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**OFFICE OF THE
NEW YORK STATE COMPTROLLER**

**DIVISION OF STATE
GOVERNMENT ACCOUNTABILITY**

**EXPLORE CHARTER
SCHOOL**

**FINANCIAL MANAGEMENT
PRACTICES**

Report 2006-N-18

AUDIT OBJECTIVE

Our objective was to determine whether Explore Charter School (Explore) established and maintains an adequate system of internal control over the following areas of financial operations: financial oversight; procurement and disbursements; payroll; and equipment inventory.

AUDIT RESULTS - SUMMARY

Explore, a Charter school with about 370 students, is located in New York City. Explore offered instruction in grades Kindergarten through seven for the 2006-07 year. In the 2007-08 school year Explore will begin offering instruction at the eighth grade level. The overall system of internal control for Explore was adequate, but we identified certain weaknesses in Explore's controls over financial operations, particularly in the areas of procurement and disbursements, and equipment inventory.

For example, when we reviewed nine agreements for consultant services totaling \$214,043, we found Explore did not use a competitive procurement process for six of the agreements totaling \$182,553. As a result, school officials had no assurance the services were obtained for the lowest price available. Explore has no written policies and procedures addressing competitive procurement practices. We recommend Explore develop such policies and procedures, and ensure they are followed.

We also found that the school's purchasing requirements often were not met. As a result, there was less assurance purchases were properly authorized and the school actually received what it paid for in all instances. In addition, disbursements from the Petty Cash Fund were not adequately accounted for, the purpose of the disbursements was not always

documented, and the documented disbursements were not always for appropriate purposes.

Equipment inventories were not adequately controlled because Explore does not maintain perpetual inventory records for its equipment and does not perform an annual physical inventory of its equipment. In fact, Explore has not established policies and procedures for equipment inventory control. We attempted to locate 22 equipment items that were purchased in the 2005-06 and 2006-07 fiscal years, but were unable to find four of the items. The missing items included musical instruments and a printer/scanner.

We also found that undelivered paychecks were not adequately safeguarded, and announcements about upcoming Board of Trustees meetings were not kept up-to-date on the school's web site. Our report contains ten recommendations for improving internal controls over financial management practices. Explore officials agreed with our findings and have agreed to make changes.

This report dated, August 29, 2007, is available on our website at: <http://www.osc.state.ny.us>. Add or update your mailing list address by contacting us at: (518) 474-3271 or Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

BACKGROUND

In December 1998, the New York State Legislature passed a law authorizing the creation of charter schools in the State. This legislation is known as the New York Charter Schools Act of 1998 (Act). It authorized the establishment of charter schools as independent public schools governed by not-

for-profit boards of trustees and managed according to the terms of a five-year performance contract or “charter.” Such charters provide opportunities for teachers, parents, community members, and not-for-profit organizations to establish and maintain schools that operate autonomously of existing schools and school districts.

Established in June 2001, Explore Charter School (Explore) is one of 31 schools currently approved by the New York City Department of Education (DoE) and chartered by the Regents of the State of New York. Located in Brooklyn, the school offered instruction at the Kindergarten through the seventh grade level for the 2006-07 school years. In the 2007-08 school year, Explore will begin offering instruction at the eighth grade level. During the school year that ended in June 2007, Explore had approximately 370 students.

Explore has an institutional partner in the Friends of Explore Charter School, Inc. (Friends of Explore), a group of individuals that is committed to providing Explore with the support it needs to achieve its mission. The Friends of Explore sponsors events that showcase the achievements of Explore’s students. Among its achievements, Explore has been the recipient of the prestigious Blackboard Award for Academic Excellence. In 2007, Explore was one of 53 charter schools recognized for excellence by the Center for Education Reform. In addition, Explore has recently received a renewal of its charter for five years.

Under the Act, Explore is entitled to receive funding from local, State and federal sources. Such funding includes per pupil payments for general operating support, additional State resources for special education, No Child Left Behind federal funds, and in-kind services

from DoE - the school district in which Explore is located.

According to Explore’s financial statements, for the fiscal year ended June 30, 2006, the school’s operating expenses totaled \$3.51 million, of which \$2.62 million related to personal service costs (including fringe benefits) and the remainder related to other than personal service costs. Revenues for the same fiscal year totaled about \$3.61 million, of which \$3.09 million was basic school aid provided by DoE. In addition to the direct revenues, Explore also receives in-kind support from DoE, as DoE pays for the rental of the school building, building maintenance, student food services, and student bus services. This support is not quantified by Explore officials.

AUDIT FINDINGS AND RECOMMENDATIONS

Financial Oversight

Board Oversight

Charter schools are to be governed by a Board of Trustees (Board). Explore’s Board is composed of ten members, who are elected to three-year terms. According to the Act, the Board shall have final authority for policy, operational decisions, and fiscal management of the school.

Explore’s by-laws required the Board to meet at least six times during the 2005-06 academic year and ten times during the 2006-07 academic year. We reviewed the Board meeting records for these two academic years. The meeting minutes for the 2005-06 year indicated that the Board conducted six meetings during that year. For 2006-07, the Board had met four times at the time of our review and provided us with a schedule for six additional meetings for the year. It thus

appears that the Board is meeting as frequently as required.

Explore's by-laws also require that all Board meetings be open to the public in accordance with Article 7, Section 104 of the New York State Public Officers Law. Article 7, Section 104 of the Public Officers Law requires that a public notice of the time and place of a meeting be given to the news media and posted conspicuously in one or more designated public locations at least 72 hours before the meeting.

We determined that Explore officials did not fully comply with Article 7, Section 104 of the Public Officers Law, because they did not notify the news media of impending Board meetings and did not ensure that the dates of upcoming meetings (as posted on the school's web site) were correct. At the time of our audit, the meeting dates posted had not been updated in six months.

Explore officials provided us with copies of memos that had been sent to students' parents informing them of upcoming Board meetings. In addition, we saw that scheduled Board meeting dates were posted on the bulletin board in the school's lobby. However, the surrounding community was not adequately informed of the meetings, as called for in the Public Officers Law. Explore officials agreed and have made the appropriate updates to the school's web site.

Annual Independent Audit

According to Section 2854(1)(c) of the Act and Explore's charter, a certified public accountant is to conduct an annual fiscal audit of the school. The charter also requires that the audits be conducted in accordance with generally accepted government auditing standards, as issued by the United States Government Accountability Office.

We reviewed the audit reports issued by the certified public accountants. We found the school has been audited annually and the audit reports state that the audits were conducted in accordance with generally accepted government audit standards.

Recommendation

1. For each scheduled Board meeting, ensure that, at least 72 hours before the meeting, a public notice of the time and place of the meeting is given to the news media. Maintain the schedule of meetings on the web site in a timely manner.

(Explore officials agree with this recommendation.)

Procurement and Disbursements

Procurement

A competitive procurement process provides assurance goods and services are obtained for the lowest price available. To determine whether Explore's procurement process was adequately competitive, we reviewed nine contracts or agreements for consultant services provided to Explore during the 2005-06 and 2006-07 fiscal years. As of November 30, 2006, Explore had paid a total of \$214,043 for these services.

We found that, in six of the nine contracts/agreements, Explore did not use a competitive procurement process, as it did not obtain written bids from at least two vendors. As a result, school officials have no assurance the services were obtained for the lowest price available. Explore's payments on these six contracts/agreements totaled \$182,553.

Explore officials stated that two of the six agreements were awarded to sole source

vendors (i.e., only those particular vendors were capable to providing the services sought by the school). However, the officials did not have any written documentation to support this. Explore had spent \$3,825 and \$7,230 on these two educational services agreements.

Explore has written Financial Policies and Procedures (Manual), but this Manual does not have any written policies or procedures to guide employees on how to conduct a competitive bidding process or when to enter into a contract. We recommend Explore develop such policies and procedures, and ensure they are followed.

Explore officials stated that the school had an informal bidding process for high-cost contracts. The officials stated that they were in the process of formalizing their competitive bidding policies and procedures in their Manual, and had presented a draft copy to the Board of Trustees. The officials stated that they planned to implement the new policies and procedures prior to the 2007-08 academic year.

Disbursements

The Manual requires that a purchase order be used whenever a purchase is made. The purchase order must be approved by both the appropriate Academic Director and the Business Manager. If for some reason a purchase order is not used, the employee who authorized the purchase must sign the invoice to document his or her approval. When a shipment of goods is received by the school, the packing slip should be reviewed for accuracy and compared against the purchase order.

To determine whether these purchasing requirements were being met, we selected a judgmental sample of 66 of the 829 purchase transactions processed by the school between

July 2005 and November 2006, and reviewed the documentation relating to the purchases. The 66 purchases totaled \$112,320. Our sample consisted of various types of purchases (e.g., office supplies, equipment, personal services) from various types of vendors (e.g., both individuals and companies), and the purchases were made by check as well as by credit card.

We found that the purchasing requirements were not met for 28 of the 66 purchases (42 percent), totaling \$54,228. For example, in 23 of the purchases, there was no purchase order and/or no authorizing signature on the payment request. In addition, in four of the purchases, there was no documentation indicating that the good or service had actually been received, and in two of the purchases, there was no invoice. In the absence of this documentation, there is less assurance the purchases were authorized and less assurance the school actually received what it paid for.

Explore officials agreed with our findings and stated that they are taking corrective actions to ensure compliance in the future by more closely monitoring disbursements.

Petty Cash

According to the Manual, a Petty Cash Fund should be maintained to reimburse employees for emergency items needed for school-related purposes. The Manual states that employees should be reimbursed upon submission of a receipt, and all disbursements from the Fund should be recorded in a Petty Cash Log. The Manual does not set any limit on the total Fund balance, and does not set any limit on individual disbursement amounts.

We reviewed the records relating to the Petty Cash Fund, and counted the total cash and

receipts on hand on November 28, 2006. We identified a number of internal control weaknesses. First, the cash and receipts on hand totaled \$1,106, but the accounting records indicated that \$1,487 in cash and receipts should have been on hand. As a result, \$380 in cash and/or receipts was not accounted for.

Also, four of the receipts, totaling \$161, were not recorded in the Petty Cash Log. In addition, the Log showed three instances in which petty cash, totaling \$124, was given to employees without any receipts supporting the disbursements. Explore officials told us that \$51 of the \$124 should not have been disbursed from the school account. They said this disbursement (which represented a scholarship award for a school uniform) should have been made from an account belonging to the Friends of Explore.

In November 2006, the former Chief Financial Officer, who was acting as a financial consultant for Explore, told us that the Petty Cash Fund had not been reconciled, and petty cash receipts had not been recorded, since June 30, 2006. He indicated that he had been busy with the charter renewal process. He also said that some of the receipts (from July 2006 through September 2006) were not at the school, but were instead in the possession of an employee of his consulting firm.

We recommend that a number of actions be taken to improve the school's controls over its Petty Cash Fund. Fund activity must be actively monitored, the Fund balance must be reconciled regularly, limits must be set both for the Fund balance and for individual disbursements, and all Fund records and related documentation must be maintained at the school.

Explore officials acknowledged the control weaknesses. They told us they have reconciled the Fund and implemented a strict policy to limit the Fund's use while new procedures are being developed. They said they have presented the Board with a draft of the new procedures, which they plan to implement prior to the 2007-08 academic year.

Recommendations

2. Establish written policies and procedures for a competitive procurement process, and ensure that the policies and procedures are followed.
3. Ensure compliance with established policies and procedures for disbursements.
4. Actively monitor the use of the Petty Cash Fund and ensure that the Fund is used in accordance with established policies and procedures.
5. Reconcile the Petty Cash Fund regularly.
6. Establish limits for both the total Petty Cash Fund replenishment amount and individual reimbursement amounts.
7. Maintain all Petty Cash Fund records and related documentation at the school.
8. Recover \$51 from the Friends of Explore for the reimbursement that should have been made from its account.

(Explore officials agree with these recommendations and state that most have been implemented.)

Payroll

The Manual requires that a listing of all school employees be produced each payroll period, and the employees sign the listing, by their names, as they pick up their paychecks/pay stubs. Further, good internal controls require that all undelivered paychecks be safeguarded by school officials.

To determine whether paychecks were distributed in accordance with the Manual and undelivered paychecks were adequately safeguarded, we observed the distribution of paychecks on November 29, 2006. We found that employees signed for their paychecks/pay stubs as required, but undelivered paychecks/pay stubs were left in the school's business office without being adequately safeguarded.

School officials promptly secured the undelivered paychecks when we brought the matter to their attention, but the school's written policies and procedures do not require that such action routinely be taken. As a result, paychecks/pay stubs could be lost or stolen and the employees could suffer identity theft because sensitive information (such as the employee's social security number) is contained on the paychecks/pay stubs.

Explore officials agreed and have implemented a new policy requiring all undelivered paychecks to be stored in a locked drawer until they can be hand-delivered to the appropriate staff member.

Recommendation

9. Establish a policy and procedure to ensure the safekeeping of undelivered paychecks/pay stubs.

(Explore officials agree with this recommendation.)

Equipment Inventory

According to Explore's financial statements for the 2005-06 fiscal year, the school's equipment had a book value of \$180,997. To maintain adequate control over this equipment, Explore should maintain a perpetual inventory record and perform an annual physical inventory of all equipment belonging to the school. The inventory record should include the equipment's acquisition date, cost, serial number, and disposition date, if appropriate. Further, each item should be tagged to denote Explore's ownership, and the item's location should be documented.

We found Explore does not maintain perpetual inventory records for its equipment and does not perform an annual physical inventory of its equipment. In fact, Explore has not established basic policies and procedures for equipment inventory control.

To determine whether Explore's equipment inventory was being adequately safeguarded, we judgmentally selected 22 equipment items, costing \$36,937, from the school's purchasing records. The records indicated that, between July 2005 and October 2006, a total of 156 items were purchased. In selecting our sample, we focused on higher-cost items and items with a greater risk of theft.

We were unable to locate 4 of the 22 items. The missing items included musical instruments and a printer/scanner. The cost of the missing items was \$2,314. In addition, Explore officials acknowledged that a digital camera and a laptop computer had been stolen during the past two years.

Explore officials agreed with our findings and are in the process of establishing an inventory system. The Board is reviewing the new policies and procedures, which school

officials plan to implement during the 2007-08 fiscal year.

Recommendation

10. Develop and implement formal policies and procedures for the recording, control, valuation, and disposition of inventoried equipment.

(Explore officials agree with this recommendation.)

AUDIT SCOPE AND METHODOLOGY

We conducted our audit in accordance with generally accepted government auditing standards. We audited Explore's controls over selected financial management practices for the period July 1, 2005 through April 4, 2007. To accomplish our objective, we interviewed Explore officials and reviewed laws, policies and procedures related to the financial operations of the school. We also examined the financial operating records of Explore and the work performed by the firm of certified public accountants engaged to audit Explore's financial statements. Our review included Explore's Financial Policies and Procedures, which set out criteria for the school's financial practices.

To determine whether Explore's procurement and disbursement practices were adequately controlled, we reviewed nine contracts/agreements for consulting services from the 2005-06 and 2006-07 fiscal years,

and 66 of the 829 purchase transactions processed by the school between July 2005 and November 2006. We also reviewed the records relating to the Petty Cash Fund, and counted the total cash and Fund receipts on hand on November 28, 2006.

To determine whether there were effective controls in payroll operations, we observed the distribution of paychecks on November 29, 2006. To determine whether equipment was adequately safeguarded, we selected a judgmental sample of 22 items to locate. We also visited Explore's web site and reviewed the minutes of the Board meetings that were held between July 2005 and December 2006.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York States. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

AUTHORITY

The audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution, and Section 33 of the General Municipal Law.

REPORTING REQUIREMENTS

We provided a copy of this report, in draft, to Explore officials for their review and comments. Their comments were considered in preparing this final report.

Explore officials agreed with all of the recommendations and a copy of their response to this report is included as Appendix A.

Within 90 days after the final release of this report, we request the Chairman of the Explore Charter School Board of Trustees to

report to the State Comptroller, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

CONTRIBUTORS TO THE REPORT

Major contributors to this report were Kenrick Sifontes, Steve Lynch, Marc S. Geller, Altagracia Rodriguez, Bebe H. Belkin, Brenda Maynard, Hugh Zhang and Dana Newhouse.

APPENDIX A - AUDITEE RESPONSE



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July 23, 2007

Mr. Steven E. Sossei, Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Dear Mr. Sossei

Explore Charter School is pleased to have the opportunity to respond to the audit report of the Office of the State Comptroller. The helpful suggestions in this report are in the process of being implemented.

Summary & Background

We wish to clarify the current and projected enrollment figures that are included in the *Summary* and *Background* sections of the report.

- The academic year ending July 2006, Explore had approximately 320 students in kindergarten through sixth grades.
- The current academic year, which ends July 2007, Explore has approximately 370 students in kindergarten through seventh grades.
- In the 2007-2008 academic year, Explore will reach its full growth of 420 students in kindergarten through eighth grades.

Based on the New York State Comptroller's website, we understand that it is within your purview to include both positive and negative findings within our final audit report. Specifically, the introduction within the audit section of the website describes that the audit process "provides an objective, independent review of your program stewardship and fosters accountability to the citizens of New York." However, we note our disappointment with this report's inclusion of such limited positive findings, which we believe conveys an imbalanced picture of the excellent work of management that has resulted in Explore becoming one of the city's model charter schools.

We are pleased to report that, in its recommendation to renew Explore's charter, the New York State Board of Regents noted, "through the term of the charter, the School has been a fiscally sound educational institution... [and] has been in compliance with all applicable laws and regulations." Given that there are 3,940 charter schools across the country, we are very proud to

have been recognized by the Center for Education Reform as one of only 53 Charter Schools of the Year in May 2007. Finally, it should be noted that as of July 2007, over 1,300 students are on Explore's waiting list.

Recommendations

As indicated in our response to your preliminary report, we agree with each of the recommendations included in this report. We have already implemented new procurement and petty cash policies, are implementing an inventory control system this summer, and have tightened our adherence to our disbursement procedures.

We are grateful for the patience and professionalism of the audit staff. The audit process was illuminating and has resulted in a stronger organization. Please feel free to contact me if I can be of any further assistance.

Thank you.

Sincerely,



Karolyn Belcher
Chair, Board of Trustees