

Buffalo United Charter School

Financial Management

MARCH 2019



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Buffalo United Charter School

Audit Objective

Determine whether the Board ensured School funds are used in the most effective and economical manner.

Key Findings

- The Board assigned nearly all revenue the School received to National Heritage Academies, Inc. (NHA), which is responsible for the general management and control of the School's finances.
- The Board did not have control over School funds or how they are used.

Key Recommendations

- Negotiate changes in the terms of the management agreement with NHA to gain more control over the School's finances.
- Continue to periodically assess the terms and conditions of any management agreement to ensure it is reasonable and in the School's best interest.

School officials generally disagreed with our findings and recommendations. Appendix B includes our comments on the School's response.

Background

The Buffalo United Charter School (School) is located in the City of Buffalo, Erie County, and is governed by a five-member Board of Trustees (Board). The Board entered into a management agreement (agreement) with National Heritage Academies, Inc. (NHA), a privately held for-profit corporation located in Grand Rapids, Michigan. Most charter schools are nonprofit organizations. Less than 15 percent of charter schools across the country are managed by a for-profit organization.

The Board has contracted with NHA to operate the School since the 2003-04 fiscal year. The agreement assigns nearly all revenue the School receives to NHA, which is responsible for the general management and control of the School's finances.

Quick Facts

Employees	61
Enrollment	630
Average Amended Budget 2014-15 – 2016-17	\$9.5 million

Audit Period

July 1, 2014 – March 6, 2018

Financial Management

How Should the Board Manage School Finances?

The board is ultimately responsible for safeguarding public funds intended for educational purposes, even when it contracts with a management corporation to operate the school. The board should fulfill this responsibility by providing adequate oversight of the corporation to ensure that all transactions are accounted for and that funds are used effectively and efficiently for educational purposes.

To facilitate its effective management of the School's financial operations, the Board adopted bylaws requiring the Treasurer to perform, or cause for the performance of, the following:

- Keep an adequate and correct accounting of the School's receipts and disbursements,
- Make the records available at all times for inspection by a Board member,
- Make all deposits and disbursements as the Board directs,
- At least annually, prepare an accounting of the School's financial transactions and financial condition.

The bylaws also provide for the Treasurer to have other powers and exercise them as the Board may prescribe.

Additionally, the annual budget is a key tool that reflects the Board's spending priorities and revenue sources and allows the Board and School officials to monitor actual results against planned activity. Budget estimates should be realistic, based on the combination of historical trends and known or reasonably anticipated new information.

Complete, accurate and sufficiently detailed financial reports, such as the budget and budget-to-actual monitoring reports, provide essential information that the Board can use to make budget amendments and to manage both the School's financial operations and the corporation providing those services.

The Board Did Not Have Control Over School Funds or How They Were Used

The School's previous Board entered into an agreement¹ with NHA that assigned it nearly all revenue the School receives. NHA is responsible for the general management and control of the School's finances. As a result, NHA performs nearly all of the key financial duties and the Board relies almost exclusively on NHA to handle the School's finances. NHA has not fully disclosed detailed internal

¹ This initial agreement began in 2003 and was subsequently updated by a revised agreement approved by a previous School Board in 2011.

cost information and how operating costs are allocated to the School. As a result, the Board has limited ability to verify whether the charges and reporting are accurate and appropriate. We question whether the Board can sufficiently monitor NHA to ensure that School funds are properly safeguarded and used for intended educational purposes.

Budgetary Control – While the Board technically approves the annual budget, it is not in control of the budget’s preparation or management. NHA prepares and manages the budget and any subsequent amendments to it. However, the NHA-prepared budget and amendment documents lacked sufficiently itemized detail which the Board could have used to ensure accuracy and reasonableness. As a result, NHA received and disbursed nearly all² School revenues, which averaged approximately \$9.5 million annually for the three completed fiscal years of our audit period, without Board review or approval. As such, the Board’s approval of the budget and any subsequent amendments is essentially meaningless as a form of internal control.

When the budgeted revenue amounts were amended (Figure 1), NHA also adjusted various cost allocations, increasing the School’s expenses, to maintain a balanced budget. However, without itemized information on these amendments, the Board cannot effectively evaluate, monitor or ensure that the additional revenue that NHA received from the School is used to pay for additional and appropriate expenses for which the funds were intended.

Figure 1: Budgeted vs. Actual Revenue

	2014-15	2015-16	2016-17
Original Budget – Revenue	\$8,998,487	\$9,269,787	\$9,830,418
Amended Budget – Revenue	\$9,721,466	\$9,600,070	\$9,233,491
Total Amendments	\$722,979	\$330,283	(\$596,927)
Percent of Original Budget	8%	4%	(6%)
Actual Revenue	\$9,573,667	\$9,651,984	\$9,151,425

Further, while School principals are authorized to approve purchases of \$500 or less, anything above that amount is submitted to, approved and disbursed by NHA. Therefore, the Board did not control vendor selections to ensure goods and services were obtained or provided in the School’s best interests. Further, the Board did not inspect claims and vouchers submitted to NHA for payment to ensure accuracy and appropriateness. As a result, the Board cannot ensure public funds were used for the educational purposes for which they were intended. Additionally, although the Board selects and approves individuals hired to work at the School, NHA determines the pay rates and benefits. Consequently,

² The Board retains direct control to disburse an amount up to \$35,000 or 2 percent of the School’s annual revenue, whichever is greater.

in total, NHA reported \$9.4 million in average annual disbursements over the three-year period for expenses such as vendor and payroll payments that the Board had little control over.

Schedule of Expenses – The New York State Education Department (SED) requires charter schools to report the nature of expenses in two categories consisting of educational program (regular, special and other education) and support services (fundraising, management and general services) on a schedule of expenses (schedule). NHA prepared and provided these schedules annually to the Board, which approved and provided them to SED. During our audit period, total general fund educational program expenses annually averaged approximately \$5.9 million (63 percent) and total support services averaged approximately \$3.5 million (37 percent).

We analyzed the educational program expenses category on these schedules to assess the amount of personnel costs that NHA reported (salaries, wages, payroll taxes and employee benefits) to determine the amount spent on personnel directly supporting student education. NHA reported an annual average of \$3.6 million in personnel costs, or 61 percent of the total annual category for educational program expenses (38 percent of the total average annual School expenses).³ We also calculated the amount of this category's costs spent for each full-time equivalent (FTE) of student enrollment. The average per-FTE cost was \$5,700.

For perspective, we also analyzed the other category on the schedule reported to SED titled Support Services. Within this category are management and general services⁴ costs, which NHA reported as annually averaging \$3.5 million, which was 100 percent of expenses reported in this category or 37 percent of the School's total average annual expenses during our audit period.

NHA officials told us that in addition to the profit amounts they earn from managing the School, another example of a cost they allocate to this category was grant procurement costs which annually averaged \$143,000. Because NHA did not provide us with supporting documentation to ensure the accuracy or reasonableness of this amount, we compared this average annual cost to the average annual amount of grant revenue received. On average, grant procurement costs were approximately 30 percent of annual grant revenues received. However, the grant revenues received during our audit period were entitlement grants, meaning; the grant revenue was based on student enrollment and demographics and did not require extensive administrative support to

³ The remaining expenses in this category annually averaged approximately \$2.3 million, composed primarily of: building lease (\$897,000), supplies/materials (\$500,000), building costs (\$443,000), professional services (\$268,000), staff development (\$77,000), student services (\$52,000) and technology costs (\$52,000).

⁴ No fundraising expenses were reported.

research and obtain. As a result, we question NHA's grant procurement cost allocation to the School reported in this category.

NHA officials also told us that NHA allocates an average of \$253,000 annually of its own "board" expenses and an additional \$237,000 annually of executive administration costs in this category to the School. However, while we asked for more clarification and documentation on how money in this category was spent, neither was provided. We note that the Board retains direct control just over \$35,000 in the annual budget.

Because of the lack of information available to evidence the nature of the management and general services costs and to gain perspective, we calculated the amount of this category's total costs spent for each full-time equivalent (FTE) of student enrollment. NHA's average per-FTE cost was \$5,600, or nearly as much as the \$5,700 average FTE cost for personnel directly supporting the educational programs.

Prior Recommendations – Our Office previously audited the School in 2012⁵ and made two recommendations, neither of which the Board successfully implemented completely. As a result of our current audit findings, we once again make these two recommendations. We encourage the Board to thoroughly evaluate the School's contractual relationship with NHA to ensure that public funds are used effectively and economically and for the educational purposes for which they were intended.

What Do We Recommend?

The Board should:

1. Negotiate changes in the terms of the management agreement with NHA to gain more control over the School's finances.
2. Continue to periodically assess the terms and conditions of any management agreement to ensure it is reasonable and in the School's best interest.

⁵ Report no. 2012M-142, "Buffalo United Charter School – Financial Management" (December 2012)

Appendix A: Response From School Officials



BUFFALO UNITED CHARTER SCHOOL

A PUBLIC CHARTER SCHOOL MANAGED
BY NATIONAL HERITAGE ACADEMIES

January 29, 2019

Office of the New York State Comptroller
Division of Local Government & School Accountability
Buffalo Regional Office
Attn: Jeffrey Mazula
Main Street, Suite 1032
Buffalo, NY 14203-2510

On behalf of the entire Board of Buffalo United Charter School (BUCS), I submit this letter in response to the draft audit report by the Office of the State Comptroller, dated January 2, 2019.

The Board realizes it is our responsibility to provide oversight to ensure that school funds are used effectively and efficiently for educational purposes. We take these responsibilities very seriously and appreciate the opportunity to review our processes and procedures. At the same time, we dissent, respectfully but strongly, with some key assertions contained in your draft report, as further noted below.

We have noted two recommendations in the audit report: (1) that the Board should negotiate changes in the terms of its management agreement with National Heritage Academies, Inc. ("NHA") to gain more control of the school's finances; and (2) that the Board should periodically assess the terms and conditions of any management agreement to ensure that they are reasonable and in the best interests of the school. It is our contention that we have exercised due diligence and caution in our oversight of NHA's provision of services to the school, and we are continually engaged in monitoring and assessing NHA's performance under our management agreement in effort to ensure that NHA is being held accountable for its performance and that our agreement with NHA is serving the best interests of the school.

In response to the first recommendation contained within the draft audit report, we respectfully disagree with the suggestion that the Board does not have control of the school's finances. As described in the report, the Board has contracted with NHA to provide the educational program, management services, and financial services to BUCS. Although the Board has delegated the day-to-day financial decisions to NHA, we retain ultimate control over the school's finances. All financial decisions made by NHA related to the school must be made within the framework of the Board-approved budget.

See Note 1 Page 9

The budget process has two stages, the preliminary spring budget approval (prior to the start of the fiscal year) and the fall budget approval (after the school year begins and student count can be more reasonably estimated). This process meets the requirements for budgeting in New York State. We recognize that it is our responsibility to review and approve the budget and



subsequent amendments. Evidence of the care we take in the budget process (including the Board's discussion and analysis of the budget) can be found in all Board meeting minutes from 2017-2018.

See
Note 2
Page 9

The audit report also mentions that the Board lacked detailed information regarding the school's financial operations. It should be noted that since the 2010-11 budget cycle, NHA has been providing the Board with greater detail on the budget at the Board's request, and has been supportive of any inquiries made by the Board for further detail, which we have not been hesitant to make. The quarterly financial reports also include this increased level of detail to better help the Board in its oversight of fiscal operations. In addition to the foregoing, it should not be overlooked that the Board, on an annual basis, independently selects and engages a reputable and national independent auditor to review the school's financial statements and to provide an opinion as to whether the school's financial statements are fair, accurate and in accordance with Generally Accepted Accounting Principles. To the best of my knowledge this audit firm has not identified any deficiencies at BUCS. We use that report in furtherance of our responsibility to protect and control the school's finances and to ensure that funds are being used effectively, efficiently and appropriately for the benefit of the school.

See
Note 3
Page 9

On the matter of periodic reviews of the services agreement: since 2011, when the Board performed a comprehensive review and assessment of the school's management agreement with NHA, a new and improved management agreement was negotiated that specifically enhanced the Board's ability to hold NHA accountable for its services. This arrangement specifically addresses the ability of the Board to terminate the arrangement if expectations fall short or if the Board no longer views the contract to be within the best interest of the school. The Board continues to regularly review its management agreement with NHA in light of NHA's performance, and the Board's ultimate responsibilities to the school. The Board has always been and continues to be committed to making changes and improvements where we feel it is necessary and in the best interests of the school.

The Board would also like to address several comments made in the report.

The audit report observes that the Board did not control vendor selections to ensure that goods and services were obtained or provided in the school's best interest. It is unclear to the Board why we must approve every vendor used for goods and services as this is not a state requirement. As mentioned above, the Board selects and contracts with an independent audit firm. Part of the audit firm's responsibility is to ensure that the school is following state and federal regulations regarding the selection of vendors. None of these independent annual audits has ever included any finding or concern about vendor selection.

See
Note 4
Page 9

See
Note 5
Page 9

We also dispute the assertion that grant procurement costs were unreasonable because entitlement funds do not require administrative support. The school's grant procurement costs are a shared services allocation to the school from NHA that falls within the guidelines of

See
Note 5
Page 9



Generally Accepted Accounting Principles. This methodology is audited by the school's independent auditor and has consistently been deemed to be a reasonable methodology.

See Note 5 Page 9

Thank you for the opportunity to respond to the audit report. We will continue to review the recommendations in the audit report and a separate corrective action plan will be filed to directly address them.

Sincerely,

Andrew J. Freedman
Board President
Buffalo United Charter School

Appendix B: OSC Comments on the School's Response

Note 1

While the Board approves the budget, it has little control, as the School's agreement with NHA assigns nearly all revenue to NHA.

Note 2

While the Board technically approves the annual budget, NHA prepares and manages the budget and any subsequent amendments to it. When the budgeted revenue amounts were amended, NHA also adjusted various cost allocations, increasing the School's expenses, to maintain a balanced budget.

Note 3

We have amended the draft report to reflect these actions taken. We encourage School officials to continue with these efforts.

Note 4

The Board is responsible for ensuring that all money disbursed is for proper School purposes. By controlling vendor selections, it can provide better assurance that goods and services are purchased, and the respective payments made, in the School's best interests.

Note 5

Subsequent to receiving the School's response letter, we asked both the School and NHA officials to assess how the audit firm ensures that the School is following State and federal regulations regarding vendor selection and that the shared services allocation methodology is reasonable. The School provided us information from the audit firm which indicated that the audit firm was not responsible for either of these functions. Instead, the audit firm stated that both functions were the School management's responsibility.

Appendix C: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Section 2854 of the New York State Education Law, as amended by Chapter 56 of the Laws of 2014. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We reviewed the management agreement, School Charter, bylaws, annual reports, audited financial statements and Board meeting minutes and interviewed Board members, School officials and NHA personnel to gain an understanding of the School's financial operations.
- We reviewed the initial annual budget and subsequent amendment documents for both revenues and expenses for 2014-15 through 2016-17. We requested any additional supporting information available for those documents.
- We reviewed the annual schedule of expenses and identified certain cost categories significant to the School's operation as personnel costs directly supporting the cost categories of educational programs and management and general services. We asked NHA and School officials for any additional documentation of details regarding these costs. We then calculated the total costs in these categories as a percentage of total annual expenses to analyze the costs' overall significance. Lastly, to gain perspective and compare these two cost categories, we divided these two total costs by the FTE student enrollment number of 630 as of June 30, 2017.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

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 forward the plan to our office within 90 days.

Appendix D: Resources and Services

Regional Office Directory

www.osc.state.ny.us/localgov/regional_directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/localgov/costsavings/index.htm

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/localgov/planbudget/index.htm

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/localgov/pubs/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/localgov/finreporting/index.htm

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/localgov/researchpubs/index.htm

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.state.ny.us/localgov/academy/index.htm

Contact

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