Thomas P. DiNapoli
COMPTROLLER

OFFICE OF THE
NEW YORK STATE COMPTROLLER

DIVISION OF STATE
GOVERNMENT ACCOUNTABILITY

MERRICK ACADEMY CHARTER SCHOOL

FINANCIAL MANAGEMENT PRACTICES

Report 2006-S-66

AUDIT OBJECTIVE

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

AUDIT RESULTS - SUMMARY

Merrick, an elementary school with about 500 students, is located in New York City. We identified a number of weaknesses in Merrick's internal controls over financial operations. For example, there was often no documentation on file to support either the amount paid or the business purpose of disbursements from a checking account that was supposed to expedite purchases of $500 or less. As a result, there was no assurance the disbursements were made for valid school purposes.

We were able to determine that two of the disbursements were not made for valid school purposes, including one payment for $140 that enabled a member of Merrick's Board of Trustees to attend a fundraising event for a State legislator. The other payment which totaled $160 allowed a Merrick staff person to attend a NAACP fundraising event. We also found that more than $1,800 in petty cash disbursements could not be accounted for and we also identified weaknesses in the controls over procurement, payroll and personal services, and equipment inventories.

Merrick uses a contractor to help manage and oversee its operations since the school opened in 2000. The contractor receives an annual management fee for its services. We determined that the fee for the 2004-05 school year was calculated incorrectly by the contractor, as it should have been $890,480 rather than the $904,819 that was charged by the contractor - a difference of $14,339.

Merrick is governed by a Board of Trustees that is supposed to meet at least five times each school year. However, we found that the Board met just twice during the 2004-05 school year and just three times during the following school year. We recommend the Board meet as frequently as it is supposed to.

Our report contains 17 recommendations for improving internal controls over Merrick's financial management practices. Merrick officials generally agree with our findings and will take steps to implement changes.

This report, dated December 21, 2007, is available on our website at: http://www.osc.state.ny.us.
Add or update your mailing list address by contacting us at:
(518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
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BACKGROUND

In December 1998, the New York State Legislature passed a law authorizing the creation of charter schools in the State. This legislation is known as the New York Charter Schools Act (Act) of 1998. It authorized the establishment of charter schools as independent public schools governed by not-for-profit boards of trustees and managed according to the terms of a 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 February 2000, Merrick Academy Charter School (Merrick) is one of 41 charter schools currently approved by the State University of New York (SUNY) and chartered by the Regents of the State of New York. Located in Queens Village, the school offers instruction at the kindergarten through sixth grade levels. During the school year that ended in June 2005, Merrick had approximately 500 students.

Under the Act, Merrick is entitled to receive funding from local, State and federal sources. Such funding includes per pupil payments for general operating support, additional State resources for special education, No Child Left Behind federal funds, and in-kind services from the New York City Department of Education (DoE) - the school district in which Merrick is located.

According to Merrick's financial statements, for the fiscal year ended June 30, 2006, the school's operating expenses totaled $4,869,961. Revenues for the same fiscal year totaled about $4,901,988, of which $4,495,287 was basic school aid provided by DoE. The rest of Merrick's revenues are derived from federal funds, donations and other State aid. Merrick operates the school in rented classroom space. The annual lease costs are about $396,000.

Merrick has used a contractor, Victory Schools, Inc. (Victory), to help manage and oversee their operations since the school opened. Victory is a national corporation that manages a number of public schools. At Merrick, Victory provides management oversight of the school's operations. For example, Victory processes and oversees all personnel and payroll functions, and supervises procurement and contracting. Certain Victory staff have signatory authority over Merrick's funds. However, Merrick's school Principal is hired by the Board and the Principal makes all subsequent hiring decisions. Further, basic procurement decisions are made by school personnel.

For the school year ended June 30, 2005, Merrick paid Victory a management fee of $904,819. Prior to April 5, 2004, this fee was set at 22 percent of the school's gross revenues. However, at that time, the contract was revised and the fee was changed to $2,000 per full-time equivalent student enrolled at Merrick beginning the 2004-05 school year.

AUDIT FINDINGS AND RECOMMENDATIONS

Financial Oversight

Board Oversight

Charter schools are to be governed by a Board of Trustees (Board). Merrick's Board is composed of 12 members, who are elected to 5-year terms. According to the Act, the Board shall have final authority for policy, operational decisions, and fiscal management of the school.

Section 8 of the school's charter requires the Board to meet at least bi-monthly during the ten-month school year and as appropriate during the summer recess. Thus, the Board is required to meet at least five times during the school year.

We reviewed the available minutes for the Board meetings held during the 25-month period June 2004 through June 2006, and interviewed Victory's officials. We found that the Board did not meet as often as required in its charter. For example, the minutes indicated that the Board met just twice during the 2004-05 school year and just three times during the following school year. As a result, the Board is not fulfilling its obligation to meet at least five times per school year.

As is described in detail throughout in this report, the Board needs to oversee the school's fiscal operations much more closely, as many of the school's fiscal practices are poorly controlled and fail to comply with requirements. It is thus critical for Board members to meet at least once every two months during the school year, as required.

Annual Independent Audit

According to Section 2854(1) (c) of the Act and Section 5.3 of Merrick's charter, a certified public accountant is to conduct an annual fiscal audit of the school. The charter also requires that the audits be conducted in accordance with generally accepted government auditing standards, as issued by the United States Government Accountability Office.

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

Recommendation

1. Develop a plan to ensure that Board meetings are held as often as required in the school's charter so that needed fiscal oversight can be provided.

   (School officials agree with this recommendation.)

Disbursements and Procurement

School-Based Checking Account

Generally, most of Merrick's disbursements are made from Victory's centralized bank accounts. However, to provide added flexibility, Victory created a school-based checking account for Merrick, thus allowing the school to expedite purchases of $500 or less. According to the school's Financial Policies and Procedures (Manual), this account is to be used only to replenish a petty cash fund and for minor payments to vendors for goods and services. It should not be used to pay employees' salaries, wages or bonuses. Checks from the account may be signed with just one signature - that of either Merrick's Principal or the Business Manager.

We examined all 154 checks written against the school-based checking account for the fiscal year ended June 30, 2005, and identified a number of problems. First, for 44 of the 154 checks (29 percent), the amount paid for the item or its business purpose was not adequately documented. In 10 of the 44 instances, there was no documentation on file to support the payment. In the absence of such documentation, there is no assurance these checks were used for valid account purposes or even for valid school purposes.

We were able to determine from the documentation on hand that 2 of the 154 disbursements were not made for valid account purposes. One payment of $160 was made to the NAACP to allow Merrick staff to attend a fundraising event. The other payment was for $140 and enabled a school employee, who is also a member of Merrick's Board, to attend a fundraising event for a member of the State Senate.

Merrick's Manual also states that all purchases should be made using the school's tax-exempt status. However, we found that the school regularly paid sales taxes when purchasing supplies through this account. For example, we determined that Merrick paid at least $97 in sales taxes to a vendor when purchasing supplies during the 2004-05 school year. A Victory official advised us that the school is working to ensure that vendors accept the tax-exempt status of Merrick.

Finally, the Business Manager is responsible for ensuring that sufficient funds are available in the school-based account before issuing checks. This can be done by keeping the check register up-to-date. However, the Business Manager does not keep the check register up-to-date. Instead, she contacts Victory officials before writing a check to ask them if there are sufficient funds in the account. This approach has not been effective, as the school had to pay $120 in overdraft charges in the 2004-05 school year because checks were written when the amount of funds in the account was not sufficient.

School officials agree controls over the account need to be strengthened and account activity needs to be monitored more closely. They indicated they have taken steps to strengthen the controls and improve the monitoring.

Petty Cash

The Manual states that the Petty Cash Fund (Fund) should not exceed $250 and is to be replenished from the school-based checking account. The Business Manager is the Fund's custodian and is required to perform a weekly reconciliation of the Fund balance. All disbursements from the Fund are to be for valid school-related purposes.

In addition, when cash is distributed from the Fund, the Business Manager is required to fill out a Petty Cash Receipt (PCR) that shows the date, the amount, and the name of the employee to whom the cash was distributed. When seeking reimbursement, the employee is required to provide the Business Manager with a receipt and any change. The change and the receipt should always add up to the amount on the PCR.

We reviewed Fund activity for the year ended June 30, 2005. We found the Fund balance was maintained at an appropriate level, as it did not exceed $250 (in fact, it was at $200). However, the Fund was poorly maintained; weekly reconciliations were not performed and the majority of the cash disbursements that were documented did not appear to be for valid school-related purposes (They were for staff luncheons and taxi fares.)

We also found that many of the disbursements were not documented. During the year ended June 30, 2005, the Business Manager distributed $2,891 from the Fund. However, there were receipts to support only $1,859 of those disbursements. Thus, the reason for spending $932 was unaccounted for. This amount was eventually reimbursed by Victory without documentation at the Principal's request.

We performed Petty Cash Fund reconciliation on August 30, 2006, and found that cash on hand and store receipts totaled $172 rather than $200. When questioned about this discrepancy, the Business Manager told us she had used $25 to pay for a taxi ride to her home because she had worked late the prior evening. However, she could provide neither a PCR for the cash distribution nor a receipt for the taxi trip. She also did not account for the remaining $3. We recommend that a log be used to track the running balance of the Fund, periodic unannounced Fund reconciliations be performed, and Fund activity be monitored more closely.

Procurement

The Business Manager performs most of the school's procurement activities, under the supervision and direction of the Principal. According to Victory's procurement procedures, the Business Manager is authorized to make purchases of $250 or less. The Principal is authorized to commit up to $1,000 for a single purchase. Purchases in excess of $1,000 must be approved by officials at Victory.

Merrick's Manual requires that goods and services be purchased at the lowest possible prices. The Manual also requires that purchases be initiated through a formal requisition process and a formal purchase order be used. The Manual further requires that school officials send receiving documents to Victory to confirm that the purchased goods were received.

To determine whether these procurement requirements were being met, we randomly selected 43 of the 596 purchase transactions processed by the school during the 2004-05 school year and reviewed the documentation relating to these purchases. We found that the procurement requirements were not met in a number of instances, as follows:

- For 11 of the purchases, there was no documentation indicating more than one vendor was solicited prior to making the purchase. As a result, there is no assurance the lowest available price was obtained for these purchases.

- For 7 of the purchases, there was no documentation indicating the required approvals were obtained before the purchases were made. In addition, for 17 of the purchases, there were no requisition forms on file. As a result, there is no assurance these purchases were properly authorized.

- For 9 of the purchases, there were no receiving reports on file. As a result, there is no assurance the school actually received what it paid for in these instances.

Management Fee

Merrick pays Victory an annual management fee. For the three years ended June 30, 2005, this fee totaled $683,504 (2002-03), $761,012 (2003-04), and $904,819 (2004-05). Prior to April 5, 2004, this fee was set at 22 percent of the school's gross revenues. However, at that time, the contract was revised and the fee was changed to $2,000 per full-time equivalent student beginning with the 2004-05 school year. The fee is generally calculated by Victory and deducted directly from the school's bank accounts, which are managed by Victory.

We attempted to verify the accuracy of the fee calculation for the 2004-05 school year and found that it was incorrect. The fee for that year should have been $890,480. However, Merrick was charged $904,819 instead, an overpayment of $14,339. The error was made because Victory calculated the fee on the basis of the old agreement (22 percent of the school's gross revenues) rather than the revised agreement ($2,000 per student). We recommend school officials recover the $14,339 overpayment from Victory.

Recommendations

2. Ensure that the school-based checking account is used in accordance with procurement procedures, and all disbursements are fully documented.

3. Ensure that school funds are not used to purchase tickets to politically-related or other fundraising events.

4. Ensure that sales taxes are not paid for school purchases.

5. Ensure that the check register for the school-based account is kept up-to-date to avoid overdraft charges.

6. Ensure that the Petty Cash Fund is used only for valid school-related purposes, all cash disbursements are properly documented, and weekly reconciliations are performed.

7. Use a log to track the running balance of the Petty Cash Fund.

8. Conduct periodic unannounced reconciliations of the Petty Cash Fund.

9. Ensure that documentation exists to support that more than one vendor is solicited, as appropriate, prior to making a purchase.

10. Ensure that purchases are properly authorized and receiving reports are retained.

    (School officials agree with recommendations 2 through 10.)

11. Recover the $14,339 management fee overpayment from Victory.

    (School officials contend that there was not an overpayment because it was never the intent of either party to make the new rate effective for the 2004-05 school year. Instead, the new rate was to be effective for the 2005-06 school year.)

Payroll and Personal Services

Controls

Under ideal conditions, the payroll function should be separated from the personnel function. In such a system, employees would be hired or terminated by the personnel office and placed on or removed from the payroll by an independent payroll office based upon the advice of the personnel office. The payroll office would process the transactions authorized by the personnel office and the personnel office would monitor the work of the payroll office. Someone independent of both operations would distribute the payroll checks.

Thus, when payroll and personnel responsibilities are properly separated, no one person can control a payroll transaction from beginning to end. When payroll transactions are controlled from beginning to end by a single individual, unauthorized or fraudulent transactions may not be detected.

However, at Merrick, the personnel functions and the payroll functions are handled almost exclusively by a single individual - the

Business Manager. Every two weeks, the Business Manager prepares a spreadsheet with all the payroll changes for that payroll period (i.e., new hires, terminations, pay rate changes) and submits this spreadsheet to Victory. Victory prepares the payroll on the basis of this spreadsheet and sends the completed payroll back to the Business Manager. The Business Manager reviews and approves the payroll, and distributes the paychecks. Controls over payroll are thus weak; because payroll, personnel and paycheck distribution responsibilities are concentrated under one individual.

The Principal is supposed to review the spreadsheet with the payroll changes and approve it before Victory staff process the transactions. If this were done, some compensating control would be provided. However, Victory personnel told us they do not require the Principal's explicit approval before processing the payroll. Instead, they process the payroll if the Principal was copied on the email transmitting the spreadsheet to Victory. As a result, the compensating control is significantly weakened and there is inadequate assurance that all payroll transactions are, in fact, authorized.

We recommend the Principal's explicit approval be required for all payroll changes. We also recommend that someone other than the Business Manager be responsible for reviewing the completed payroll and distributing the paychecks. We further recommend new employees be required to report to Victory's corporate headquarters before they are placed on the school's payroll.

Attendance and Accrual Records

An adequate payroll control system requires that records be maintained to support the hours worked and the amount of time an individual is absent. At Merrick, a central Staff Absence and Lateness Record is maintained by the Business Manager. Employees are not required to maintain their own time and attendance records.

According to the Business Manager, teachers are allowed to take up to six days of sick leave and up to two days of personal leave each school year. Hourly staff does not accrue leave time and, therefore, do not get paid when they are absent. Salaried employees who do not have sufficient leave accruals to cover their absences must receive a deduction in pay in one of their summer payrolls. A monthly reconciliation of absences is performed by the Business Manager and totaled at the end of the school year to determine whether anyone's pay needs to be reduced during the summer.

We examined the process used at Merrick for tracking employee absences and identified certain weaknesses. First, the Staff Absence and Lateness Record did not always clearly indicate whether employees were absent for a full day or simply late. Second, there were instances in which staff were marked as absent on the Staff Absence and Lateness Record, but were not recorded as absent on the monthly reconciliation record.

We compared the March 2006 Staff Absence and Lateness Record with the monthly reconciliation performed by the Principal and found that 6 of the 34 absences recorded on the daily record for the period March 1 through March 20, 2006 were not included on the monthly report. The end result of these errors was that two staff had been overpaid a total of $787. One of the employees was paid for one unearned day and the other was paid for three unearned days.

As a result of these control weaknesses, there was no assurance that employee absences were accurately recorded and fully taken into account. We recommend the Staff Absence and Lateness Record be modified so that it clearly indicates whether employees are absent for a full day or simply late. We also recommend that the monthly reconciliation of absences be verified periodically.

Recommendations

12. Separate payroll and personnel responsibilities by requiring that (a) the Principal's explicit approval be obtained for all payroll changes before the school's payroll is processed, (b) someone other than the Business Manager be responsible for reviewing the completed payroll and distributing the paychecks, and (c) new employees report to Victory's corporate headquarters before they are placed on the school's payroll.

    (School officials disagree with parts (a) and (c) of the recommendation. They believe that there are other compensating controls that mitigate these risks. Concerning part (b), school officials agree with the recommendation and now have a person other than the business manager distributing the pay checks/stubs.)

13. Modify the Staff Absence and Lateness Record so that it clearly indicates whether employees are absent for a full day or simply late.

14. Verify periodically the accuracy of the monthly reconciliation of absences.

    (School officials agree with recommendations 13 and 14.)

Equipment and Inventory

Merrick's Manual requires that all equipment be tagged or identified in accounting records by a control number. The Manual also requires school officials to perform a physical count (inventory) of the school's fixed assets and curriculum materials at least once a year. The inventory list must be amended as new items are purchased and obsolete items are discarded.

To determine whether these inventory requirements were being met, we conducted interviews, examined financial and inventory records, and performed a physical count of Merrick's electronic equipment (we deemed these items to be more susceptible to theft).

The inventory records contained 224 items of electronic equipment with a value of $83,852. However, we found that these records were not accurate, as 15 recently-purchased laptops were not included in the records. We also were unable to locate six items.

We also identified other control weaknesses, as the disposal of equipment was not recorded and duties were not adequately separated among different employees (The same person who compiled the inventory list of electronic equipment also performed the annual physical count and had the authority to dispose of equipment without first obtaining approval.) In addition, the inventory records did not show the cost of each item, the date the item was received, and the date of disposal (if applicable).

School officials agreed with our findings and told us they would comply with their inventory requirements. They said that a periodic physical inventory would be performed by someone who had no access to inventory records; an item's cost, date of acquisition, and date of disposal would be recorded; newly-acquired equipment would be promptly added to the records; and discarded equipment would be removed from the records.

Recommendations

15. Ensure that newly-acquired equipment is promptly added to the inventory records and discarded equipment is promptly removed from the records.

16. Ensure that periodic physical inventory counts are taken by someone who is not responsible for maintaining inventory records and is not authorized to dispose of equipment without approval.

17. Include in the inventory records the cost of each item, the date the item was received, and the date of disposal (if relevant).

    (School officials agree with recommendations 15 through 17.)

AUDIT SCOPE AND METHODOLOGY

We conducted our audit in accordance with generally accepted government auditing standards. We audited Merrick's controls over selected financial management practices for the period July 1, 2004 through January 3, 2007. To accomplish our objective, we interviewed officials of Merrick and Victory; and we reviewed laws, policies, and procedures related to the financial operations of the school. We also examined the financial operating records of Merrick and the work performed by the firm of certified public accountants engaged to audit Merrick's financial statements. Our review included Merrick's and Victory's Financial Policies and Procedures Manuals, which set out criteria for the school's financial practices.

To determine whether disbursement, procurement and contracting practices were in compliance with the Manuals, we examined all 154 checks written against the school-based checking account for the fiscal year ended June 30, 2005. We also reviewed the Petty Cash Fund activity for the fiscal year ended June 30, 2005, and performed a Petty Cash Fund reconciliation on August 30, 2006. In addition, we randomly selected 43 of the 596 purchase transactions processed by the school during the 2004-05 school year and reviewed the documentation relating to these purchases. We also verified the accuracy of the management fee paid to Victory for this school year.

To determine whether payroll operations were adequately controlled, we reviewed a judgmental sample of payroll changes for the fiscal year ended June 30, 2005. To determine whether equipment was being adequately controlled, we performed a physical count of Merrick's electronic equipment and verified the accuracy of the inventory records for such equipment. We also reviewed the minutes for the Board meetings that were held between June 2004 and June 2006.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York 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 copy of preliminary results of the matters presented in this report to Merrick and Victory officials for their review and comments. Their comments were considered in preparing this report. Merrick and Victory officials agree with most of our recommendations and have taken action to implement those recommendations they agree with.

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

CONTRIBUTORS TO THE REPORT

Major contributors to this report were Steven E. Sossei, Kenrick Sifontes, Stephen Lynch, Tom Trypuc, Altagracia Rodriguez, Hector Arismendi, Mostafa Kamal, Orin Ninvalle, Irina Kovaneva, Brenda Maynard, Adele Banks, Daphnee Sanon, and Dana Newhouse.

Victory Schools

November 21, 2007

Mr. Kenrick Sifontes
Audit Manager
New York State
Office of the State Comptroller
123 William St., 21st Floor
New York, NY 10038

Dear Mr. Sifontes:

The Merrick Academy-Queens Public Charter School and Victory Schools would first like to thank you and your team for the professionalism and consideration of the daily operations of the school during the audit.

I have reviewed the draft audit report and have included our commentary below:

FINANCIAL OVERSIGHT

Recommendation #1 – Develop a plan to ensure that Board meetings are held as often as required in the school's charter so that needed fiscal oversight can be provided.

School/Management Company commentary – We agree that the Board of Trustees did not meet the required number of times as outlined in the charter. However, members of the Board were routinely kept informed about the schools finances in the monthly financial reporting package that is issued to all Board members during the school year.

DISBURSEMENTS AND PROCUREMENT

Recommendation #2 – Ensure that the school-based checking account is used in accordance with procurement procedures, and all disbursements are fully documented.

School/Management Company commentary – The School agrees that the school-based account should be used in accordance with the procurement procedures that are in the accounting and finance manual. Most, if not all of the items mentioned as an exception to the rule, had taken place during the tenure of the former Business Manager of the school. Since the current Business Manager had taken over in September 2005, the procedures and the controls over this area have been strengthened.

Recommendation #3 – Ensure that school funds are not used to purchase tickets to politically-related or other fundraising events.

School/Management Company commentary – The School agrees that school funds should not be used to purchase tickets to politically-related or other fundraising events. From time to time, the school may receive private donations and also holds some fundraising events at the school (candy or bake sales, dinners, etc.). This is listed in Other Income or Private Contributions.

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When the school has donated some funds in the past, it has always been earmarked out of those funds. The total amount contributed was always a token contribution and never more than $200.

Recommendation #4 – Ensure that sales taxes are not paid for school purchases.

School/Management Company commentary – The School agrees that we should not pay sales tax for school purchases and have subsequently resolved the matter with the vendor who was still charging the sales tax to the school.

Recommendation #5 – Ensure that the check register for the school-based account is kept up-to-date to avoid overdraft charges.

School/Management Company commentary – The School agrees and has subsequently kept this account up-to-date. This issue had mainly taken place during the tenure of the former Business Manager of the school. Since the current Business Manager had taken over in September 2005, the procedures and the controls over this area have been strengthened.

Recommendation #6 – Ensure that the Petty Cash Fund is used only for valid school-related purposes, all cash disbursements are properly documented, and weekly reconciliations are performed.

School/Management Company commentary – The School agrees and has subsequently strengthened the controls over this account.

Recommendation #7 – Use a log to track the running balance of the Petty Cash Fund.

School/Management Company commentary – The School agrees and has subsequently implemented the recommended procedure.

Recommendation #8 – Conduct periodic unannounced reconciliations of the Petty Cash Fund.

School/Management Company commentary – The School agrees and may implement as an additional control over the account.

Recommendation #9 – Ensure that documentation exists to support that more than one vendor is solicited, as appropriate, prior to making a purchase.

School/Management Company commentary – The School agrees and does on occasion solicit additional vendors where applicable. Some of the goods and services that the School purchases are very specialized and tailored to an education environment and therefore, limit the number of vendors that the School may solicit. The School has also utilized the approved vendor list and pre-negotiated contracts from the New York State Office of General Services. In addition, the School relies on the knowledge and buying power of Victory Schools to ensure that the goods or services received is of a high quality and a competitive price.

Recommendation #10 – Ensure that purchases are properly authorized and receiving reports are retained.

School/Management Company commentary – The School agrees that the comment above is a valid control. However, all payments made from School funds are reviewed and approved by

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different layers of Management at the School and at Victory Schools. Although some items may not have had a pre-authorized approval, they were all for valid school-related expenses and were subsequently reviewed and approved by the proper levels of approval. The School does agree that receiving reports should be retained as stated in the School's Accounting Policies and Procedures Manual. Both of these control issues have been subsequently performed on a going forward basis.

Recommendation #11 – Recover the $14,339 management fee overpayment from Victory.

School/Management Company commentary – This issue arose due to an incorrect date used in the "Second Charter School Management Agreement". The original management agreement covered the first five years of the school's operation, ending on June 30, 2005. During this term, the management fee was calculated using a percentage of gross revenues. The second management agreement is supposed to cover the period July 2005 thru June 2010, which is when the first charter renewal period expires. In this agreement, the management fee is calculated using a per student fee. When the contract was drafted, the commencement date was erroneously entered as the 2004/2005 school year instead of the 2005/2006 school year. If the calculation was based upon the per pupil fee, the amount recorded was incorrect by the $14,339. However, the intent of all of the parties to the "Second Charter School Management Agreement" (the Merrick Academy Board of Trustees, Victory Schools and the Charter School Institute) is that the term commences with the 2005/2006 school year, and therefore, there was no overpayment.

PAYROLL AND PERSONNEL SERVICES

Recommendation #12 – Separate payroll and personnel responsibilities by requiring that (a) the Principal's explicit approval be obtained for all payroll changes before the school's payroll is processed, (b) someone other than the Business Manager be responsible for reviewing the completed payroll and distributing the paychecks, and (c) new employees report to Victory's corporate headquarters before they are placed on the school's payroll.

School/Management Company commentary – The School agrees that having strong controls over the payroll process is very important and believes that the issues mentioned in the report are adequately monitored and mitigated where needed. (a) Even though the Principal's written approval is not provided, the Principal does in fact review the bi-weekly payroll before it gets submitted to Victory for processing and signs off on all new hires, salary changes and terminations on a separate form. As a back-end check, Victory submits a monthly financial report that will clearly indicate what salary line items the school is under or over budget on and this is periodically reviewed by Victory with the Principal and Business Manager during the school year. (b) The School did change the person responsible for distributing the actual pay checks/stubs from the Business Manager to a different employee. (c) Having all new employees report to Victory's corporate headquarters is neither economically nor logistically viable for all employees. Usually, all new key employees of the School (Principal, Business Manager, Lead Teacher, etc.) report to Victory in the hiring process for training. However, these individuals are employees of the school, not Victory Schools. As a back-end control, various Victory employees are at the school during a given week or month and in general, have a good idea of who is on staff for all of the departments.

Recommendation #13 – Modify the Staff Absence and Lateness Record so that it clearly indicates whether employees are absent for a full day or simply late.

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School/Management Company commentary – The School agrees and has subsequently implemented this control.

Recommendation #14 – Periodically verify the accuracy of the monthly reconciliation of absences.

School/Management Company commentary – The School agrees and has subsequently implemented this control.

EQUIPMENT AND INVENTORY

Recommendation #15 – Ensure that newly acquired equipment is promptly added to the inventory records and discarded equipment is promptly removed from the records.

School/Management Company commentary – The School agrees and has subsequently implemented this control.

Recommendation #16 – Ensure that periodic physical inventory counts are taken by someone who is not responsible for maintaining inventory records and is not authorized to dispose of equipment without approval.

School/Management Company commentary – The School agrees and has subsequently implemented this control.

Recommendation #17 – Include in the inventory records the cost of each item, the date the item was received, and the date of disposal (if relevant).

School/Management Company commentary – The School agrees and has subsequently implemented this control.

If you need any further information or have any additional questions after you review our response, please feel free to contact me at (212) 786-7913.

Sincerely,

Paul J. Augello, Jr.
V.P. Finance & Controller

Cc: Steven Klinsky
Margaret R. Harrington, Ed. D
James Stovall, Esq.
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