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**SUBMITTAL FOR PRESENTATION AND ACTION**

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DATE OF SUBMITTAL: November 24, 2017

DATE OF MEETING: November 28, 2017

TO: Catherine Payne, Chairperson

FROM: Sione Thompson, Executive Director

AGENDA ITEM: III. Presentation and Action on Ka‘u Learning Academy’s Financial Audit for Fiscal Year 2017

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I. DESCRIPTION

Update and action on the Financial Audit for Fiscal Year 2017 for Ka‘u Learning Academy (KLA).

II. AUTHORITY

Pursuant to Hawaii Revised Statutes (“HRS”) §302D-17(a), “An authorizer shall continually monitor the performance and legal compliance of the public charter school it oversees, including collecting and analyzing data to support ongoing evaluation according to the charter contract. Every authorizer shall have the authority to conduct or require oversight activities that enable the authorizer to fulfill its responsibilities under this chapter, including conducting appropriate inquiries and investigations, so long as those activities are consistent with the intent of this chapter and adhere to the terms of the charter contract.”

Section 12.1 of KLA’s State Public School Charter Contract provides that “the Commission continually monitor the performance and legal compliance of the School. The Commission shall have the authority to conduct or require oversight activities that enable the Commission to fulfill its responsibilities under Ch. 302D, HRS, including conducting appropriate inquiries and investigations, so long as those activities are consistent with the intent of Ch. 302D, HRS, and adhere to the terms of this Contract.”

### III. BACKGROUND

Section 302D-32, Hawaii Revised Statutes (HRS), requires that “each charter school shall annually complete an independent financial audit that complies with the requirements of its authorizer.” In addition, the Charter Contract for KLA, in Section 11.3.4, states “Each fiscal year, the School shall provide for an independent annual financial audit conducted in accordance with Generally Accepted Auditing Standards and Governmental Auditing Standards and performed by a certified public accountant (CPA) ...”

On November 15, 2017, Commission staff received KLA’s Independent Financial Audit for Fiscal Year 2016-17, provided as **Exhibit 1** of this submittal. A review of the audit found that the school had been cited for several material weaknesses and incidents of non-compliance. The audit report defined a material weakness as “a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.”

The audit reported the following findings:

- **Finding 2017-001: Lack of Internal Controls and Additional Oversight - continuation of 2016-001**
  - A lack of separation of duties in school financial procedures was noted as a material weakness. Specific instances noted included:
    - Funds for bill payments were disbursed with no approval by an appropriate level of authority;
    - Reimbursements for personal travel costs and payment for a utility bill for school management were made to KLA following the close of the fiscal year; and
    - A lack of documentation for 12 charges made on the school debit account could not provide support for the disbursement of school funds.
  - This finding was previously reported in KLA’s 2015-2016 financial audit and continued into the current audit.
  
- **Finding 2017-002: Accounting does not follow Generally Accepted Accounting Principles (GAAP)**
  - It was reported that school management did not utilize accrual accounting which resulted in significant adjustments to the school’s financial reports at the end of the fiscal year.
  - Financial reports completed during the school year were not an accurate representation of the school’s financial status.
  
- **Finding 2017-003: Non-compliance with Department of Labor Laws and Regulations**
  - Employee compensation, specifically bonuses, were not run through payroll.
  - Educational Assistants were paid as independent contractors.

IV. INFORMATION FOR CONSIDERATION

Each reported audit finding potentially violates the provisions of the school’s Charter Contract with the Commission and could require oversight and corrective actions. The following chart provides the section(s) of the Charter Contract that each finding may potentially violate:

FINDING	SECTION OF THE CHARTER CONTRACT
Finding 2017-001	Section 9.4: <u>Management and Financial Controls</u> . At all times, the School shall maintain appropriate governance and management procedures and financial controls which shall include, but not be limited to: (a) budgets, (b) accounting policies and procedures, (c) payroll procedures, (d) financial reporting and (e) internal control procedures for receipts, disbursements, purchases, payroll, and fixed assets.
Finding 2017-002	Section 9.1: The School shall maintain accurate and comprehensive financial records, operate in accordance with Generally Accepted Accounting Principles, and use public funds in a fiscally responsible manner.
Finding 2017-003*  <b>* In addition, Finding 2017-003 raises concerns regarding KLA’s compliance with state collective bargaining requirements as determined by Charter 89, HRS.</b>	Section 10.1: <u>Collective Bargaining</u> . The School shall be subject to collective bargaining under Ch. 89, HRS, and shall comply with the master agreements as negotiated by the State.  Section 11.6: <u>Personnel Data</u> . The School shall maintain accurate and complete personnel and payroll information and shall provide such information to the Commission, in the format and timeframe prescribed by the Commission, as required for the Legislature or any State agency including but not limited to the Department of Budget & Finance, Employees' Retirement System, and the Hawaii Employer-Union Health Benefits Trust Fund. The School shall ensure each employee receiving State benefits qualifies for benefits.

The Commission has the authority to act to address a charter school’s failure to meet the contractual requirements and non-compliance with laws and regulations. Pursuant to HRS §302D-5, the Commission as an authorizer is responsible for monitoring, in accordance with charter contract terms, the performance and legal compliance of public charter schools; and determining whether each charter contract merits renewal, nonrenewal, or revocation. Additionally, it requires the Commission to be responsible for and ensure the compliance of a public charter school it authorizes with all applicable state and federal laws, including reporting requirements.

Under state law, specifically Section 302D-17, HRS, the Commission’s oversight and corrective actions include:

1. Requiring a school to develop and execute a corrective action plan within a specified time frame;
2. Reconstituting the governing board of the charter school; and
3. Revocation of a Charter Contract.

Lastly, an analysis of KLA’s financial information, as reported in the audit, found that the school would receive a Rating of “Does Not Meet Target” for the Financial Performance Framework for the 2016-2017 school year. KLA’s results overall and for each indicator are represented in the chart below. Areas highlighted in red represent fiscal indicators that the school received a rating of “Does Not Meet Target”.

Current Ratio Greater than or equal to 1.1	Enrollment Variance equals or exceeds 95% in the most recent year	Days Cash on Hand $\geq$ 60 days or 30-60 days trending upward	Total Margin is positive	Debt to Assets Ratio is less than 50%	Cash Flow is positive	Unrestricted Fund Balance Percentage greater than 25%	Change in Total Fund Balance is positive	Overall Annual Rating
2.4	124.7%	15	3.4%	23.3%	-\$38,070	14.3%	\$33,389	DOES NOT MEET

**Exhibit 1**

**Ka'u Learning Academy Annual Audit for Fiscal Year 2016 -2017**