Office of the New York State Comptroller

Division of Local Government & School Accountability

Aloma D. Johnson Fruit Belt Community Charter School

Building Lease

Report of Examination

Period Covered:

July 1, 2008 — March 5, 2012

2012M-54

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 the Aloma D. Johnson Fruit Belt Community Charter School, entitled Building Lease. 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 Aloma D. Johnson Fruit Belt Community Charter School (School) is governed by a Board of Trustees (Board) which comprises 11 members, including two institutional partner representatives,[1] one parent, and one teacher representative. Charter school trustees are invited and voted in by sitting members, or invited through advertising in local media.[2] Although the School's by-laws stipulate that there is an 11 member board, the School had five Trustees for 2008-09 fiscal year, eight for the 2009-10 and 2010-11 fiscal years, and nine for the 2011-12 fiscal year. The Board is responsible for the general management and control of the School's financial and educational affairs.

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, which are part of the charter school application.

The School operates from a leased building owned by the St. John Baptist Church (Church). The Rev. Dr. Bennett W. Smith Sr. Family Life Center Inc. (Life Center Inc.), a not-for-profit entity, also operates from the same location. Life Center Inc.'s Internal Revenue Service Form 990 indicates that it is affiliated with the Church. The Church controls and/or is affiliated with a number of corporations or not for profits, several of which are involved in community economic revitalization programs. The School and the Life Center Inc. are listed in the Church's organization chart as some of the 11 entities under its control, with the pastor as the chief executive officer of the holding entity.

Construction for the building, now leased by the School, began in 2000 and was completed in 2001, costing approximately $3.8 million; financed with $1.6 million in pledges from the Church, a $1 million grant from New York State and $1.2 million in other Federal and local grants. The Church had intended to operate a childcare program. Since its completion, the building has housed a parochial school for

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[1] Per the charter agreement, two seats are reserved for the two initial principal applicants, the institutional partners' representatives — Daemen College, and the St. John Fruit Belt Community Development Corporation (FBCDC), being one of the affiliates of the Church, with the pastor being the President of the Board of Directors of FBCDC.

[2] For a new Board member, the sponsors/founders invite, interview, and approve prospective applicants.

the Church, a childcare center and a high school for a neighboring charter school. Currently, part of the building is used as a community center after school hours, and on weekends.

The School's 2011-12 fiscal year operating expenses totaled approximately $3.4 million. These expenses were funded primarily with revenues derived from billing area school districts for resident pupils (87 percent) and from certain State and Federal aid attributable to these pupils (13 percent). The K-4 primary school had approximately 300 enrolled students and 65 employees as of December 31, 2011.

Objective

The objective of our audit was to examine the School's process for selecting and negotiating the related financial terms to obtain building space needed for school operations. Our audit addressed the following related question:

- Did the Board use an adequate process to identify suitable building space for school operations and negotiate related financial terms that best meets School needs?

Scope and Methodology

While our audit was for the period June 1, 2008 to March 5, 2012, we reviewed the charter school application from October 2007.

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 plan to initiate corrective action.

The Board has the responsibility to initiate corrective action. We encourage the Board to prepare a plan of action that addresses the recommendations in this report, and to forward the plan to our office within 90 days. For more information on preparing and filing your 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 School Director's office.

Building Lease

The Board is entrusted with the responsibility of safeguarding School resources. The Board fulfills this responsibility, in part, by fully evaluating existing options before committing these resources.

When selecting a suitable site on which to construct a school building, or locating an existing building for acquisition or lease, the Board should establish a process to properly identify the needs of the School in terms of the location, size of the building, suitability for intended use and future expansion, and should confirm that related costs are appropriate to ensure the School's long term financial viability. The Board should analyze all cost aspects and compare them to comparable properties and current market conditions. This would provide assurance that the agreed upon terms are reasonable and align with market conditions. With respect to lease agreements, the rent payment often is intended to cover all the landlord's operating expenses, including maintenance, insurance and property taxes. However, in other lease agreements, some or all of these types of expenses are paid by the tenant separately from the rent and are referred to as Common Area Maintenance (CAM). When comparing leases for different properties, it is important to analyze the total cost for each, including any CAMs, and any leasehold improvements necessary to make the property suitable for its intended use. This process should also entail exploring the option of buying and rehabilitating existing buildings and/or buying land and constructing a new building suitable for school needs.

The Board should establish the appropriate fiscal environment, or tone at the top, by promoting a theme of fiscal responsibility and ethical conduct among all Board members. Education Law requires a charter school to set guidance for the trustees including filing disclosure of financial interest forms to ensure their independence in representing the interest of the school and to avoid less than arm's length transactions. An arm's length transaction is when the buyer and seller of a service act independently and have no relationship to each other. The concept of an arm's length transaction is to ensure that both parties to a transaction are acting in their own self interest and are not subject to any pressure or duress from the other party.

However, we found no evidence that the Board had fulfilled its fiduciary responsibility to the School by ensuring that it fully evaluated the choice of its school building. In fact, the Board selected a building that was owned by an organization that it had extremely close ties to with no evidence that it is paying market value. In addition, the terms of the lease were not complied with as it appears that the School had been occupying and possibly renovating space that was not included in the lease agreement and without prior State Education Department (SED) approval. We also found that the terms and conditions of the lease, including the cost of leasehold improvements, directly impacted the School's financial condition, initially resulting in cash flow problems to the School, while also providing a significant financial benefit to the landlord.

Site Selection

The charter school application requires the applicant to identify and notify SED of a suitable location for the school prior to final approval of the charter. The New York State Office of General Services annually publishes a list of vacant and unused buildings, or portions thereof, that are owned by the State and may be suitable for the operation of a charter school. Education Law requires that this list shall be provided to applicants for charter schools and to existing charter schools. Further, at the request of a charter school or a prospective applicant, a school district is required to make available a list of vacant and unused school buildings, or portions thereof, including private school buildings, within the school district that may be suitable for the operation of a charter school.

We found that the Board did not use an adequate process for site selection and lease cost analysis. The Board could not demonstrate that it identified and fully evaluated other site options other than the current location. Although the audit committee chairperson (who also serves on the Board) stated that inquiries were made to the Buffalo City School District (District) about the list of vacant buildings, he could not provide us with supporting documentation to verify that a list had been obtained, let alone that any properties listed were evaluated for suitability. He indicated that all inquiries were verbal and not documented.

The audit committee chairperson further stated that all former District buildings would be "cost prohibitive" to buy and rehabilitate due to, among other issues, asbestos abatement. However, there is no evidence that the Board performed a cost-benefit analysis on alternative sites or analyzed whether the lease costs were reasonable or whether purchasing this or another building was a viable option.

The Board also did not hire a professional engineer to perform any analysis. As such, the Board has no assurance that other options would have resulted in costs greater than the current lease arrangement. The Board also did not contact the New York State Office of General Services for a list of State buildings with space available in the area. We found that the leased building appears to meet the School's current needs for cafeteria, gymnasium and classroom space. However, we were told by the School audit committee chairman that the building cannot accommodate future expansion beyond the current grades K-4 configuration.

Lease Agreement and Cost Analysis

The School signed a $304,000 CAM-inclusive five-year lease agreement dated June 1, 2008. However, the period indicated on the lease is June 1, 2008 to May 31, 2012, one year less than the term indicated. As such, it's unclear when the lease ends and whether the landlord could request that a new lease be negotiated for the 2012-13 school year. According to the audit committee chairperson, the lease was negotiated by the first Board President who resigned after serving for one year. The lease allowed the tenant exclusive use of the third floor and certain portions of the first floor, and use of the gymnasium and the cafeteria for certain hours on weekdays. Portions of the first floor are used by the landlord after school hours and on weekends as a community center. The lease also stipulates that the School is responsible for improvements to the leased space.

In 2010, the School negotiated with the landlord for additional classroom space as more grade levels were added and enrollment had increased. However, it appears that the School had been occupying and possibly renovating space that was not included in the lease agreement and without prior SED approval. Furthermore, we noted during our review of the charter application that there were some inconsistencies between the charter application and the initial lease agreement. The application projected that enrollment would be 180 students in 2008-09, increasing to 240 students in the subsequent fiscal year, and again the following fiscal year to 300 students. However, the initial lease agreement approved by SED indicated that the School was only allowed 180 students enrolled even though it was a multi-year lease. As such, it was a foregone conclusion, providing that enrollment projections were achieved, that the School would need to renegotiate the lease in order to continue operating at this site. Furthermore, correspondence from the School to SED indicates that the School had been occupying space not included in the initial lease since July 2009 and that renovations had already been made to the space at the School's expense.

The Board minutes indicated, and the audit committee chairperson confirmed, that the landlord had asked for lease payments to increase to $609,000 annually for the School to increase its use to include the second floor of the building. This would have resulted in a $305,000 increase in the annual cost of the lease, retroactive to July 1, 2009. The final amount agreed upon and approved by SED was an annual lease payment of $525,000, retroactive to July 1, 2010. The audit committee chairperson stated that he conducted an analysis of the lease options available, including options of buying and rehabilitating existing buildings, and concluded it was cost effective to continue the leasing arrangement with the Church. However, he could not substantiate this conclusion with any documentation. While there was notation in the Board minutes regarding lease rental rates on a square foot basis, no such supporting documentation was provided for our review. Furthermore, in the correspondence with SED, the Board President stated that the lease was reasonable based on costs of similar commercial space in the surrounding area. However, we were not provided any supporting documentation to demonstrate that such analysis had indeed occurred.

The audit committee chairperson told us that while he was involved in the evaluation analysis, he was never assigned the role and did not negotiate the lease amendment. However, the Board minutes indicate that the Board assigned him the role of negotiating the lease amendment with the landlord.

Financial Impact

The terms and conditions of the lease, including the cost of leasehold improvements, directly impacted the School's financial condition. In its first year of operation, the 2008-09 fiscal year, the School incurred an operating loss of $449,317. The School experienced cash flow problems that resulted in overdrawn bank accounts and significant bank charges. For example, from January 1, 2010 to December 31, 2011 the School paid bank charges/fees totaling over $4,200 on a non-interest bearing account.

The School's finances subsequently improved, due primarily to increased enrollment, and the School reported a surplus of $746,000 in the 2010-11 fiscal year. As financial condition improved, the landlord requested that the annual lease payment double from $304,000 to $609,000. The final lease approved by SED was $525,000. At this rate the School would have paid the landlord approximately $1.7 million by the end of the lease period, May 31, 2012, slightly more than the net out of pocket costs incurred by the landlord in funding the construction of the building. Furthermore, the School spent over $350,000 in leasehold improvements to configure suitable classrooms as well as to resurface the parking lot shared with the Church. As such, the School will have paid more than $2 million to use a building that only cost the landlord approximately $1.6 million.[3] While, this is a CAM-inclusive lease, and therefore the landlord has also incurred operation and maintenance costs, but not property taxes, as the property is exempt, this agreement results in a significant financial benefit to the landlord

Related Parties and Disclosure of Financial Interest

The signatories for the lease agreement for the landlord and School were the pastor of the Church and the first Board President, respectively. The pastor was one of the initial founders of the School and was involved with the application process. Initial and

[3] The remaining costs of building the facility were financed with Federal, State, and local grants.

progress application material was signed by the pastor; the final charter agreement accepted by SED was signed by the former Board President. Furthermore the pastor and the former Board President served together as President of the Board of Directors, or Executive Director, and Board Chairperson and Director, respectively, for the Life Center Inc. and the St. John Fruit Belt Community Development Corporation (FBCDC). The relationship between the landlord and the first Board President — both being involved with the application process for the School and serving on the Board of the Life Center and FBCDC — and the Board President's husband being a trustee of the Church (the landlord) required her, pursuant to the School by-laws, to refrain from negotiating the lease agreement and recuse herself from voting. The School's Code of Ethics also requires the Trustees to avoid engaging in activities that appear to be unduly influenced by other persons with interest in the matter being considered by the Board. However, the Board minutes indicated that she was one of the four Board Trustees who voted in favor of the lease agreement.

We reviewed the disclosure of financial interest forms filed by Board Trustees for the 2009-10 and 2010-11 fiscal years and found that only one Trustee disclosed a potential conflict. The remaining Trustees did not disclose any potential conflicts despite what appears to be a close interwoven relationship with the Church, the FBCDC and/or its affiliated not-for-profit entities. For example, the School financed the leasehold improvements by opening a line of credit with a bank that was secured with assets of the FBCDC and the Church, further demonstrating the close relationship between these parties.

The pastor of the Church stated to us that the lease amount was not negotiated with School officials, but rather he asked the School Board to pay what the Board deemed to be a fair lease amount. This contradicted what was said by the audit committee chairperson, that the landlord had asked for $609,000 when the lease was renegotiated and which was noted in the School's Board minutes. During our meeting, the pastor stated that the documentation for the site selection and lease option analysis were with the attorney which they would provide to our office within 48 hours. However, the School audit committee chairperson subsequently notified us that they would not be providing additional documentation and indicated that SED's approval of the initial and amended lease agreements was sufficient confirmation that they had met all cost analysis requirements.

Recommendations

1. The Board should properly fulfill its fiduciary responsibility by conducting site selection reviews and cost analyses for real estate transactions. Such analyses should include whether it would be more cost beneficial, and feasible, to acquire and renovate an existing building, acquire land and construct a building, or lease a

facility. If needed, the Board should consider hiring a professional to assist with these analyses.

2. If the Board chooses to continue leasing the existing building, it should, prior to negotiating a new lease agreement, obtain comparative market rates to provide assurance that the terms and conditions of the lease agreement are in the best interests of the School. The Board should properly document its analysis and actions taken in the Board minutes.

3. The Board must ensure that all the terms of the lease agreement are complied with and seek SED approval prior to modifying the terms and conditions of lease agreements.

4. The Board must ensure that members who disclose a conflict or perceived conflict of interest in a contract recuse themselves from discussing or voting on contracts.

APPENDIX A

RESPONSE FROM SCHOOL OFFICIALS

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

THE ALOMA D. JOHNSON
Fruit Belt
COMMUNITY
CHARTER SCHOOL

June 12, 2012

Robert E. Meller
Chief Examiner of Local Government and
School Accountability
Office of the State Comptroller
295 Main Street, Suite 1032
Buffalo, New York 14203-2510

Dear Mr. Meller:

Having reviewed the draft report of examination for the financial condition of the Aloma D. Johnson Fruit Belt Community Charter School for the period of July 1, 2008 through March 5, 2012, we understand the objectives of the audit, the scope and methodology, and the findings. Additionally, it is the intention of the Aloma D. Johnson Fruit Belt Community Charter School that the recommendations being made by the report will be documented through the submission of a corrective action plan as outlined by the Division of Local Government and School Accountability.

The focus of this report was the building lease. The school received the following recommendations:

1. The Board should properly fulfill its fiduciary responsibility by conducting site selection reviews and cost analysis for real estate transactions. Such analysis should include whether it would be more cost beneficial, and feasible, to acquire and renovate an existing building, acquire land and construct a building or to lease a facility. If needed, the Board should consider hiring a professional to assist with this analysis.
2. If the Board chooses to continue leasing the existing building, it should, prior to negotiating a new lease agreement, obtain comparative market rates to provide assurance that the terms and conditions of the lease agreement are in the best interests of the School. The Board should properly document its analysis and actions taken in the Board minutes.
3. The Board must ensure that all the terms of the lease agreement are compiled with and seek SED approval prior to modifying the terms and conditions of lease agreements.
4. The Board must ensure that members who disclose a conflict or perceived conflict of interest in a contract recuse themselves from discussing or voting on contracts.

In response to these concerns, the Board has acted to institute a Building Committee. This committee has been established to conduct site selection and cost analysis for real estate transactions. Additionally, the Building Committee will be involved in obtaining comparative market rates before renegotiating the lease on the existing building upon the expiration of the building lease. The Building Committee will be responsible for documenting all analyses done regarding the building.

Additionally, procedures are in place to secure SED approval of all modifications of terms and conditions of the lease.

Moving forward, minutes will include a declaration of conflicts of interest of Board members. These conflicts of interest will be stated before any discussion on topics related to contracts.

The Board would like to take this opportunity to thank the Office of the State Comptroller for their recommendations. These recommendations will serve to strengthen our internal controls and the fiduciary responsibility of the board.

Sincerely,

Jerry L. Linder, President
Aloma D. Johnson Fruit Belt Community Charter School

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 information technology.

During the initial assessment, we interviewed appropriate School officials, performed limited tests of transactions, and reviewed pertinent documents, such as School policies, procedures, by-laws, Board minutes, and financial records and reports.

After reviewing the information gathered during our initial assessment, we then decided upon the reported objective and scope for the area with the greatest risk. We examined the School's processes for selecting and negotiating the terms for building space. Our audit included various procedures to gather relevant evidence concerning our stated objective, as follows:

- We interviewed School officials to get an understanding of the processes used.
- We reviewed charter application documentation.
- We reviewed the School's by-laws addressing code of ethics and conflict of interest.
- We reviewed the lease agreement and Board minutes relating to the lease agreement.
- We conducted internet searches and reviewed documents provided by officials to gain an understanding of the relationship between the School and the St. John Baptist Church affiliated corporations and/or not-for-profit organizations

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.

APPENDIX C

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