

**New York State  
Office of Parks, Recreation and Historic Preservation**

**Final Audit  
Saratoga Performing Arts Center, Inc.**

On November 22, 2004, the New York State Office of Parks, Recreation and Historic Preservation (OPRHP) issued a preliminary audit of the finances and management of the Saratoga Performing Arts Center, Inc. (SPAC) pursuant to the current lease agreement between the parties. The preliminary audit was based on the work products of both the internal audit staff of OPRHP and the more comprehensive review provided by The Bonadio Group, a Rochester NY accounting, auditing and financial consulting firm.

The preliminary audit contained six Findings and Recommendations supported by a series of more specific recommendations contained in the body of the preliminary audit. The Findings and Recommendations dealt with the issues of inadequate fundraising and outside support, the flawed decision to terminate the New York City Ballet (NYCB) based on inaccurate and incomplete information; the overcompensation of the President of SPAC and the lack of clearly defined duties and performance goals for both the offices of President and Director of Development, the wife of the President; the need to reaffirm SPAC's mission and commitment to the fine arts; the need for the Board of Directors to expand its oversight and management roles and outreach to the community; and the excessive Severance Agreement for the SPAC President agreed to by the Board on November 15, 2004. The preliminary audit is attached to and made part of this Final Audit.

On December 20, 2004, the Chairman of the SPAC Board of Directors provided OPRHP with a formal response to the preliminary audit. A copy of the Board's response is attached to this Final Audit. In its response, SPAC specifically addresses the six Findings and Recommendations of the preliminary audit and it addresses several specific recommendations contained in the body of the preliminary audit.

**Interrelationship between Chesbrough and Board Members Breyo and Mather**

Since the release of the preliminary audit, the following information has come to light and is included for the record as part of this Final Audit report:

Shortly after the release of the preliminary audit, and in response to a press inquiry, SPAC issued a statement containing information regarding the paid service of SPAC President Herbert A. Chesbrough on the Board of Directors of a trust controlled by Ayco Co., a vendor of SPAC at that time. At the same time that Mr. Chesbrough served as a paid director of the Ayco affiliate, Ayco CEO John Breyo served as a Director of SPAC. Mr. Breyo had served on the personnel committee which Board minutes indicate was the committee that negotiated Mr. Chesbrough's 1999 employment contracts and his company, Ayco, hired the consultant who prepared the compensation study used to support the 1999 Mr. Chesbrough compensation agreement. According to the statement issued by SPAC, the arrangement with Mr. Chesbrough serving on March 16, 2005

the Ayco affiliated Board was approved by then-SPAC Chair Charles Mather, with no notice given to the SPAC Board. Review of the minutes of SPAC Board meetings during this time support this fact. As documented in the Preliminary Audit, SPAC also engaged the services of Mather and Co., which provided insurance services to SPAC, valued at \$784,000 for the years from 1997 to 2004, and that this relationship was not fully disclosed on SPAC's tax filings with the Internal Revenue Service.

The news coverage generated by this press statement, as well as the existence of the issues raised by the preliminary audit, resulted in inquiries to this office by the Charities Bureau of the New York State Attorney General. As a result of these inquiries, a formal referral was made by OPRHP on December 7, 2004 to the Charities Bureau to review the preliminary audit as it related to the Severance Agreement and determine whether it complied with the requirements of State and Federal law. The inquiry by the Charities Bureau continues to the present. The Severance Agreement has been terminated by agreement of the parties as of December 14, 2004. The Charities Bureau has imposed a "standstill agreement" upon SPAC and Mr. Chesbrough, under the terms of which no further agreement regarding Mr. Chesbrough's severance may be made without the approval of the Attorney General's Office.

OPRHP has carefully reviewed the response to the preliminary audit provided by SPAC. At this time, OPRHP can issue its Final Audit, reserving for itself the right to address any issues resulting from the Charities Bureau inquiry and the ultimate arrangement regarding the disengagement of Mr. Chesbrough's employment relationship. In addition, it is the intention of OPRHP to review the status of SPAC's compliance with the Findings and Recommendations of the Final Audit after a reasonable period of time has passed so as to enable SPAC to implement them.

### **Findings and Recommendations**

The preliminary audit made six general Findings and Recommendations to which SPAC responded. In this section of the Final Audit, OPRHP will review these Findings and Recommendations, analyze SPAC's response thereto, and make final recommendations.

**1. SPAC's financial difficulties are the result of inadequate fundraising and outside support.**

*The preliminary audit found that SPAC relied too heavily on ticket sales as a source of revenue to support operations. SPAC needs to improve the quality of its development efforts, increase its endowment and expand the level of support within the community it serves. SPAC also needs to develop a long-range strategic business plan.*

**SPAC Response:** SPAC agreed with each of these findings, recognizing the need to add to the endowment to bring it to a \$10 million level. SPAC's efforts in hiring a new President (see below) focused on extensive and proven fundraising experience and ability. A fundraising committee is to be formed and fundraising programs developed consistent with a Long Range/Strategic Business Plan to be developed in consultation

with the new President. SPAC will work with the broad community of patrons and supporters to improve SPAC's public image.

**Comment:** *SPAC appears to be taking the necessary steps to improve its fundraising and outside support, thereby lessening its dependence on ticket sales to support operations.*

**2. The decision to eliminate the New York City Ballet was flawed and was presented based on inaccurate and incomplete information.**

*The preliminary audit found that SPAC based its February 2004 decision to eliminate the NYCB after the 2005 season was based upon an incomplete and/or inaccurate assumption that there was \$900,000 "accounting gap" between ticket sale revenue and production costs. This "gap" did not take into account directed gifts in support of the NYCB nor were nearly identical "gaps" with respect to the Philadelphia Orchestra disclosed. In addition, it was determined that NYCB underwrote its own residency to the extent of \$700,000 per year and that average attendance at SPAC exceeded that at Lincoln Center (excluding "The Nutcracker").*

**SPAC Response:** While not agreeing wholly with the analysis contained within the preliminary audit, SPAC unequivocally stated its commitment to maintaining the NYCB and the Philadelphia Orchestra at SPAC. SPAC acknowledged that in order to do so, revenues must be improved from all sources and expenses must be controlled in all areas.

**Comment:** *While SPAC claimed in its audit response that its original decision to terminate the NYCB reflected a desire to "create more variety" in its dance programs, minutes from the Board meeting at which the decision was made, attended by only ten board members and with no advance written agenda, reflect that the decision was based solely on financial concerns and did not consider the impact the decision would have on the core mission of SPAC – the summer residency of one of the premier dance companies in the country.*

**3. The President, an employee of SPAC, does not perform at the level commensurate with his compensation. The duties of the SPAC President and its Director of Development should be clearly defined, performance goals established, and compensation awarded based on attainment of those goals, commensurate with similar positions in like organizations.**

*The preliminary audit found that the duties of the President and of the Director of Development overlapped, were ill defined and were illogical. The concern was heightened by the fact that the positions were occupied by spouses and were the two highest paid positions within SPAC. While the compensation of the President was at the higher end of the spectrum for performance arts related non-profits, SPAC's development program does not measure up to those similarly related entities and SPAC had no*

*strategic plan to increase its endowment, despite the creation of such a plan being charged to the President. After the execution of his 1999 employment contract, the President's duties were dramatically reduced through the off-loading of the responsibility of the popular music series to Clear Channel Entertainment (CCE). The compensation of the President, already found to be at the higher end of the spectrum, was enhanced by questionable loan and performance bonus arrangements, poorly defined expense account access and other questionable practices.*

**SPAC Response:** SPAC attributed the President's higher than average compensation to tenure and the extensive job responsibilities performed by the President which, in the benchmarked entities, were performed by individuals other than the president. In addition, SPAC claims to have relied upon compensation consultants in arriving at the compensation of the President. SPAC affirmed that in the hire of its new President, compensation will be determined by reference to benchmarked surveys prepared by independent compensation consultants.

**Comment:** *SPAC offered no objective support for the proposition that the President's higher than average compensation was attributable to tenure and the extensive job responsibilities assigned to him. OPRHP's analysis of the reports of SPAC's compensation consultants show that they did not support the level of compensation afforded the President. Based on a comparison completed by The Bonadio Group, OPRHP has determined that the compensation of the President exceeded the mean by at least \$60,000 annually over the first six years of his current compensation agreement. Attached hereto is the analysis of the compensation package contained within the several agreements between SPAC and its President for the years 1999 to present.*

#### **4. SPAC needs to reaffirm its mission and commitment to the fine arts.**

*The preliminary audit found that the primary mission of SPAC since its inception in the mid-1960's was to bring the cultural performance arts, specifically the NYCB and the Philadelphia Orchestra, to an upstate venue. The successful partnership with Clear Channel Entertainment, Inc. (CCE) to produce the popular music series should be more fully leveraged to support SPAC's primary mission.*

**SPAC Response:** SPAC reaffirmed its commitment to the original mission/vision of SPAC and will strive in every way possible to continue residency of the NYCB and Philadelphia Orchestra at SPAC. SPAC reaffirmed that its partnership with OPRHP is fundamental to SPAC achieving its mission, a partnership that would ensure that funding is available to bring SPAC facilities to a state of good repair and one that would encourage the State to provide significant and sustained annual operating support.

**Comment:** *There never has been contemplated a subsidization of the operating budget of SPAC, a responsibility clearly of the corporate entity itself. SPAC is the recipient of rent free space and substantial operating support in the form of services provided by OPRHP; monetary subsidization of operations has never been nor is it now*

*contemplated. OPRHP looks forward to working with the new management at SPAC in implementing its capital plan.*

**5. The Board of Directors needs to expand its oversight and management roles in the operation of SPAC and reach out to its community of patrons, members, and supporters.**

*The preliminary audit found that the Board of Directors needed to take a more active, independent and public role in SPAC's day-to-day management and decision making. Committees needed to be continued or established to deal with critical areas of concern. The Board needed to become the public face of SPAC and become more transparent and open to the public. The size of the Board should be increased.*

**SPAC Response:** SPAC committed to expanding its oversight and management roles and established several committees, including a governance/nominating committee and is restructuring the Board and committee structure in accordance with best practices and in accord with the governance principles of the federal Sarbanes-Oxley Act. SPAC is committed to transparency consistent with responsible governance and the need for connection with and presence in the community. SPAC stated that its policy is for the President and the Board Chair to be the principal spokespersons for SPAC. SPAC agreed with the recommendation regarding the size of the Board and continues to actively seek new members. SPAC has established written whistleblower and records retention policies.

**Comment:** *As the Agency responsible for the administration of virtually all of the taxpayer funds invested in SPAC, OPRHP believes that it has a unique and vital role in ensuring that those monies are invested wisely and utilized to maximum efficiency. Thus, it has become clear that OPRHP should have direct representation on the SPAC Board in order to ensure accountability to the community, the public and the taxpayers and to ensure maximum cooperation between SPAC and OPRHP on operational, public relations, fundraising and scheduling issues .*

**6. The Severance Agreement for SPAC's President as approved by the Board of Directors on November 15, 2004, is excessive and should be reconsidered.**

*The preliminary audit found the Severance Agreement of November 15, 2004 to be excessive and possibly in violation of New York State law. Concern was voiced for the perception of SPAC within the community of patrons and members and the integrity of its financial decision making and its continued tax exempt status.*

**SPAC Response:** Subsequent to the release of the preliminary audit, the Severance Agreement of November 15, 2004 was terminated by agreement of the parties. SPAC has committed to negotiating a new severance agreement in consultation with appropriate governmental officials.

**Comment:** *Any severance package should take into account the level of compensation of Mr. Chesbrough under the several agreements that constitute his current compensation package, the extent to which his compensation exceeded the mean of CEOs of similarly situated arts related non-profit corporations and the reduction of his job responsibilities over the term of his compensation package. Based on the disproportionate level of performance to compensation, and to enable SPAC to successfully deal with its deteriorating financial condition, it is the recommendation of OPRHP that Mr. Chesbrough immediately resign.*

In addition to the above six Findings and Recommendations, the preliminary audit made several other recommendations to which SPAC has responded. These include the creation of a record retention and security policy; development of job descriptions for each staff position; tighter controls over the expense accounts of employees, including reimbursement only for SPAC related expenses; providing agendas and sufficient notice to Directors for meetings; creation of a policy regulating SPAC donations to charitable organizations; establishment or revision of conflict of interest and procurement policies and the prohibition of staff members from receiving compensation from any firms associated with Board members; the continuation of the use of outside auditors, with a new auditor to be retained for year end 2005; the continuation of strict accounting of box office transactions; and the annual review of fund raising proposals and outcomes.

## Final Recommendations

After careful consideration of the findings of the preliminary audit, the response of SPAC to the preliminary audit and subsequent press releases and other communications and documents from SPAC relating to the preliminary audit or to issues resulting from the preliminary audit, OPRHP makes the following recommendations.

1. Increase the number of active Board of Directors members to the maximum of 36, as provided in the by-laws, with one-third or 12 members constituting a quorum. Included in this increased number would be two additional representatives of OPRHP, in addition to the two existing Saratoga-Capital Regional Park Commission members. The two new representatives would be designated by the Commissioner of Parks, Recreation and Historic Preservation. These two designees should be standing members on the executive, compensation, budget/finance, nominating and, when applicable, search committees. This would allow for better communication between OPRHP and SPAC as well as better coordination of construction projects, service requirements and relations with outside agencies.
2. Implement a plan of term limits for members of the Board with the Board retaining the authority to waive the applicable limit in cases of extraordinary circumstances, such as where the individual member can continue to contribute valuable services or is in the midst of a development campaign.
3. SPAC would amend its conflict of interest policy, contained in its by-laws, to prohibit the hiring of Board members as employees, to prohibit the hiring of immediate family members of Board members as upper level management employees, and to prohibit the election of Board members who are employed by a private entity which does, or is likely to do, substantial business with SPAC. This policy would further reassure the patrons and supporters that fiscal responsibility is paramount to SPAC.
4. SPAC would complete the process commenced last year of establishing an independent audit committee by amending its by-laws to include a charter for the audit committee which charter shall require that, at a minimum, it be composed of Board members who have financial experience and at least one of whom is a financial expert. In addition, the charter would require that the annual report and the adopted annual budget are publicly available, preferably on line. The annual report would be signed by each Board member.
5. SPAC would complete the process commenced last year of establishing a governance/nominating committee by amending its by-laws to include the previously adopted charter thereof and that charters for all committees be included in the by-laws.
6. In accord with its contractual right to inspect and audit the books and records of SPAC, OPRHP would also have the right to review and comment upon SPAC's

annual budget and the right to review and comment SPAC's selection of its outside auditor(s). Monthly, quarterly, annual and other regular budgetary and financial reports prepared by SPAC for presentation to its own management and/or its Board of Directors shall also be provided to OPRHP on an ongoing basis. OPRHP also would have the right to participate in meetings with SPAC's outside auditor(s) and to review audit materials, documents and draft financial statements prior to their presentation to the Board.

7. In order to safeguard its endowment, SPAC would adopt an investment policy which, among other things, would authorize the replacement of the fund manager after six months of underperformance. In addition, SPAC would adopt an investment spending policy and review the same on a periodic basis.
8. Any compensation package to upper level management should be conditioned upon meeting performance goals established at the beginning of each fiscal year. Such goals would relate back to the adopted annual budget and the Board approved long term strategic plan.
9. Closer coordination with OPRHP, NYCB, the Philadelphia Orchestra and CCE with respect to cross-promotions, scheduling, joint fund raising and development, thereby better leveraging SPAC's relationships with these entities.

## **Analysis of Executive Compensation**

Following release of the preliminary audit, SPAC agreed to withdraw the Severance Agreement that had been approved at its November 15, 2004 meeting and committed to negotiating a new Severance Agreement “in consultation with state officials.” In order to respond to any such inquiries, the OPRHP asked the Bonadio Group to prepare a detailed analysis of the outgoing President’s existing compensation using information available from the eight benchmarked sources with budgets and missions comparable to that of SPAC. The information compiled below shows the compensation of Herbert A. Chesbrough under the 1999 compensation agreement, as compared with these benchmarks, both including SPAC and excluding SPAC.

<u>Year</u>	<u>SPAC</u>	<u>Mean including SPAC</u>	<u>Mean Excluding SPAC</u>
2003-	\$315,065	\$200,111	\$185,742
2002-	\$304,643	\$201,200	\$188,270
2001-	\$292,200	\$197,441	\$185,596
2000-	\$262,969	\$174,769	\$162,169
1999-	\$254,298	\$157,598	\$143,784

### **Existing Retirement Benefits Accruing to Chesbrough**

In addition the compensation structure of the President, OPRHP reviewed SPAC’s employee retirement plan and other vested retirement benefits accruing to Mr. Chesbrough and determined that the outgoing President was slated to receive the following amounts, at SPAC’S expense, *in addition to all other sums received or to be received by Chesbrough:*

- In excess of \$65,000 per year, guaranteed for life, from the defined benefit program available to all SPAC employees, over and above the various “deferred compensation” provisions contained within his 1999 contract;
- A \$1.0 million “estate enhancement” insurance policy that had been established and funded by SPAC;
- Undetermined payments derived from:
  - A deferred compensation account for Mr. Chesbrough that has been funded over the last 12 years by SPAC with payments totaling at least \$485,000; and
  - A \$1.0 million split life variable insurance policy established and initially funded by SPAC, which may be converted to an annuity by Mr. Chesbrough.

In addition, OPRHP has determined that SPAC paid the legal fees of the attorney, a former counsel for SPAC, retained by Mr. Chesbrough to negotiate the prior Severance Agreement on his behalf.

Considering the amount that he has been compensated in the past, and considering the reduction in his job responsibilities, as well as vested amounts that will be available to him after his retirement, OPRHP believes that Mr. Chesbrough is not due any further amounts in consideration of his immediate resignation.