

PERFORMANCE AUDIT REPORT

Pennsylvania Department of Education

Charter School Payment Appeals

August 2016



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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EUGENE A. DePASQUALE
AUDITOR GENERAL

August 24, 2016

The Honorable Tom Wolf
Governor
Commonwealth of Pennsylvania
Harrisburg, PA 17120

Dear Governor Wolf:

This report contains the results of the Department of the Auditor General's performance audit of the Pennsylvania Department of Education (PDE) with regard to evaluating PDE's process for addressing charter school payment appeals. Unless otherwise noted, this audit covered the period January 1, 2011, through December 31, 2015, with updates as necessary through the report's release. This audit was conducted under the authority of Section 402 of The Fiscal Code, 72 P.S. § 402, and in accordance with applicable generally accepted government auditing standards. Those 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our performance audit had two objectives, from which we report three findings and 15 recommendations. Briefly, our objectives covered the following: (1) determine whether PDE properly processed charter school payments in accordance with applicable laws, regulations, and policies, and (2) evaluate the adequacy of PDE's processes and procedures for addressing charter school payment appeals.

We found that although PDE properly reviewed and approved redirection payment requests for payment, a lack of clarity in the Charter School Law (CSL) and PDE's policies and procedures, resulted in unclear guidance to school districts if subsidy funds are erroneously withheld. The language in the CSL may favor charter schools over the school districts regarding the timing of PDE paying charter schools and in the timing of providing a school district with an opportunity to be heard regarding a disputed amount. Additionally, the CSL gives authority to PDE to withhold money from a school district to pay a charter school, but does not specify how and by whom a school district will be refunded if the withholdings were subsequently found to be unwarranted.

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We also found that non-charter school students' education funding was potentially hurt due to delays in PDE's appeals process. We found that of the total 857 appeals filed by school districts during the audit period, 630 appeals remain in open status with minimal action by PDE, including 317 appeals in which \$28.5 million have been withheld from school districts and redirected to charter schools. Lack of follow-up by PDE has resulted in appeals receiving minimal or no action, in some cases for 2 to 3 years. Any delay in the appeals process potentially leaves school districts without funding that can be used for the education of non-charter school students.

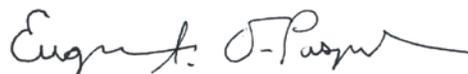
Our review of PDE correspondence to school districts and charter schools found conflicting language in regard to appointing a hearing examiner to a school district's appeal of a charter school payment that may have caused confusion for both parties, contributing to the significant delays noted in the appeals process.

As I mentioned previously, there are aspects of the CSL that may require legislative changes in order to improve upon the processes related to charter school redirection payments and the related appeals and to clarify language in the law regarding a school district's "opportunity to be heard." Specifically, we found that the CSL lacks clarity and may create an unfair advantage to the charter schools which can contribute to the financial hardships of school districts.

We urge PDE to proactively work with the General Assembly and particularly, the Senate and House Education Committees, to seek the legislative changes necessary to appropriately fine-tune the language of Section 1725-A(a)(5) and (6) of the CSL and to request additional resources to properly implement the redirection payment and hearing processes.

In closing, I want to thank PDE for its cooperation and assistance during the audit. PDE is in agreement with the findings and recommendations and stated that in several instances has already taken action to remedy the issues identified. We will follow up at the appropriate time to determine whether and to what extent all recommendations have been implemented.

Sincerely,



Eugene A. DePasquale
Auditor General

PA Department of Education

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Executive Summary

The Pennsylvania Department of Education (PDE) is responsible for overseeing public education in the Commonwealth, including education provided through charter schools under the state's Charter School Law (CSL).¹

As provided in the CSL, charter schools receive funding based on a formula for both non-special education students and for special education students. The funds are to be paid by the school district where the student resides. If the school district fails to make payments to a charter school, then upon request by the charter school, PDE will deduct the amounts invoiced by the charter school from state payments due to the school district and make the redirection payment to the charter school. Within 30 days of such a deduction, a school district may notify PDE that the deduction is inaccurate. PDE shall provide the school district with the right to be heard concerning its objection.

Our performance audit addressed PDE's processing of redirection payments to charter schools and school districts' appeals of those payments. Our audit had two audit objectives. Listed below is an overview of our two objectives and the results of our audit work. Unless otherwise noted, our audit covered the period January 1, 2011, through December 31, 2015, with updates as necessary through the report's release.

Our audit contains three findings and makes 15 recommendations for improvement. Two of the recommendations involve seeking legislative changes for the General Assembly to consider. Overall, PDE agrees with the audit report's findings and recommendations. PDE stated that it is committed to implementing all of our recommendations; however, it indicated in several instances that its ability to implement our recommendations is contingent on the department having access to additional resources.

¹ 24 P.S. § 17-1701-A *et seq.* (Act 22 of 1997, as amended).

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Objective 1

Finding 1: Due to lack of clarity in the Charter School Law and PDE's policies and procedures, guidance to school districts was unclear if subsidy funds are erroneously withheld.

As part of our first audit objective to determine whether PDE properly processed the more than \$1 billion in redirection payments to charter schools, we found that the redirection payments we tested were in compliance with PDE's internal procedures, the CSL, and case law. However, the current language of the CSL lacks clarity and may create an unfair advantage to the charter schools, potentially contributing to the financial hardships of school districts. Additionally, PDE's Basic Education Circular (BEC), which serves as a guide to PDE's personnel, school districts, charter schools, and other users, contains language that deviates from the procedures followed by PDE staff as well as case law. We also found that PDE did not document internal procedures in writing for staff to refer to when processing redirection payments until we requested a copy of the guidelines at the beginning of our audit. As one of our recommendations, we urge PDE to seek legislative changes to Section 1725-A(a)(5) and (6) of the CSL, as necessary, to improve upon the processes related to charter school redirection payments and the related appeals.

Objective 2

Finding 2: Non-charter school students' education funding potentially hurt due to delays in PDE's appeals process.

No written internal PDE procedures or guidance in the BEC existed during our audit period documenting the procedures or timeline for the payment appeals process. Delays caused by PDE's appeals process resulted in 74 percent of all appeals remaining in open status with minimal action by PDE as of December 31, 2015. This includes 317 general appeals in which \$28.5 million has been withheld from school districts and redirected to charter schools. We found delays relating to various stages of the appeals process. For instance, general appeals have remained in the hearing process for almost 3½ years without any follow-up by PDE, and general appeals have been with the Office of the Secretary for three years while awaiting decisions. Any delay in the appeals process potentially leaves school districts without funding that can be used for the education of non-charter school students. PDE should implement procedures to facilitate timely response to appeals and seek legislative changes, as necessary, to clarify the CSL regarding the appeals process.

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***Finding 3:
Conflicting
language in PDE's
correspondence to
school districts and
charter schools may
have caused
confusion for both
parties, contributing
to significant delays
in the appeals
process.***

Conflicting language in PDE's correspondence to school districts and charter schools may have caused confusion for both parties, contributing to significant delays in the appeals process. PDE changed language in March 2013 to the standard letter it issues to school districts and charter schools setting forth the procedures for the appeals. Although PDE management intended the change to encourage the parties to seek alternative dispute resolution prior to engaging in the hearing process, we found the revised language conflicted with other correspondence sent from PDE which stated that a hearing officer will be assigned. The inconsistent language is evidence of a lack of communication within PDE offices, and may also have undermined the intent of Section 1725-A(a)(6) of the CSL, which requires the secretary to provide a school district with "an opportunity to be heard" concerning the disputed amount. Additionally, PDE failed to reach out to these respective school districts with open appeals to obtain the current status.

PA Department of Education**Introduction
and
Background**

This audit report presents the results of our performance audit of the Pennsylvania Department of Education’s (PDE) administration and oversight of charter school redirection payment requests and appeals filed by school districts related to such requests. Our performance audit was conducted in accordance with applicable generally accepted government auditing standards.

Our audit had two objectives (See Appendix A - *Objectives, Scope, and Methodology* for more information):

- Determine whether PDE properly processed charter school payments in accordance with applicable laws, regulations, and policies.
- Evaluate the adequacy of PDE’s processes and procedures for addressing charter school payment appeals.

In the sections that follow, we present brief background information on PDE, charter schools, charter school funding, and a school district’s opportunity to appeal a charter school payment. This information is relevant in understanding PDE’s administration and oversight of charter school payments and school district appeals.

**Background information on the Pennsylvania
Department of Education****Historical perspective**

Article III, Section 14 of the Constitution of Pennsylvania states: “[t]he General Assembly shall provide for the maintenance and support of a thorough and efficient system of public education to serve the needs of the Commonwealth.”² In conjunction with this constitutional requirement, some form of an executive level agency has existed to oversee public education in the Commonwealth for over 180 years.³

² Pa. Const. art. III, Section 14 (relating to Public school system), Constitutional Convention of 1967-1968.

³ Pennsylvania has a proud history of providing free public education to all of its residents and gradually established its public school system. Although its 1776 and 1790 constitutions had provisions for an early form of a school system for certain residents, in 1834, Pennsylvania enacted the Free School Act establishing its earliest **public** school system as overseen by the Secretary of the Commonwealth. In 1857, the Office of Superintendent of Common Schools was created; by 1876, this office was known as the Department of Public Instruction which was then renamed as the Department of Education in 1969. See <http://www.phmc.state.pa.us/bah/aaGuide/AA-RG->

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Organizational structure

The Secretary of Education is PDE's chief executive.⁴ The Secretary is appointed by the Governor and confirmed by a majority of the Pennsylvania Senate.⁵ In addition to the Executive Office and the offices that support the executive functions,⁶ PDE has organized itself into five major operational offices,⁷ each headed by a Deputy Secretary, which oversee PDE's programs and goals, one of which is the Office of Administration. Within this office is the Bureau of Budget and Fiscal Management (BBFM), which has the responsibility of, among other important duties, processing PDE charter school payments. In addition, PDE's Office of Chief Counsel has the duty of, among many others, handling the appeals related to school districts' objections to payments made by PDE to charter schools on behalf of the school districts.

Background information on charter schools

In 1997, Pennsylvania enacted the Charter School Law⁸ to provide opportunities for teachers, parents, students, and community members to establish and maintain public schools that operate independently from the existing school district structure as a method to accomplish the following: improve student learning; increase learning opportunities for all students; encourage the use of different and innovative teaching methods; create new professional opportunities for teachers; provide parents and students with expanded choices in the types of educational opportunities that are available within the public

22.html, <https://archon.klnpa.org/psa/?p=collections/classifications&id=489>, and <https://www.psba.org/2014/09/pa-schools-need-fair-funding-formula/> Accessed: June 27, 2016

⁴ 71 P.S. § 1038. During the audit period, which began on January 1, 2011, the following individuals served as the Secretary or Acting Secretary of PDE: Amy C. Morton (acting), January 1, 2011 – January 14, 2011; Ronald J. Tomalis, January 18, 2011 – May 31, 2013; William E. Harner, Ph.D. (acting), June 1, 2013 – August 26, 2013; Carolyn C. Dumaresq (acting), August 26, 2013 – January 19, 2015; and Pedro A. Rivera, January 20, 2015 – Current.

⁵ 71 P.S. § 67.1(d)(1).

⁶ This includes the Policy Office; Government Relations Office; Office of Press and Communications; and Office of Chief Counsel. The State Board of Education and Professional Standards and Practices Commission are also housed within PDE.

⁷ The offices/deputates include: 1) the Office of Child Development and Early Learning; 2) Office of Elementary and Secondary Education; 3) Office of Administration; 4) Office of Commonwealth Libraries, and 5) Office of Postsecondary and Higher Education. The operational offices are made up of various bureaus, divisions, and sections, including the Office of Safe Schools.

⁸ 24 P.S. § 17-1701-A *et seq.* (Act 22 of 1997, as amended).

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school system; and be accountable for meeting measurable academic standards.⁹

The local school boards are granted authority to function as the charter school authorizer by reviewing and acting upon applications for the establishment of charter schools, to oversee and regulate charter schools, and to revoke, renew, or not renew charters. PDE is the authorizer of cyber charter schools, which were created by Act 88 of 2002.¹⁰

Schools that operate under a charter are divided into three general categories—charter schools, regional charter schools, and cyber charter schools. Both charter schools and regional charter schools (collectively referred to as "charter schools") are independent public schools established and operated under a charter from the local school board and in which students are enrolled or attend. These schools are commonly referred to as "brick-and-mortar" charter schools and focus on teacher-led discussion and teacher knowledge imparted to students through face-to-face interaction at the schools' physical facilities located within the boundaries of the school district that granted the charter.

A cyber charter school is an independent public school established and operated under a charter from PDE that uses technology in order to provide a significant portion of curriculum and to deliver a significant portion of instruction to its students through the internet or other electronic means without a school-established requirement that students be present at a supervised physical facility designated by the school, except on a very limited basis, such as for a standardized test.¹¹

⁹ 24 P.S. § 17-1702-A.

¹⁰ See 24 P.S. § 17-1741-A *et seq.* Please note that some charter schools approved under Sections 1717-A and 1718-A of the CSL, as amended, from 1997 to mid-2002 did provide "instruction through the Internet or other electronic means" and were authorized by Act 88 of 2002 to continue this type of instruction until their charters expired as long as they abided by the required statutory requirements and regulations. See 24 P.S. §§ 17-1717-A, 17-1718-A, and 17-1749-A(c).

¹¹ PDE issued a Basic Education Circular in July 2013 which restricts cyber charter schools' use of physical locations to "ONLY for (1) standardized testing and or/other testing; (2) tutoring; and (3) supplemental services related to special education, such as speech therapy, physical therapy, occupational therapy. Students may be at physical locations only for the time needed to participate in these services and activities." See <http://www.education.pa.gov/K-12/Charter%20Schools/Pages/cyber-charter-facility-use-FAQ.aspx#.VxYzDp3D-Uk> Accessed: July 11, 2016.

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Charter schools and cyber charter schools must be organized as a public, nonprofit corporation.¹² A charter may not be granted to a for-profit entity.¹³

Background information on charter school funding

Although local school districts or PDE process a basic education subsidy to charter/cyber schools, there is no tuition charge for a student attending a charter school.¹⁴ Funding for charter schools is addressed in Section 1725-A of the Charter School Law (CSL).¹⁵

Charter schools should receive for each student enrolled an amount paid by the school district of residence of each student that is based upon a statutory funding formula. A funding formula exists for both non-special education students and for special education students.

Charter schools should use Selected Expenditure per Average Daily Membership rates when billing a resident school district. School districts calculate the rates each year for PDE and at the charter school's request by completing Form PDE-363, "Funding for Charter Schools, Calculation of Selected Expenditures Per Average Daily Membership."

Section 1725-A(a)(5) and (6) of the CSL provides as follows, in part:

(5)...If a school district fails to make a payment to a charter school as prescribed in this clause, the secretary shall deduct the estimated amount, as documented by the charter school, from any and all State payments made to the district after receipt of documentation from the charter school. (6) Within thirty (30) days after the secretary makes the deduction described in clause (5), a school district may notify the secretary that the deduction made from State payments to the district under this subsection is inaccurate. The secretary shall provide the school district with an opportunity to be heard concerning whether the charter school documented that its students were enrolled in the

¹² 24 P.S. § 17-1720-A.

¹³ <http://www.education.pa.gov/K-12/Charter%20Schools/Pages/default.aspx> Accessed: June 8, 2016.

¹⁴ For simplicity purposes, we will collectively refer to charter schools and cyber charter schools as charter schools throughout this report.

¹⁵ 24 P.S. § 17-1725-A.

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charter school, the period of time during which each student was enrolled, the school district of residence of each student and whether the amounts deducted from the school district were accurate.¹⁶

Therefore, it is apparent that under Section 1725-A(a)(5) of the CSL, a charter school may ask the Secretary of Education to redirect a school district's subsidy when the school district fails to pay the charter school for educating resident students. The request must be in writing and include a copy of the invoice prepared in the format required by PDE.¹⁷ Furthermore, the local school district may under Section 1725-A(a)(6) of the CSL notify the Secretary within 30 days that the deduction was inaccurate and to request the opportunity to be heard.

PDE's change in policy on year-end reconciliation payments

After the conclusion of a school year, charter schools prepare a reconciliation report that summarizes the amount they have calculated as due from a school district over the course of the school year, the amount the charter school received from the school district for the school year, and the difference in the two amounts, which is the amount the charter school invoices the school district for the year. During the audit period, PDE processed year-end reconciliation requests and paid charter schools funds that were deducted from a school district's current year subsidy, since the funds from the school year in question were generally fully expended by the time that the year-end reconciliation was performed and invoiced. School districts have 30 days from the deduction date to notify PDE of their objection to the payment.

However, on January 8, 2016, PDE emailed charter schools notifying them that PDE was changing their policy on processing end-of-year reconciliations. The email stated that, based upon the Commonwealth Court's interpretation of the charter school law (CSL) in a decision issued in 2012, PDE could no longer withhold monies from a school district's current year funding for charter school claims made against a prior year. Therefore, PDE would no longer take part in the end-of-year reconciliation process. Instead, the email stated that charter schools may work directly with school districts to reconcile each prior school year's tuition payments.

¹⁶ 24 P.S. § 17-1725-A(5) and (6).

¹⁷ <http://www.education.pa.gov/K-12/Charter%20Schools/Pages/Charter-School-Funding.aspx> Accessed: May 26, 2016.

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Prior to notifying the charter schools of this change in procedure, PDE had already received year-end reconciliation payment requests that had not yet been processed for payment. On March 7, 2016, PDE issued letters to the applicable school districts to inform them of the change in policy and that monies would not be withheld from their funding. Instead, the matter would proceed to an administrative hearing and the manner in which funds would be paid, based on the Secretary's decision, would be decided by the charter school and school district.

Redirection payments to charter schools from State Property Tax Reduction Allocation funds

Although there are PDE guidelines¹⁸ that govern payments to be made to charter schools by school districts and PDE from basic education and special education subsidies, the state budget impasse that began July 1, 2015, created difficulties for school districts to make the required payments because their state subsidies were being withheld. Therefore, charter schools requested that PDE make payments to them on behalf of the school districts. Since the usual funding sources were not available due to the budget impasse, PDE management approved payments to the charter schools from deductions to school districts' State Property Tax Reduction Allocation (SPTRA) funds.¹⁹ PDE notified school districts that payments totaling \$4,904,611 were being made to 27 charter schools in August 2015. PDE also approved payments in October 2015 totaling \$43,735,805 to 49 charter schools.

On October 15, 2015, PDE notified school districts via e-mail that deductions had been made from "available subsidies in the October 2015 State Property Tax Reduction Allocation payment and made payable to the requesting charter school(s)."

On October 21, 2015, the Pennsylvania School Boards Association (PSBA) filed a lawsuit against PDE and the state Treasurer regarding their intent to use SPTRA funds to pay charter schools for tuition payments that they claimed were due them from school districts. Based upon the initiation of these legal proceedings, the state Treasurer put payments from SPTRA funds to the charter schools on hold.

¹⁸ PDE-363 guidelines. <http://www.education.pa.gov/Documents/Teachers-Administrators/School%20Finances/Finances/Financial%20Documents/Finances%20PDE-363%20Guidelines%20July%202012.pdf> Accessed: June 28, 2016.

¹⁹ SPTRA funds are tax relief funds raised through gaming revenue that are distributed to each school district for the benefit of taxpayers.

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On December 9, 2015, the Commonwealth Court issued an order stating that SPTRA funds were not to be distributed to charter schools (except for any obligation connected to litigation involving Chester Upland School District).²⁰ According to PDE management, redirection payments were subsequently made by PDE to the charter schools on January 5, 2016, from school districts' Basic Education Funds.

Background information on charter school payment appeals

When PDE notifies a school district that it intends to deduct funds from the school district's monthly subsidy payment, language is included that states if the school district believes the deduction is inaccurate the school district has 30 days from the date of the deduction to send an objection to PDE's Division of Subsidy and Data Administration (DSDA).²¹ Once DSDA receives an objection letter from a school district, the information is forwarded to PDE's Office of Chief Counsel which assigns a docket number to the objection and generates an initial letter (procedure letter) setting forth the procedures for the appeal which is sent to the school district and charter school. Depending on certain events, the appeals can then be assigned to a hearing officer for a hearing to take place. Refer to the flowchart on the following page.

PDE classifies charter school payment appeals into three categories:

- *Charter School Funding Appeals (general appeals)* - All general appeals made by school districts are classified in this category. For example, school districts may object to a payment because they believe the charter school billed for a student that does not reside in their district or that the charter school is invoicing for a program that the school district does not offer (e.g., kindergarten for four-year-old children).
- *Charter School Funding Appeals for PDE-363 (PDE-363 appeals)* - Appeals concerning the form PDE-363 which was developed by PDE for school districts to use to calculate rates

²⁰ See <https://www.psba.org/2015/12/psba-pleased-with-order-to-block-use-of-property-tax-relief-funds-for-charter-payments/> Accessed: July 11, 2016.

²¹ Section 17-1725-A(a)(6) of the CSL.

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for nonspecial and special education. Charter schools use these rates to invoice school districts for students that reside in their district and are enrolled in the charter school. This type of appeal resulted from charter schools notifying PDE that they believed there were flaws in the formula used to calculate the rates and requested payments for prior school years based upon what they believed was the correct method to calculate the rates. Since the charter school redirection payment requests were for prior school years in which there are no longer any appropriated funds from which to withhold payment, these requests proceeded to an appeal without a deduction being made from the school district.

- *Charter School Funding Appeals for Prior Years - No Withholding (prior year appeals)* - Appeals resulted from charter schools requesting that PDE withhold funds from a school district for a prior school year in which there are no longer any appropriated funds from which to withhold payment. As a result, the matter was classified as an appeal without a deduction being made from the school district.

PDE also categorized the status of the appeals into one of the following four²² categories:

- Open – PDE received the school district’s objection to the payment to the charter school and PDE issued a procedure letter to both the school district and charter school involved in the dispute which outlines the procedures that apply to the hearing process, but no further action has occurred.
- Hearing – The appeal has gone through the same process as listed above in the Open status, except that it has been assigned to a hearing officer²³ who works with the school district and charter school and/or their legal representative to gather information regarding each of their positions concerning the disputed amounts.
- Secretary – The appeal is with the PDE Secretary who is responsible for making a decision on the matter.

²² PDE listed seven appeals with no status. Upon further inquiry it was determined that the parties involved in the seven appeals were in mediation outside of the hearing process. Therefore, for purposes of this report, we have included the seven appeals in the “Open” category.

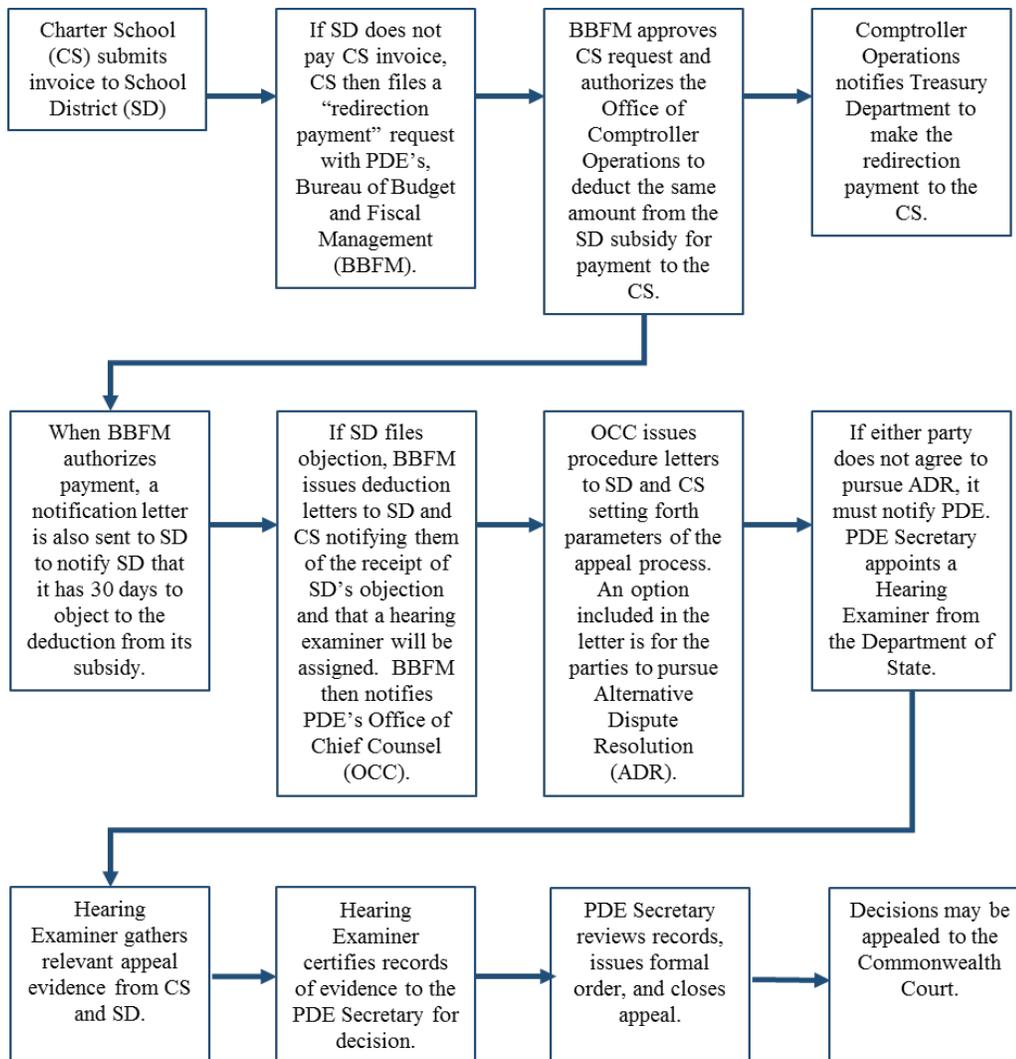
²³ PDE utilizes hearing officers from the Department of State to conduct the hearing process on its behalf with the school districts and charter schools.

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- Closed - The Hearing Officer or the Secretary has issued an order closing the appeal based upon actions such as the parties reaching an agreement on the dispute, the objection to the payment was withdrawn, or the Secretary made a decision on the appeal.

The redirection payment and appeals processes is shown in the exhibit that follows:

PDE’s Payment and Appeal Process



Source: Developed by Department of the Auditor General Staff from review of PDE documents.

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Once a decision has been reached on an appeal, the following scenarios would apply depending on the category of the appeal and outcome:

- ✓ **General Appeals** – in instances where funds have already been withheld from the school district and payment made to the charter school:
 - If a school district’s appeal is denied, there is no further payment action necessary since the charter school already received payment prior to the appeal.
 - If a school district’s appeal is upheld and PDE finds that the funds paid to the charter school should be returned to the school district, PDE management stated that it would be up to the school district to recoup the funds regardless of the fiscal year involved. Possible methods of recoupment include:
 - The school district could off-set future invoices from the charter school.
 - The charter school could pay the judgment directly.
 - The school district could seek an enforcement action through the judicial system.

The decision on which action to pursue is up to the school district and the charter school.

 - If a school district is successful in its appeal and a charter school is no longer in operation, the school district would have to seek available judicial remedies similar to other creditors in similar situations. For example, that may include filing a claim in bankruptcy court if the charter school has declared bankruptcy.
- ✓ **PDE-363 and Prior Years No-Withholding Appeals** - charter schools requested redirection payments regarding funds from prior school years but PDE sent the requests directly to appeal without making any deductions from school district funds.
 - If a school district’s appeal is upheld, there is no further payment action necessary since there was no money deducted from its funds prior to the appeal.

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- If a school district’s appeal is denied and payment is due to the charter school, PDE management stated that it does not have the authority to withhold payments for prior year deduction requests.²⁴ As a result, the charter school would collect the funds directly from the school district.

Status of Appeals

The following chart provides details on the status of the appeals (as of December 31, 2015) that were submitted to PDE during the period January 1, 2011 through December 31, 2015:

PDE Charter School Appeal Status
As of December 31, 2015

Category	Number of Appeals in:				Number of Appeals that:	
	Open Status	Hearing Status	Secretary Status	Closed Status	Had Funds Withheld from School District	Did Not Have Funds Withheld from School District
General	317	25	32	148	522	-
Disputed Amounts Withheld from School Districts	\$28,500,236	\$1,412,722	\$560,076	\$4,100,599	\$34,573,633	-
PDE-363	279	3	3	4	-	289
Disputed Amounts Not Withheld from School Districts	\$21,297,234	\$1,593,965	\$1,512,600	\$1,935,246	-	\$26,339,045
Prior Years No Withholding	34	8	0	4	-	46
Disputed Amounts Not Withheld from School Districts	\$2,229,810	\$282,816	\$0	\$41,617	-	\$2,554,243
Total Number of Appeals					522	335
Total Disputed Amount					\$34,573,633	\$28,893,288

Source: Developed by Department of the Auditor General staff from information provided by PDE.

²⁴ See *Chester Cmty. Charter Sch. v. Commonwealth, Dep’t of Education et al.*, 44 A.3d 715 (Pa. Cmwlth. 2012).

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As reported in the table, 317, or more than 60%, of the 522 *General* appeals that had funds withheld from a school district were *Open* as of December 31, 2015. The issue of delays in processing appeals is discussed further in Finding 2.

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Finding

1

Due to lack of clarity in the Charter School Law and PDE's policies and procedures, guidance to school districts was unclear if subsidy funds are erroneously withheld.

The Pennsylvania Department of Education (PDE) annually receives various state and federal appropriations from the Pennsylvania General Assembly. These appropriations include subsidy funding for school districts and charter schools to provide basic and special education in the commonwealth. School districts receive funding from PDE, and based on the Charter School Law (CSL),²⁵ school districts are required to make monthly payments to charter schools for students who reside in their districts and are enrolled in a charter school.²⁶ The CSL also requires PDE to make a payment (redirection payment) to a charter school if a district fails to make a payment to that charter school.²⁷ During the period January 1, 2011 through January 12, 2016, PDE paid 118 charter schools more than \$1 billion in redirection payments²⁸ made from deductions to school district state subsidies.

The current language of the CSL may favor the charter schools over the school districts.

Based on our review of the CSL provisions that require PDE to make redirection payments to the charter schools on behalf of school districts, we found that the CSL lacks clarity and may create an unfair advantage to the charter schools which can contribute to the financial hardships of school districts as follows:

- Based upon a 2010 Pennsylvania Commonwealth Court interpretation²⁹ of the CSL, PDE processes the charter school redirection payment requests upon receipt of invoices provided

²⁵ The CSL, known as Act 22 of 1997, is part (i.e., Article XVII-A) of the Pennsylvania Public School Code. See 24 P.S. § 17-1701-A *et seq.*

²⁶ 24 P.S. § 17-1725-A(a)(5).

²⁷ Section 1725-A(a)(5) of the CSL states, in part: "If a school district fails to make a payment to a charter school as prescribed in this clause, the secretary shall deduct the estimated amount, as documented by the charter school, from any and all State payments made to the district after receipt of documentation from the charter school."

²⁸ Redirection payments included both monthly payments due from the school district to a charter school and year-end reconciliation payments due after reconciliations are performed to determine amounts due between the school district and charter school at the end of each school year. This payment information was provided by PDE.

²⁹ *Chester Cmty. Charter Sch. v. Commonwealth, Dep't of Education et al.*, 996 A.2d 68 (Pa. Cmwlth. 2010) (known as *Chester I*).

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by the charter schools. The CSL lacks clarity as to whether PDE may pay the charter school immediately after the subsidy deduction or hold the subsidy deduction in escrow until the school district has the opportunity to be heard concerning their redirection payment objection before the payment is made to the charter school. PDE management stated that it will not make the payment requested by the charter school if the school district provides a cancelled check supporting that they have already made payment to the charter school. However, if the school district has information other than cancelled checks to support why they object to the payment to the charter school, this information will not be considered until the appeals process has been exercised.

- The CSL does not provide an expedited timeframe in which PDE must provide the school district with an opportunity to be heard regarding the disputed amount. As reported in Finding #2, 374 of the 522 general appeals (72 percent) initiated during the five year period 2011 to 2015 had not been resolved by PDE as of December 31, 2015. The unresolved appeals are attributed to issues with PDE causing or permitting long time delays in the appeals process. Any delay in the appeals process results in a delay to the school districts receiving funds for any upheld appeals.
- The CSL gives authority to PDE to withhold money from a school district to pay a charter school, but does not specify how and by whom a school district will be refunded if the withholdings were subsequently found to be unwarranted. This situation is further exacerbated if the charter school in question is no longer in operation when it is determined that the amount withheld from the school district and paid to the charter school is in fact due back to the school district.

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PDE's Basic Education Circular contains language that deviates from case law on the withholding of subsidy funds.

PDE's Basic Education Circular (BEC)³⁰ serves as a guide to PDE's personnel, school districts, charter schools, and other users for implementing the CSL by outlining the formal process by which PDE is to make payments to charter schools; however, it contains language that deviates from the procedures being followed by PDE staff, and from a 2010 Pennsylvania Commonwealth Court case on the charter school payment issue.³¹ The BEC outlines, in part, the following:

If the Secretary of Education finds that the documentation submitted by the charter school clearly supports the charter school's withholding request, the request will be granted. Otherwise, the request should be denied.

This guidance in the BEC offers the opportunity for PDE to deny a charter school's request upon consideration of the documentation submitted by the charter school. However, based on case law, PDE's policy is to review and process the redirection payment request upon receipt from the charter school. Its review process does not include an evaluation of the information that the request is based on, including issues such as the validity of the number of students educated by the charter school or the rate used by the charter school to calculate the amount due. Therefore, contrary to the guidance in the BEC, PDE does not consider information provided in the school district's documents to potentially deny a charter school's request. As a guide for implementation of the CSL, the BEC should be revised to reflect current case law to avoid confusion by its users such as PDE staff, school districts, charter schools, or any other users.

³⁰ PDE's Basic Education Circular 24 P.S. §17-1701-A, "Charter Schools", dated October 1, 2004, Topic 10, sets forth the procedures for "PDE Payments to Charter Schools." A Basic Education Circular provides the PDE's guidance on the implementation of law, regulation, and policy.

³¹ The Pennsylvania Commonwealth Court held on preliminary objections in 2010 that, "[t]he Department has a **mandatory, non-discretionary duty** to withhold subsidies to a school district based upon the estimated amount documented by the charter school." [Emphasis added.] See *Chester Cmty. Charter Sch.*, 996 A.2d 68, 78 (Pa. Cmwlth. 2010).

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Lack of written procedures.

As part of our audit, we requested that PDE provide us with standard operating procedures regarding processing charter school subsidy redirection payment requests. PDE management acknowledged that the procedures were not in writing until after we made our request on December 11, 2015. Therefore, there were no consistent guidelines in place for PDE staff to refer to when processing redirection payment requests during our audit period January 1, 2011 to December 31, 2015.

Up-to-date written procedures are an integral part of management internal controls to provide specific guidance to staff to ensure that processes are performed properly, consistently, and timely, and are properly documented. PDE's failure to have written internal procedures along with outdated information in the BEC during the audit period increased the risk of PDE staff improperly processing redirection payments, as well as the fact that certain school districts, charter schools, or other users may have misunderstood the process and the consequences for them.

PDE properly reviewed and approved redirection payment requests for payment.

PDE's standard operating procedures outline the process for making payments to charter schools in the event that a school district fails to make a payment to a charter school. Charter schools are required to submit documents to PDE that include a list of the school districts that the charter school is requesting redirection payments and an invoice for each school district. Charter schools are to also send a copy of the invoice to the respective school districts.

The invoice should include details on the amount the charter school has calculated is due from the school district, the amount of any payments the charter school has received from the school district, and the difference, which is the amount that the charter school is requesting PDE pay to them on behalf of the school district. PDE staff verifies the amount listed on the invoice for each school district to the amount on the list of all the school districts that the charter school claims owes them funds. If the information agrees, PDE management will authorize the Office of Comptroller Operations to make a

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deduction from the school district's subsidy for payment to be made to the charter school. PDE subsequently notifies the school district and charter school of the deduction.

The CSL allows a school district 30 days after the state subsidy deduction to file an objection with PDE if the school district contends that the deduction was inaccurate. The CSL also requires the Secretary of Education to provide the school district an opportunity to be heard for any disputed deductions.³² Issues related to the appeals process are discussed in Finding #2.

As part of our audit objective to determine whether PDE properly processed the more than \$1 billion in redirection payments to charter schools in accordance with applicable laws, regulations, and policies, we selected, based on auditor judgment, 25 redirection payment requests totaling \$13.4 million to evaluate PDE's payment process.

For the 25 payment requests selected, we verified that PDE received the required documents from the charter schools that requested redirection payments and that PDE had reviewed the documents and approved the payments. Additionally, we found that PDE issued letters to school districts notifying them that a deduction was being made to their funding and a payment was being made to the charter school requesting the redirection payment. The letters also notified the school districts that, if it believed the charter school deduction was inaccurate, it had 30 days after the deduction to send a letter to PDE regarding their objection. Therefore, the redirection payments selected were in compliance with PDE's internal procedures, the CSL, and case law.

However, although the redirection payment requests were reviewed and approved by PDE management, school districts submitted 522 objections for \$34.6 million of the total payments made to charter schools during the period January 1, 2011 through December 31, 2015. Of the 522 objections, 374 objections totaling \$30.5 million remain unresolved as of December 31, 2015. PDE's failure to resolve these disputes is, in part, due to a lack of adequate processes and monitoring as well as delays or lack of action on appeals. This issue is discussed in Finding 2.

³² 24 P.S. § 17-1725-A(a)(6).

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Recommendations

We recommend that PDE:

1. Seek legislative changes, as necessary, to improve upon the processes related to charter school redirection payments and the related appeals pertaining to Section 1725-A(a)(5) and (6) of the CSL.
2. Update the Basic Education Circular on Charter Schools to reflect the current procedures in place regarding PDE's approval process of redirection payment requests and applicable case law.
3. Maintain and update, as needed, written procedures for its redirection payment process and regularly monitor processes to ensure that the procedures are being followed appropriately.

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Finding 2**Non-charter school students' education funding potentially hurt due to delays in PDE's appeals process.**

Pennsylvania's Charter School Law (CSL) requires PDE to make a payment to a charter school if a school district fails to make its monthly payments for students that reside in their district and are enrolled in the charter school.³³ The CSL further states that if the school district believes the deduction is inaccurate, it has 30 days from the date of the deduction to object to the deduction and shall be given the opportunity to be heard.³⁴

It should be noted that PDE provided us with a general outline regarding processing appeals to charter school subsidy redirection payment requests but acknowledged that, although the procedures were in place during the audit period, they were not in writing until after our request for the written procedures on December 11, 2015.

In addition to not having written internal procedures available to staff during our audit period, the only reference to payment appeals in PDE's Basic Education Circular (BEC)³⁵ states the following:

Per Section 1725-A(a)(6) of the law, a school district may notify the Secretary within 30 days after a deduction is made that the deduction is inaccurate.

Therefore, there are no written guidelines documenting the procedures or timeline for the appeals process that include procedures regarding PDE issuing procedure letters and the language in the letters regarding the school district and charter schools participating in alternative dispute resolution; the appointment of hearing examiners and PDE's use of hearing examiners from the Department of State; and the final decision process that is the responsibility of the Secretary.

Additionally, as there is a timeline imposed on the school district for filing an objection to a subsidy deduction, a timeline should also be outlined for the previously described key events of the appeals process

³³ Section 1725-A(a)(5) of the CSL, 24 P.S. § 17-1725-A(a)(5), states, in part, "If a school district fails to make a payment to a charter school as prescribed in this clause, the secretary shall deduct the estimated amount, as documented by the charter school, from any and all State payments made to the district after receipt of documentation from the charter school."

³⁴ 24 P.S. § 17-1725-A(a)(6).

³⁵ The BEC is to serve "as a guide for charter schools, school districts, parents, and students." See section 10 with regard to the "Charter School Payments".

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which includes procedures for the hearing through the final decision made by the Secretary.

Up-to-date written procedures are an integral part of internal controls because they provide specific guidance to staff to ensure that processes are performed properly, consistently, and timely and are also properly documented to allow for review by other entities, such as auditors. Further, supervisory review is necessary to ensure the procedures were completed in accordance with the written procedures. PDE's failure to have written internal procedures along with the lack of information in the BEC during the audit period may have contributed to the significant delays noted in the processing of appeals of charter school redirection payment requests.

Classification of objections from school districts.

After PDE receives an objection from a school district regarding a deduction that has been made from its subsidy, PDE will issue a procedure letter (see the Background section of the report for further information explaining this process). PDE then categorizes objections received from school districts into one of the following:

- Charter School Funding Appeals (general appeals)
- Charter School Funding Appeals for PDE-363 (PDE-363 appeals)
- Charter School Funding Appeals for Prior Years - No Withholding (prior years appeals)

The following chart summarizes the status of appeals in which PDE issued a procedure letter to the school district and charter school during the period January 1, 2011, through December 31, 2015. Within the three categories, PDE provided the status of each appeal, as of December 31, 2015, to include Open³⁶, Hearing, Secretary, or Closed (see the Background section of the report for further information explaining the categories and status of the appeals).

³⁶ PDE listed seven appeals with no status. Upon further inquiry it was determined that the parties involved in the seven appeals were in "mediation", outside of the hearing process. Therefore for purposes of this report, we have included the seven appeals in the "Open" category.

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**Status of Charter School Redirection Payment Appeals
as of December 31, 2015**

Category	Appeals in Open Status	Appeals in Hearing Status	Appeals in Secretary Status	Appeals in Closed Status	Total Appeals	Total Dollar Amount of Appeals That Had Funds Withheld from School Districts	Total Dollar Amount of Appeals That Did Not Have Funds Withheld from School Districts ^{a/}
General	317	25	32	148	522	\$34,573,633	-
PDE-363	279	3	3	4	289	-	\$26,339,045
Prior Years	34	8	0	4	46	-	\$2,554,243
Totals	630	36	35	156	857	\$34,573,633	\$28,893,288

Note:

a/ The dollar amounts listed for the PDE-363 and Prior Years appeals have not been withheld from school districts. The payment of these amounts to the charter schools is pending the outcome of the appeals. See the Background section of the report for further explanation on objections that proceeded to the appeals process without a deduction being made from the school districts' subsidy.

Source: Developed by Department of the Auditor General staff from review of charter school funding appeals lists provided by PDE.

Of the total 857 appeals, 630 appeals (74 percent) remain in open status with minimal action by PDE, including 317 of the 522 general appeals (61 percent) in which \$28.5 million have been withheld from school districts and redirected to charter schools.

As part of our objective to evaluate the adequacy of PDE's processes and procedures for addressing charter school redirection payment appeals, we analyzed key dates in the appeals process from a selection of 40 of the 857 appeals. The 40 appeals were judgmentally selected to ensure coverage across all categories and statuses (see further details regarding our test selection in Appendix A – Objective, Scope, and Methodology).

The analysis of the 40 appeals highlighted the significant amount of time between various steps in the appeals process due in part to delays or no action taken by PDE. The key events in the process we analyzed included the following:

- Notification letter - PDE's letter to the school district notifying them that a deduction is going to be made from their subsidy based on a request by a charter school.

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- Objection letter - School district's letter to PDE objecting to a payment requested by a charter school.
- Deduction letter - PDE's letter to the school district and charter school notifying them that a deduction has been made from the school district's subsidy based on a request by the charter school and acknowledging that it has received the school district's objection to the deduction.
- Procedure letter - PDE's letter to the school district and charter school setting forth the procedures for the appeal.
- Appointment of a hearing examiner by the PDE Secretary.
- Hearing examiner certifying the hearing records to the PDE Secretary for a decision.
- PDE Secretary issuing a decision/ruling on the appeal.

General Appeals

A payment to a charter school will proceed to an appeal if PDE receives an objection letter from the school district. Of the 522 General Appeals, we found that the length of time between the date of the school district's objection letter and the date that PDE issued the procedure letter to begin the appeals process ranged from the same day to as long as **533 days**, with an average of **123 days**.³⁷ PDE management generally attributed some delay in issuing procedure letters to the following:

- The initial time it took to establish the process for issuing procedure letters for school districts' objections to subsidy deductions.
- Receiving the objection letter prior to the funds being deducted from the school district's subsidy (procedure letters are not issued until after a deduction has been made).

³⁷ We are unable to report on the timing of letters for the PDE-363 and Prior Years-No Withholding appeals due to PDE not requiring objection letters from the school districts before classifying them as appeals. We also were unable to determine the range of dates for 12 of the 522 General appeals due to either the objection letter date or the procedure letter date not being presented on the report provided by PDE.

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- A lack of staffing. Specifically, PDE stated the following:

The legislative mandate for the Department to resolve these cases did not provide the Department with additional resources to handle these appeals; therefore, resources to resolve them are drawn from existing resources. The Department does not have a dedicated case manager and support staff for these appeals.

We also noted delays in issuing procedure letters for all three appeal categories during the time period that PDE revised the standard language in procedure letters issued after March 1, 2013 (see Finding 3 for further information on the revisions to the standard language). Prior to issuing the revised procedure letters in March 2013, PDE had not issued a procedure letter for General appeals since November 19, 2012. We noted 72 appeals with objection letters dated prior to November 19, 2012, and another 41 appeals with objection letters dated between November 19, 2012 and March 4, 2013, that were affected by the hold that was placed on issuing procedure letters while the language was being revised. PDE began receiving objection letters to PDE-363 appeals in June 2012, and objections to Prior Years – No Withholding appeals in November 2012; however, the first procedure letters were not issued for these appeal categories until March 2013.

In addition to the delays discussed above, we also found delays in each of the four stages as listed below and further explained in the sections that follow:

- a. Open – a lack of follow-up by PDE has resulted in minimal action for more than **2 years** for 36% of the General appeals in open status.
- b. Open – lack of action by PDE may have contributed to financial hardships on school districts as appeals remain open **for years**.
- c. Hearing – appeals have remained in the hearing process for almost **3 1/2 years** without any follow-up by PDE to determine the status of appeals.
- d. Secretary – appeals have been with the Office of the Secretary for **3 years** while awaiting a decision on the matter.

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- e. Closed – appeals were closed during the audit period, but only one required a decision to be made by the Secretary.
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Length of Time in Current Status as of December 31, 2015

Current Status	Number of Appeals	Range of Days in Current Status	Range of Days Since Appeal Opened ^{a/}
Open	317	120 – 1,032	120 – 1,032
Hearing	25	624 – 1,253	657 – 1,323
Secretary	32	462 – 1,127	800 – 1,323
Closed	148	N/A ^{b/}	6 – 1,001

Notes:

a/ Procedure letter date until December 31, 2015 or until the date the appeal was closed.

b/ The number of days since an appeal has closed is not relevant to the audit objective.

Source: Developed by Department of the Auditor General staff from review of charter school funding appeals lists provided by PDE.

a. Lack of follow-up by PDE has resulted in minimal action for more than 2 years for 36% of the General appeals in open status.

Of the 317 General appeals that were still open as of December 31, 2015, we found that 115 appeals, or 36%, have been open for over **2 years**, with the oldest being open almost **3 years**. There had not been any response to the procedure letter from the school districts or charter schools and PDE had only followed up with five³⁸ school districts. The following table summarizes the length of time that the appeals have been in Open status (the date of the procedure letter until December 31, 2015):

Length of Time in Open Status through December 31, 2015

Number of Years	Less than 1 Year	1 to 2 Years	Over 2 Years	Total
Total Appeals	86	116	115	317
Total Amount of Appeals	\$7,508,541	\$11,086,734	\$9,904,961	\$28,500,236

Source: Developed by Department of the Auditor General staff from review of charter school funding appeals lists provided by PDE.

³⁸ PDE followed up with five school districts that combined had a total of eight appeals that were in various appeal statuses. As of December 31, 2015, five of the eight appeals remained open, two were closed, and one was with the Secretary.

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The \$28.5 million in open appeals were for deductions that have been made from the school districts' subsidy payments and paid directly to charter schools. As a result, the school districts are usually waiting years for an appeal decision and to receive their reimbursement for those appeals that are eventually upheld. Thus, school districts are without access to necessary funds potentially owed them for the education of the non-charter students in their school district. The longer that an appeal remains in Open status with no action being taken unnecessarily prolongs a school district's opportunity to be heard and the disputed deductions to be resolved.

b. Lack of action by PDE may have contributed to financial hardships on school districts as appeals remain open for years.

We selected 8 of the 317 Open General appeals, totaling over \$2 million, to evaluate the timing of action on appeals that occurred by the school district and PDE. These eight appeals have remained in open status for an extended period of time, from 4 to 34 months (the date of the procedure letter until 12/31/15) with minimal action by PDE.

PDE management explained that appeals remain open until it hears from one of the parties regarding alternative dispute resolution (ADR) before assigning a hearing examiner. All eight school districts received procedure letters stating that a hearing examiner would not be appointed until the school district or charter school notified PDE that ADR was unsuccessful or would not be attempted.

However, this language conflicts with language in letters the school districts and charter schools previously received from PDE's Bureau of Budget and Fiscal Management (BBFM) that stated a hearing examiner would be assigned. The issue of conflicting language in PDE letters is fully discussed in Finding #3.

We believe the conflicting language may have caused confusion with the school districts and charter schools, potentially resulting in them not taking the action PDE considers necessary to move the appeal forward in the process. Therefore, the school districts' appeals totaling over \$2 million have remained open for an extended period of time with follow-up by PDE on only one of the eight General Open appeals.

Of the eight appeals in open status selected for testing, we contacted five of the school districts regarding their understanding of their

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appeal. Four of the school districts responded that they had either resolved the issue or were currently involved in ADR with the charter school. However, none of them had notified PDE of these developments. The school districts did not currently require any action from PDE; however, PDE was unaware of this since it had not performed any follow-up with the school districts.

The fifth school district responded that it is in ongoing litigation with PDE concerning the appeal. The school district began objecting on an almost monthly basis to PDE withholding their funds to send to the cyber charter school who they claim was "...operating improperly as a brick and mortar charter school under the guise of a cyber charter, in violation of its charter, Pennsylvania's Charter School Law and Cyber Charter School Law." In spite of the repeated objections, PDE deducted \$524,618 from the school district's subsidies from March 2013 until August 2015 and the district was still awaiting action from PDE on its appeal when PDE issued a letter to the cyber charter school indicating that they "... must immediately cease and desist from using physical facilities in connection with the operation of cyber charter schools...." Within six days of PDE's letter, the cyber charter school announced that it was closing several of its learning centers and, in December 2015, the cyber charter school ceased all operations, surrendered its charter, and filed for bankruptcy.

The school district claims that the delay in PDE addressing the school district's concern allowed for the charter school to receive payments from the school district's funds for operating a cyber charter school that was not in compliance with the CSL. When we made a general inquiry of PDE on how a school district would receive reimbursement if their appeal of a payment to a charter school that is no longer in operation was upheld, PDE management indicated the following:

If a school district is successful in its appeal and a charter school were no longer in operation, a school district would have to avail itself of available judicial remedies similar to other creditors in similar situations. For example, that may include filing a claim in bankruptcy court if the charter school declared bankruptcy.

This example demonstrates that the lack of action by PDE can create financial hardships on school districts, leaving the school districts without funds to use to educate students that may be rightfully theirs if their appeal is upheld.

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c. Appeals have remained in the hearing process for almost 3 1/2 years without any follow-up by PDE to determine the status of the appeals.

In addition to the General Appeals that have been in open status for excessive periods of time, we also noted that General Appeals have been in hearing status for an excessive length of time. From the date that the PDE Secretary appointed a hearing examiner until December 31, 2015, the length of time for the 25 appeals in hearing status ranged from **624 to 1,253 days**, with an average of **941 days**.³⁹ We selected 7 of the 25 appeals, totaling approximately \$974,000, to further evaluate the timing of PDE's actions in the hearing process. The results of our review were as follows:

- **Appeals with a hearing examiner for up to 3 1/2 years with no follow-up by PDE.**

Appeals remained with a hearing examiner from **2 to almost 3 1/2 years**, and, as of the time of our testing, none of the 7 appeals tested were followed-up by PDE to determine why the appeals' hearings were still ongoing for an extended period of time. Management stated that the process is party-driven and when parties request extensions for purposes of settlement negotiations, they are usually liberally granted in order to save the parties' as well as Commonwealth's resources and to avoid unnecessary litigation.

While we acknowledge that the parties may have requested extensions that lengthened the hearing process, we question why PDE did not follow-up with the hearing examiners as to the status of any of the seven appeals to ensure that there were no other reasons for the delays that needed to be addressed. Management stated, "On December 29, 2015, [PDE] followed up with the Officer [sic] of Hearing Examiners and have confirmed that the hearing officers have/will be requiring updates from long outstanding appeals." However, PDE should follow-up with the hearing examiners to ensure these updates are actually being obtained considering at the time of our inquiry no updates were obtained for the seven appeals tested.

³⁹ For three of the 25 General appeals in hearing status, the hearing examiner appointment date was not included on the report provided by PDE, and therefore, the respective timeframe could not be determined.

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- **PDE's Office of the Secretary (Secretary) took almost 2 1/2 years to make a decision on a motion made in a hearing.**

The hearing on one school district's appeal, in the amount of \$537,362, was unable to continue without the Secretary's decision on a motion. When we made a general inquiry regarding the amount of time that it takes for the Secretary to make decisions on matters forwarded from a hearing examiner, PDE management stated that they could not discuss specific cases, but made the following general observations:

The prior administration had three Secretaries or Acting Secretaries at one point in relatively quick succession. The need to bring new secretaries up to speed with legal issues involved (along with the other pressures attendant to onboarding) may have extended the review process. Additionally, some of the cases involve complex or novel issues, which depending on the case, complexity or novelty may be a factor. Finally, when cases are resolved by order of the Secretary, rather than through agreement of the parties, the Department is required to prepare an opinion with findings of fact and legal analysis supporting its conclusion. The careful drafting of such an opinion takes time.

We acknowledge that during this period the Secretary's position was held by three different individuals.⁴⁰ However, the turnover in the Office of the Secretary underscores the need for the appeals and any motions made regarding the appeals to be processed in a timely manner to avoid, if possible, the delays that do inevitably occur when there is turnover within an office.

We contacted a school district regarding their understanding of their appeal for one of the seven appeals tested in hearing status. The school district had waited almost **2 1/2 years** for the Secretary to make a decision on a motion and appoint a hearing examiner. The school district responded, in part, that "The District originally objected to deductions made to [its] subsidy in December of 2011. It has been nothing less than an

⁴⁰ During the audit period, which began on January 1, 2011, the following individuals served as the Secretary or Acting Secretary of PDE: Amy C. Morton (acting), January 1, 2011 – January 14, 2011; Ronald J. Tomalis, January 18, 2011 – May 31, 2013; William E. Harner, Ph.D. (acting), June 1, 2013 – August 26, 2013; Carolyn C. Dumaresq (acting), August 26, 2013 – January 19, 2015; and Pedro A. Rivera January 20, 2015 – Current.

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appalling disregard for the District's objection since that time, since the District's position was that the deduction was not justified." The school district stated that they objected to the deduction because they had already paid the charter school for a portion of the amount that was deducted.

This is another example in which PDE's lack of action potentially leaves school districts, for an extended period of time, without funds that were already withheld to make payment to charter schools. If school districts' claims and appeals are reviewed and decided upon timely, for those that are upheld, these funds can be used for the education of the non-charter students.

d. Appeals have been with the Office of the Secretary for 3 years while awaiting a decision on the matter.

We further reviewed General appeals that were in Secretary status as of December 31, 2015. We again noted excessive timeframes from the date that the hearing examiner certified the record to the PDE Secretary until December 31, 2015, when the appeal remained waiting for a decision by the Secretary. Of the 32 General appeals in Secretary status as of December 31, 2015, the timeframe ranged from **462 to 1,127 days**, with an average of **687 days**.⁴¹

Of the 32 General appeals in Secretary status, we selected 7 appeals, totaling over \$200,000, to further evaluate the timing of PDE's actions on the appeals. These 7 appeals had been with the Office of the Secretary through December 31, 2015, awaiting a decision for a period ranging from **535 to 1,119 days**. As previously mentioned, PDE management stated there were three different secretaries over this time period and some cases could involve complex issues.

However, we reviewed an example in which the Office of the Secretary took nearly **3 years** to take a simple action on one of the appeals. In this case, the hearing examiner returned the appeal to the Secretary because neither the school district nor the charter school responded to any of the hearing examiner's correspondence. It took almost **3 years** for the Secretary to contact the school

⁴¹ For two of the 32 appeals in secretary status, the date the secretary received the appeal for consideration was not included on the report provided by PDE, and therefore, the respective timeframe could not be determined. Additionally, for one appeal the status date used was 11/13/15 when PDE followed up with the school district.

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district and inquire if the matter was still an issue or if the case should be dismissed. This issue was not complex and we question why it took an extended period of time for the Secretary to take action on this appeal.

e. Although appeals were closed during the audit period, only one required a decision to be made by the Secretary.

For the 148 general appeals which were closed, we noted timeframes which ranged from **6 to 1,001 days**, with an average of **115 days**, from the date of the procedure letter until the PDE Secretary closed the appeal.⁴²

Of the 148 Closed General appeals, we selected 11 appeals, totaling over \$630,000, to evaluate the actions by PDE to close the appeal. We noted that all 11 of the appeals were closed at the request of the school district, and therefore, no decision was needed by the Secretary or hearing examiner. In fact, PDE confirmed that for all 156 appeals (General, PDE-363, and Prior Years) closed during the period January 1, 2011 through December 31, 2015, all but one was closed without requiring any review or decision by the Secretary. Therefore, although PDE closed appeals during the audit period, it was not due to actions taken by the Secretary.

The significant amount of time between steps in the appeals process due in part to delays or no action taken by PDE has resulted in delays in a school district's opportunity for a hearing regarding their objections to deductions from their state funds. The longer it takes for an appeal to be heard, the more likely it is that parties to the original objection may leave their employment which may cause issues with the new administrators who are not as familiar with the cause for the objections. School districts have a right to be heard in a reasonable time concerning their objections to deductions from their state funds.

⁴² For four of the 148 closed appeals, the procedure letter dates were not included on the report provided by PDE, and therefore, the respective timeframe could not be determined.

PA Department of Education**PDE-363 Appeals**

In June 2012, PDE received a redirection payment request from a charter school with the justification that additional funds were due to them because prior payments were calculated based upon what the charter school cited as “flaws in the PDE-363 form.” The charter school claimed that the PDE-363 form that was drafted by previous PDE administrations included deductions that they believed are not allowed by the CSL. In their request, the charter school included a new rate per student based upon their recalculation without the “unauthorized deductions” and an amount to be withheld from the school district and paid to them.

As of December 31, 2015, PDE had received 289 requests from charter schools that contained the same PDE-363 form issue. PDE management stated that all of the charter schools’ payment requests had moved forward in the appeals process without any deductions being made from the school districts’ subsidies.

We selected 4 of the 289 appeals to analyze the timing of key dates in the appeals process. The four appeals included one from each status: Open, Hearing, Secretary, and Closed. During our review, we noted delays by the Office of the Secretary on making decisions on motions from the appeals, similar to that previously reported on the General appeals.

Additionally, we noted that, as of the time of our testing, the charter schools in all four appeals selected for review had withdrawn their requests for withholding and reimbursement. We inquired of PDE management the status of the remaining PDE-363 appeals. PDE management indicated that, as of May 31, 2016, of the 289 PDE-363 appeals, charter schools withdrew their requests for withholding and reimbursement for 143 appeals totaling \$20,852,332. The remaining 146 appeals totaling \$5,486,713 were still in Open status. Since almost half of the appeals have now been withdrawn by the charter schools and to avoid any unnecessary action and further delay on the appeals, PDE should take a proactive approach and contact the remaining charter schools to inquire if they still wish to proceed to a hearing on the matter.

PA Department of Education**Prior Years No Withholding Appeals (Prior Years)**

In October 2012, PDE began to receive payment requests from charter schools in regard to revisions to prior year reconciliations⁴³ with a school district. These revisions affected school years back to 2006-2007. PDE informed the charter school and school district that since there were no available funds for the school year associated with the charter school's claim, the matter would go directly to a hearing without a deduction from the school district.⁴⁴ Any payments from school districts to charter schools regarding these payment requests are pending the outcome of the appeals.

As of December 31, 2015, PDE had received 46 Prior Years type requests, totaling \$2,554,243, from charter schools. We selected three of these appeals, one each from status of Open, Hearing, and Closed to perform analysis on the key dates of events of the appeals. Our results were as follows:

- One appeal had been open since March 2013. PDE management stated that they have not followed up with the parties involved because they are waiting to hear from them regarding whether ADR was successful or not.
- One appeal was closed when the parties resolved the matter on their own.
- One appeal the charter school petitioner requested the appeal be combined with seven other ongoing appeals the school had in Hearing status. This request was sent to the Secretary for consideration; however, there was no action by the Secretary for 29 months until the Secretary denied the request and ordered a response from the parties regarding either possible ADR or a request that a hearing examiner be appointed. The charter school requested a hearing and the Secretary appointed a hearing examiner.⁴⁵ Although there were items for the Secretary to consider regarding the request to consolidate, **2 1/2**

⁴³ Reconciliations are performed to determine amounts due between the school district and charter school at the end of each school year.

⁴⁴ PDE cited the *Chester Cmty. Charter Sch. v. Commonwealth, Dep't of Education et al.*, 44 A.3d 715 (Pa. Cmwlth. 2012) (known as *Chester 2*) as the cause for being unable to withhold current funds from the school district.

⁴⁵ Documents provided to us by PDE on March 14, 2016 revealed that a pre-hearing conference was held on March 4, 2016 and a hearing was scheduled for May 16, 2016.

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years is clearly an excessive amount of time to take action on a motion.

As previously noted with the General and PDE-363 appeals, Prior Years appeals have remained in Open status for a significant amount of time as a result of the Office of the Secretary taking an excessive amount of time to take action required to enable the hearing process to proceed. These delays make the appeals process increasingly difficult as there are changes in PDE secretaries and staff, and potentially changes in school district and charter school administrators and/or legal counsel. Therefore, PDE should make timely actions and decisions on appeals a priority.

Recommendations

We recommend that PDE:

1. Develop and document in writing a timetable and processes to facilitate timely appeal response determinations to be supplied to an appealing school district.
2. Consider assigning a dedicated case manager and support staff to process objections and the subsequent appeal procedures.
3. Develop process and matrix to monitor status of open school district appeals.
4. Immediately follow-up with school districts on appeals that have been open for an extended period of time to determine if the school district is aware that PDE is waiting for a response from them before proceeding in the hearing process.
5. Develop process to expedite the issuance of procedure letters to school districts and charter schools to speed up the appeals process.
6. Develop process for regular monitoring and a system of tracking all hearing examiners and open cases. The system should reflect the amount of time appeals are open, hearing examiner assigned, when assigned, status of hearing, date PDE received records from the hearing examiner, etc.
7. Develop a regular weekly or monthly routine process for the Secretary to make decisions on appeals returned from the

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hearing examiner. This should be followed by an immediate notification to the school district and the charter school on the PDE determination of the appeal.

8. Determine if legislation is deemed necessary to clarify what is meant by “opportunity to be heard”, identify the timeframe in which an appeal should be heard, and determine the necessity of contacting the Senate and House Education Committees to request that legislation be introduced to further clarify 24 P.S. § 17-1725-A(a)(6).

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Finding 3**Conflicting language in PDE's correspondence to school districts and charter schools may have caused confusion for both parties, contributing to significant delays in the appeals process.**

As discussed in Finding 2, there were significant time lapses between key actions in the appeals process which affected a school district's opportunity to be heard concerning their objections to deductions from their state funds in order to make payments to charter schools. We found that the timing to appoint a hearing examiner significantly increased for appeals in which procedure letters outlining the appeals process were issued to school districts and charter schools after March 1, 2013.

Once PDE receives and approves a redirection payment request from a charter school, PDE's Bureau of Budget and Fiscal Management (BBFM) notifies the school district of the charter school's request and that it has 30 days after the deduction to notify PDE of their objection to the deduction. Once BBFM authorizes the deduction from school district funds and the payment to the charter school, it issues a letter (deduction letter) to the school district and charter school notifying them of the amount of the deduction, the month the deduction occurred, the fund from which the deduction was made⁴⁶, and acknowledgement that it has received the school district's objection to the deduction. Subsequently, the Office of Chief Counsel issues a letter (procedure letter) to the school district and charter school setting forth the procedures for the appeal.

According to PDE management, standard language in the procedure letter, issued by the Office of Chief Counsel, was changed beginning in March 2013 to encourage the school districts and charter schools to engage in alternative dispute resolution (ADR) prior to engaging in the hearing process. However, based upon our review of the language in the revised procedure letter, we found that it conflicted with the language in the deduction letter sent by BBFM to school district and charter school administration. The following table highlights the conflicting language:

⁴⁶ Funding sources included: Basic Education, Special Education, Pupil Transportation, and Tuition for Orphans. See also 24 P.S. § 17-1725-A(a)(2) and (3) for the statutory funding formula for non-special education and special education students.

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PDE's Conflicting Language

Deduction Letters

- Sent to respective school districts and charter schools.
- Issued by BBFM

Standard language says this:

Since the Department has already received notice from the District that it objects to this deduction, **a hearing officer will be assigned** to conduct proceedings in this matter.
 [Emphasis added.]

Procedure Letters

- Sent to respective school districts and charter schools (issued after March 1, 2013)
- Issued by the Office of Chief Counsel

Standard language says this:

To allow the parties time to engage in ADR, **a hearing officer will not be appointed** for this proceeding...
 [Emphasis added.]

Source: Developed by Department of the Auditor General staff from review of PDE documents.

We inquired of PDE management as to why the two letters contain conflicting language. Although PDE did not directly respond to our question, PDE management did indicate that they would be changing the standard language of the deduction letter to state that the matter will be referred to staff in PDE's Office of Chief Counsel who will then issue the procedure letter, thereby addressing this inconsistent language. As a result, it appears that PDE was not aware of the conflicting language in the deduction letters as compared to the procedure letters, but because of our inquiry has initiated a change to correct the conflict.

We previously noted in Finding 2 that significant time lapses occurred within various stages of the appeals process which affected a school district's opportunity to be heard concerning their objections to deductions from state funding. We found that for appeals initiated after the March 2013 procedure letter, there was a significant increase

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in the amount of time between the date of the procedure letter and the date a hearing examiner was appointed to the appeal.

Specifically, of the 33 General appeals selected for review (see Finding 2 for selection methodology), we found that 12 appeals had procedure letters dated prior to March 2013. For those 12 appeals, a hearing examiner was appointed an average of **65 days**⁴⁷ after the date of the procedure letter. The remaining 21 procedure letters were dated after March 1, 2013. Of those 21 appeals, seven were assigned to a hearing examiner. For these seven assigned appeals, the average number of days to appoint the hearing examiner was **221 days** (over seven months) after the date of the procedure letter. Of the remaining 14 appeals, six were closed at the request of the school district without a hearing and eight still remained in open status as of December 31, 2015. Therefore, for those appeals that we reviewed, the average time to appoint a hearing examiner, after the change in procedure letter language in March 2013, increased from an average of 65 to 221 days, or an increase of almost 3 1/2 times the number of days.

When questioned about the increased delay in appointing a hearing examiner, PDE management stated that as indicated in the current procedure letter, they do not appoint a hearing examiner until they have heard from either the school district or charter school involved in the appeal that the ADR has been unsuccessful or will not be attempted. Therefore, PDE takes a passive role and waits on action from one of the parties before appointing a hearing examiner.

We acknowledge that language in the new procedure letter does state that a hearing officer will not be appointed until one of the parties involved contacts them regarding the status of ADR; however, the conflicting language between the deduction and procedure letters may have caused confusion within the school districts and charter schools. As a result, the school districts and charter schools may be unaware that one of them must contact PDE in order for the hearing process to proceed.

The inconsistent language is evidence of the appearance of lack of communication within PDE offices. This may also have undermined the intent of Section 1725-A(a)(6) of the CSL which requires the secretary to provide a school district with “an opportunity to be heard” concerning the disputed amount.⁴⁸ In the 2010 Chester *Cmty. Charter*

⁴⁷ Days listed in this finding refer to calendar days.

⁴⁸ 24 P.S. § 17-1725-A(a)(6).

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Sch. Case,⁴⁹ the Commonwealth Court observed: “[i]t is then incumbent upon the school district to request a hearing if it does not agree with the amount of the Department's withholding. A prompt hearing could be conducted before any funds actually change hands.” It appears that if a hearing examiner is not appointed within a reasonable amount of time, there is very little likelihood of a “prompt” hearing and the school districts and charter schools are left with an inadequate process.

In November 2015, the PDE Secretary began to issue orders to school districts requesting a written response within 15 days as to why PDE should not dismiss the appeal for failure of the school district to move the case forward. If a response is not received from the school district, PDE assumes the school district is no longer pursuing the case and therefore the case will be discontinued and dismissed. However, of 317 General appeals in open status as of December 31, 2015, PDE only issued orders to school districts on five appeals.⁵⁰ We contacted one of the school districts issued an order by PDE to inquire regarding its understanding of the status of their Open appeal. The school district responded that the charter school had corrected the issue, however the school district had not notified PDE that it no longer required any action by PDE on the matter.

The confusion caused by the conflicting language between the deduction and procedure letters, along with PDE's failure to reach out to the respective school districts with open appeals, may have contributed to significant delays in the appeals process. Since deductions for appeals have already been made from the school districts' subsidy payments and paid to charter schools, for every day that goes by with no action on an appeal, a school district potentially goes without funds that are rightfully theirs to use to educate its students.

Recommendations

We recommend that PDE:

1. Edit the language in its deduction and procedure letters to remove any conflicting language regarding the actions

⁴⁹ *Chester Cmty. Charter Sch. v. Commonwealth, Dep't of Education et al.*, 996 A.2d 68, 78 (Pa. Cmwlth. 2010).

⁵⁰ PDE issued orders to five school districts for a total of eight appeals that were in various appeal statuses. As of December 31, 2015, five of the eight appeals remained open, two were closed, and one was with the Secretary.

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necessary for a hearing examiner to be appointed to the appeal.

2. Ensure its offices properly communicate so that any future changes to language in the deduction letters, procedure letters, and/or any other correspondence are consistent with one another.
3. Contact school districts that received the deduction letters and procedure letters with conflicting language and clarify that a hearing officer has not been appointed to their appeal because PDE is awaiting notice from either the school district or charter school regarding the status of the alternative dispute resolution.
4. Pro-actively reach out to all respective school districts to obtain the current status of open appeals.

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Agency's Response and Auditors' Conclusion



Prior to this audit report's release, we provided a draft copy of our audit findings and recommendations to PDE for its review. On the following pages, we present PDE's response to our findings and recommendations in its entirety. Our conclusion follows PDE's response.

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COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF EDUCATION

August 2, 2016

The Honorable Eugene A. DePasquale
Auditor General
Department of the Auditor General
Room 229 Finance Building
Harrisburg, PA 17120

Dear Auditor General DePasquale:

Attached to this letter, please find the response from the Pennsylvania Department of Education to the Department of the Auditor General's draft Performance Audit of its Charter School Subsidy Redirection Payment and Appeal Process of the Pennsylvania Department of Education.

Thank you for the opportunity to comment on this draft report and for the courtesies extended by your staff to the staff of the Department during this audit. As a whole, the Department agrees with the draft report's findings and recommendations and in several instances has already taken action to remedy the issues identified, including:

- Adopting clearer and more comprehensive procedures related to the processing of charter school subsidy redirection payment requests.
- Improving the consistency of the letters sent to school districts regarding the charter school subsidy redirection payment appeal process.
- Establishing regular interdepartmental meetings to discuss the activities surrounding the charter school subsidy redirection and appeal process.
- The Department has proposed, and the Governor's Office has approved, the creation of a Division of Charter Schools to ensure increased communication, accountability and technical support for both cyber and regular charter schools.

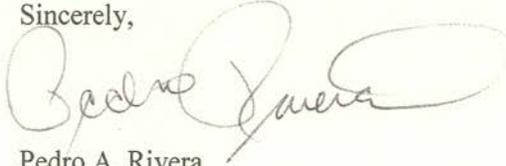
The Department is committed to implementing all of the audit's recommendations with fidelity, and will continue to work to improve its charter school subsidy redirection payment and appeal process. However, in several instances, the Department's ability to implement the audit's recommendations is tied to its receipt of additional resources. The Department does not currently have the level of staffing necessary to address some of the changes recommended for

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the charter school subsidy redirection payment and appeal process. Therefore, I hope that this report will assist others in seeing the pressing need for the Commonwealth to invest in the internal resources of the Department.

Once again, thank you for the chance to comment on this draft report and for the opportunities for improvement it identifies.

Sincerely,

A handwritten signature in dark ink, appearing to read "Pedro A. Rivera". The signature is fluid and cursive, with a large initial "P" and "R".

Pedro A. Rivera
Secretary of Education

PA Department of Education

**PDE Response: Audit of Charter School Subsidy
Redirection Payment and Appeal Process
August 2, 2016**

Finding 1. Due to lack of clarity in the Charter School Law and PDE's policies and procedures, guidance to school districts was unclear if subsidy funds are erroneously withheld.

The Department agrees the Charter School Law (CSL) is in need of revision by the Legislature and is committed to working with stakeholders to improve this law. The Department also agrees that its Basic Education Circular identified in this report requires an update. The current administration has made progress in improving the thoroughness of the Department's policies and procedures, (including, documenting its procedures in greater detail), and the Department is committed to regularly monitoring its activities to ensure its existing procedures are being followed.

Recommendations

We recommend that PDE:

- 1. Seek legislative changes, as necessary, to improve upon the processes related to charter school redirection payments and the related appeals pertaining to Section 1725-A(a)(5) and (6) of the CSL.**

The Department is committed to working with stakeholders, including the Legislature, school districts and charter schools to improve upon the processes related to charter school subsidy redirection payments and the related appeals. As reflected in this report, one of the significant difficulties presented by the current formulation of the CSL is that the law imposes administrative duties upon the Department without providing the Department with additional resources to carry out those duties. In considering future changes to the CSL, careful thought should be given to administrative costs associated with the administration of these laws and to making appropriate provision for those costs.

- 2. Update the Basic Education Circular on Charter Schools to reflect the current procedures in place regarding PDE's approval process of redirection payment requests and applicable case law.**

The Department agrees with this recommendation.

- 3. Maintain and update, as needed, written procedures for its redirection payment process and regularly monitor processes to ensure that the procedures are being followed appropriately.**

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The Department agrees with this recommendation. We also note the Department had some basic written procedures in place prior to the auditor's request. However, as reflected in this report, as of December 11, 2015, it revised these existing procedures and made them clearer and more comprehensive. The Department intends to maintain and update these procedures going forward as recommended by this finding.

Finding 2. Non-charter school students' education funding potentially hurt due to delays in PDE's appeals process.

As the report notes, the legislative mandate for the Department to manage the charter school subsidy redirection payment process did not include additional resources to handle appeals so that resources to resolve them are currently drawn from the Department's existing, limited resources. The Department agrees that unnecessary delays in the processing appeals is undesirable to the extent that such delays cause unnecessary litigation expenses or delay the legitimate recovery of funding. The Department is committed to improving the appeals process related to charter school subsidy redirection payment appeals, including mitigating the impact of any delays to the extent of its resources to do so. The Department notes that the current administration has been successful in working with the parties in these appeals resulting in the resolution of 159 matters.

Recommendations

We recommend that PDE:

- 1. Develop and document in writing a timetable and processes to facilitate timely appeal response determinations to be supplied to an appealing school district.**

The Department intends to adopt an internal policy with guidelines concerning the process and a timetable for appeal determinations.

- 2. Consider assigning a dedicated case manager and support staff to process objections and the subsequent appeal procedures.**

The Department will take this recommendation under advisement; however, without dedicated funding for such a position, the Department is unable to commit to hiring a dedicated case manager and support staff to handle the number of appeals that result from the statutorily prescribed charter school subsidy redirection payment and appeal procedures.

- 3. Develop process and matrix to monitor status of open school district appeals.**

The Department agrees with this recommendation.

- 4. Immediately follow-up with school districts on appeals that have been open for an extended period of time to determine if the school district is aware that PDE is waiting for a response from them before proceeding in the hearing process.**

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The Department will follow up with school districts concerning appeals that have been open for an extended period, subject to staff capacity to do so.

5. Develop process to expedite the issuance of procedure letters to school districts and charter schools to speed up the appeals process.

The Department will take this recommendation under advisement; however, without dedicated funding for additional staffing to implement such a process it is unable to commit to such a process.

6. Develop process for regular monitoring and a system of tracking all hearing examiners and open cases. The system should reflect the amount of time appeals are open, hearing examiner assigned, when assigned, status of hearing, date PDE received records from the hearing examiner, etc.

The Department agrees with this recommendation.

7. Develop a regular weekly or monthly routine process for the Secretary to make decisions on appeals returned from the hearing examiner. This should be followed by an immediate notification to the school district and the charter school on the PDE determination of the appeal.

The Department intends to adopt an internal policy with guidelines concerning the timetable for appeal determinations. Part of this policy is expected to include regular meetings with the Secretary to make decisions concerning these matters.

8. Determine if legislation is deemed necessary to clarify what is meant by “opportunity to be heard”, identify the timeframe in which an appeal should be heard, and determine the necessity of contacting the Senate and House Education Committees to request that legislation be introduced to further clarify 24 P.S. § 17-1725-A(a)(6).

The Department is committed to working with stakeholders, including the Legislature, school districts and charter schools to improve upon the processes related to charter school subsidy redirection payments and the related appeals. As noted above, any changes to the CSL must carefully consider the costs associated with any new mandates imposed on the Department with respect to the administration of the CSL and should provide the Department with additional resources to meet new requirements.

Finding 3. Conflicting language in PDE’s correspondence to school districts and charter schools may have caused confusion for both parties, contributing to significant delays in the appeals process.

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The Department agrees that the language in the procedure letter, as identified by your staff on page 39 of the report, warranted improvement, and the Department has changed the letter to address this observation.

Recommendations

We recommend that PDE:

- 1. Edit the language in its deduction and procedure letters to remove any conflicting language regarding the actions necessary for a hearing examiner to be appointed to the appeal.**

The Department agrees that the language in the procedure letter, as identified by your staff on page 39 of the report, warranted improvement, and the Department has changed the letter to address this observation.

- 2. Ensure its offices properly communicate so that any future changes to language in the deduction letters, procedure letters, and/or any other correspondence are consistent with one another.**

The Department agrees with this recommendation and its staff has begun to hold regular meetings to discuss the activities surrounding the charter school subsidy redirection and appeal process.

- 3. Contact school districts that received the deduction letters and procedure letters with conflicting language and clarify that a hearing officer has not been appointed to their appeal because PDE is awaiting notice from either the school district or charter school regarding the status of the alternative dispute resolution.**

The Department will follow up with school districts concerning appeals, subject to staff capacity to do so.

- 4. Pro-actively reach out to all respective school districts to obtain the current status of open appeals.**

The Department will follow up with school districts concerning appeals, subject to staff capacity to do so.

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Auditors' Conclusion to the Department of Education's Response

PDE agreed with the findings and recommendations and stated in several instances that it has already taken action to remedy the issues identified. PDE further stated that its ability to implement certain audit recommendations is tied to its receipt of additional resources as it does not currently have the level of staffing necessary to address some of the changes recommended for the charter school subsidy redirection payments and appeals processes. If additional resources are required to implement our recommendations, PDE should work quickly and productively to determine the best course of action in order to obtain funding for the necessary resources.

Additionally, as reported in the recommendations to our first two findings, PDE should proactively work with the General Assembly and particularly, the Senate and House Education Committees to pursue legislative changes to the Charter School Law to improve upon the processes related to charter school redirection payments and the related appeals, as well as to clarify the hearing process.

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Appendix A**Objectives, Scope, and Methodology**

The Department of the Auditor General conducted this performance audit in order to provide an independent assessment of the Pennsylvania Department of Education's (PDE) oversight of charter school redirection payment requests and appeals filed by school districts related to such requests.

We conducted this audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Objectives

Our audit objectives were as follows:

1. Determine whether PDE properly processed charter school payments in accordance with applicable laws, regulations, and policies. (See Finding #1)
2. Evaluate the adequacy of PDE's processes and procedures for addressing charter school payment appeals. (See Findings #2 and #3)

Scope

Unless otherwise stated, our audit covered the period January 1, 2011, through December 31, 2015, with updates as necessary through the report's release.

PDE management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that its department is in compliance with applicable laws, regulations, contracts, grant agreements, and administrative policies and procedures.

In conducting our audit, we obtained an understanding of PDE's internal controls, including any information systems controls, if

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applicable, that we considered to be significant within the context of our audit objectives.

For those internal controls that we determined to be significant within the context of our audit objectives, we also assessed the effectiveness of the design and implementation of those controls as discussed in the Methodology section that follows. Any deficiencies in internal controls that were identified during the conduct of our audit – and determined to be significant within the context of our audit objectives – are included in this audit report.

Methodology

To address our audit objectives, we performed the following:

- Obtained and reviewed Section 1725-A of the Charter School Law (CSL), applicable case law regarding charter school redirection payments, PDE's Basic Education Circular (BEC) on Charter Schools, and PDE's internal procedures for processing charter school subsidy redirection requests.
- Interviewed and corresponded with PDE's management including staff from the Division of Subsidy Data and Administration (DSDA), Bureau of Budget and Fiscal Management (BBFM), and the Office of Chief Counsel to assess controls and gain an understanding of the procedures related to PDE's administration and oversight of charter school redirection payment requests and appeals.
- Conducted an interview with management from the Department of State's (DOS) Office of Chief Counsel to gain an understanding of the role of the DOS's hearing examiner staff in processing appeals related to charter school redirection payment requests.
- For the period January 1, 2011, through January 12, 2016, obtained a listing of payments made to charter schools by PDE on behalf of school districts.

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- Tested a judgmental selection of 2 charter school redirection payment requests approved by PDE management to be paid from State Property Tax Reduction Allocation funds and 23 redirection payment requests from the 40 appeals selected for testing in Objective 2 in order to get coverage across the years in our audit period and from different appeal statuses. We tested the 25 selected payments to ensure that records, including charter school invoices and supporting documents, supported the redirection request made by the charter school, that PDE properly approved the redirection payments, and that PDE notified school districts of the funds withheld from its subsidy payments and its rights to object.
- Obtained and reviewed the listings of the three categories (general, PDE-363, and prior years – no withholding) of appeals filed by school districts against charter schools during the period January 1, 2011, through December 31, 2015. The listings including the status (open, closed, secretary, and hearing), docket number, and disputed amount of each appeal as well as the date of school district’s objection, date PDE issued a procedure letter, and whether PDE conducted follow-up with the school district regarding the status of the appeal in the form of issuing an order and rule to show cause (RSC) letter.
- Analyzed the three categories of appeals (general, PDE-363, and prior years - no withholding) to determine whether PDE issued an order and RSC related to any of the appeals, and to determine the amount of time between key events in the appeals process including how long it took PDE to issue correspondence to the school district and charter school to begin the appeal process and how long an appeal remained in its status, as of December 31, 2015, of either open, hearing, secretary, or how long it took for the appeal to be closed.

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- Selected 40 of the 857 appeals using auditor judgment to ensure coverage across all categories and statuses to evaluate the actions taken by PDE as well as the timing of the key actions in the appeals process, where applicable, by determining the number of days between (1) PDE's procedure letter and December 31, 2015; (2) PDE's procedure letter to the letter assigning a hearing officer; (3) the letter assigning a hearing examiner and December 31, 2015; and (4) the letter certifying records to PDE's Secretary to the date PDE's Secretary made a decision or December 31, 2015. Information regarding our selection of 40 appeals is provided in the following chart:

Category	Number of Appeals in Open Status	Number of Appeals in Hearing Status	Number of Appeals in Secretary Status	Number of Appeals in Closed Status	Total Number of Appeals Reviewed	Total Dollar Amount of Appeals Reviewed
General	8	7	7	11	33	\$3,876,948
PDE-363	1	1	1	1	4	\$4,318,867
Prior Years	1	1	0	1	3	\$378,509
Totals	10	9	8	13	40	\$8,574,324

- Contacted 8 school districts from the 33 general appeals judgmentally selected for testing to inquire about the school districts' understanding of the status of its appeals. The basis of our selection was to achieve coverage throughout our audit period and within the open, hearing, and secretary statuses.

Data Reliability

In performing this audit, we obtained from PDE data files regarding charter school payments and appeals when the school districts subsequently file an objection regarding the payments made to the charter schools. PDE extracted the data file of charter school payments from the Commonwealth's SAP accounting system which included payments from January 1, 2011 to January 12, 2016. We utilized this data file for selecting payments to test in order conclude about PDE's performance in processing the payments to charter schools.

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PDE maintains a list of the appeals related to the school districts' objections to charter school payments on a Microsoft Excel spreadsheet. We obtained this file for appeals initiated between January 1, 2011 and December 31, 2015. For each appeal, the spreadsheet includes the case number assigned to the appeal, the names of the school district and charter school, the dollar amount of the appeal, general notes on what events have occurred in the appeal and the status of the appeal. We utilized this data file to select appeals to test and to make conclusions about PDE's performance in processing and addressing the charter school payment appeals.

Government Auditing Standards requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations. The assessment of the sufficiency and appropriateness of computer-processed information includes considerations regarding the completeness and accuracy of the data for the intended purposes.

The reliability of data from the SAP accounting system from which the charter school payments was extracted is evaluated as part of the Commonwealth's GAAP and Single Audits. Additionally, to assess the completeness and accuracy of the SAP charter school payment data provided to us by PDE, we conducted additional audit procedures as follows:

- We independently prepared SAP expenditure reports through the SAP Business Warehouse and compared these reports to the charter school payment data files extracted by PDE in order to ensure PDE included all charter schools receiving payments in the extracted file and that payment amounts were reasonable.
- We ensured that the PDE data file and source documents agreed for a selection of payments.

Based on the above, we found no limitations with using the data for our intended purposes. In accordance with *Government Auditing Standards*, we concluded that PDE's computer-processed data was sufficiently reliable for the purposes of this engagement.

To assess the completeness and accuracy of appeals data provided to us, we conducted audit procedures as follows:

- Interviewed PDE officials with knowledge about the data, and specifically the processes used for data entry and/or input.

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- Reviewed the appeals data for completeness of the fields and for gaps in the numerical order of case numbers assigned to each appeal. For any incomplete fields or gaps in the case numbering, we obtained adequate information from PDE to confirm reasonableness of the data.
- Obtained from the Department of State's Office of Chief Counsel, a listing of appeals that entered into the hearing process and ensured that all appeals were included on PDE's listing.
- Traced a selection of appeals from the data file to source documents and confirmed accuracy of the information included in the data file.

Based on the above, we found no limitations with using the data for our intended purposes. In accordance with *Government Auditing Standards*, we concluded that PDE's computer-processed data was sufficiently reliable for the purposes of this engagement.

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Appendix B**Distribution List**

Upon its release, this report was distributed to the following Commonwealth officials:

The Honorable Tom Wolf
Governor

The Honorable Pedro A. Rivera
Secretary
Department of Education

The Honorable Sharon P. Minnich
Secretary of Administration
Office of Administration

The Honorable David W. Volkman
Executive Deputy Secretary
Department of Education

The Honorable Lloyd Smucker
Republican Chair
Senate Education Committee

The Honorable Larry Wittig
Chairperson of the Board
State Board of Education

The Honorable Andrew Dinniman
Democratic Chair
Senate Education Committee

The Honorable Pedro A. Cortés
Secretary
Department of State

The Honorable Stanley Saylor
Republican Chair
House Education Committee

The Honorable Randy Albright
Secretary of the Budget
Office of the Budget

The Honorable James R. Roebuck, Jr
Democratic Chair
House Education Committee

The Honorable Timothy Reese
State Treasurer
Treasury Department

Mr. Brian Lyman, CPA
Director, Bureau of Audits
Office of Comptroller Operations

The Honorable Bruce L. Castor, Jr.
Acting Attorney General
Office of the Attorney General

Ms. Mary Spila
Collections/Cataloging
State Library of Pennsylvania

The Honorable Bruce Beemer
Acting Attorney General
Office of the Attorney General

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PA Department of Education

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