Charter Schools Division (CSD) Summary of
Kubiak Melton & Associates, Auditors, Report to the Office of State Auditor
The Great Academy & The Great Academy Foundation
July 1, 2016 to January 31, 2022

Presented to the Public Education Commission (PEC)
January 20, 2023

Executive Summary

The Foundation's revenues from the Academy amounted to 99.5% of total revenues during the period. Only $12,521 or (0.5%) of $2,280,355.00 was received from other sources such as fundraisers and donations. Many of the foundation's expenses, had they been spent as public funds, would be in noncompliance with:

- The The anti-donation law Article IX, Section 14 of the State of New Mexico Constitution
- The New Mexico Travel and Per Diem Act (Title 2, Chapter 42, Part 2 NMAC)
- The Procurement Code (NMSA 1978 § 13-1-28 through 13-1-199)

Areas of concern:

- Travel Expenses: exceeding state maximums, paying for alcoholic beverages, expenses under school director's name when they were for other individuals, expenses in excess of receipts provided, conference lodging and airfare paid for 6 individuals when only 4 attended conference
- School Support Expenses in conflict with State's Anti-Donation Clause
- MOU between Academy and Foundation lacking information
- No approved annual Foundation budget
- Foundation Internal Controls: processes for expenditure approval, cash disbursements
- Foundation Non Compliance with Mortgage Agreement Requirements
- Missing Significant Information on Lease Agreement
- Total Lease Amounts to be paid to the foundation compared to the mortgage amount
    - TGA will pay the Foundation $5.5 million including $1 million in prepayments
    - 2017 mortgage agreement principal was $1.1million,with $1,562,743.39
- Payments for building and maintenance
- Conflicts of interest contribute to weakness in the Foundation's control environment
    - The Academy's Executive Director (ED) and Director of Academics (DOA) had professional service contracts (PSCs) with the Foundation
    - No mechanisms in place to track time as employee vs time as contractor
    - The Dean of Students (DOS) served as Foundation Board President, with authority to approve contracts and payments, including to ED, while an employee reporting to ED
    - The Academy employed three related individuals: the ED, the DOA and the Student/Community Outreach Coordinator (COC). The COC was also one of the authorized signers on the Foundation's bank account

Detailed Summary

Foundation's Travel and Per Diem Expenses

The Foundation travel expenses indicated the Foundation paid for all travel related expenses for both the Academy and Foundation Board Members and several other

- In Fourteen (14) instances, actual meal costs exceeded the maximum of $30 for in-state travel for a 24-hour period. The total costs in question would be $1,714.68.
- In nine (9) instances actual meal costs exceeded the maximum of $45 for out of state travel for a 24-hour period. The total costs in question would be $1,373.92.
- In 11 instances reimbursement for actual expenses were granted when partial day per diem rates were required. On the last day of travel when overnight lodging is no longer required, partial day per diem shall be made. The total costs in question would be $581.39.
- In four (4) instances the Foundation paid for or reimbursed individuals' meals that included purchases of alcoholic beverages. The amount of alcohol purchased was $36.94.
- In four (4) instances lodging reservations were made under the ED's name when the supporting documentation indicated the lodgings were for other individuals. The lodging costs in question would be $2,905.28.
- In three (3) instances an individual was reimbursed for actual meals at the out-of-state rate of $45 per day when actual meals were less than $45 had the Foundation not included the cost of alcoholic beverages in the reimbursement. The total costs in question would be $135.00.
- In four (4) instances the expense per the general ledger was more than the cost that was stated in the supporting documentation (receipts, reservation confirmations, etc.). The difference between the documentation and the general ledger amounts total to $297.49.
- In two (2) instances lodging reservations indicated that the accommodation was for more than one individual. One reservation confirmation indicated the accommodation was for two (2) adults and one (1) child, and a second reservation confirmation indicated the accommodation was for two (2) adults and two (2) children.
- In one (1) instance the Foundation paid for airfare and lodging for six (6) individuals to travel to Nashville, Tennessee. Only able to verify the related conference registration for four (4) of those individuals. The additional costs incurred for the two (2) additional individuals is estimated to be $2,072 not including meals, the amount of which could not be determined.

Foundation's School Support Expenses

The Foundation's school support expenses for gifts/prizes/donations and food/meals conflicted with the State's Anti-Donation Clause;

- $23,547 in purchase of gift cards, prizes, clothing, birthday or other celebratory gifts, reimbursements to students and/or families for school-related costs, and, in rental assistance provided to student's families.

- $16,495 in purchases of food/meals for staff, students, and families, including purchases of food for student and staff birthday celebrations

<u>MOU between the Foundation and the Academy</u>

The MOU between the Foundation and Academy lacked specific information or an annual budget to support the MOU on how much the Foundation intended to spend and in what areas. More specificity as to the nature and extent of the financial support would allow for more financial accountability by the Foundation.

The MOU also lacked key information such as:

- The effective date of the agreement, as an "ongoing" agreement may not be the best benefit of either the Academy or the Foundation at any given point in time.
- How the financial support would be provided (i.e., advanced payments, reimbursements, direct payments to the vendor, etc.).
- The length of the MOU term.
- Who executed the MOU.
- Any restrictions and limitations.

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<u>Foundation's Annual Budget</u>

The Foundation did not have an annual budget approved by the Board of Directors. Given that the Foundation had spent approximately $1.9 million dollars over the scope of the special audit engagement, auditors would have expected to see annual budgets approved to demonstrate accountability and transparency.

<u>Foundation's Internal Controls over Cash Disbursements</u>

Prior to the Foundation's Financial Procedure and Internal Control Policy effective September 3, 2021, the Foundation only required for the Board to "acknowledge" expense approval forms meaning there would be no documentation of a formal approval for the expense (i.e. no signature, initials, approval stamp, etc.).

Expenses had an expense approval form attached with both the Director of Operations and the Board President or Board Treasurer's signature. The signatures all appeared to be electronically copied or digital. Upon inquiry of the BOS employee, we were informed that the Board President and Board Treasurer's electronic signatures were available to the BOS employee, who used them after getting verbal approval for the expense approval form. The Foundation has recently started using DocuSign.

The original backup documentation for all accounting information during the period July 1, 2016, through June 30, 2017, was purged by the Foundation and therefore, unavailable for review. Because of this, assessment of expenses for that period are unavailable.

****<u>Finding 001-Foundations Non Compliance with Loan/Mortgage Agreement Requirements</u>**

The Foundation was out of compliance with the following three mortgage requirements:

- The Foundation did not keep a depository account with the lender as required by the mortgage agreement for FY 2017 through January 31, 2022.
- The Foundation was not in compliance with the debt service coverage ratio requirement in FY 2017 through 2020.
- The Foundation’s Board of Directors approved a resolution on December 15, 2019, dissolving the Foundation effective December 31, 2019, with all assets and liabilities of the Foundation to be transferred to TGA Foundation, LLC, a newly formed for profit entity in January 2020 without consent from the lender as required by the loan agreement

Lease Agreement

Over the term of the current lease and the amount of the mortgage principal, the Academy will pay the Foundation a total of $5.5 million in lease payments (including the $1,000,000 in prepayments but excluding additional rent payments). To put this figure into context, when the Foundation signed the mortgage agreement in 2017, the mortgage principal amount was $1,100,000. Under the mortgage agreement, the Foundation will pay the lender $1,562,743.39, which includes the balloon payment in 2027 of $693,567.39.

Missing Significant Information on Lease Agreement

The lease agreement starting January 1, 2019, did not indicate the $250,000 prepayment of rent within the body of the lease. The main purpose of executing a new lease was triggered by this prepayment. The lease payment amortization schedule included the $250,000 prepayment. It was determined to be a weakness in both the Academy’s and the Foundation's management and governance.

Timeline of Lease Agreement and Mortgage Agreement

The mortgage term is a fraction of the lease term.

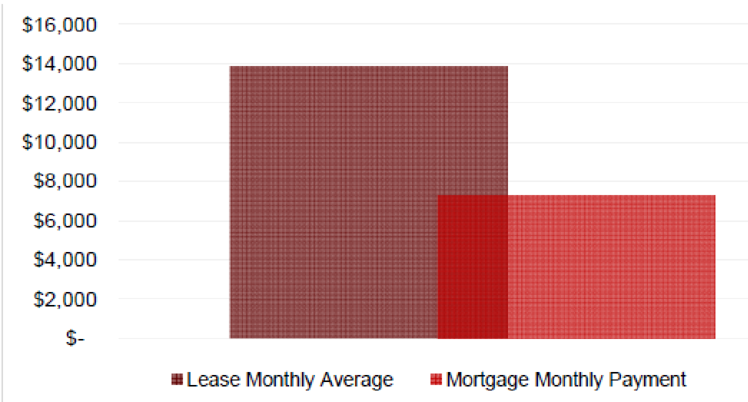
- Lease terms typically span 16 to 20 years, while the mortgage spans 10 years with a balloon payment of $693,567.39 at the end of the term. New leases were entered into upon every rent prepayment.
- The Foundation will have to refinance the balloon payment when the mortgage comes due in 2027. If the Academy’s charter is not renewed, the Foundation may be left in a difficult position trying to refinance the building without a long-term lease agreement in place.

Total Lease Amounts to be Paid to the Foundation Compared to the Mortgage Amount

The Academy will pay the Foundation a total of $5.5 million in lease payments which includes the $1 million in prepayments, nearly $4 million more than the mortgage amount. When the Foundation signed the mortgage agreement in 2017, the principal was $1.1million, and total payments to the lender $1,562,743.39 including the balloon payment..

Monthly Lease Amounts Compared to Monthly Mortgage Amounts

From July 1, 2016 toJanuary 31, 2022, the monthly net rent payments range from $13,251.48 to $14,625, averaging $13,862.59. Starting in July 2017, the average monthly mortgage payment was $7,304. The chart below shows the average difference of $6,559 the Academy was paying over the Foundation's monthly mortgage payment, interest, and escrow.



Finding 002-Lack of Foundation Expenditure Support

Significant Amounts Paid to One Individual for Building and Maintenance Projects

Payment to a maintenance vendor was only supported by a quote for a 3-Phase landscaping job. There was not an invoice to support the payment for these services.

$330,499 of the $439,239 in building maintenance was paid to one individual from fiscal years 2018 through 2021. Payments were for a wide range of projects including tiling, painting, roof replacement, carpet removal/install, landscaping, storage cleaning/organization, and patio work.

Building and Maintenance Costs

The Foundation's building & maintenance costs were $439,329. The Academy paid direct building & maintenance costs of $102,501, for a combined total of $541,830 from July 1, 2016, through January 31, 2022, making this the largest expenditure for the Academy to the Foundation.

Finding 003-The Academy and Foundation's Internal Control Environment

An overarching environment of conflicts of interests contributed to a weakness in the Foundation's control environment, with individuals who are employees of the Academy also having professional service contracts (PSCs) with the Foundation, including an Academy employee who also served as the Foundation's Board President and Treasurer.

- The Academy's Executive Director (ED) entered into a second PSC related to Facilities Management, TGA ReplicationInitiative, and Concert Fundraiser services for the period January 1, 2019 through June 30, 2021. During this time, the Academy's ED was also employed by the Academy. The Academy's ED was also employed as the Special Education Director/Teacher from July 27, 2020 to May 28, 2021.

- The Director of Academics/Principal (DOA) entered into a PSC with Foundation on June 29, 2018 for the scope of work. During this time, the DOA was also employed full-time by the Academy.

- The Foundation executed a PSC for the period January 1, 2019 through June 30, 2019, with the Academy's Business Office Support (BOS) employee to provide financial and administrative support to the Foundation while this individual was a full-time employee of the Academy as the Business Office Support/SPED EA/Truancy Officer. This person was also the Director of Operations for the Foundation.

- The Foundation and the Academy did not have any mechanism or policies and procedures for these individuals to track their time spent as a contractor of the Foundation and their time spent as an employee of the Academy. These PSCs could be perceived as standalone full-time positions, or even more than a full-time position, on top of already full-time Academy positions.

If these individuals were charged with these duties as employees and not contractors, a conflict of interest would not exist as they would be compensated by a single entity.

Also noted that the PSCs indicated above were drafted on Foundation letterhead but included the wording: "This agreement is made and entered into by and between the GREAT Academy,hereinafter referred to as the "School…" Under a normal arms-length transaction, it would be unlikely that such an error would occur.

Foundation's Board President/Treasurer

The Foundation appointed the Academy's Dean of Students (DOS) to the Board of Directors on July 31, 2019 where this person served as the Foundation's Treasurer from July 31, 2019 and was appointed as Board President on August 25, 2021. This individual then served as the Board President until October 6, 2021. During this individual's time on the Foundation's Board, this person was also a full-time employee of the Academy to which this person's reported to the Academy's ED.

The Foundation's Board President has the authority to review and vote on approval of contracts and expenses. As such, this person approved payments for services rendered under the PSCs listed in leading paragraphs.

Both the DOS and BOS employees are part of the Foundation's review and approval process for expenses. A conflict of interest exists due to these circumstances since the DOS and BOS employee would be reviewing and approving expenses related to the Academy's ED's PSC with the Foundation. Both the DOS and BOS employee could feel pressure to approve the payment of expenses related to the Academy's ED and the DOA's PSCs in order to protect themselves from retaliation from authority as employees of the Academy that report to the ED. This would also be the case with any expense that the Foundation is incurring as an expense on the behalf of the Academy.

It should also be noted that the Academy employed three related individuals at once. The ED, the DOA and the Student/Community Outreach Coordinator (COC) were all immediate family members. The COC was also one of the authorized signers on the Foundation's bank account.

The Foundation's contracts did include a conflict of interest clause: "Conflict of Interest. The Contractor warrants that it presently has no interest and shall not acquire any interest, direct or indirect, which would conflict in any manner or degree with the performance or services required under the agreement."

Per the 2013 COSO Framework, the Control Environment component has five (5) principles relating to it:

- The organization demonstrates a commitment to integrity and ethical values.

- The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
- Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
- The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

As a result of the above instances of conflicts of interest, the Academy could be in violation of the following laws:

- Chapter 22 NMSA 1978 “Public School Code”, Article 8B “Charter Schools Act”, Section 22-8B-5.2B, “Governing body conflicts of interest”, which states in part, “No member of a governing body or employee, officer or agent of charter school shall participate in selecting, awarding or administering a contract with the charter school if a conflict of interest exists. A conflict of interest exists when the member, employee, officer or agent or an immediate family member of the member, employee, officer or agent has a financial interest in the entity with which the charter school is contracting. A violation of this subsection renders the contract voidable.”
- Chapter 10 NMSA 1978 “Public Officers and Employees”, Article 16 "Governmental Conduct Act" Section 10-16-4 “Official act for personal financial interest prohibited; disqualification from official act; providing a penalty”, which states,

    A. A. It is unlawful for a public officer or employee to take an official act for the primary purpose of directly enhancing the public officer's or employee's financial interest or financial position. Any person who knowingly and willfully violates the provisions of this subsection is guilty of a fourth-degree felony and shall be sentenced pursuant to the provisions of Section 31-18-15 NMSA 1978.

    B. B. A public officer or employee shall be disqualified from engaging in any official act directly affecting the public officer's or employee's financial interest, except a public officer or employee shall not be disqualified from engaging in an official act if the financial benefit of the financial interest to the public officer or employee is proportionately less than the benefit to the general public.

    C. C. No public officer during the term for which elected and no public employee during the period of employment shall acquire a financial interest when the public officer or employee believes or should have reason to believe that the new financial interest will be directly affected by the officer's or employee's official act.

- Chapter 10 NMSA 1978 “Public Officers and Employees”, Article 16 "Governmental Conduct Act" Section 10-16-13 “Prohibit bidding”, which states, “No state agency or local government agency shall accept a bid or proposal from a person who directly participated in the preparation of specifications, qualifications or evaluation criteria on which the specific competitive bid or proposal was based. A person accepting a bid or proposal on behalf of a state agency or local government agency shall exercise due diligence to ensure compliance with this section.”

- Chapter 10 NMSA 1978 “Public Officers and Employees”, Article 16 "Governmental Conduct Act" Section 10-16-13.2 “Certain business sales to the employees of state agencies and local government agencies prohibited”, which states in part,

    A. A public officer or employee shall not sell, offer to sell, coerce the sale of or be a party to a transaction to sell goods, services, construction or items of tangible personal property, directly or indirectly through the public officer's or employee's family or a business in which the public officer or employee has a substantial interest, to a person over whom the public officer or employee has regulatory authority.

    B. A public officer or employee shall not accept from a person over whom the public officer or employee has regulatory authority an offer of employment or an offer of a contract in which the public officer or employee provides goods, services, construction, items of tangible personal property or other things of value to the person over whom the public officer or employee has regulatory authority.