
**Thomas P. DiNapoli
COMPTROLLER**



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**OFFICE OF THE
NEW YORK STATE COMPTROLLER**

**DIVISION OF STATE
GOVERNMENT ACCOUNTABILITY**

**CARL C. ICAHN CHARTER
SCHOOL**

**FINANCIAL MANAGEMENT
PRACTICES**

Report 2007-S-70

AUDIT OBJECTIVE

Our objective was to determine whether the Carl C. Icahn Charter School (Icahn) established and maintained an adequate system of internal controls over the following areas of financial operation: financial oversight, cash disbursement and procurement, payroll and personal services and computer usage.

AUDIT RESULTS - SUMMARY

We determined that Icahn has established and maintained an adequate system of controls over some areas of their operations. However, as detailed in this report, we determined that controls can be strengthened to improve the school's financial management. The areas in need of strengthening included cash disbursements, procurement, and payroll. Furthermore, the Board should more closely monitor Icahn's transactions to ensure compliance with policies and procedures. Our report contains nine recommendations for improving internal controls over financial management practices. Most notably, we found the following:

- Of 50 sampled disbursements, totaling \$185,902, six, totaling \$6,163, reimbursed the cost of staff parties. Of that amount, \$1,288 was spent on alcoholic beverages. Icahn officials stated that these parties were funded by a private grant that allowed such expenditures. However, we found that the grant was intended solely for the school's operating expenses. Additionally, Icahn officials could not document the true source of these expenditures because the school co-mingled donated and public funds in one account. We also found documentation such as pre-approvals and invoices

missing for another 12 of the sampled documents totaling \$102,857.

- Icahn had no policies requiring competitive bidding for expenditures exceeding minimum cost thresholds. Only one of 18 contracts executed during our audit period was competitively bid. However, this contract was awarded to a relative of a school administrator. Icahn officials stated that four of the 18 contracts, totaling \$93,436, were executed with sole source vendors. However, there was no documentation to support the sole source classification. Icahn also had no policies or procedures governing the selection of sole source vendors. Additionally, six contracts were not signed by the school or the vendor.
- Icahn did not require pre-approval of its employees' after-hours work; nor were there clear timekeeping procedures for the employees. Additionally, Icahn's Assistant Principal for Administration handled all key payroll duties. These duties should be separated between different employees to ensure payroll transactions are appropriate.
- The board did not routinely establish starting salaries or approve staff bonuses. Additionally, Icahn did not pay bonuses to two teachers and two staff who were entitled to receive them.

This report, dated February 8, 2008, 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 Services
State Audit Bureau
110 State Street, 11th Floor
Albany, NY 12236

BACKGROUND

In December 1998, the New York State Legislature authorized the creation of charter schools in the State by passing the New York Charter Schools Act of 1998 (Act). This legislation 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 March of 2001, the Carl C. Icahn Charter School (Icahn) is one of 48 such schools approved by the State University of New York (SUNY) and chartered by the Regents of the State of New York. Located in the Bronx, New York, the school offers instruction at the kindergarten through seventh grade. Under the Act, the school 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, Title 1 dollars, and in-kind services from the New York City Department of Education (DOE); the district in which Icahn is located. During the school year that ended in June 2007, Icahn had approximately 280 students. For the 2007-2008 school year Icahn plans to add an eighth grade, and increase student enrollment to 324 students.

Icahn Associates Corporation (IAC), a privately owned corporation, provides administrative, accounting, and other support services to the school. Icahn officials told us that IAC donates these services to the school.

According to Icahn’s financial statements for the fiscal year that ended June 30, 2006, the school’s operating expenses totaled \$2.44 million, of which \$1.93 million related to personal service costs (including fringe benefits). Revenues for the same fiscal year totaled about \$2.55 million, including \$2.17 million in basic school aid, \$360,928 in other government grants, corporate contributions, and \$21,887 in special education, interest income, and other sources.

Icahn’s academic achievement ranks among the highest of the charter or public schools in the State. For the academic years ending June 2004, 2005, and 2006, Icahn received congratulatory letters from the Board of Regents and SED because they had met and exceeded all applicable state standards for English Language Arts and Math.

AUDIT FINDINGS AND RECOMMENDATIONS

We determined that Icahn has established and maintained an adequate system of controls over some areas of their operations. However, as detailed in this report, we determined that controls can be strengthened to improve the school’s financial management. The areas in need of strengthening included cash disbursements, procurement, and payroll.

Financial Oversight

Board Oversight

Like all of New York’s charter schools, Icahn is governed by a Board of Trustees. The Board’s nine members, who represent a variety of occupations, are elected for one-year terms. The Act, and Icahn’s by-laws, grant the Board final authority over the school’s policies, and operational and fiscal management decisions. Board members have

a fiduciary responsibility for school assets and finances; and they must exercise good faith, due diligence, care, and caution. Accordingly, the Board has an important responsibility to design, adopt, and monitor policies and procedures for safeguarding the school's resources from misappropriation or improper use.

We found that the Board met nine times during the 2005-06 academic year, and nine times, again, in 2006-07 as required by Icahn's by-laws. Additionally, the minutes of these meetings documented the Board's active discussion of the school's financial matters (i.e. budget, payroll, revenue, inventory, etc.). We also found that the Board complied with the Act by requiring and ensuring that employees and contractors, who have direct contact with students, are fingerprinted to enable the background criminal history checks.

However, as detailed later in this report, we found that the Board needs to take stronger action to develop, improve and monitor policies and procedures governing Icahn's procurement, cash disbursements, payroll, and other accounting and operational practices.

Annual Independent Audit

According to Section 2854 (1) (c) of the Act, an annual fiscal audit of the school is required. The State Education Department (SED) further requires that all such audits be conducted in accordance with generally accepted government auditing standards, as issued by the United States Government Accountability Office.

We reviewed the reports provided by Icahn's auditing firm for the 2005-06 fiscal year. The reports provided by the auditing firm indicate that the audit was conducted in accordance with generally accepted government auditing

standards. The firm provided all of the required auditor's reports and the audit results were discussed with the Board.

Cash Disbursements and Procurement

Supporting Documentation

A good system of internal controls consists of policies and procedures that allow a school to provide reasonable assurance that it is using its resources effectively and that it is complying with applicable laws and regulations. Good business practices require that adequate supporting documentation be obtained before school funds are disbursed. Such practices also require the filing of a copy of the pre-approval form and the purchase order for each purchase. The school's Accounting Manual (Manual) requires that authorization for purchases be documented prior to the order of goods or services. In addition, the Manual requires that orders of goods and services over \$10,000 (... "individually or in the aggregate" ...) be authorized by two individuals - the Treasurer or Secretary of the Board of Trustees and the Director of Operations or the Principal. Icahn officials also told us that evidence of pre-approval appears on the purchase orders.

For the period of July 1, 2005 through May 17, 2007, Icahn made 946 cash disbursements totaling \$1.79 million. To determine whether school officials maintained adequate documentation to support disbursements, we selected a judgmental sample of 50 cash disbursements totaling \$185,902. The sample consisted of various types of disbursements (e.g., equipment, personal services) and various types of vendors (e.g., both individuals and companies). We determined that Icahn's internal controls related to cash disbursement were not operating as designed. We found a lack of supporting documentation for 12 of the sampled disbursements, totaling

\$102,857. For example, school officials were not able to locate two invoices totaling \$2,344. In addition, purchase orders or other forms of pre-authorization were not available for five of the disbursements. We also found that required Board approvals, for purchases exceeding \$10,000, were not obtained in four instances. Finally, one packing slip was missing.

School officials acknowledged the discrepancies. However, they explained that one of the purchases, regarding a temporary unit to house the second grade, was pre-approved by the Board. However, we found that the Board minutes do not reflect this authorization. The officials also stated that the missing packing slip was never shipped with the package.

We also found that six of the sampled disbursements, totaling \$6,163, funded the cost of school staff parties. Of that amount, \$1,288 was spent on alcoholic beverages. School officials explained that the cost of these parties was reimbursed from a private grant (Charles Hayden Foundation). The officials also said that funds from this grant could be used for any purpose. However, we reviewed the grant documents and found that it was intended solely for the school's operating expenses. Additionally, we could not verify that the grant actually funded these parties because Icahn does not maintain separate accounts for donated funds. All school funds (State and donated funds) are deposited and commingled in one account. Thus, we question these expenditures and, especially, the cost of the alcoholic beverages.

We believe the Board should monitor Icahn's disbursements more closely to ensure the transactions are approved, documented and appropriate.

Sales Tax

According to Section 2853(1) (d) of the Act, a charter school shall be exempt to the same extent as other public schools from all taxation, fees, assessments, or special ad valorem levies on its earnings and its property, including property leased by the charter school.

We reviewed a sample of 50 cash disbursements to determine whether the school was paying sales tax on its purchases. We found that the school had paid \$384 in sales tax on 15 of the 50 sampled disbursements. Icahn officials stated the 15 examples reflected minor emergency purchases. The officials also cited difficulty in obtaining the proper forms from the State Department of Taxation and Finance, and in vendor acceptance of the forms. They further stated that they have discussed this issue with the New York City Center for Charter School Excellence and found that most charter schools are facing the same problem.

Since Icahn paid sales tax on 30 percent of the sampled transactions, we believe that unnecessary sales tax expenditures may be more prevalent and significant to the remaining disbursements that we did not sample. Therefore, the Board should ensure that the tax exempt certificates are used when purchases are made. School officials should also work closely with vendors to ensure that tax exempt forms are accepted.

Contracts

A competitive procurement process provides assurance that goods and services are obtained for the lowest prices available. To achieve these goals the Board must establish clear policies and procedures that will govern operations, and ensure that all employees comply with these policies and procedures.

However, we found that the Board has not developed guidelines to ensure that significant expenditures are competitively bid, contract documents are actually executed, and that evidence justifying vendor selections is maintained.

During our audit, we requested copies of all active contracts Icahn had tendered during the 2005-06 and 2006-07 academic years. School officials provided us with, what they identified as 18 contracts for goods and services totaling \$358,091. We reviewed the documents and found that for six procurements, totaling \$172,387, there were no signed contract documents

School official's acknowledged the lack of signed contracts for these six vendors. However, they stated that they had discussed four of the six with the Board, and they considered the other two, each less than \$2,500 to be insignificant, thus not requiring contracts. However, this does not preclude the need for a formal contract to fix rates and deliverables; and to protect the interests of both contracting parties.

We also found that the Board has not established competitive bidding thresholds for Icahn's purchases. Therefore, the school runs the risk of paying more for goods and services. In the absence of thresholds, we applied the New York City Department of Education's (DoE) minimum competitive bidding threshold (purchases of goods and services of \$251 or more require competitive bidding) to analyze Icahn's purchases. Based on the DoE's threshold Icahn would have needed to solicit bids for 17 of the 18 contracts totaling \$258,091.

Icahn officials told us four of the seventeen contracts, totaling \$93,436, were executed with sole source vendors. However, there was no backup documentation to support the

sole source classification. Icahn officials were also unable to justify the lack of bids for 12 other contracts.

Icahn has no policies governing the competitive bidding and vendor selection process (i.e., requests for proposals format and publication requirements, maintenance of bidder lists, control of sealed bids, technical and cost review criteria, Board approval, etc.). Without such policies in place, a vendor selection that is not in the school's best interest is possible. For example, Icahn officials solicited bids for cleaning services and awarded a \$52,620 contract to the lowest cost bidder - a relative of a school administrator. Although some evidence of the bid process was maintained; there was no evidence of a technical assessment of the potential vendors (i.e., experience, insurances, references, credentials, etc.); or whether the bids were sealed, safeguarded and opened under a controlled environment. Therefore, the vendor selection does not provide assurance that the transaction was open and fair.

Overall, Icahn officials agreed with our findings and stated they will revise their policies for contracting and other school related procurements.

Recommendations

1. Revise contract and other procurement policies to:
 - Establish competitive bidding thresholds,
 - Define the complete competitive bidding process (i.e., requests for proposals, control of sealed bids, bid review, vendor selection criteria, contract documents to be executed, etc.);

- Establish criteria for selection of sole source vendors;
 - Require the retention of contract history documents (i.e., request for proposals, bids received, vendor selection decisions, Board approvals, signed contracts, etc.); and
 - Define documentation requirements for non-contractual purchases.
2. Periodically monitor Icahn's disbursements to ensure compliance with the Board's policies.
 3. Require Icahn to establish separate accounts for public and donated funds.
 4. Ensure that tax exempt certificates are used for Icahn's disbursements.
 5. Comply with procurement and related policies established by the Board.

(Icahn officials agree with recommendations 1 through 5. They either have addressed or will address these matters.

Payroll & Personnel Services

Icahn's annual payroll expenditures were approximately \$1.93 million. Effective controls over payroll operations require that appropriate policies and procedures be in place and monitored. However, we found that Icahn lacks policies and procedures for various internal control areas related to the payroll process, such as segregation of duties, approval and payment of bonuses, approval of per-session payments, and determination of starting salaries.

Segregation of Duties

The personnel function should be responsible for initiating, calculating, and documenting all payroll changes. The payroll function should process all of these changes and ensure that they are executed properly. Someone independent of both functions should distribute the payroll checks. Such control elements are essential in ensuring that one person does not have unchecked access to the entire processing cycle. Proper supervision is also necessary to ensure adequate and timely reporting of employee attendance and the prevention or detection of abuses.

Icahn, like other charter schools, has limited staff and resources to fully separate all of these functions. However, we determined that Icahn officials must review their processes to determine how they can better separate these duties with the school's available resources.

Icahn's payroll is handled by the payroll department of Icahn Associates Corporation. Icahn's Assistant Principal for Administration has many responsibilities in both the areas of payroll and human resources. He enters the payroll data for new employees into the payroll system, prepares the payroll, calculates and inputs salary increases into the payroll system, processes and distributes pay checks to employees, compares the pre-payroll to the final payroll, and reconciles payroll input to payroll output. He maintains all personnel files, prepares the payroll and hands out bi-weekly paychecks. Therefore, there are no checks and balances and a potential exists for inappropriate and undetected payroll transactions to occur.

Icahn officials agreed with our findings and said that they would review the Assistant

Principal for Administration's duties and better distribute them among other employees, including a newly hired Assistant Principal.

Bonuses

On June 28, 2006, the Board voted to authorize \$167,500 in employee bonuses for the fiscal year ended June 30, 2006. We requested the policies and procedures governing such bonuses, but school officials told us there were none. In the absence of written policies and procedures governing the authorization and payment of bonuses, there is less assurance the payments will be made in a fair and reasonable manner.

We compared the Icahn's bonus award letters to payroll records and found two teachers and two staff who had earned bonuses totaling \$12,000 but were never paid for these bonuses. According to the Board minutes, employees were to be paid their bonuses in September 2006, when the new school year started. However, two teachers and two staff did not return to work at the school in September; and did not receive their bonuses which were earned for the previous school year. In the absence of policies and procedure it was unclear whether Icahn was obligated to have paid the bonuses.

Icahn officials stated that bonuses are issued as an incentive to retain employees and therefore these were not paid. However, they agreed with the need to establish criteria for bonuses, and said they would update Icahn's financial policy and procedure guidelines accordingly.

Time Records for Per-Session Pay

School officials stated that employees are required to sign in and out at the beginning and end of each school day. In addition,

teachers who work after school or on Saturdays have separate time sheets which must be signed to show the time started and the time finished. Per-session pay is given to employees at the rate of \$38 per hour for school activities outside of the regularly scheduled work day. Employees are paid at a rate of \$125 per day for work performed on Saturday.

We found that the school's policies and procedures do not provide adequate instruction for preparing timesheets. There were no policies in place for authorizing and documenting per-session payments. Written pre-approvals are not received for per session pay and these activities are not monitored to ensure that the hours paid for are actually worked. Thus, there is an increased risk of erroneous payments.

Icahn officials agreed with us, stating that they will update their policies and procedures. Icahn officials also stated that the Principal will begin issuing per session pay pre-approvals to both the Assistant Principal for Administration and employees indicating the exact time and dates that are being authorized.

Salaries and Accruals

Icahn's by-laws state that the Board has the power to fix employees starting salaries. However, Icahn's Principal, rather than the Board, performs this task using the DOE's salary schedules as a guide. Icahn officials told us that a Board consensus enables the Principal to fix the school's salaries. However, we found no evidence of this approval in the Board's minutes.

We believe the Board should retain the authority to fix starting salaries as an independent check to ensure that the salaries are equitable and appropriate.

School officials stated that the principal will ensure that the Board approves all salaries.

Recommendations

6. Update policies and procedures to ensure that the time records capture all the hours worked, and that per-session pay is pre-authorized.
7. Develop written policies and procedures for employee bonuses.
8. Review employee responsibilities for payroll, and to the extent possible, segregate duties.
9. Fix and approve starting salaries as required by the Icahn's by-laws.

(Icahn officials agree with recommendations 6 through 9 and state they either have addressed or will address these matters.)

AUDIT SCOPE AND METHODOLOGY

We conducted our audit in accordance with generally accepted government auditing standards. We audited Icahn's controls over selected financial management practices for the period July 1, 2005 through June 29, 2007. To accomplish our objective, we interviewed Icahn officials and reviewed laws, policies, and procedures related to the financial operations of the school. We also examined the financial operating records of Icahn and the work performed by the firm of certified public accountants engaged to audit Icahn's financial statements. Our review included the school's Accounting Manual and by-laws.

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 State. 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 draft copy of this report to Icahn officials for their review and formal comment. Icahn's comments were considered in preparing this report and are included as Appendix A. Icahn officials agreed with our recommendations and indicate steps they have taken or will take to implement them.

Within 90 days after the final release of this report, we request that the Chairman of Icahn Charter School Board of Trustees report to the State Comptroller, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, and the reasons why.

CONTRIBUTORS TO THE REPORT

Major contributors to this report were Kenrick Sifontes, Stephen Lynch, Marc Geller, Daniel Raczynski, Ryan Wendolowski, Hu Zhang, Jeremiah Johnson, and Ron Pisani.

APPENDIX A - AUDITEE RESPONSE



Carl C. Icahn Charter School

1525 Brook Avenue
Bronx, New York 10457
Telephone (718) 716-8105
Fax (718) 716-8106
www.ccics.org

Jeffrey Litt, Principal
Richard Santiago, A.P. Operations
Daniel Garcia, A.P. Curriculum & Instruction

Steve Sorokin, Director of Assessment
Migda Agosto, Staff Developer
Xioel Terrero, Guidance Counselor

January 10, 2008

Mr. Kenrick Sifontes
Office of the State Comptroller
Division of State Government Accountability
123 William Street, 21st Floor
New York, NY 10038

Re: **Carl C. Icahn Charter School ("Charter School")**
Report 2007-S-70

Dear Mr. Sifontes:

Thank you for your Draft Audit Report (the "Report") relating to our internal controls, financial operations, financial oversight, disbursements and procurements and payroll. We appreciate the thoughtfulness of your audit and we are grateful to the audit team for their professionalism and sensitivity to the daily operations of the school during their time with us. We are proud that our school has been recognized as a highly successful charter school by the United States Department of Education, Charter Schools Institute and the New York State Education Department and we strive to maintain high standards with respect to our fiscal operations and accountability.

In accordance with your letter dated December 11, 2007, below are our initial responses to the recommendations outlined in your Report. Within ninety days of the issuance of the final Audit Report, the Board of Trustees will further advise the State Comptroller on the status of the implementation of certain recommendations.

Responses to Recommendations:

1. **(Recommendation to the Board). Revise contract and other procurement policies.**

We will discuss with the Board the need to better document our procurement guidelines and to establish written policies and procedures for competitive bidding as well as sole source vendor selection.

2. **(Recommendation to the Board). Periodically monitor Icahn's disbursements to ensure compliance with the Board's policies.**

We will discuss this recommendation with the Board and Treasurer in order to implement new procedures to strengthen our policies in the area of written pre-approvals (including purchase orders) and retention of supporting documentation.



Carl C. Icahn Charter School is chartered by the New York State Board of Regents and the State University of New York Charter Schools Institute and is a result of the collaborative efforts of the Foundation for A Greater Opportunity and the Center for Educational Innovation-Public Education Association. The Icahn Charter School is a public school open to all children on a space available basis, by lottery.

Our current procedure regarding purchases in excess of \$10,000 requires prior authorization by the Treasurer. Additionally, we will request ratification by the Board at subsequent meetings. We would like to add that all such purchases mentioned in the draft report were purchased on behalf of and for the benefit of the Charter School.

In connection with your comments on staff events, we recognize your concern in this area. We would like to reiterate that these were appropriate social functions for the staff, however, we will discuss with the Board the implementation of procedures to formalize the governance of teacher and staff events.

3. **(Recommendation to the Board). Require Icahn to establish separate accounts for public and donated funds.**

We have discussed this with the Treasurer and a recommendation will be made to the Board to establish separate accounts for public and donated funds.

4. **(Recommendation to the Board). Ensure that tax exempt certificates are used for Icahn's disbursements.**

We will continue to use our best efforts to utilize vendors that recognize our tax-exempt status and to obtain a tax exempt certificate in lieu of the tax exempt letter we currently provide to vendors. Additionally, a majority of the sales tax that was paid related to our previous practice of providing stipends, known as "Teacher's Choice." This practice enabled teachers to purchase their own materials which led to a majority of the Charter School's payment of sales tax. We no longer provide these stipends.

5. **(Recommendation to the Board). Comply with procurement and related policies established by the Board.**

Please see our response to Recommendation 1.

6. **Update policies and procedures to ensure that the time records capture all the hours worked, and that per-session pay is pre-authorized.**

Although we feel our approvals are adequate, we acknowledge that our memo authorizing the exact times and dates of service could be more specific. We are currently in the process of investigating timesheet programs and procedures that effectively meet this recommendation.

7. **Develop written policies and procedures for employee bonuses.**

We accept this recommendation and will discuss new policies and procedures with the Board regarding the granting and timing of employee bonuses.

We would like to clarify that two teachers and two staff members were not granted bonuses. The draft report states that four teachers were not granted bonuses.

8. **Review employee responsibilities for payroll, and to the extent possible, segregate duties.**

* Comment

* State Comptroller's Comment: This matter was corrected in the final report.

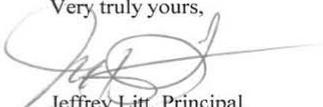
Following the hiring of a new assistant principal we are in a better position to implement procedures to ensure better segregation of duties over the payroll function. We are currently investigating such reallocation of tasks.

9. **Fix and approve starting salaries as required by the Icahn's by-laws.**

We will ensure in the future that Board minutes reflect authorization of salaries.

We wish to thank you and your staff for your review of our school and if you have any questions regarding this response, please do not hesitate to contact us.

Very truly yours,



Jeffrey Litt, Principal