



New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Oversight of Financial Operations

Brooklyn Excelsior Charter School



Report 2011-S-14

December 2012

Executive Summary

Purpose

To determine whether Brooklyn Excelsior Charter School (Excelsior) officials exercise adequate oversight over the school's fiscal affairs and maintain an adequate system of internal controls over financial operations. The audit covered the period July 1, 2009 through June 30, 2010.

Background

Established in 2002 and opened in 2003, Excelsior is governed by a Board of Trustees (Board) and managed and operated by National Heritage Academies Inc. (NHA), a privately-held corporation. Through a written Management Agreement, NHA is responsible for all aspects of Excelsior's operations. In return, NHA receives all of the school's revenues and pays the costs of its operations. Excelsior's revenues for the fiscal year ended June 30, 2010, totaled \$10.23 million, all of which was paid to NHA in accordance with the Management Agreement.

Key Findings

- We could not fully determine the extent to which Excelsior officials exercised their fiscal oversight because we were unable to verify the true cost of Excelsior's operations or the extent to which the \$10 million of annual public funding benefited students. The reason for these limitations is that NHA officials did not provide support for \$1.7 million of costs allocated to the school. NHA officials claimed the information was private and proprietary.
- We noted other areas where the Board has been lax in fulfilling its fiduciary responsibility. We question whether the Board exercised due diligence and care in approving NHA's related party lease of the school building at a rate almost \$800,000 per year above market value. As a result, NHA has already recovered its full \$16.3 million cost of purchasing, renovating and outfitting the entire facility in less than 10 years of operation.
- We identified conflicts of interest that exist because NHA employed a Board member at a salary of more than \$138,000, as well as the Board's failure to comply with certain provisions of its adopted by-laws.

Key Recommendations

- Verify that expenses allocated to Excelsior by NHA are reasonable and fair, and are based on items that were actually provided to the school.
- Reevaluate the lease agreement at the end of its current term and negotiate reduced future lease payments that reflect market conditions.
- Develop and implement an appropriate policy to control and account for cash receipts from students and fundraising activities.

Other Related Audits/Reports of Interest

[Brooklyn Charter School: Financial Management Practices \(2006-N-9\)](#)

[KIPP Academy Charter School: Financial Management Practices \(2006-N-15\)](#)

**State of New York
Office of the State Comptroller**

Division of State Accountability

December 7, 2012

Corey Martin
Board President
Brooklyn Excelsior Charter School
856 Quincy Street
Brooklyn, NY 11221

Dear Mr. Martin:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government funded services and operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities, and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the Brooklyn Excelsior Charter School: *Oversight of Financial Operations*. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, and Section 2854 of the Education Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller
Division of State Government Accountability*

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State Government Accountability Contact Information:

Audit Director: John Buyce

Phone: (518) 474-3271

Email: StateGovernmentAccountability@osc.state.ny.us

Address:

Office of the State Comptroller
 Division of State Government Accountability
 110 State Street, 11th Floor
 Albany, NY 12236

This report is also available on our website at: www.osc.state.ny.us

Background

In December 1998, the Legislature passed the Charter Schools Act (Act) which authorized the establishment of charter schools as independent public schools in New York State. Under the Act, charter schools are entitled to receive funding from local, State, and Federal sources, including per-pupil State aid payments for general operating support and special education; Federal No Child Left Behind Title I funding; and direct financial support and in-kind services from the local school district in which they are located – in this case, the New York City Department of Education (DoE). Each charter school is governed by a not-for-profit board of trustees and managed according to the terms of its own five-year contract or charter.

The Brooklyn Excelsior Charter School (Excelsior) was initially approved by the State University of New York (SUNY) and chartered by the Regents of the State of New York in 2002. Governed by a board of trustees (Board), Excelsior received a one-year charter renewal in March 2007 and then a five-year renewal in July 2008. Excelsior is currently operated and managed by National Heritage Academies Inc. (NHA), a privately-held for-profit corporation that operates 71 charter schools across the United States, including six schools in New York State. In May 2010, the Act was amended to, among other things, increase the number of authorized charter schools from 200 to 460, and prevent new schools from being managed by for-profit management companies such as NHA.

Through a written Management Agreement (Agreement) dated May 8, 2003 and last amended on January 4, 2010, NHA is responsible for all aspects of Excelsior's operations. These responsibilities include determining the school's curriculum; providing or contracting for all educational services; managing its business administration, personnel, and payroll functions; contracting for the provision of all services; and purchasing materials, supplies, and equipment. In exchange, the Agreement entitles NHA to all of Excelsior's revenues including State aid, local funding, special education funding, grants and donations. NHA is obligated to pay all of the schools operating costs as contained in its annual budget, while any surplus funding is retained by the corporation as profit.

For fiscal year ended June 30, 2011, Excelsior enrolled 722 students in kindergarten through eighth grade. Financial statements provided by Excelsior and NHA indicate that, for the fiscal year ended June 30, 2010, the school's operating expenses totaled \$10.23 million, of which \$3.95 million was related to personal service costs, including salaries and fringe benefits. Revenue for the same period totaled \$10.24 million, of which \$8.99 million came from local school aid provided by DoE. In addition, Excelsior received textbooks, library books, and data processing supplies valued at \$43,953 under the New York Text Book Program.

For the fiscal year ended June 30, 2010, NHA charged \$2,571,680 in rent expenses to the school. This amount, which represented 25 percent of the school's expenses for that period, did not include utilities or maintenance expenses.

Audit Findings and Recommendations

We were unable to verify the true cost of Excelsior’s operations or determine the extent to which the \$10 million of annual public funding provided to the school was actually used to benefit its students, in large part because NHA officials did not provide financial records to support many significant costs allocated to the school. We concluded that by failing to obtain and examine this support, the Board has been lax in fulfilling its fiduciary responsibility. In particular, we question the Board’s approval of a related party lease of the school building at a rate almost \$800,000 per year above market value. We also question certain potential conflicts of interest that exist because of NHA’s employment of a Board member, and the Board’s failure to comply with certain provisions of its adopted by-laws.

Restrictions on Access to Financial Records

During our audit, NHA officials did not provide financial records to support certain expenses charged to Excelsior. For example, NHA officials withheld detailed documentation on how they allocated \$1.6 million in corporate support services (“back office”) costs to Excelsior. These costs, which represented 16 percent of the school’s total operating costs, included the following:

<i>Allocated Support Cost</i>	<i>Amount</i>
Academic & General Support	\$ 608,261
Human Resources	264,076
Technology Services	247,360
Instructional Support	121,653
Board Support	118,784
Accounting	109,903
Enrollment & Parent Relations	56,175
Marketing & Business Development	37,277
Other Occupancy Expenses	9,699
Other Miscellaneous Expenses	<u>45,102</u>
Total Allocated Corporate Services	\$ 1,618,290

Board members we spoke with told us they did not know the details behind the allocated costs, but they added that they trusted NHA and were not looking to micromanage the company. NHA officials advised us that the allocation methodology was proprietary, as it relates to NHA’s confidential financial information.

NHA also leases equipment from Charter Development Company, LLC (CDC), a wholly-owned subsidiary of NHA that owns the building which houses Excelsior. NHA assigns the equipment to the various schools it

operates and allocates costs to these operations. For the 2009-10 school year, NHA allocated \$131,046 in equipment costs to Excelsior. NHA officials explained that this allocation, which was determined at the beginning of the school year, was for assets already in use, as well as for “forecasted” purchases. We question the appropriateness of including “forecasted” purchases when determining the amount of expenses to allocate to the school.

We attempted to determine what the equipment had cost CDC and what NHA had paid to sublease it, but NHA also considers this information to be proprietary and has not provided

it to the Board. By failing to obtain and examine support for these costs, the Board is lax in fulfilling its fiduciary duty. Without access to relevant equipment lease costs information, the Board is not able to verify whether the equipment costs allocated to the school are reasonable or appropriate, and whether the terms of the Agreement are being complied with. Board members we spoke with advised us that they would work with NHA officials to review all of NHA's allocation methodologies and make appropriate changes. Board officials also advised that, for the 2011-12 school year, NHA has modified its procedures to exclude "forecasted" purchases from the equipment costs it allocates to the school.

The issues of transparency and complete accountability for funding are fundamental to our public education system. Furthermore, it is likely that these same problems impact other charter schools across the State where other management companies may also seek to withhold what they term to be proprietary information from scrutiny by their schools' governing boards. We therefore intend to bring the issue of required disclosures to the attention of the State's three chartering entities (the State Education Department, the State University of New York and the New York City Board of Education) to ensure that these matters are consistently addressed as individual schools' charters and management contracts come up for renewal.

Board Oversight

The Act and Excelsior's by-laws both vest the Board with final authority over Excelsior's policies, operational decisions, and fiscal management. Thus, Board members have a fiduciary responsibility to care for the school's assets and finances; and are required to employ good faith, due diligence, care, and caution in the exercise of their responsibilities. Accordingly, the Board is obligated to ensure that all financial decisions are in the school's best interests. While we noted that Excelsior does have an active Board that meets regularly to deal with a range of issues, its oversight of the school's fiscal affairs is lacking.

Under the terms of the Agreement, NHA provides all staffing, materials, equipment, facilities, and supervision. The Board has also authorized NHA to manage all of the school's fiscal operations, including accounting and financial reporting. However, even though the Board has delegated these tasks to NHA, it cannot absolve itself of its inherent fiduciary responsibilities. As indicated in the following sections of this report, we determined that the Board has not always exercised due diligence, care, and caution in managing financial aspects of the school.

Lease Agreement

The school's 55,627 square-foot building is sub-leased from NHA, which leases it from its wholly-owned subsidiary, CDC. The current lease, which was signed on July 20, 2009, covers the period of October 1, 2008, through July 20, 2013. The lease requires the school to pay NHA \$2.57 million annually in rent; about 25 percent of its annual revenue. In addition, Excelsior is responsible for the full cost of operating the building, including utilities and maintenance. These additional expenses totaled about \$660,000 in 2010 and increased the school's annual occupancy cost to \$3.23 million, or 32 percent of its revenues. We interviewed several current Board members and

NHA officials, and reviewed the lease and related documents, to determine whether the Board had exercised due diligence and care in leasing this space. Evidence indicates the Board did not act in the best financial interests of the school when it executed this lease agreement.

Excelsior moved to its current location in 2004. In January 2009, the Board commissioned a nationally-recognized, publicly-traded real estate firm to perform a formal appraisal of the building. The appraisal, which cost \$15,600, indicated that the fair market rental was \$1.78 million annually or \$32 per square-foot. NHA's attorney, who is located in Michigan, reviewed the appraisal and informed the Board that the suggested price per square-foot was insufficient to provide NHA with an appropriate return on its investment. In addition, the attorney advised that NHA considered Excelsior a high credit risk based on the overall financial condition of the school, its lack of independent credit worthiness, unspecified political uncertainty, and the risk that the school's five-year charter might not be renewed. The attorney proposed that these factors justified a rent of \$50 per square-foot, but the Board's contracted appraiser disagreed, stating that NHA's proposed rent was unreasonable under current market conditions.

We found the Board largely ignored the independent appraisal it had just commissioned and unanimously approved the new lease (with one abstention due to a conflict of interest) at \$46.23 per square foot. As a result, the school is paying \$791,572 more per year, or \$3.96 million more over the term of the five year lease to NHA. We asked Board members why they had approved the lease at the higher price. They advised us that the higher rent was agreed upon after extensive research by the Board, whose membership includes a real estate professional, and after consultation with the Board's attorney. They further advised they took the school's interests and NHA's points of view into consideration, and that they felt NHA had a right to receive a reasonable return on its investment. However, Board members did not provide any evidence of their own research and deliberations, or define what they meant by a reasonable rate of return.

Unaudited documents provided by NHA show the land and the building in which the school is located were purchased for \$3.2 million, and CDC invested an additional \$13.1 million in improvements to make the building ready for occupancy in 2004. By June 30, 2011, after just seven years of operation, NHA has already recovered more than all of its acquisition and renovation costs through its rental charges to Excelsior, which total just under \$17 million, and stands to collect about \$2.6 million more during each of the two years remaining on the lease. Considering that NHA justified the high rent it charged the school based upon a need to recover its capital costs quickly from a high risk tenant, and the fact that those costs have now been more than recouped, the Board needs to negotiate a decrease in its lease payments at the conclusion of the current lease.

We also found other indications that Excelsior may not be getting the best value for the significant amount of rent it pays. We reviewed an evaluation report prepared by the SUNY's Charter School Institute for the 2009-10 academic year. This evaluation stated that, while the facility generally met the school's needs, there were certain deficiencies. For example, the report noted the building does not have any large common spaces for morning assemblies and other whole-school gatherings, nor does it have a cafeteria. As a result, students must eat lunch in their classrooms; a practice that has been described as messy and chaotic. We also observed that the school also

does not have a gymnasium for physical education activities.

Conflict of Interest

According to Excelsior's by-laws, any Board member who has an interest in a contract or other transaction presented to or discussed by the Board for authorization, approval, or ratification must disclose that interest promptly, fully, and frankly before the Board acts on the contract or transaction. If a conflict is deemed to exist, the member is not allowed to vote on, or use his or her personal influence, or even to be present during the discussion or deliberations regarding the subject. Finally, Board members who have an actual or potential conflict of interest should not participate in discussions or vote on matters in which they may have a financial, organizational, or personal interest.

We found that the Board did not adhere to these provisions of Excelsior's by-laws. In March 2007, NHA hired the vice-president of Excelsior's Board as a consultant to provide training services to community members who were interested in partnering with NHA to launch a charter school in Washington, D.C. This arrangement continued until the Board member's resignation in June 2010. We were unable to determine the total compensation paid to this individual by NHA since NHA officials refused to provide that information. However, we were able to determine that he was paid at least \$138,439 in calendar year 2007. This Board member's potential conflict-of-interest was originally disclosed in the March 2007 Board minutes. The minutes also indicated that the Board member would recuse himself from Board votes relating to the management agreement between the Board and NHA.

When we reviewed the February 2009 through June 2010 Board minutes, we determined that the Board member was present at all meetings held during that period. Although abstaining from the vote to approve the lease of the school building, he participated fully in all other Board business. Since virtually all Board matters concern the arrangement with NHA, in some manner, it seems that a conflict of interest issue would have been impossible to avoid. For example, we found this Board member did not recuse himself from discussions dealing with the appointment of an audit firm, even though it was the same audit firm employed by NHA. In addition, he voted on motions regarding the 2009-10 budget. As both a consultant to NHA and vice-president of the Board, this member was in a position that could have potentially influenced decisions that were not in the best financial interests of the school.

Non-Compliance with By-Laws

By-laws are the written rules for conducting the business of an organization. They generally provide for the scheduling of meetings, election of officers, filling of vacancies, and the duties of officers and committees. Excelsior's by-laws state that neither the Secretary nor the Treasurer of the Board can serve concurrently as President. However, in June 2010, a Board member was appointed interim President while continuing to serve as Treasurer. This interim appointee continued to serve in both positions for another 16 months, until October 2011. NHA officials advised us that at that time the President's selection was confirmed and a new member was then selected to serve as Treasurer.

Internal Controls Over Financial Operations

We determined that, for the most part, Excelsior has appropriate controls in place to ensure that all public funds it receives are immediately paid over to NHA as required by the Management Agreement. More specifically, the Agreement requires that all monies received by Excelsior on behalf of the school be transferred to an NHA bank account within three business days of receipt. These funds include State aid payments, local funding, special education funding, and grants and donations. We verified that all public funding was deposited into Excelsior's bank account and that all this money was transferred to NHA within three days as required.

We did note that Excelsior conducts certain fundraising events, such as book fairs and cake sales, to raise funds for extra-curricular activities. The Principal informed us that teachers and Assistant Principals also collect fees from students for student trips and graduation exercises. The Principal also told us that only Assistant Principals issue receipts when they collect funds, and that they are required to keep copies of all receipts. The funds are then given to the school's secretary for deposit. Thereafter, NHA officials transfer the funds from the general checking account to the Principal's discretionary account, where the money is used to fund student activities.

We were unable to determine whether all funds collected were deposited into the school's general checking account because the Principal could not produce copies of receipts or other similar records. Moreover, NHA officials advised that there was no formal school procedure that required receipts to be issued and copies maintained when cash was collected from students and at fundraising activities. NHA officials reported that \$20,392 was deposited during the 29-month period of February 2009 through June 2011. However, without appropriate records, we have no assurance that this represents all funds collected from fundraisers and students.

Board officials advised us that they will work with NHA to develop and implement written policies for cash collections. In addition, school officials will issue sequentially-numbered receipts and maintain copies of those receipts.

Recommendations

1. Verify that expenses allocated to Excelsior by NHA are reasonable and fair, and are based on items that were actually provided to the school.
2. Reevaluate the lease agreement at the end of its current term and negotiate reduced future lease payments that reflect market conditions.
3. Ensure that Board members comply with Excelsior by-laws and policies, particularly as they relate to potential conflicts of interest and the holding of concurrent Board positions.
4. Develop and implement an appropriate policy to control and account for cash receipts from students and fundraising activities.

Audit Scope and Methodology

We audited Excelsior's controls over financial management practices for the period July 1, 2009 through June 30, 2010. The objective of our audit was to determine whether school officials exercise adequate oversight over the school's fiscal affairs and maintain an adequate system of internal controls over financial operations.

To accomplish our objective, we reviewed Excelsior's financial records, by-laws, and minutes of Board meetings, as well as NHA's financial policies and procedures manual. We also interviewed Excelsior and NHA officials, as well as officials at SUNY's Charter Schools Institute. To complete our audit work, we met with the accounting firm that performed Excelsior's latest financial statement audit and reviewed workpapers relevant to the work they performed for Excelsior.

We conducted our performance audit in accordance with generally accepted government auditing standards. These 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.

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 management 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 2854 of the Education Law.

Reporting Requirements

We provided a draft copy of this report to Excelsior officials for their review and formal comment. Their comments were considered in preparing this report, and are included at the end of the report. Excelsior officials disagreed with several of our findings and, although they did not directly respond to each of our recommendations individually, they did indicate their intent to comply with all the suggestions made therein. We must emphasize that, to properly fulfill its fiduciary responsibility, it is critical that the Board take steps to obtain from NHA the detailed financial records necessary to examine and evaluate the nature and extent of all NHA costs allocated to

the school, including all related party transactions. For this reason, we will be also be bringing the issue of transparency and proper disclosure to the attention of the State's chartering entities so that they may consider statewide solutions as part of the charter renewal process.

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

Contributors to This Report

John Buyce, Audit Director
Kenrick Sifontes, Audit Manager
Stephen Lynch, Audit Supervisor
Jeffrey Marks, Examiner-in-Charge
John Ames, Staff Examiner
Nicholas Angel, Staff Examiner
Elizabeth McNiff, Staff Examiner

Division of State Government Accountability

Andrew A. SanFilippo, Executive Deputy Comptroller
518-474-4593, asanfilippo@osc.state.ny.us

Elliot Pagliaccio, Deputy Comptroller
518-473-3596, epagliaccio@osc.state.ny.us

Jerry Barber, Assistant Comptroller
518-473-0334, jbarber@osc.state.ny.us

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Agency Comments



BROOKLYN EXCELSIOR CHARTER SCHOOL

A PUBLIC CHARTER SCHOOL MANAGED
BY NATIONAL HERITAGE ACADEMIES

July 17, 2012

Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, NY 12236-0001

Via Federal Express

To Whom It May Concern:

Thank you for your June 19, 2012 e-mail with the Final Draft of the Audit for Brooklyn Excelsior Charter School (Audit Report #2011-S-14) conducted by the Office of the State Comptroller (OSC). On behalf of the entire Board of Brooklyn Excelsior, I am sending this letter to respond to the findings included in the report.

Our response will first make some observations about factors that are not mentioned in your findings. As you know, public charter school funding is limited to the operational aid a student would receive if attending a district public school. Funding provided to charter schools does not include any facilities aid, one of the most expensive costs for any public school. This context is significant, since facility costs for a new elementary school are extremely high, and the ability of a school to obtain financing for an endeavor of this type is severely limited – especially with a charter limited to five years. Financing options become more robust only after a school builds a record of academic and operational success. In light of this daunting challenge of acquiring essential operating and startup capital, it was a great advantage to Brooklyn Excelsior to have a management partner with the necessary financial resources, strong credit, and operational know-how to start a new public charter school. This has given us the ability to carry out our academic program at a time and place where students are the beneficiaries and our efforts are not hindered by challenges accessing credit that would otherwise be insurmountable.

- 856 QUINCY ST ● BROOKLYN, NY 11221-3612
- 718 246 5681 OFFICE ● 718 246 5864 FAX
- BROOKLYNEXCELSIORCHARTERSCHOOL.ORG

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Below are our responses to specific parts of the Final Report. For convenience, we have grouped these responses under the same headings used in your letter.

Background

One date in this section of your report warrants clarification. As supported by the documents provided during the audit, a new management agreement was signed January 9, 2007, and was subsequently amended on January 4, 2010.

* Comment 1

Audit Findings and Recommendations

Restrictions to financial records

The financial agreement between Brooklyn Excelsior and National Heritage Academies, Inc. (NHA): The findings raise detailed questions about financial arrangements between Brooklyn Excelsior and NHA, the school's operator. The best way to address these questions is to consider how this relationship is structured.

Brooklyn Excelsior has engaged NHA to operate the school as its partner. The management agreement addresses not only the details of financial arrangements between the two parties but also the oversight role of the Brooklyn Excelsior Board. These financial and oversight arrangements are also spelled out in the charter agreement between Brooklyn Excelsior and its charter school authorizer, the State University of New York Board of Trustees. It is important to note that Brooklyn Excelsior submits annual reports to both the Charter Schools Institute of the State University of New York (CSI) and to the New York State Education Department, which is governed by the New York State Board of Regents. These reports confirm that the school is consistently in good academic, organizational, and financial standing.

The financial agreement and the oversight provisions of the contract between Brooklyn Excelsior and NHA include these highlights:

- The roles of both the Board and NHA are clearly delineated. The Board has responsibility for approving school budgets. NHA is responsible for managing the school revenues and expenses to effectively implement the budget. This task includes seeking board approval for any changes or amendments needed to this budget.

* See State Comptroller's Comments, on page 22.

- In partnership with the Brooklyn Excelsior Board, and per the authority and oversight of this Board, NHA assumes accountability for providing the academic program, including personnel (subject to the approval of the Board), curriculum, and facilities. This would include – and has included – covering any financial deficit for the program at no cost to the school. For example, the Charter School Institute of the State University of New York's 2008 Renewal Report for Brooklyn Excelsior provides an excellent example of the benefits of this partnership: "During [Brooklyn Excelsior's] first four years of operation, NHA contributed \$3.7 million to offset an excess of expenses over revenues. These funds were contributed to the school and were not a loan."
- Under the agreement, Brooklyn Excelsior is assigned an allocation of centrally provided services that are allocated across all the schools served by NHA. These include student assessment, school quality, personnel services, coaching and professional development, legal and compliance services, technology development, and so on.
- The school's annual budget, which reflects these allocations, is approved and overseen by the Board after an in-depth review by the treasurer and by trustees with specific areas of interest. The Board also reviews financial statements quarterly. These financials are shared, discussed, and formally approved at the Board meetings.
- The allocation of central service costs, which are in fact costs borne by NHA and not the school, is included in Brooklyn Excelsior's annual audited financial statements as supplemental information and is audited annually by an independent accounting firm.
- In addition to approving and monitoring the budget, the Brooklyn Excelsior Board monitors both overall school performance and student outcomes. The school's results in terms of academic performance, parent satisfaction and employee satisfaction suggest to us that Brooklyn Excelsior is a successful school. We think this is the clearest possible documentation of a more than adequate investment in the academic program by NHA – and proof of favorable results obtained by sound and appropriate methods.

Consistent with the recommendation in your findings, the Brooklyn Excelsior Board and NHA will revisit and review NHA's allocation methodologies.

Equipment costs: The Final Report indicates that NHA would not provide historical cost information for the equipment purchased by CDC. This is incorrect. NHA provided the

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listing of CDC-owned equipment in use at the school and the historical cost information for each piece of equipment.

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Comment
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As noted in your report, as of the 2011-12 school year, NHA has modified its procedures to allocate costs to schools for equipment usage. The equipment cost allocation is now based exclusively on equipment that is in use and has a remaining useful life. A "true-up" is done in the subsequent fiscal year for any new equipment purchases. Although not mentioned in the Final Report, documentation to support the modified procedures was submitted to the audit team at their request.

Board oversight

The Brooklyn Excelsior Board respectfully disagrees with your assertion that the Board of Trustees of Brooklyn Excelsior "has not always exercised due diligence, care, and caution in managing the school." In expressing this opinion, the report refers to assertions advanced in other parts of the findings. These specifics are addressed in detail elsewhere in this letter.

In addition to these specific responses, I wish to make two fundamental points on behalf of my colleagues on the Board regarding the great care we give to our responsibilities to the State University of New York, the New York State Department of Education, the employees of Brooklyn Excelsior, and the children and families we are entrusted to serve.

First, I respectfully submit that your findings give too little credit to this board for the energy, commitment, expertise, and *bona fides* provided by the professionals who proudly serve on it. We are a sophisticated group of experienced professional people. We are committed to this school and the children and families we have the privilege – and responsibility – to serve. My colleagues on the Board bring impeccable qualifications and seriousness of purpose to the mission of the school generally and to their governance and oversight responsibilities specifically. We are imperfect, but the tone and content of your findings regarding our effectiveness as a Board are not supported with actionable data or facts. We respect the OSC's responsibility to ensure that all New York State taxpayer dollars are allocated effectively. We simply ask that you not dismiss the time, effort, and care we take in volunteering to serve as Board members of this successful school as well as the school's strong track record in serving students and families.

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Comment
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* See State Comptroller's Comments, on page 22.

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As a Board, we focus on exercising governance oversight that ensures that Brooklyn Excelsior is academically, organizationally, and fiscally viable. The school's mission is "to operate a public charter school and to provide education to children in grades kindergarten through eighth grade based on rigorous teaching methods, parental involvement, student responsibility, and basic moral values." There is ample evidence that the Brooklyn Excelsior approach is working. The school's academic record shows consistently strong academic performance in both academic achievement and growth. On the 2011 New York State assessments, Brooklyn Excelsior outperformed other schools in the district by 24 percentage points in English language arts and 28 percentage points in math. The school also has been designated consistently as "In Good Standing" under the No Child Left Behind accountability system. In light of this record, it is not surprising that Brooklyn Excelsior has been granted two full-term charter renewals and was invited to submit an application for early renewal. Overall, this record suggests that this management model and the Board's oversight of the school have been effective.

Second, it is troubling to see that your section asserting lapses in Board oversight emphasizes a description of the management agreement between Brooklyn Excelsior and NHA. You take note of the deliberate, considered decision of the Brooklyn Excelsior Board to delegate all aspects of many operational management functions to our management partner. In doing so, the OSC seems to imply that this decision is, in some way, a dereliction of duty *per se*. We disagree. In any school, business, or not-for-profit enterprise, staffs operate and boards oversee. This is not merely common; it is *expected*. Nothing about the Brooklyn Excelsior-NHA agreement is inconsistent with that tradition or practice.

Lease agreement

The Brooklyn Excelsior Board respectfully disagrees with the assertion that "compelling evidence indicates the Board did not act in the best interests of the school when it executed the lease agreement." Below is some of the material Brooklyn Excelsior provided to the OSC during the audit process as evidence of the Board's due diligence on the lease:

How the Board worked with NHA on the lease: NHA provided the Brooklyn Excelsior Board with a detailed lease proposal and extensive information to support that proposal. The Brooklyn Excelsior Board then commissioned, funded, received, and considered

* Comment 4

* See State Comptroller's Comments, on page 22.

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the independent market analysis by Grubb-Ellis.¹ The Brooklyn Excelsior Board later requested and considered additional information and perspective from NHA and the Board's legal counsel – specifically, on the NHA business model and how it affected NHA's approach to leases. These interactions unfolded in several different meetings and conversations.

The Board's independent assessment of lease issues: The Board's deliberations did not end with its interactions with NHA and its representatives. The Board, which includes one active professional in the real estate industry, independently discussed, reviewed, and evaluated this information at great length. We closely reviewed the Grubb-Ellis findings and input from NHA's legal counsel related to fair market value and the case for the proposed rent. Of course, the Board's own legal counsel, Hiscock & Barclay, also reviewed the documents and the lease agreements on our behalf during negotiations.²

This process led to a rent agreement that will last the full five years of the current charter period. We believe the lease and the process that led to it protects the interests of the Board, the school, and its students. We believe that the agreement and the rent are fair and reasonable.

Separately from the initial lease negotiation process, the Brooklyn Excelsior Board and its legal counsel negotiated successfully to secure certain addendums to our agreement with NHA that are very favorable to the school. For example, the Board successfully negotiated a very powerful position related to the long-term control of the building.

Your findings do not note many different provisions of the current agreement between Brooklyn Excelsior and NHA that are favorable to the school and its Board:

- There is no automatic "inflator" in the lease amount like those found in many other leases. This provides the school with predictable costs during a time of tremendous uncertainty in education funding.
- NHA funded and paid for the extensive rehabilitation the building required. This means that neither the Brooklyn Excelsior Board nor the State of New York is indebted to NHA for the building and did not have to secure loans to pay for the

¹ As Grubb-Ellis acknowledges in its report, no "apples to apples" comparison was possible between existing buildings and the BECS real estate. Nonetheless, Grubb-Ellis thoroughly outlined the key issues and points, and its insights added value to the Board's deliberations.

² The Board's discussion and decision process is documented in the June 9, 2009 meeting minutes.

rent/construction of the facility. NHA incurred all the start-up risks, and none were passed on to the Board. This is unique among both charter and district schools.

- Overall, the agreement structure fully protects the Board – and, for that matter, the taxpayers – from any future burden of covering funding shortfalls. Under our management agreement, any such shortfalls remain the sole responsibility of NHA.

Outcomes from this lease: Most significantly, this lease allows Brooklyn Excelsior to operate in a stand-alone facility of exceptional quality. Before it became home to our school, the Quincy Street building was empty, abandoned, and in serious disrepair. Today Brooklyn Excelsior is proud of this building's status as a landmark in the neighborhood. This building has been central to the school's success creating a thriving environment and culture for learning. It is a big reason why Brooklyn Excelsior today is a successful school with a robust academic program and student body.

Conflict of interest

The findings of the OSC audit assert that the Brooklyn Excelsior Board did not adhere to its own bylaws related to conflicts of interest in relation to the activity of one former Board member. In several key respects, this assertion is inaccurate. Although evidence of compliance with the by-laws was provided to the OSC, the Final Report was not updated to reflect this information.

- The decision to allow NHA to engage the Board Member as an independent contractor was fully considered by the Brooklyn Excelsior Board. The Board also sought and received input from its legal counsel, Hiscock & Barclay, which sent a formal legal letter to the Charter Schools Institute (CSI), Brooklyn Excelsior's authorizer, to raise this question. That the appropriateness of the Board Member's continuing Board activities was vetted and approved by the Board's independent legal counsel *prior* to entering into the agreement – and vetted and approved again by the charter school's authorizer *prior* to entering into the agreement – is clear evidence that Brooklyn Excelsior Board was vigilant and aggressive in its oversight responsibilities on this question. This legal memo was provided to the OSC.
- The second paragraph of this section of your letter states: "The Board member's conflict-of-interest was disclosed in the Board meeting minutes in February 2009 (two years later) and, according to the minutes, he stated that he would remove himself from any action or discussion dealing with the agreement with NHA." In

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* See State Comptroller's Comments, on page 22.

fact, as Board minutes document, the Board Member first disclosed this conflict of interest issue fully in 2007. He reminded the Board of this conflict in 2009, when the Board discussed reappointing the Board Member. The Board Member also recused himself from discussion and votes on which there was any possible conflict. He did this, for example, on June 27, 2008, and again on June 9, 2009, when the Board discussed the real estate assessment and gave consideration to the lease agreement. The referenced meeting minutes were provided to the OSC.

The same paragraph ends: "This Board member may have been able to influence decisions that were not in the best financial interests of the school." In candor, this assertion sells our Board short. It reflects the unjustified assumption that we would lack the knowledge, experience, or spirit to challenge any Board member or school official in any action that raises the possibility of a conflict of interest. Our record in oversight matters and our careful handling of this situation belies this assertion.

The bylaws clearly state that the Board has the authority to determine the possibility of undue influence. The Board never lost sight of this authority, and it never determined that the Board Member had any unjustified influence. As the OSC notes, the Board Member resigned from the Board in 2010 and is no longer affiliated with the school.

More broadly, we are concerned with the suggestion that every Board vote must imply a potential conflict. This presumption is not justified, and it reflects a view of how a school governance structure works that is too narrow.

- The same paragraph says: "When we reviewed the Board minutes from February 2009 through June 2010, we determined that this Board member only refrained from one Board vote – during the approval of Excelsior's building lease." That's true – because that was the only discussion for which this step was necessary because of the nature of the management/lease agreements.

Non-compliance with bylaws

The findings state that one Board member simultaneously served in two leadership roles – as both president and treasurer – for 16-month period beginning with the resignation of another Board member. The school recognizes the value of having

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individuals serve only one role each in Board leadership, and as noted in the report, has since identified a separate trustee to serve as treasurer on a permanent basis.

Internal controls over financial operations

We are pleased that the OSC has reported that the school has appropriate financial controls in place based on its testing of payments from the Board to NHA, NHA cash disbursements, NHA credit card disbursements, and payroll information.

Regarding cash receipts, the Brooklyn Excelsior Board knows of no impropriety in the deposit of cash receipts at Brooklyn Excelsior Charter School. Cash receipts at the school site are typically minimal because they are the result of local fundraising efforts (such as bake sales, field trip collections, etc.). Nonetheless, the OSC's finding highlights an opportunity for improvement. We appreciate this guidance. As noted in the Report, Brooklyn Excelsior will work with NHA to develop and implement a written policy regarding cash receipts. In addition, when miscellaneous funds are collected at the school, the school office will issue cash receipts using a sequentially numbered receipt book.

Responses to draft recommendations

As this letter makes clear, the Brooklyn Excelsior Board respectfully disagrees with several parts of the OSC's Final Report. In this context, however, we add that we already comply or will comply with all of the suggestions made in the recommendations.

Sincerely,



Corey Martin
Board President
Brooklyn Excelsior Charter School

cc: Jeffrey Marks
John Kelepurovski
Susan Beans

State Comptroller's Comments

1. We modified our final report to reflect the information provided by Excelsior' officials.
2. Although NHA officials provided a listing of CDC owned equipment, they did not provide historical cost information for each piece of equipment. Without such information, we are unable to determine if the cost allocated to Excelsior was reasonable or appropriate.
3. We did not question the qualifications, energy, and commitment of Excelsior' Board members; nor did we review or question the school's academic performance. Rather, our examination focused solely on oversight of Excelsior's fiscal affairs and the Board's fiduciary responsibility to ensure that financial decisions serve the best interest of the school.
4. Despite repeated requests, Excelsior and NHA officials failed to provide documentation, such as copies of evaluations and minutes of meetings pertaining to their lease deliberations. Based on available information, including statements made to the auditors and our observations of certain deficiencies in the facility, we maintain that the rent is unfair and unreasonable and that the Board did not act in the best interest of the school when it executed and renewed the lease rental agreements. Moreover, as our audit indicates, NHA has already recouped its entire investment in Excelsior and stands to earn a significant profit on that investment.
5. On request, a copy of the legal memo was provided to the auditors' on August 1, 2012. The memo to the Board from its attorney states, "For purposes of our review, we have assumed that", the Board member in question, "proposed work for NHA would be to consult with NHA regarding potential Washington, D.C. charter school opportunities and assist NHA in recruiting and training potential charter school board members in the Washington, D.C. area, and would be unrelated to his duties as a Board member to the School." In addition, the legal counsel for SUNY's Charter School Institute advised that the Board member in question should recuse himself from voting on all matters involving NHA even where the Board may determine that no conflict exists. Moreover, the minutes of the March 2007 Board meeting noted that the individual in question will recuse himself from Board votes relating to the management agreement between the Board and NHA. Finally, Article III of the management agreement states that NHA shall be responsible to the Board for the administration, operation and performance of the school. Such responsibility is limited by, among other things, the budget NHA and the Board agree upon and the availability of funding to pay for said services. As indicated in our report, the Board member did not recuse himself from votes relating to Board issues, such as the budget.
6. The Final Report has been modified to reflect that the Board member first disclosed the conflict of interest issue in March 2007. This information was previously unavailable to us because our audit examined BECS books and records for the period of July 1, 2009 through June 30, 2010.