



COMMUNITY Charter School Conflict of Interest Policy

Report of Examination

Period Covered:

July 1, 2007 — March 12, 2012

2012M-60



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 2012

Dear School Officials:

A top priority of the Office of the State Comptroller is to help School officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support School operations. The Comptroller oversees the fiscal affairs of public schools statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and School board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard School assets.

Following is a report of our audit of COMMUNITY Charter School, entitled Conflict of Interest Policy. 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 Education Law.

This audit's results and recommendations are resources for School officials to use in effectively managing operations and in meeting the expectations of taxpayers, students and their parents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

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. The COMMUNITY Charter School (School), located in the City of Buffalo, is governed by a Board of Trustees (Board) that currently has six members. The Board is responsible for the general management and control of the School's financial and educational affairs. The Board appoints a Principal, who is responsible, along with the Business Administrator and other administrative staff, for the day-to-day management of the School under the direction of the Board.

Charter schools have less legal operational requirements than traditional public schools. Most of the charter school's requirements are contained in its by-laws, charter agreement and the fiscal/financial management plans.

The School's operating expenses for the 2010-11 fiscal year were approximately \$3.7 million. These expenses were funded with revenues of approximately \$4.7 million derived from billing area school districts for resident pupils and from certain State and Federal aid attributable to these pupils. The School has approximately 325 students in kindergarten through 6th grade.

The School operates from a building it currently owns. Prior to July 2007, the School was leasing the building from the previous owners for approximately \$54,000 a year. In July 2007, the School purchased the building for \$550,000. Since then, the School has built a bus loop, expanded the building, and upgraded other aspects of the building.

Objective

The objective of our audit was to examine the School's process of addressing potential conflicts of interest. Our audit addressed the following related question:

- Did the Board comply with the School's conflict of interest policy when obtaining contracted goods and services?

Scope and Methodology

Our overall goal was to assess the School's financial operations for the period July 1, 2007 to March 12, 2012. To accomplish this, we evaluated selected areas in general governance, financial oversight and condition, purchasing, cash receipts and disbursements, payroll and personnel services, and inventory and asset control. After evaluating these areas it appears that School officials have established adequate controls for most of these areas and, therefore, limited risk

exists. However, we found weaknesses concerning the controls over potential conflicts of interest.

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 are included in Appendix B of this report.

**Comments of School
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with School officials and their comments, which appear in Appendix A, have been considered in preparing this report. School officials generally agreed with our findings and recommendations and indicated they would be taking corrective action.

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

Conflict of Interest Policy

The Board is entrusted with the responsibility of safeguarding School resources. The Board fulfills this responsibility, in part, by ensuring compliance with the School's conflict of interest policy. We found that the former Board President engaged in business transactions with an owner of a construction company to which the School has paid \$2.4 million since 2007. The Board, however, did not follow the School's conflict of interest policy because it did not determine whether this relationship resulted in a conflict of interest as the policy requires. Further, School officials did not use competitive procedures to obtain these construction services, and did not produce a written contract that stated the scope of the work or the basis of payment. As a result, there is a risk that the former Board President could have improperly benefited from his position as a Trustee, and that the School could have paid more than necessary for construction services.

Conflict of Interest Policy – The School's by-laws establish a policy that provides the process and procedures for addressing potential conflicts of interest. The policy requires that a Board member disclose to the Board his or her financial interests and other relevant information in connection with any actual or possible conflict of interest. After disclosure, and after providing the Board member with an opportunity to make a presentation to the Board, the Board member must leave the meeting. The remaining members of the Board are then responsible for deciding if a conflict of interest exists and for reporting to the New York State Education Department if one does exist. The President of the Board, "if appropriate," is required to appoint a disinterested person or committee to investigate more advantageous alternatives to the proposed transaction or agreement. If a more favorable transaction or arrangement that would not give rise to a conflict of interest cannot reasonably be obtained, the Board must determine, by majority vote of the disinterested Trustees, whether the transaction or arrangement is in the School's best interests and is fair and reasonable.

Although the School's conflict of interest policy adequately addresses potential conflicts of interest,¹ the policy is not always followed. In addition to the disclosure requirement in the School's conflict of interest policy, State guidelines require the Board members to complete annually a "Disclosure of Financial Interest Form" as part of

¹ The Education Law was amended on May 28, 2010, to state that charter schools officers and employees must comply with the provisions of Sections 800 – 809 of the General Municipal Law relating to conflicts of interest for municipal officers and employees.

the School's annual report. When we reviewed the annual disclosure of financial interest forms (i.e., annual disclosure form) for the 2008-09 through 2010-11 fiscal years for all Board members, we found at least one instance when the School's conflict of interest policy was disregarded. For the 2008-09 school year, the former Board President disclosed unspecified financial interests with a construction company to whom the School had paid \$2.4 million for various capital projects since July 2007. We were not provided any evidence that the former Board President adequately disclosed the relevant facts to the Board or that the remaining disinterested Board members determined whether the former Board President had a conflict of interest, as required by the School's conflict of interest policy.

The annual disclosure form that the former Board President submitted for the 2009-10 school year did not disclose a financial interest in any company that contracted with the School. During the 2010-11 school year, the former Board President and two other Board members resigned and did not complete the annual disclosure forms. Instead, the former Principal² prepared forms for them, which were not signed by the Board members. The annual disclosure form prepared by the former Principal for the former Board President shows a financial interest in the same construction company that was listed on the former Board President's 2008-09 annual disclosure form.

Despite information he reported on the 2008-09 annual disclosure form, the former Board President stated that he and an owner of the construction company had no formal business partnership, but only periodically purchased, renovated, and sold residential buildings together. However, we found that the former Board President and an owner of the construction company had purchased seven properties totaling \$556,000, and sold five of these properties for \$967,000 since January 2007. The former Board President and an owner of the construction company purchased one of these properties in August 2010 for \$38,000, and sold it to the former Board President and another party with the same last name for \$80,000 in January 2011. During the same period, the School had been paying the construction company for various School capital projects and improvements. In our view, these financial connections give rise to at least a potential conflict of interest. Under the School's conflict of interest policy, we believe the former Board President was required to disclose these facts to the Board, and the other members of the Board were required to determine whether the facts resulted in a conflict of interest. We found no evidence of compliance with these requirements.

² Because these Board members did not fill out or sign financial disclosure forms for 2010-11, the Principal completed the forms as the School's representative, in compliance with SED guidelines. The Principal was terminated in March 2012.

One other Board member stated on his 2008-09 annual disclosure form that he received \$6,650 from the School for painting work. However, we determined that the Board complied with the provisions of its conflict of interest policy for this transaction. The rest of the Board members, except for the former Board President, had no financial interest disclosed in their forms for the three school years we reviewed.

Construction Services – While the School’s by-laws did not require the use of competitive pricing procedures when procuring construction services, it is a good business practice to follow such procedures to provide School officials with assurance that they are obtaining the appropriate quality of services at the most favorable terms and conditions. Moreover, in circumstances where potential conflicts of interest exist, the School’s policy requires the Board to investigate alternative options to the proposed transaction or arrangement and to determine whether the proposed arrangement will produce a result that is fair and reasonable and serves the best interests of the School. However, School officials regularly used the same construction company whenever they needed construction work performed without using a competitive pricing process, and without investigating alternative options.

It is also a good business practice to ensure that services are performed based on written contracts that define the scope of services and the terms for payment. However, School officials did not provide us with any evidence that they had written contracts with the construction company. Without written contracts, neither we nor School officials can evaluate whether fees charged were appropriate, whether payments were accurate, and whether the contractor’s performance generally conformed to the scope of work and other terms and conditions of the agreement.

To illustrate, we found that the \$2.4 million paid to the construction company included approximately \$139,000 identified as a general contractor fee and additional moneys for a supervision fee. The following are examples of the fees the School paid:

- In August and September 2009, the School paid \$286,125 to construct a bus loop located at the front of the School building. The total payment included a general contractor fee of \$13,529 and a supervision fee of \$4,000.
- From May 2010 to January 2011, the School paid over \$1.5 million to the construction company for a building expansion project, which included a general contractor fee of \$92,782 and a supervision fee of \$40,000.

Without using a competitive process to obtain services, the School may be overpaying for services; without a written contract, the School could be paying for charges that are inappropriate or inaccurate.

Recommendations

1. The Board should ensure that its conflict of interest policy is complied with.
2. The Board should ensure all Board members prepare and sign the annual disclosure of financial interest form required as part of the School's annual report.
3. To help ensure the School obtains contracted services at the most favorable terms and conditions, the Board should consider revising the School's by-laws to include the use of competitive processes for such procurements.
4. The Board should ensure that it enters into and has available written contracts that clearly define the scope of services to be provided and the terms and conditions for payment and ensure that payments are made in accordance with such written contracts.

APPENDIX A

RESPONSE FROM SCHOOL OFFICIALS

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

In their response, School officials refer to a contract which they included as an attachment. We have not included this attachment in our report because the School's response is adequate to address its concerns on this issue.

C.O.M.M.U.N.I.T.Y Charter School
Board of Trustees' Response to Draft Audit Report & Corrective Action Plan

May 22, 2012

The Board of Trustees appreciates the Office of State Comptroller's recent efforts as it pertains to C.O.M.M.U.N.I.T.Y. Charter School. We have taken the suggestions seriously, and have reviewed, evaluated, and implemented change in all areas, as recommended by OSC.

Conflict of Interest Policy

Response: The Board of Trustees agrees that more could have been done in this area. We were aware of Mr. Helfer's house purchasing with Mr. Lamparelli. We did discuss this with Mr. Helfer, and he assured us that there was no conflict of interest. But, in retrospect, his dealings with Mr. Lamparelli does give the appearance of impropriety, given that Mr. Lamparelli's construction company provided services to our school.

Corrective Action Plan: In the future, the Board will:

- (1) be more diligent in its responsibilities to real or potential conflicts of interest.
- (2) create a subcommittee to address and investigate potential conflicts of interest.
- (3) conduct a work session to stress importance of real or potential conflicts
- (4) seek legal counsel, when conflict may exist

Annual Disclosure Forms

Response: The Board recognizes that member resignations in mid year present issues with respect to completion of these forms. We had several Board members resign in the past few years without completing the Annual Disclosure Form. Several attempts were made to encourage compliance, but to no avail.

Corrective Action Plan: In the future, the Board will:

- (1) secure completed and signed Disclosure Forms from each Board member
- (2) review completed Annual Disclosure forms before forwarding to SED
- (3) secure exit interview forms from outgoing Board members

Competitive Bidding and Contracts for Services Rendered

Response: The Board has provided a signed contract for services from Lamparelli Construction for the expansion of the bus loop (attached hereto). We were assured that competitive pricing from subcontractors occurred. Fees paid to Lamparelli were 6.6% and 8.8% for construction projects (Bus loop, building expansion). In our opinion, these fees are not excessive. We believe that we received fair value for the construction services. However, we could not produce documentation to evidence competitive bidding, because we learned, after the fact, there were verbal not written quotes.

(2)

Corrective Action Plan: In the future, the Board will:

- (1) Utilize competitive bidding for expenditures exceeding \$20,000
- (2) Obtain record of written contracts that clearly define scope of services to be provided and terms and conditions for payment
- (3) Seek legal counsel for review of contracts
- (4) Conduct formal Board approval
- (5) Maintain file of contracts

The Board of Trustees is adamant about improving its Policies and Procedures, as recommended by the Office of State Comptroller, immediately. Once again, we thank OSC for assisting us in these important areas.

Sincerely,

A handwritten signature in cursive script, appearing to read "Carmen Iannaccone", is written over a horizontal line.

Carmen Iannaccone

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

The objective of our examination was to assess the financial operations of the School. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: general governance, financial oversight and condition, cash receipts and disbursements, purchasing, payroll and personnel services.

During the initial assessment, we interviewed appropriate School officials, performed limited tests of transactions, and reviewed pertinent documents, such as School by-laws, procedures, Board minutes, and financial records and reports. In addition, we tested selected computerized financial data to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined that the controls appeared to be adequate and that limited risk existed for most of the financial areas we reviewed. We then decided upon the reported objective and scope for the area with the greatest risk. We examined the School's conflict of interest policies and procedures for the period July 1, 2007 to March 12, 2012. Our audit included various procedures to gather relevant evidence concerning our stated objective, as follows:

- We reviewed the School Charter, by-laws, annual report, and Board meeting minutes to determine whether the School has adequate conflict of interest policies and procedures.
- We reviewed Board members' annual disclosure of financial interest forms for the 2008-09, 2009-10, and 2010-11 school years to determine whether these forms were properly completed.
- We investigated any disclosed financial interests to determine whether the School complied with its own policies and procedures.
- We interviewed School officials and current/former Board members.
- We compared Board members' names and addresses against employee lists and vendor lists to identify potential related parties. For potential related party transactions, we performed further internet searches using specialized software and reviewed public records.
- We examined all 22 vouchers paid to a contractor since July 2007 to document the stated purposes of these payments.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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