



Charter School of Educational Excellence

Middle School Capital Project and Board Oversight of the Management Company

Report of Examination

Period Covered:

July 1, 2013 — August 19, 2014

2015M-7



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

May 2015

Dear Charter School Officials:

A top priority of the Office of the State Comptroller is to help charter school officials manage school resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support school operations. The Comptroller audits the financial operations of charter schools outside of New York City to promote compliance with relevant statutes and observance of good business practices. This oversight identifies opportunities for improving school financial operations and Board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard school assets.

Following is a report of our audit of the Charter School of Educational Excellence, entitled Middle School Capital Project and Board Oversight of the Management Company. 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 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*



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 operational requirements than traditional public schools. Most of a charter school's operational requirements are contained in Education Law Article 56 and the school's bylaws.

The Charter School of Educational Excellence (School) is located in the City of Yonkers. The School is governed by the Board of Trustees (Board), which comprises eight members. The Board is responsible for the general management and control of the School's financial and educational affairs. The Board appoints the Principal, who is responsible, along with the Director of Operations and other administrative staff, for the School's day-to-day management under the Board's direction. Additionally, the School contracts with a management company (Company) to assist with the School's academic and financial operations.

As of June 30, 2014, the School had approximately 640 enrolled students and 77 employees. The School's 2013-14 fiscal year operating expenses totaled approximately \$10 million, funded primarily with revenues from students' home school districts and State and federal aid.

Scope and Objectives

The objectives of our audit were to determine if the Board provided sufficient oversight of the Middle School construction project and of the Company for the period July 1, 2013 through August 19, 2014. We extended our scope back to July 1, 2009 to review records for the Middle School's construction. Our audit addressed the following related questions:

- Did the Board establish proper procedures to ensure that the Middle School capital project was completed within the specified timeframe and at the authorized amount?
- Did the Board provide sufficient oversight of the Company to safeguard School funds?

Audit Results

The Board did not establish procedures to ensure that the Middle School project costs were within authorized limits. The project was completed in May 2012, eight months after the original targeted completion date, at a total cost of \$10.9 million, which exceeded the authorized cost by \$2.6 million. In addition, we reviewed the selection process for the general contractor and professional service providers for the project and determined that School officials did not seek competition for

approximately \$6.8 million in project-related expenses to the general contractor, the architect and the owner’s representative. Without a competitive process, School officials cannot be certain that they contracted for these services in the School’s best interest.

The Board also needs to improve its oversight of the Company’s activities. Our examination of the School’s financial activities disclosed that the School does not have custody of its funds until after the Company pays most of the School’s bills and deducts their expenses. The Company then transfers the remaining funds into the School-controlled bank account. We also found that the Board and School officials do not receive or review bank statements and bank reconciliations. Without adequate oversight, the Board cannot be assured that Company officials use School funds for their intended purposes. We also reviewed the Company’s agreement and determined that the School was operating under an expired contract. Operating under an expired agreement could expose the School to significant liabilities related to fees charged and services provided by the Company.

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 officials’ 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 and is governed under Education Law Article 56. Charter schools generally have fewer operational requirements than traditional public schools. Most of the regulations for a charter school are contained in its bylaws, charter agreement and fiscal/financial management plans.

The Charter School of Educational Excellence (School) is located in the City of Yonkers. The oversight of School operations is provided by the Board of Trustees (Board), which comprises eight members. The Board is responsible for the general management and control of the School's financial and educational affairs. The Board entered into a contract with a management company (Company) to provide services including payroll, human resources and academic assistance.

The Board appoints the Principal, who is responsible, along with the Business and Operations Director and other administrative staff, for the School's day-to-day management under the Board's direction. The School's 2013-14 fiscal year operating expenses totaled approximately \$10 million, funded primarily with revenues from students' home school districts and State and federal aid. As of June 30, 2014, the School had approximately 640 enrolled students and 77 employees.

Objectives

The objectives of our audit were to determine if the Board provided sufficient oversight of the Middle School construction project and the Company. Our audit addressed the following related questions:

- Did the Board establish proper procedures to ensure that the Middle School capital project was completed within the specified timeframe and at the authorized amount?
- Did the Board provide sufficient oversight of the Company to safeguard School funds?

Scope and Methodology

We evaluated the Board's oversight of the Middle School construction project and its oversight of the Company as it relates to financial operations for the period July 1, 2013 through August 19, 2014. We extended our scope back July 1, 2009 to review records for the Middle School's construction.

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. 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 officials' response letter.

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 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.

Middle School Capital Project

The Board is responsible for overseeing and managing the School's capital projects, but may hire consultants to provide assistance. Because of the significant resources involved, the Board should ensure that capital projects are properly planned and monitored. Capital projects are long-term projects which generally require relatively large sums of money to acquire, develop, improve and maintain. All capital projects must be properly planned to accurately estimate costs. Proper planning can minimize the possibility of cost overruns which could have a negative impact on finances.

If a capital project's estimated costs exceed available funding, the project should not proceed until additional funding can be identified and/or project modifications are made. Once sufficient funding has been identified, capital projects must be adequately monitored to ensure that the work done is in accordance with expectations and expenses do not exceed the amounts authorized.

The School did not seek competition for approximately \$6.8 million in project-related expenses paid to the general contractor, the architect and the owner's representative. In addition, the Middle School capital project exceeded the authorized amount of \$8.3 million by approximately \$2.6 million. As a result, the School may have incurred unnecessary costs.

Selection Process

The School is not required by statute to engage in a competitive process when seeking general contractors and professional services. Nonetheless, the Board has a duty to acquire such services at the most beneficial terms and conditions, which could have been achieved through a competitive process. An effective competitive process includes confirming that vendors have the necessary expertise to provide services by issuing requests for proposals and requests for qualifications to service providers. The process should also require written contracts that detail the terms and deliverables, such as the contract period, the services to be provided and the basis for compensation. Written contracts also help to protect the School in the event that contractors default on their obligations or make excessive claims.

Architect – School officials told us that they spoke with several architects for the project but could not recall the specific number and could not provide any supporting documentation, such as proposals, to validate their assertions. School officials also said that the architect selected was willing to assist the School with the predevelopment

phase and wait for payment. On December 22, 2009, the Board approved a contract for architectural and engineering services totaling \$173,900. Officials did not provide any evidence indicating they interviewed or contacted other architects or engineers.

Owner's Representative – School officials told us that they performed a search for individuals who had experience with charter school development projects and found few individuals with such experience. School officials said they could not recall the number of individuals they interviewed for the position and did not have any supporting documentation, such as proposals, to validate their assertions. School officials told us that the owner's representative was retained based on his past experience with the construction of other charter school capital projects. On December 29, 2009, the Board approved a contract with the owner's representative totaling \$150,000. His responsibility included managing all aspects of the project, including the site planning approval process, pre-development, pre-construction, construction and post-construction. However, School officials did not provide any documentation to evidence their search, or receipt of proposals from other individuals, to show that they used a competitive process to select the owner's representative.

General Contractor – School officials told us that the general contractor was retained based on its past and current projects. School officials also told us that they wanted a building design method using modular construction. After further research, they believed that the general contractor that they selected had reasonable costs and efficient transportation for the modular buildings. In addition, this general contractor was the only contractor who could complete the project within a one-year timeframe.

The owner's representative was responsible for researching three companies that would be able to perform the project. He visited the three companies and recommended the successful general contractor to the Board because he believed that this contractor had far more experience with building schools and in particular using steel and concrete construction instead of wood construction. An on-site visit of the general contractor's facility led the owner's representative to conclude that the general contractor was far superior to the other two companies in constructing modular buildings using steel and concrete construction. School officials also reviewed the general contractor's financial history and determined that the company was financially solvent. Additionally, the School's attorney, the City of Yonkers attorney and bond counsel verified that the general contractor was solvent.

On September 20, 2010, the Board approved a \$7.1 million contract with the general contractor. School officials did not provide us

with any proposals that they received from other contractors or any documentation to support their assertions and basis for their selection. Therefore, it is questionable as to whether or not School officials used a competitive process in awarding the contract for the Middle School's general construction.

School officials could not provide us with any documentation showing that they sought competition when selecting the architect, the owner's representative and the general contractor. By seeking competition and exploring viable options, School officials would have better assurance they received the best services at the lowest possible cost. Without a competitive process, School officials cannot be certain that they contracted for these services in the School's best interest.

Cost Overruns

The key to meeting project goals is to establish a realistic, comprehensive budget that anticipates all costs associated with the project. Building project costs fall into six basic categories: land and building acquisition; construction activities; professional services; furniture, fixtures and equipment; owner's costs; and contingencies. Failure to properly plan a project could lead to significant cost overruns resulting in the project exceeding the amount authorized.

In 2010, the Board authorized a bond resolution not to exceed \$12.3 million which included a maximum authorized amount of \$8.3 million to finance the cost of the Middle School project which has a period of probable usefulness of 40 years. In December 2009, the Board approved a contract for an architectural and engineering firm for \$173,900 and the owner's representative for \$150,000. In September 2010, the Board hired the general contractor (modular manufacturer), who was responsible for the modular building construction costing approximately \$7.1 million. The Middle School's construction began in December 2010.

The general contractor and modular builder for the project was responsible for all aspects of the project, including electrical work, plumbing, and heating, ventilating, and air conditioning. As of July 2011, the general contractor was paid approximately \$6.5 million before filing for bankruptcy in September 2011, prior to the project being completed. The original contract amount for the general contractor was approximately \$7.1 million. However, change orders totaling \$590,632 brought the total contract amount to approximately \$7.7 million. At this time, the general contractor had several subcontractors employed to perform various parts of the project.

As a result of the original contractor filing for bankruptcy, the School entered into an agreement with one of the existing subcontractors to act as general contractor and manage the project. Additionally,

the School entered into assumption agreements¹ with other existing subcontractors to complete their respective project phases. As of May 2012, School officials paid a total of \$4 million to the existing subcontractors to complete the project. This included a payment of approximately \$1.49 million to the replacement general contractor. The project was completed in May 2012, eight months after the targeted completion date. The total project cost was \$10.9 million, which exceeded the authorized amount by \$2.6 million. This overrun was due to change orders to existing subcontractors and assumption contracts with these subcontractors. School officials indicated that in order to finance the additional cost of the project, they had to use other School funds and accept concessions from subcontractors.

The School did not seek competition for the general contractor, the architect and the owner's representative for the Middle School project. In addition, School officials did not seek competition when the original general contractor defaulted on the contract. Instead, they retained the existing subcontractors to complete the project. As a result, the School incurred delays and additional costs totaling approximately \$2.6 million.

Recommendations

1. The Board should use a competitive process when selecting major contractors or professionals for a capital project.
2. The School should strengthen cost control safeguards to protect against construction cost overruns for future capital projects.

¹ Assumption agreement is the term used for contracts that the School entered into with existing subcontractors to complete the section of the project not completed due to the withdrawal of the general contractor.

Management Company Oversight

The School's bylaws require the Board to monitor financial operations. The New York State Education Department's Financial Oversight Guidebook stipulates that schools are to implement controls at the Board/management level, such as establishing procedures for the periodic review of accounting records to ensure they are up-to-date, complete and accurate, and review of bank statement reconciliations on a monthly basis to ensure that cash receipts are properly accounted for and cash disbursements are in accordance with Board-approved expense authorizations. In addition, controls should ensure that payments for consultant services are supported by signed and dated copies of contracts that provide the details, dates and costs of the services to be provided. Oversight may also include periodically reviewing supporting documents for selected transactions and financial trend analysis. In many instances, such review and analysis will identify problem areas that warrant follow-up procedures.²

The Board delegated some of its management duties to the Company and did not exercise sufficient oversight of the School's funds. In addition, the Board and School officials did not have a written contract that was in effect with the Company, as required by the bylaws. As a result, School funds are at greater risk of misappropriation and errors could occur without detection.

In 2004, the Board contracted with the Company to assist with the School's financial and educational operations. The contract made the Company responsible for providing the School with academic, operations, human resources and financial services. As such, the Company is responsible for preparing the School's annual budget and financial statements, managing and reconciling School bank accounts and making payments for all of the School's budgeted operating expenses. The agreement authorizes the Company to have custody of all School funds, except for those funds raised by the Parent's Association, and maintain those funds in School's bank accounts for

² The Company's policies and procedures state that the responsibility for cash receipts must be segregated from those for cash disbursements, in accordance with proper cash-handling procedures. The Administrative Assistant is responsible for collecting cash and checks, the Accounting Department for depositing and the Business Manager for accounting for all of these transactions. Checks are pre-numbered and are printed on safety paper. Blank checks are controlled by Accounting, and access to checks is limited to the Accounting Department staff. The Chief Fiscal Officer performs the bank reconciliation. Payroll is processed through a payroll-processing vendor with information provided by the School's Human Resource Associate on a bi-weekly basis to the Company. The Company's Human Resources Department inputs this information into the payroll system.

which the Company has signature authority. During the period July 1, 2013 through July 31, 2014, approximately \$13.8 million of the School's funds were deposited into the Company-controlled bank accounts.

Each month School officials deposit all of the tuition collected into a bank account controlled by a bond trustee.³ The bond trustee makes the debt service payments and then transfers the remaining balance of the tuition collected to a bank account controlled by the Company. The signatories on the Company-controlled bank accounts are the Company's Chief Executive Officer and General Counsel. The bank statement address is the Company's address, not the School's address. Therefore, the Company receives the bank statements directly. According to the contract, the Company makes payments for payroll, utilities, rent, insurance and their service fees. After these payments are made, the Company transfers the remaining amount to a School-controlled bank account. The Company prepares the monthly bank reconciliations for all bank accounts, including the School-controlled account.

We reviewed the bank statements for three accounts for the month of July 2014⁴ to determine if all transfers were accurate and complete. Our examination determined the following:

- School officials properly deposited \$1.5 million of tuition receipts into the bond trustee's checking account.
- The bond trustee made \$207,355 in debt service payments from the custody account and transferred approximately \$1.3 million from the custody account to the Company-controlled account.
- The Company made payments of \$634,942 from the Company account and made two transfers totaling \$500,000 from the Company account to the School-controlled checking account.

We reviewed the \$634,942 payments made by the Company and found that \$382,788 was for payroll payments, \$34,638 was for lease and utility payments and \$200,000 represented a transfer made to another Company-controlled account. The remainder was for miscellaneous School-related expenses. We determined that the payments were for School purposes.

³ The School uses a bond trustee who is responsible for proceeds of bonds used for the capital project construction. In addition, the bond trustee makes debt service payments from tuition receipts that School officials deposit directly into a bank account that the bond trustee controls.

⁴ We selected the three most current months before the audit started. The month of July was the only month that had transfer activities.

Although we were able to trace and account for the funds transferred and expended from the Company-controlled account, the School is at increased risk of misappropriation of funds because the Company receives funds other than tuition, makes payments, receives the bank statements and prepares the bank reconciliations with no oversight or review by School officials.

In addition, the School operated under an expired contract. We reviewed the July 2010 renewal agreement with the Company and found that the agreement expired in January 2014. The agreement also did not specify the fee to be paid for the 2013-14 school year. In the 2013-14 school year, the School paid the Company \$540,800 for management services, which was the same fee as 2012-13.

Subsequent to audit fieldwork, the Board had the Company make changes to the accounts to provide the Board Chairman (Chairman) with signature authority on all accounts. As of September 2014, the Chairman was unaware of his status as a signatory on the Company-controlled bank accounts.

The Board needs to improve its oversight of the Company's activities. The Board did not review bank reconciliations, monitor receipts from various sources or ensure that the Company's contract had not expired. These deficiencies could expose the School to significant liabilities related to fees charged and services provided by the Company. In addition, without adequate oversight, the Board cannot be assured that Company officials use School funds for their intended purposes.

Recommendations

The Board should:

3. Finalize an updated agreement with the Company as soon as possible.
4. Ensure that the Chairman is knowledgeable of his signature authority on the Company-controlled bank accounts.
5. Review bank statements and bank reconciliations periodically to ensure that cash receipts are properly accounted for and cash disbursements are in accordance with Board-approved expense authorizations.

APPENDIX A

RESPONSE FROM SCHOOL OFFICIALS

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

The School's response letter refers to an attachment that supports the response letter. Because the School's response letter provides sufficient detail of its actions, we did not include the attachment in Appendix A.



Charter School of Educational Excellence

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By Certified Mail and Email

April 15, 2015

Tenneh Blamah
Chief Examiner of Local Government and School Accountability
Office of the New York State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, NY 12553

Re: Response to the New York State Office of the Comptroller
Draft Report of Examination for the Period Covered of July 1 – August 19, 2014

Dear Ms. Blamah:

As a follow-up to my March 23, 2015 meeting with representatives of the Office of the State Comptroller ("OSC") and review of the draft Report of Examination on the Middle School Capital Project and oversight of [REDACTED] in respect to the financial operations of the Charter School of Educational Excellence ("CSEE"), I ask that the comments attached to this letter be made a part of the final report. I further request that the attached services agreement between CSEE and [REDACTED] effective through June 30, 2018 be considered by OSC in finalizing the Report of Examination.

The Recommendations of the OSC in respect to Middle School construction and oversight of [REDACTED] will be addressed in the Corrective Action Plan submitted as a follow-up to these comments.

Sincerely yours,

Eduardo LaGuerre
Chairman, Board of Trustees

Encl:
cc: A. Kama (by email)

**COMMENTS OF THE CHARTER SCHOOL OF EDUCATIONAL EXCELLENCE IN RESPONSE TO THE OFFICE OF
THE NEW YORK STATE COMPTROLLER'S REPORT OF EXAMINATION IN RESPECT TO THE MIDDLE
SCHOOL CAPITAL PROJECT AND BOARD OVERSIGHT OF THE MANAGEMENT COMPANY**

Preface to Comments

The Middle School Capital Project commenced construction in the 2009-2010 Fiscal Year and was completed in the 2010-2011 Fiscal Year.

CSEE contracts for advisory and support services, not management services, from [REDACTED]. This has been the case since the inception of the school, and in particular since the commencement of the agreement between CSEE and [REDACTED] dated July 1, 2010.

Middle School Construction Project

In respect to Recommendation 1, CSEE understands the need to use competitive processes to more thoroughly document criteria and information used in selecting major construction and professional service contractors for capital projects, as well as the need to use additional cost control safeguards to keep future CSEE capital projects within budget and on schedule.

For example, capital projects undertaken by CSEE for the 2013-2014 fiscal year necessary to construct classrooms and other facility space, including a playground and related leasehold improvements, were awarded after requests for and receipt of competitive bids. What's more, a new food service provider was chosen based on proposals received after the issuance of a "Request for Proposals."

Selection Process

With respect to the Middle School construction project, there were additional reasons beyond those stated in the Report of Examination for the selection of the general contractor using a modular construction process instead of the traditional field erected construction process.

One reason was CSEE's ability to construct the project without relocating existing school operations during project construction.

A second reason was that the contractor selected fabricated modules inside a factory, whereas the other two module construction companies used facilities requiring work outside in the elements.

A third reason was that CSEE believed that the general contractor selected offered the low cost construction option.

With respect to Recommendation 2, CSEE understands that additional cost control safeguards are necessary for future capital project construction and service contracts. That said, it must be noted that CSEE used standard AIA construction documents for construction and architectural and engineering services provided for the construction of the Middle School and the main cost control mechanism in those documents.

Pursuant to those documents, the General Contractor submitted Payment Applications reviewed by the Architect. CSEE's representative requested payment of the Bond Trustee only after the Architect made a determination that payment was warranted according to work completed and stored on site. These controls could not offer protection against the general contractor-subcontracting work at prices higher than those documented by the contract, and the general contractor's misappropriation of contract funds.

Even with cost overruns caused by the default in the performance of the contract and the misappropriation of contract funds by the general contractor, the hard cost per square foot compares favorably to both the average New York City School Construction Authority hard cost per square foot of constructing school facilities, and the hard cost per square foot of comparable size school facilities constructed after, but close in time, to the time period when the CSEE middle school project was constructed.³

- The CSEE middle school project hard cost per square foot is **\$363** (\$10.9M divided by 30,000 square feet).
- The average NYC School Construction Authority FY 2010 hard cost per square foot for the construction of school facilities was **\$515** and **\$638** for FY 2013
- Construction costs for the Bronx Lighthouse middle school completed in 2012 were **\$442** per square foot (\$11.2M divided by 25,000 square feet).
- Construction costs for the South Bronx Charter School for International Cultures and the Arts elementary school completed in 2014 were **\$460** per square foot (\$18.3M divided by 40,000).

Because the CSEE Middle School ultimately was constructed at a square foot cost **lower** than schools constructed by other nearby charter schools, as well as the New York City School Construction Authority, it is clear that the CSEE Board of Trustees acted prudently with public funds and in the best interests of its children, families and staff with respect to the selection of contractors and the construction of the CSEE Middle School.

See
Note 1
Page 19

Cost Overruns

CSEE submits that entering into contracts with subcontractors of the defaulting general contractor was a reasonable, cost effective course of action providing a greater likelihood that Middle School

³ School Construction Authority Mayor's Management Report, Page 189 (attached)

construction would be completed, compared to the option of bidding work after the default of the general contractor. There are three reasons why this was a smart course of action.

First, detailed, prior knowledge was required of how building systems (e.g., HVAC, plumbing, and electrical) integrated with the modules fabricated for the construction of the Middle School. The potential loss of this knowledge through the stoppage of work, preparation of bid packages and the award of contracts pursuant to bids could have adversely impacted completion of construction, particularly since the Middle School project was close to substantial completion at the time of the general contractor's default.

Second, the demobilization of subcontractors and remobilization of the same or substitute contractors would have cost more time, and likely more money, thereby increasing the risk of a total default by CSEE and the closure of the school for economic reasons by its charter authorizer.

Finally, the subcontractor that entered into a contract to perform as general contractor for the completion of the Middle School provided CSEE with credit. That credit enabled CSEE to complete the construction of the Middle School.

It also must be noted that CSEE entered into written contracts with all subcontractors whose work was required to complete construction of the Middle School after the default of the general contractor. These contracts -- with the exception of the general contractor contract providing for the performance of work on a "time and materials" basis, as opposed to the "Guaranteed Maximum Price," of the defaulted general contractor -- were entered into at costs equal to or lower than those payable under their subcontracts with the general contractor.

Board Oversight of the Management Company

CSEE respectfully disagrees with the conclusion in the Report of Examination that "[t]he Board relinquished its management duties to the Company and did not exercise sufficient oversight of the School's funds." The report does not accurately reflect the CSEE Board of Trustees' oversight of the relationship between CSEE and [REDACTED] in respect to the operation of the school.

See
Note 2
Page 19

The term of the contract between CSEE and [REDACTED] referenced in the Report of Examination began on July 1, 2010 and ended on January 11, 2014. CSEE and [REDACTED] in May of 2014 verbally agreed to continue their relationship under the terms of the expired agreement while a new contract was negotiated. The CSEE Board authorized the negotiation of a new agreement at a May, 2014 Board meeting.

See
Note 3
Page 19

As the Report of Examination notes, CSEE continued to pay the same fee amount in the 2013-2014 fiscal year as in the 2012-2013 fiscal year. More importantly, the CSEE relationship with [REDACTED] continued according to the provisions of the expired agreement, under which the CSEE Board of Trustees maintained "final authority for policy, operational and budget" decisions of the school.

According to these provisions, the CSEE Board of Trustees maintained its authority to:

- Establish and finalize the CSEE budget each year.
- Select and contract with vendors (other than insurance, benefit and payroll service providers secured at lower cost through the pooled purchasing capability of [REDACTED])
- Set the school curriculum
- Establish staffing and compensation plans, hire school employees and evaluate their performance

Given the power, authority and responsibilities that the CSEE Board of Trustees maintained throughout its relationship with [REDACTED], CSEE finds it hard to understand how the report could conclude that the CSEE Board of Trustees has relinquished its management duties to [REDACTED]

See
Note 2
Page 19

In respect to Recommendation 3, CSEE acknowledges that it should have had a contract in effect with [REDACTED] at all times when [REDACTED] was providing services to CSEE in support of school operations. It is important to note, however, that the bulk of the expenditures from the [REDACTED] Bank account in the custody of [REDACTED] are used to pay payroll, benefits, lease, tax and management contract expenses which are fixed by contract or budget and do not involve discretion on the part of [REDACTED]. In respect to Recommendations 4 and 5, CSEE acknowledges the need to improve oversight of [REDACTED] activities in relation to the [REDACTED] Bank account and review of bank statements and reconciliations.

The attached services agreement is one step that has been taken to improve oversight of [REDACTED] activities in respect to CSEE funds in its custody. Additional actions being taken with respect to CSEE funds and the recommendations of the OSC Report of Examination will be addressed in the Corrective Action Plan to be submitted by CSEE.

APPENDIX B

OSC COMMENTS ON THE SCHOOL OFFICIALS' RESPONSE

Note 1

Our audit objective did not include a comparison of capital project costs incurred by other charter schools.

Note 2

The report was amended to show that the Board delegated some of its management duties to the Company and did not exercise sufficient oversight of the School's funds.

Note 3

After our exit conference with School officials held on March 23, 2015, School officials presented us with a written agreement between the School and the Company signed April 14, 2015 and effective as of July 1, 2014.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objectives of our audit were to determine if the Board provided sufficient oversight of the Middle School construction project and of the Company for the period July 1, 2013 through August 19, 2014. We extended our scope back to July 1, 2009 to review records for the Middle School's construction.

To accomplish the objectives of this audit:

- We interviewed School officials and employees, including the Director of Operations and the Chairman, to gain an understanding of the School's internal control environment.
- We reviewed available documents, including applications and certificates of payment, applications for examination and approval of final plans and specifications, change orders, claims and contracts. We examined change orders to determine whether they were approved, signed and dated by the appropriate School officials and paid accordingly.
- We reviewed all payments for project costs made to the initial general contractor, totaling approximately \$6.5 million, to determine if they were appropriate.
- We reviewed a random sample of six payments made to the owner's representative totaling \$60,250 to compare construction management fees to the project costs to determine if they were appropriate.
- We reviewed six payments made to the architect totaling \$110,807 to verify if the payments were properly supported, reviewed, approved and allowed by the contract.
- We reviewed all payments made to vendors during the Middle School's construction totaling \$10.9 million to verify if the payments were properly supported, reviewed, approved and allowed by the contract.
- We reviewed the School's charter, bylaws, agreement with the Company, monthly financial reports and service agreements with select contractors and consultants.
- We reviewed all checks and voided checks issued from the School-controlled checking account during the months of May and June 2014 to determine if all checks were issued sequentially.
- We traced all checks cleared on the May and June 2014 School-controlled checking account to the general ledger to determine if all checks were recorded.
- We reviewed a random sample of 20 disbursements from the Company-controlled checking account and traced them to invoices, purchase receipts and the general ledger to determine if they were supported, approved and legitimate School expenses.
- We reviewed a judgmental sample of 20 disbursements from the School-controlled checking account and traced them from the general ledger to the invoices and service contracts to

determine if they were paid according to the contracts, in a timely manner, supported by invoice/receipt and signed by an authorized signer, and whether the check amounts equaled invoice amount.

- We calculated the total amount of funds deposited in the Company's bank accounts for the period July 1, 2013 through July 31, 2014.
- We reviewed all bank transfers from the bond trustee controlled account, Company-controlled account and School-controlled account during the month of July 2014 to determine if all bank transfers were accurate and complete.
- We interviewed Board members to determine if they reviewed payments to service providers and outside consultants to verify the legitimacy and accuracy of claims.
- We interviewed Board members and School officials to determine if they were aware of any fraudulent activity for the scope areas.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX D

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