



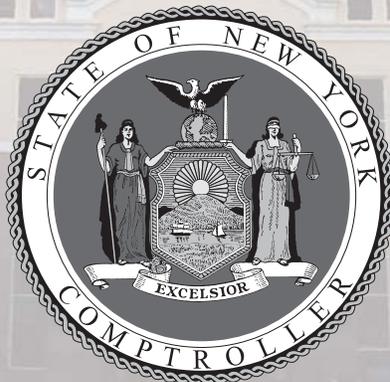
# Southside Academy Charter School Board Oversight

## Report of Examination

Period Covered:

July 1, 2011 — June 30, 2013

2013M-318



Thomas P. DiNapoli

# Table of Contents

	<b>Page</b>
<b>AUTHORITY LETTER</b>	2
<b>INTRODUCTION</b>	3
Background	3
Objective	3
Scope and Methodology	3
Comments of School Officials and Corrective Action	4
<b>BOARD OVERSIGHT</b>	5
Recommendations	8
<b>APPENDIX A</b> Response From School Officials	9
<b>APPENDIX B</b> Audit Methodology and Standards	13
<b>APPENDIX C</b> How to Obtain Additional Copies of the Report	14
<b>APPENDIX D</b> Local Regional Office Listing	15

# State of New York Office of the State Comptroller

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## **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 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 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 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 Southside Academy 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 [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. 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. Southside Academy Charter School<sup>1</sup> (School), located in the City of Syracuse, is governed by a Board of Trustees (Board) that has five members. In 2002, the Board entered into a management agreement with National Heritage Academies Inc. (NHA), a privately held for-profit corporation located in Grand Rapids, Michigan.<sup>2</sup> The management agreement states that NHA, subject to the oversight and authority of the Board, is responsible for the management, operation, administration, accounting and education at the School.

All revenues the School receives are transferred to NHA, which is responsible for the control of the School's finances and for expending the revenues in accordance with the approved budget and as otherwise authorized by the Board. In addition, NHA is entitled by the agreement to retain as compensation a fee for its services rendered, comprising the difference, if any, "between the amount of revenues and the amount of revenues actually expended by or on behalf of the School during its fiscal year." The Board also has a lease agreement with an NHA subsidiary for the building where the School operates.

During fiscal year 2012-13, the School enrolled about 680 students in kindergarten through eighth grade. The School's budgeted expenditures for the 2012-13 fiscal year were approximately \$9 million, funded by revenues 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 NHA. Our audit addressed the following related question:

- Did the Board properly monitor NHA's operation of the School and ensure School funds were effectively and efficiently used?

## Scope and Methodology

Our overall goal was to assess the School's financial operations. Since financial operations were handled by NHA, we evaluated the Board's oversight of NHA as it relates to financial operations for the period July 1, 2011 to June 30, 2013. We extended our scope back to 2007 for information related to the building lease.

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<sup>1</sup> Established in 2002

<sup>2</sup> NHA operates 75 charter schools across the United States, including six schools in New York State.

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

**Comments of School  
Officials and Corrective  
Action**

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

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

## Board Oversight

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 NHA to ensure that all transactions are accounted for and that public funds are used effectively and efficiently for educational purposes.

The Board contracted with NHA to be responsible for the administration, operation and performance of the School in accordance with the School's Charter and subject to the oversight and authority of the Board. The management agreement states that NHA will provide the School with a projected budget that contains reasonable detail as requested by the Board and includes all projected expenditures and costs reasonably associated with operating the School and the NHA school program. Budget amendments may be made as deemed necessary by the Board and NHA. The agreement transfers all School revenues to NHA, and the revenues are to be expended by NHA in accordance with the approved budget and as otherwise authorized by the Board. In addition, NHA is responsible for the detailed financial reporting of all revenues and expenditures and any other financial information deemed necessary by the Board for the Board to monitor performance and efficiency and to reconcile the fee paid to NHA. NHA is entitled to retain as compensation a fee for its services rendered, comprising the difference, if any, "between the amount of revenues and the amount of revenues actually expended by or on behalf of the School during its fiscal year."

While the Board meets regularly to deal with a range of issues, its oversight of the School's fiscal affairs could be improved. NHA provides the Board with projected budgets, budget amendments and quarterly financial statements for its review. Although the Board reviews and approves budgets and budget amendments, the budgetary information and the quarterly financial statements lack transparency to allow the Board to identify the fee for services paid to NHA, to distinguish indirect from direct costs and to determine how indirect costs are allocated by NHA to the School. For example, \$2.9 million in indirect costs have been allocated to the School by NHA, but the Board has not received support for how the costs are allocated. As a result, this limits the Board's ability to adequately monitor NHA and verify that indirect costs allocated to the School are accurate and appropriate.

The School's 2011-12 fiscal year budget developed<sup>3</sup> by NHA and approved by the Board was modified twice. NHA officials stated that their standard process is to develop a preliminary budget prior to the start of school, an amended budget based on actual school enrollment and per pupil funding, and a final budget later in the year to reflect changes experienced during the school year. As NHA's estimates of School revenue increased or decreased throughout the year, NHA adjusted all detailed budget expenditures to equal 100 percent of available revenue with no explanation of the specific driver of the increased or decreased expenditures. In addition, the quarterly reports show that the School's actual revenues always equaled reported expenditures because any operating surplus<sup>4</sup> generated before NHA's fee is taken into account is then expended to compensate NHA for its services. However, the budget and the financial reports provided to the Board are not transparent because they do not show the amount of the NHA fee budgeted or paid. Board members told us they were unaware of how much the School had paid in fees to NHA and did not receive or request information to reconcile the fee. Because of the lack of transparency, the Board's ability to monitor the School's financial operations is weakened and could result in the Board expending more moneys than reasonable for a fee that could otherwise be used to directly benefit the students of the School.

We asked NHA officials how much their fee was in the 2011-12 and 2012-13 fiscal years. NHA officials told us there is no specific figure representing their fee. NHA receives all the revenues and pays out all operating costs – and the Board approves a balanced budget where revenues equal expenditures – but there is no line in the budget that represents a fee to NHA. NHA told us its fee is included in the NHA costs allocated to the School (as discussed below). However, we found no indication of a fee identified in the 2011-12 fiscal year that was included in these allocated costs.

In addition, although the School's budget, amendments and quarterly financial statements provide a detailed report of expenditures by type, they do not distinguish site-based (direct) costs from allocated (indirect) support costs.<sup>5</sup> According to NHA, allocated support costs consist of expenditures that are incurred centrally at NHA and are considered to be shared corporate support costs among all NHA schools. These costs cannot be specifically identified to a particular

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<sup>3</sup> Developed by NHA with input from the School Principal and Deans

<sup>4</sup> Revenues that exceed expenditures

<sup>5</sup> According to NHA, expenditures are either directly related to a particular school site such as staff salaries, benefits, training, supplies, textbooks, building, equipment, repairs and utilities; or to central services that are allocated among NHA schools based on usage, such as student assessment, facilities department costs, marketing and admissions, information technology management and financial and human resource services.

school; rather NHA uses an allocation method to record these expenditures to its schools. For example, the School’s independent audited financial statements for 2011-12 reported \$2.9 million in indirect costs classified as “Supporting Services Management and General,” as shown in Table 1:<sup>6</sup>

<b>TABLE 1: Supporting Services Management and General – 2011-12</b>	
<b>Allocated Corporate Services</b>	<b>Amount</b>
<b>Academic and General Support</b>	<b>\$1,001,555</b>
<b>Human Resources</b>	<b>\$525,146</b>
<b>Technology Services</b>	<b>\$394,490</b>
<b>Accounting Fees</b>	<b>\$264,346</b>
<b>Instructional Support</b>	<b>\$215,695</b>
<b>Board Support</b>	<b>\$193,131</b>
<b>Support Services</b>	<b>\$114,973</b>
<b>Enrollment and Parent Relations</b>	<b>\$106,493</b>
<b>Marketing and Business Development</b>	<b>\$92,331</b>
<b>Occupancy</b>	<b>\$30,553</b>
<b>Total Allocated Corporate Services</b>	<b>\$2,938,713</b>

It was not until after the completion of the fiscal year that the Board was provided with a breakdown of these costs, which represented 32 percent of the School’s total operating costs. Although the costs were distinguished in the audited financial statements, NHA officials did not provide detailed documentation to support their \$2.9 million allocation of support costs to the School. Board members told us they did not know the details behind these costs. NHA also advised us that it considers the specifics as to the allocations of any specific school to be proprietary, as they relate in detail to operations of NHA, a privately held enterprise. As such, it did not provide us with support for the costs allocated to the School for either the 2011-12 or 2012-13 fiscal years.<sup>7</sup>

As of the date of our fieldwork, the financial reports that NHA provided to the Board for 2012-13 did not distinguish indirect from direct costs, and the Board had not requested a breakdown and supporting documentation for any costs allocated to the School. Board members told us they are satisfied with the services NHA provides, and they do not believe NHA is making much profit from the School and

<sup>6</sup> Direct costs for “Program Services” totaled \$6,087,184 (e.g., personal services, supplies, building rent and food service).

<sup>7</sup> We requested the allocated costs for the 2012-13 fiscal year. NHA told us that the allocation would not be completed until its financial statement audits are complete.

most likely had operating deficits when the School was first opened.<sup>8</sup> However, given the lack of transparency, the Board has no way to know what is specifically included in the School's indirect costs and the amount of the fees NHA is charging the School.

Lease Agreement – The Board entered into a lease agreement with an NHA subsidiary in 2007 for a school building. According to NHA, its subsidiary built the building in 2007 for a total investment of \$6.2 million. From July 2007 through June 2013, lease payments charged to the School totaled \$6.1 million. In effect, the NHA subsidiary will have almost recovered its investment by the end of the 2012-13 fiscal year. Consequently, School officials have not demonstrated the arrangement was in the best interests of the School, particularly since NHA controls virtually all of the School's revenues through the management agreement, and the Board did not request or complete a cost-benefit analysis. Board members said they were not particularly concerned about the cost of the lease because, even if there was no cost for the lease, NHA would still receive the money through the management agreement, as NHA retains virtually all revenues not expended.

If the Board is unable to identify costs and does not know what makes up the costs, it has no way to verify or adequately oversee School operations – as provided by NHA – to ensure expenditures are appropriate and accurate. Without such detailed information, the Board cannot determine if NHA is spending money appropriately for the benefit of the students. Furthermore, spending more on a lease than the value of the building, without a cost-benefit analysis, may not be in the best interest of students. Therefore, it is imperative the Board monitor NHA to ensure School funds are effectively and efficiently used.

## Recommendations

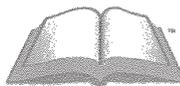
1. The Board should identify the fee paid to NHA and reconcile it as stated in the terms of the management agreement with NHA, to ensure the fee is reasonable and in the best interest of the School.
2. The Board should periodically request a breakdown of costs to verify that expenditures allocated to the School by NHA are reasonable, fair and adequately supported.
3. The Board should periodically assess the terms and conditions of any management and lease agreements to ensure that they are reasonable and in the best interest of the School.

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<sup>8</sup> Although there is a lack of transparency surrounding the amount of the fees paid to NHA, we determined that the financial reports do provide a revenue line item called "Contribution from Management Company" that would clearly show the amount NHA would contribute to the School if the School's expenditures ever exceeded its revenues.

**APPENDIX A**  
**RESPONSE FROM SCHOOL OFFICIALS**

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



December 9, 2013

Office of the State Comptroller  
Division of Local Government and School Accountability  
Syracuse Regional Office  
Attn: Rebecca Wilcox, Chief Examiner  
State Office Building, Room 409  
333 E. Washington Street  
Syracuse, NY 13202-1428

Dear Ms. Wilcox:

On behalf of the entire Board of Trustees of Southside Academy Charter School ("Southside" or the "School"), I am submitting this letter as a formal response to the draft audit report prepared by the Office of the State Comptroller ("OSC") (Audit Report #2013M-318), dated November 2013 (the "Audit Report"). We respect OSC's input in helping school officials manage government resources efficiently and effectively. We view the Audit Report as a valuable tool to assist us in evaluating whether the School's funds have been and are being put to their highest and best use. We take our responsibility as Board members, very seriously, and we use all the tools available to further the best interests of the School, including the safeguarding of all public funds received by the School.

We have identified the following three recommendations in the Audit Report:

- 1) The Board should identify the fee paid to National Heritage Academies, Inc. ("NHA"), and reconcile it as stated in the terms of the management agreement with NHA, to ensure the fee is reasonable and in the best interest of the School;
- 2) The Board should periodically request a breakdown of costs to verify that expenditures allocated to the School by NHA are reasonable and fair, and are adequately supported; and
- 3) The Board should periodically assess the terms and conditions of any management and lease agreements to ensure that they are reasonable and in the best interests of the School.

At the outset, please be advised that we respectfully submit that we believe that we have at all times exercised due diligence and caution in our oversight of NHA's services to the School. Set forth below are our comments in response to the Audit Report's findings and recommendations, which we ask that you take into further consideration in preparing your final report.

In response to the first and second recommendations set forth above, we respectfully disagree with any suggestion that the Board does not have sufficient insight into the School's expenditures. As described in the Audit Report, the Board has contracted with NHA to provide the educational program, management services, and financial services to Southside. Per the School's management agreement with NHA, NHA is to receive all of the School's revenue from all sources in exchange for providing the foregoing services, which also includes staffing,

curriculum and providing the School's facility. Only if NHA is able to provide the foregoing services, which are essential to the operations of the School, for something less than the revenue that the School receives, is it entitled to keep the difference. The Board at all times maintains ultimate control over the School's operations and finances. It simply has chosen to delegate the day-to-day financial decisions to NHA, which are required to be made within the framework of and subject to the Board-approved budget and oversight.

The Audit Report describes our budget process in detail. The budget process has three stages: the preliminary Spring budget approval (prior to the start of the fiscal year); the Fall budget approval (after the school year begins and student count can be more reasonably estimated); and the final amended budget (at the end of the school year). Our management agreement with NHA requires NHA not to expend any of the School's revenues in a way that deviates from the Board-approved budget without the Board's approval. As a Board, we recognize and follow-through on our responsibility to review and approve the budget on a yearly basis and any amendments. Evidence of the care we take in the budget process (including the Board's discussion and analysis of the yearly budget) can be found in the Board's meeting minutes.

The Audit Report also asserts that the Board lacked sufficient detailed expenditure information to make the fee paid to NHA sufficiently transparent, to allow the Board to distinguish indirect from direct costs, and to identify how indirect costs are allocated by NHA. It is important to point out that the budgets for the School and its monthly financial statements are documented with a significant amount of detail (more than 90 separate expense line items). Although the budget and monthly financial statements do not distinguish between site-based costs and costs that are centralized and allocated, there is a significant amount of detail on the type of cost. Allocations of centrally incurred costs are not broken out separately, but are included in every budget and every financial statement. In addition, the breakout of allocated costs is reviewed by an independent auditor retained by the School and disclosed in an audit report every year. The Board evaluates the performance of total school operations, and in doing so, squarely focuses on whether NHA is providing the agreed-upon services per the management agreement. We focus less on whether NHA incurs the cost for a needed service or function centrally or at the School site. That's not to say that the Board doesn't review line items on both the School's budgets and financial statements. We do and we will not hesitate to exercise our rights to question line items whenever we think it is necessary. To that end, it is also important to note that over the full term of the current charter agreement for the School, we are proud of the fact that Southside's academic performance has exceeded that of the local school district.

With regards to the third recommendation, we would like to highlight the process that we implemented in our most recent negotiations with NHA on the management and lease agreements. With respect to both agreements, the Board, with the assistance of its legal counsel, carefully reviewed and negotiated the respective agreements. In each case, there was several back and forth interactions between the parties relating to the agreements and specific provisions contained therein, including fees. At the end of the day, we as a Board believe we entered into agreements that serve the best interests of the School and offer an alternative and valued means for providing a successful and viable school for our students.



Thank you for the opportunity to respond to the Audit Report. Again, we ask that you take into further consideration our comments in preparing your final report.

Sincerely,

Kevin Walsh  
Board President  
Southside Academy Charter School

## **APPENDIX B**

### **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 (NHA), we evaluated the School's relationship with NHA.

We examined the School's management agreement for the period July 1, 2011 through June 30, 2013. We extended our scope back to 2007 for information related to the School building lease. Our audit included various procedures to gather relevant evidence concerning our stated objective, as follows:

- We reviewed the management agreement, lease agreement, School Charter, by-laws, annual reports, budgets, budget amendments, quarterly financial statements, 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 NHA personnel and three School Board members.
- We evaluated the School's annual budgeting and financial audit processes.

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 C

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