures manuals, by-laws, Board minutes, and financial records and reports.

After reviewing the information gathered during our initial assessment, we decided on the reported objective and scope for the area with the greatest risk. We examined the Board's processes relating to the establishment of and subsequent payments to affiliated entities. Our audit included various procedures to gather relevant evidence concerning our stated objective, as follows:

- We interviewed School officials to understand the processes used and reviewed related School records.
- We reviewed the School's by-laws and charter agreement.
- We reviewed the minutes of the Board's proceedings relating to the incorporation of the affiliates and any agreements between the School and the affiliates.
- We reviewed the School's disbursement records relating to any payments made to the affiliates.
- We reviewed the affiliates' incorporation certificates which we obtained from the New York State Department of State.
- We reviewed Education Law and consulted with our Division of Legal Services.
- We reviewed audited financial statements and annual budget documents.

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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