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May 12, 2009

Mr. Ted Dudley
Supervisor of Investigations
Office of Fiscal Integrity
Department of Financial Services
200 East Gaines Street
Tallahassee, Florida 32399

Re: Life Skills Charter School Investigation Narrative

Dear Mr. Dudley:

Per your request, I am providing a narrative of the recent investigation regarding Escambia County Community Land Trust, Inc. (ECCLT) and the Life Skills Charter School (Charter School).

Background

In June of 2006, the School Board of Escambia County (School Board) approved the Charter School contract between the School Board and Escambia County Community Land Trust, Inc. d/b/a Life Skills Center. The mission of the Charter School was to serve at-risk students ages 16-22 by "giving them a second chance at obtaining a quality education and vocational training and placement, thereby guiding them on a path of success." The contract was renewed in July 2007.

The day-to-day operations of the Charter School were performed by White Hat Management (White Hat). White Hat supplied all employees necessary to provide services to students. In addition, White Hat paid all expenses necessary for the operation of the school including, but not limited to, salaries for personnel, costs for curriculum materials, textbooks, library books, facilities, computers and other equipment, software, supplies, maintenance, and capital improvements of the Charter School. In exchange for these services, White Hat was to receive 97% of the funding (FTE dollars) received by the Charter School from state, federal, and local sources for the special education of the students at the Charter School. The 3% retained by the Charter School was to be used for legal fees, annual audit fees, and any other miscellaneous administrative costs.

Funds to educate the Charter School students flow from the State of Florida to the School Board, which deducts a 5% administration fee, and then remits the remaining amount to the Charter School. Whereby, contractually the Charter School is obligated to pay 97% of the remaining amount to White Hat. For example, for every \$1,000 received from the state, the School Board retains \$50, the Charter School retains \$28.50, and White Hat receives \$921.50.

In November or December of 2007, School Board personnel were made aware of correspondence between White Hat and ECCLT regarding various matters including the operation of a childcare facility on the Charter School campus and the lack of payment of management fees to White Hat. This correspondence continued through April 2008, when the School Board General Counsel determined an internal audit of the Charter School was necessary. An audit engagement letter was issued. In May 2008, School Board personnel met with the Office of Fiscal Integrity. That meeting confirmed the need

for an investigation into the financial transactions of the Charter School. The details of which are included in this document.

Investigation Details

The investigation began with the subpoena of bank records for the Charter School, including check images. The records consisted of Coastal Bank and Trust (formerly Bank of Pensacola) account #878839, which was titled Escambia Community Land Trust, Inc. for Life Skills Center Escambia County. A review of the bank activity through July 31, 2008 showed a net amount of \$494,687.14 of transfers to other Coastal Bank and Trust (CBT) accounts. A net amount of \$172,500 was transferred to CBT account #848689. A net amount of \$322,187.14 was transferred to CBT account #866466. Nearly all of the transfers included the comment "Per OJ".

The review of the account showed deposits of \$2,207,063 from the School Board. Deductions were made from the account for various expenses, the largest of which was for management fees totaling \$1,491,943.68. Based on bank records and check images, the activity of the account was re-created in QuickBooks, an accounting software package.

The bank records for CBT accounts #848689 and #866466 were then subpoenaed. Account #848689 was titled to Escambia County Community Land Trust, Inc. Account #866466 was titled to Escambia County Community Land Trust, Inc. d/b/a Maison Deville (MDV). The records included bank statements, check images, and deposit detail. Based on bank records, the activity of the accounts was re-created in QuickBooks.

The transfers previously noted in the Life Skills Center account (#878839) were agreed and reconciled to the transfers to/from accounts #848689 and #866466. In addition, we noted a net of \$150,688.73 transferred from MDV to ECCLT. To recap:

From Life Skills to ECCLT - \$172,500.00

From Life Skills to MDV - \$322,187.14

From MDV to ECCLT - \$150,688.73

It was noted that although the Charter School continued to receive FTE payments from the School Board through April 2008, payments to White Hat ceased in December 2007. White Hat continued to provide services to the students through June 2008, even though they were not receiving management fees. White Hat terminated its agreement effective June 2008.

ECCLT, Inc. Comments

ECCLT served as the parent company for the Life Skills Charter School and the Maison Deville Apartment Complex. In addition, ECCLT was engaged in the purchase and refurbishing/building of affordable housing. During the two years reviewed, it appears ECCLT only purchased and sold two properties. These transactions appeared to breakeven.

Based on the reconstruction of bank records, it appears ECCLT's only material source of income was the pass through rental of the Charter School facility. ECCLT rented the facility initially for \$5,000 per month, which was then increased to \$6,250 per month in July 2007. ECCLT also appeared to pay additional amounts for property taxes. ECCLT sublet the facility to White Hat for \$17,500 a month. Over the two-year period, it appears ECCLT netted approximately \$210,698 from the rental of the Charter School Facility.

Other sources of cash flow for ECCLT include a \$250,000 line of credit with Gulf Coast Community Bank, an \$80,000 personal loan from a local philanthropist, a loan for an unknown amount from the Florida Housing Finance Program, and transfers from the Charter School and MDV.

ECCLT's expenses were significant compared to its income. Over the two-year period, ECCLT had payroll expenses of \$596,830, health insurance of \$50,862, interest expense of \$58,932, professional fees of \$48,694, repairs and maintenance of \$45,855, utilities of \$22,054, office supplies of \$17,363, etc... In addition, approximately \$66,282 of MDV expenses were paid by ECCLT.

Maison Deville Comments

Based on research of public records, Maison Deville Apartment Complex (MDV) is a multi-family rental housing facility consisting of over 100 apartments. The property was purchased by ECCLT in September 2005. The Land Use Restriction Agreement exercised with the sale set the rental terms, which are designed to provide affordable housing to local residents. The purchase price of the property was \$4,100,000. The purchase was financed through a first mortgage with Coastal Bank and Trust for \$3,750,000 and a second mortgage of \$555,000 with the Institute of Community Economics, a Massachusetts nonprofit corporation. It was also determined that the first mortgage was personally guaranteed by ECCLT Board member Oliver Darden. In exchange for the guarantee, Mr. Darden was to receive \$86,000, which was paid in installments of \$2,050 each month.

Based on the reconstruction of the Maison Deville financial transactions, the following was noted:

Average Monthly Activity			
Rental Income	\$ 64, 144		
Laundry Income	929		
Vending Income	263		
Total Income		\$ 65,336	
First Mortgage Payment	\$ 30,969		
Second Mortgage Payment	5,145		
Insurance	10, 372		
Property Management Fee	5,700		
Guarantee Fee	2,050		
Repairs & Maintenance	13,341		
Water/Sewer/Trash	5,888		
Electricity	1,242		
Gas	220		
Telephone/Internet	320		
Office Supplies	313		
Bank Service Charges	321		
Total Recurring Expenses		\$ 75,881	
Monthly Cash Flow Deficit			\$ 10,545

The expenses above do not include an amount of approximately \$51,000 of property taxes per year, as the 2005 taxes were paid in December 2006 by ECCLT directly. A review of the tax collector's records indicates that the 2006 taxes were paid by Coastal Bank and Trust in April 2009, and the 2007 and 2008 taxes remain unpaid.

Conclusion

It appears the Maison Deville Apartments consistently operated at a \$10,000+ loss each month. It was necessary to transfer funds from the Life Skills Charter School to allow the apartments to continue to operate. It also appears ECCLT had limited sources of income related to its expenses. ECCLT had large payroll and other expenses that exceeded its sources of income. These expenses include payments for payroll, consulting fees, and "back pay" for ECCLT Board members. In order to continue to pay these expenses, ECCLT borrowed funds from various sources and transferred funds from the Life Skills Charter School directly or to the Maison Deville Apartments and then to ECCLT.

A total of \$494,687.14 was transferred from the Life Skills Charter School bank account to subsidize the other activities of the Escambia County Community Land Trust. There is no evidence that any education-related services were provided in exchange for the funds transferred. A review of bank account balances of the Life Skills Charter School, Maison Deville, and ECCLT as of July 2008 indicates there is less than \$5,000 remaining in total for all accounts. Because FTE dollars appear to have been used for other purposes, ECCLT was unable to pay management fees owed to White Hat.

For the 2007-2008 school year, the School Board paid the Charter School \$899,608 in FTE dollars. The School Board continues to hold in trust \$366,874 of net FTE dollars. The total amount of net FTE dollars for the school year was \$1,266,482. According to the management agreement between White Hat and ECCLT, 97% of the \$899,608 (less \$60,00 in dispute for childcare FTE) received by the Charter School should have been remitted to White Hat. That amount equals \$814,420. In addition, White Hat would be entitled to 97% of the \$366,874 held in trust by the School Board. That amount equals \$355,868. The total amount of management fees for the year would be \$1,170,288. It appears White Hat has been paid \$400,093. White Hat alleges \$826,398 is still owed. **The result of the investigation suggests White Hat is entitled to approximately \$770,195.** The majority of the difference represents the childcare portion of the FTE dollars, which is in dispute. If the dispute over childcare FTE is found in White Hat's favor, it appears White Hat would be entitled to a total of \$828,395.

It should be noted, 97% of the amount transferred out of the Charter School bank account to ECCLT and MDV is \$479,847, along with 97% of the amount held in trust by the School Board, \$355,868, totals \$835,715.

If you have any questions, or require detailed backup information, please do not hesitate to contact me.



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Office of Internal Auditing
Escambia County School District