

# PERFORMANCE AUDIT

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## Pennsylvania Cyber Charter School Beaver County, Pennsylvania

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September 2016



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General



Commonwealth of Pennsylvania  
Department of the Auditor General  
Harrisburg, PA 17120-0018  
Facebook: Pennsylvania Auditor General  
Twitter: @PAAuditorGen  
www.PaAuditor.gov

EUGENE A. DEPASQUALE  
AUDITOR GENERAL

Ms. Nicole Granito, Interim CEO  
Pennsylvania Cyber Charter School  
652 Midland Avenue  
Midland, Pennsylvania 15059

Mr. Brian Hayden, Board President  
Pennsylvania Cyber Charter School  
652 Midland Avenue  
Midland, Pennsylvania 15059

Dear Ms. Granito and Mr. Hayden:

We conducted a performance audit of the Pennsylvania Cyber Charter School (Cyber Charter School) to determine its compliance with certain relevant state laws, regulations, contracts, and administrative procedures (relevant requirements). We evaluated the application of best practices in the areas of finance, governance, contracts, and other areas, as noted. Our audit covered the period May 13, 2011 through March 11, 2016, except as otherwise indicated in the report. Additionally, compliance specific to state subsidies and reimbursements was determined for the school years ended June 30, 2012, 2013, and 2014. Our audit was conducted pursuant to Section 403 of The Fiscal Code (72 P.S. § 403), and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found significant noncompliance with relevant requirements, and it found that the Cyber Charter School did not effectively utilize best practices, as detailed in the eight audit findings within this report. A summary of the results is presented in the Executive Summary section of the audit report. These findings include recommendations to the Cyber Charter School and a number of different government entities, including the Pennsylvania Department of Education (PDE) and State Ethics Commission.

Our audit findings and recommendations have been discussed with the Cyber Charter School's management, and their responses are included in the audit report. We believe the implementation of our recommendations will improve the Cyber Charter School's operations and facilitate compliance with legal and administrative requirements. We appreciate the Cyber Charter School's cooperation during the audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale".

Eugene A. DePasquale  
Auditor General

September 21, 2016

cc: **PENNSYLVANIA CYBER CHARTER SCHOOL** Board of Trustees

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## Executive Summary

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### Audit Work

The Pennsylvania Department of the Auditor General conducted a performance audit of the Cyber Charter School. Our audit sought to answer certain questions regarding the Cyber Charter School's compliance with certain relevant state laws, regulations, contracts, and administrative procedures and to determine the status of corrective action taken by the Cyber Charter School in response to our prior audit recommendations.

Our audit scope covered the period May 13, 2011 through March 11, 2016, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidies and reimbursements was determined for the 2011-12, 2012-13, and 2013-14 school years.

### Audit Conclusion and Results

Our audit found significant noncompliance with certain relevant state laws, regulations, contracts, administrative procedures, and failure to implement best practices, as detailed in the eight audit findings within this report.

**Finding No. 1: The Board and the Administration Failed to Adequately Govern Numerous Related Party Transactions Involving Millions of Dollars of Public Funds.** Several members of the Cyber Charter School's Board of Trustees (Board), key administrators, and contracted vendors were involved in related party transactions that created potential conflicts of interest and a lack of public

accountability involving millions of dollars of public funds (see page 15).

**Finding No. 2: Lack of Oversight Led to High Costs and Poor Accountability from a Related Management Company.** The Board and Cyber Charter School administrators failed to oversee the curriculum, management, and other services provided by the Management Company. Because this contractor was a related party and potential conflicts of interest existed, the need for appropriate governance was heightened in order to ensure both transparency and accountability connected to these services, which cost an average of \$51.3 million annually for the three years ending June 30, 2014. Instead, failed oversight resulted in poor delivery of curriculum services, inadequate accounting for management services, and an improper Board waiver of nonperformance penalties of at least \$4.2 million (see page 26).

**Finding No. 3: The Cyber Charter School Conducted Transactions with a Related Performing Arts Center That May Have Been Financially Detrimental and Presented a Possible Conflict of Interest.**

We found that entering into a 2005 \$10 million pre-paid lease and converting the lease to a 25-year note receivable in 2009, of which \$6.8 million was still outstanding as of June 30, 2014, were fiscally irresponsible actions by the Cyber Charter School and a poor use of public funds, which, at a minimum, deprived the Cyber Charter School of an estimated \$1.4 million interest on the loan funds. We also found the Cyber Charter School paid the Arts Center for arts

education services without ever utilizing an open and public bid solicitation process (see page 41).

**Finding No. 4: The Cyber Charter School May Have Improperly Provided College Tuition Reimbursement of at Least \$32,328 on Behalf of a Board President's Daughter and Have Offered a Formal Dual Enrollment Program in Noncompliance with the Public School Code Indicating Ineffective Governance and a Lack of Transparency.**

Tuition reimbursements were provided directly from the Cyber Charter School on behalf of the daughter of a former Board President, a benefit not awarded to other students in the 2012-13 and 2013-14 school years. Further, the Cyber Charter School and its Board may have offered a formal dual enrollment program in noncompliance with the Public School Code (PSC) (see page 48).

**Finding No. 5: Members of the Board of Trustees May Have Had Potential Conflicts of Interests and Voting Conflicts in Possible Noncompliance with the Public Official and Employee Ethics Act When It Paid a Trustee-Owned Company for Computer Equipment and Services.**

The Cyber Charter School paid a related computer equipment and services company (Company) more than \$1.8 million over a seven-year period, and its board members may have been in noncompliance with the Public Official and Employee Ethics Act (Ethics Act) because it did not ensure that one of its Trustees made a prior public disclosure that he was an owner of the Company when the Board approved payments to the vendor. As a result, the Cyber Charter School also failed to implement best practices by not fostering full transparency and public accountability (see page 53).

**Finding No. 6: The Cyber Charter School's Virtual Classroom Attendance Policy Was Not Monitored or Enforced**

We found the Cyber Charter School did not monitor or enforce its own classroom attendance policy for its virtual classrooms from 2011-12 through the 2015-16 school years. By not monitoring virtual classroom attendance, the Cyber Charter School may have missed an opportunity to improve its students' chances for completing courses (see page 57).

**Finding No. 7: The Cyber Charter School Failed to Maintain Sufficient Documentation to Support Teacher Certifications.**

The Cyber Charter School's attestations regarding its evaluation of service for educators' Instructional II certificates may be unreliable because of incomplete or missing required evaluations in educators' personnel files. As a result, its educators may have received Instructional II certificates without having first met the evaluation requirements of PDE. This deficiency represents another effect of the Board's failure to monitor the Management Company, which was responsible for maintaining employees' personnel files (see page 63).

**Finding No. 8: The Cyber Charter School Did Not Collect All of the Computer Equipment Provided to Students When They Withdrew or Graduated.**

We found that the Cyber Charter School, while it has procedures in place to collect laptops from students who withdrew or graduated, does not collect other IT equipment. This not only contradicts best practices, it may also put the Cyber Charter School in noncompliance with the Charter School Law (CSL) as well as its own policies and *Parent/Guardian and Student Contract* (see page 67).

**Status of Prior Audit Findings and Observations.** With regard to the status of our prior audit recommendations to the Cyber Charter School from an audit we conducted of the 2008-09 and 2009-10 school years, we found the Cyber Charter School had taken appropriate corrective action in implementing our recommendations pertaining to: **Improperly received tax benefits without applying for tax-exempt status with the IRS** (see page 71).

We found that the Cyber Charter School had taken appropriate action in implementing our recommendations pertaining to: **Logical Access Control Weaknesses** (see page 72).

We found that the Cyber Charter School had not taken appropriate action in implementing our recommendations pertaining to: **Pennsylvania Cyber Charter School Operated with a \$13 Million Unreserved General Fund Balance** (see page 73).

We found that the Cyber Charter School had not implemented our recommendations pertaining to: **Advertising Expenses**. We also found that it had stabilized costs with regard to public outreach and advertising in order to reach potential students across the Commonwealth (see page 73).

We found that the Cyber Charter School had not taken appropriate action in implementing our recommendations pertaining to: **Poorly Constructed Management Company Services Contract Creates Inefficient Spending and Duplication** (see page 74).

## **Background Information on PA Cyber Charter School**

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### **Charter, Mission, and School Statistics**

The Cyber Charter School, located in Beaver County, Pennsylvania, opened in July 2000. It was originally chartered by the Midland Borough School District on October 7, 1999, for a period of five years. However, effective August 15, 2002, the CSL was amended to require that all cyber charter schools be authorized by PDE. Since then, the Cyber Charter School's renewal charters have been authorized by PDE instead of the Midland Borough School District.

The most recent charter renewal authorized by PDE on June 9, 2010, was for five years, allowing the Cyber Charter School to operate through June 30, 2015. As of the date of this report, the Cyber Charter School's 2014 renewal application for another five-year charter has not yet been granted or denied by PDE.

The Cyber Charter School's mission states:

The Pennsylvania Cyber Charter School is dedicated to the success of all students who have not had their needs met in a traditional educational setting. PA Cyber is dedicated to providing the services and educational programs using current technology necessary for these students to receive a high school diploma as well as to give them the opportunity to grow beyond the normal curriculum and confines of a traditional school setting. PA Cyber is committed to providing a safe and orderly environment and protecting the health, safety, and welfare of all students. It is our desire that PA Cyber students graduate and successfully procure satisfying employment or further their education to become independent, responsible citizens.

As of October 1, 2014, the Cyber Charter School provided educational services to 9,618 students from 484 sending school districts through the employment of 464 teachers,

215 full-time and part-time support personnel, and 56 administrators. In the 2013-14 school year, the Cyber Charter School received more than \$118.6 million in tuition payments from school districts required to pay for their students attending the Cyber Charter School. Funding from school districts throughout the Commonwealth represented 95 percent of the Cyber Charter School's total funding of \$124.5 million, while 3 percent and 2 percent, respectively, represented state and federal funding.

### **Academic Performance**

The Cyber Charter School's academic performance as measured by its School Performance Profile (SPP) score was 55.5 percent for the 2013-14 school year, which was a slight drop from its 2012-13 SPP score of 59.4 percent.

SPP is PDE's current method of providing a quantitative, academic score based upon a 100-point scale for all public schools. A score of 55.5 percent and 59.4 percent would be considered an "F (less than 60)" if using a letter grade system. Weighted data factors included in the SPP score are indicators of academic achievement, indicators of closing the achievement gap, indicators of academic growth, and other academic indicators such as attendance and graduation rates.

### **Governance Structure**

**Governing Board.** The Board has operated with seven voting members and two additional non-voting members - the Secretary and Treasurer. The Board currently operates with only six voting members after one resigned in November 2015. Two of the six have served more than 15 years. Another member has served more than ten years, one eight years, one seven years, and one two years.

**Founder and Former CEO.** The Cyber Charter School's Founder (Founder and former CEO) served as an executive from the outset in 2000 until his retirement in July 2012, during which most of that time he served as CEO. From 2000 until November 2007, in addition to his position with the Cyber Charter School, he simultaneously worked as the Superintendent at the local school district (Midland Borough). He also founded several other related entities,

which are summarized in the next two sections, entitled **Related Party Entities** and **Related Party Timeline**.

**Current CEO.**<sup>1</sup> Prior to 2012, the current CEO worked for the Cyber Charter School in various capacities, including Director of Admissions, Director of Budget and Finance, Director of Administrative Services, and Chief of Staff.<sup>2</sup> While working for the Cyber Charter School, he simultaneously served as a member of the local school district's board of directors (Midland Borough), which originally authorized the Cyber Charter School's charter. He remained on the local school district's board until May 2012, serving as president for the last four years of his tenure. In July 2012, after resigning from the board of the local school district, he became CEO of the Cyber Charter School.

### **Related Party Entities**

The Founder and former CEO of the Cyber Charter School also founded three other related entities that conducted business directly with the Cyber Charter School as described below.

**Management Company.** A non-profit management company, NNDS/LLS (Management Company), founded in 2005, immediately became the Cyber Charter School's highest paid vendor. The Management Company has provided a wide range of services to the Cyber Charter School from the leasing of curriculum to management services, including accounting, legal assistance, human resources, maintenance, and information technology services. The Cyber Charter School's Founder and former CEO was also the Founder and President/Controlling Officer of the Management Company.<sup>3</sup>

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<sup>1</sup> Since the close of fieldwork, the individual referred to in this report as the "current CEO" resigned in July 2016 and has been replaced by an acting CEO. For purposes of this report, however, the current CEO referred to is the individual who resigned in July 2016. Please note that the "former CEO" as cited in the report pled guilty to a tax conspiracy charge on August 24, 2016. See <http://www.post-gazette.com/local/city/2016/08/24/PA-Cyber-Charter-founder-Trombetta-pleads-guilty-to-tax-conspiracy/stories/201608240177> accessed August 29, 2016.

<sup>2</sup> According to the minutes of the Cyber Charter School's 2000 Board of Trustees, the current CEO was introduced as the Coordinator of Admissions. The other roles listed were provided from his resume, which was provided to us by the Cyber Charter School.

<sup>3</sup> A federal indictment dated August 21, 2013, of the Cyber Charter School's Founder stated that he "controlled the management and operation of NNDS until July 2012."

**Arts Center.** A performing arts center,<sup>4</sup> Lincoln Park Performing Arts Center (Arts Center), founded in 2004, provides arts education services to the Cyber Charter School and is one of its higher paid vendors. The Arts Center also leases and shares educational space with the brick and mortar charter school mentioned below. The Cyber Charter School's Founder and former CEO was also the Founder of the Arts Center.

**Brick and Mortar Charter School.** A brick and mortar charter school,<sup>5</sup> Lincoln Park Performing Arts Charter School, founded in 2006, shares space with and is the primary tenant of the Arts Center discussed above. The Cyber Charter School's Founder and former CEO was also the Founder of the brick and mortar charter school.

**Other Related Party Entities.** While the aforementioned entities are the main related parties mentioned throughout this audit report, the Cyber Charter School's Founder and former CEO also founded several other companies, including, but not limited to, a for-profit management company (Avanti Management Group), which became the highest paid vendor of the Cyber Charter School's Management Company.<sup>6</sup>

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<sup>4</sup> From a historical perspective, it should be noted that Midland Borough School District paid \$164,000 in 2002 to buy an old school building to construct the Lincoln Park Performing Arts Center. At that time, the Cyber Charter School's founder and CEO was simultaneously the Superintendent of the Midland Borough School District that was involved in the construction of the performing arts center.

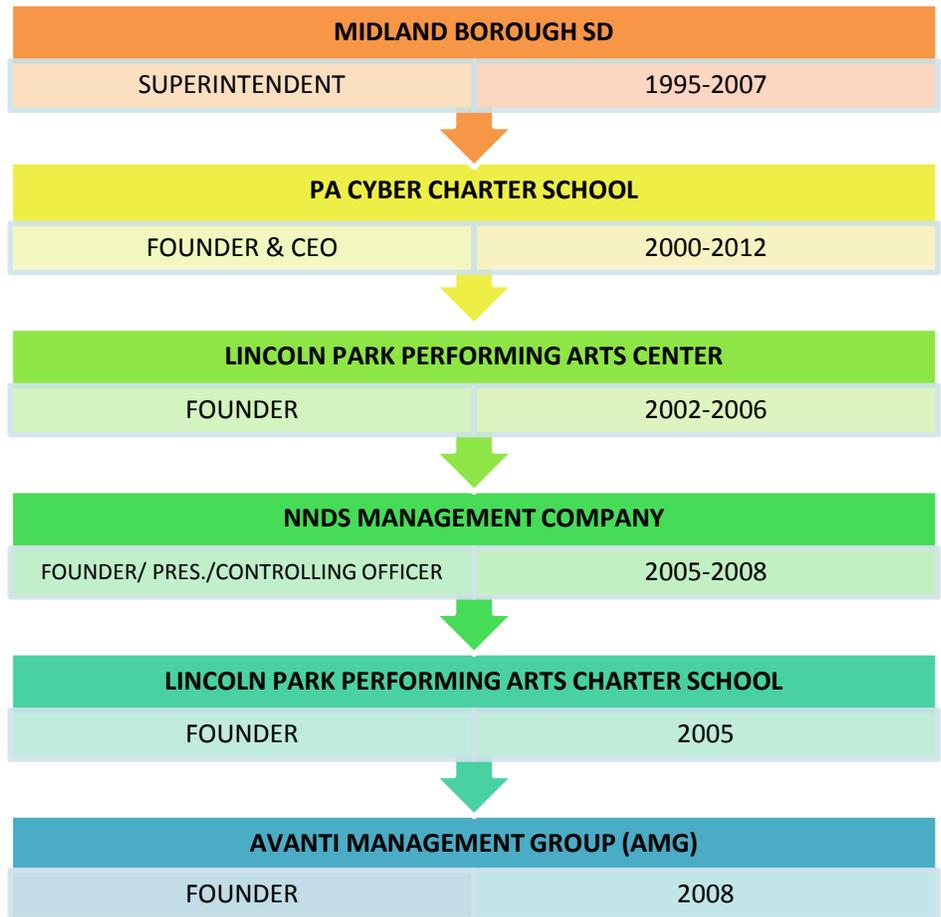
<sup>5</sup> Again, from a historical perspective, it should be noted that Midland Borough School District also approved the charter for the brick and mortar charter school while the Cyber Charter School's Founder was simultaneously serving as Superintendent of the local school district who approved the charter.

<sup>6</sup> The federal indictment of the Cyber Charter School's Founder also stated that, through four straw owners of Avanti Management Group (AMG), he also controlled the operation and management of that organization. AMG was the highest paid contractor of the Management Company for the three school years 2010-11 through 2012-13. (The 2013-14 IRS form 990 was unavailable at the time of our fieldwork).

## Related Party Timeline

The following chart summarizes the timeline of the Founder and Former CEO's overlapping executive and leadership roles in each of several related party entities described in the previous section.

**Figure 1.**  
**Related Party Entities and Overlapping Roles of PA Cyber Charter School's Founder and Former CEO**



## The Charter School Law

The board of a charter or cyber charter school is responsible for governance of the school. Specifically, under the CSL, the board has the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum, and operating

procedures, subject to the school’s charter.<sup>7</sup> In addition, the Pennsylvania Supreme Court has ruled that a charter board must retain ultimate authority over the general operations of the school, not the founder or any management company hired by the board.<sup>8</sup>

The CSL also designates board members and administrators with management or operational oversight responsibilities of charter and cyber charter schools as public officials subject to the Ethics Act.<sup>9</sup> Moreover, the CSL requires board members and meetings to comply with the Sunshine Act and open meeting requirements.<sup>10</sup>

### **Ethics Act**

The Ethics Act presides over public officials. It “declares that public office is a public trust and that any effort to realize personal financial gain through public office other than compensation provided by law is a violation of that trust.” It also declares that “because public confidence in government can best be sustained by assuring the people of the impartiality and honesty of public officials, this chapter shall be liberally construed to promote complete financial disclosure as specified in this chapter.”

The application of the Ethics Act to charter and cyber charter schools means that board members and administrators also have the responsibilities specified under this law. Additionally, the Ethics Act defines related parties and conflicts of interest and prohibits public officials and public employees from engaging in conflicts of interest.<sup>11</sup>

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<sup>7</sup> 24 P.S. § 17-1716-A(a) is applicable to cyber charter schools by way of its incorporation through 24 P.S. § 17-1749-A(a)(1).

<sup>8</sup> *W. Chester Area Sch. Dist. v. Collegium Charter Sch.*, 760 A.2d 452 (Pa. Cmwlth. 2000).

<sup>9</sup> CSL sections 24 P.S. §§ 17-1715-A(11)-(12) and 17-1749-A(a)(1) make the Ethics Act, 65 Pa.C.S. § 1101 *et seq.*, applicable to charter schools and cyber charter schools.

<sup>10</sup> The Sunshine Act, 65 P.S. § 701 *et seq.*, is incorporated through 24 P.S. §§ 1716-A(c) and 1749-A(a)(1) of the CSL.

<sup>11</sup> 65 Pa.C.S. §§ 1102 and 1103(a).

## Audit Scope, Objectives, and Methodology

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### Scope

*What is a school performance audit?*

School performance audits allow the Pennsylvania Department of the Auditor General to determine whether state funds, including school subsidies, are being used according to the purposes and guidelines that govern the use of those funds. Additionally, our audits examine the appropriateness of certain administrative and operational practices at each local education agency (LEA). The results of these audits are shared with LEA management, the Governor, PDE, and other concerned entities.

Our audit, conducted under the authority of Section 403 of The Fiscal Code (72 P.S. § 403), is not a substitute for the local annual audit required by the PSC, as amended. We conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit covered the period May 13, 2011 through March 11, 2016. In addition, the scope of each individual audit objective is detailed below.

Regarding state subsidies and reimbursements, our audit covered the 2011-12, 2012-13, and 2013-14 school years.

For the purposes of our audit work and to be consistent with PDE reporting guidelines, we use the term *school year* rather than fiscal year throughout this report. A school year covers the period July 1 to June 30.

### Objectives

Performance audits draw conclusions based on an evaluation of sufficient, appropriate evidence. Evidence is measured against criteria, such as laws, regulations, third-party studies, and best business practices. Our audit focused on assessing the Cyber Charter School's compliance with certain relevant state laws, regulations, contracts, and administrative procedures and also its application of best practices. However, as we conducted our audit procedures, we sought to determine answers to the following questions, which serve as our audit objectives:

- ✓ Was the Cyber Charter School operating in compliance with accountability provisions included in the CSL specific to its approved charter and governance structure?

To address this objective:

- Auditors reviewed the approved charter and any amendments and compared it to the CSL to determine compliance.

- In addition, auditors reviewed board policies and procedures; IRS 990 forms for the 2011-12, 2012-13, and 2013-14 school years; and charter school annual reports for the 2011-12, 2012-13, and 2013-14 school years.
- ✓ Were building lease agreements approved by the Cyber Charter School’s Board, and did its lease process comply with the provisions of the Ethics Act?<sup>12</sup>
  - To address this objective, auditors reviewed building ownership documentation and the lease agreements.
- ✓ Were the Cyber Charter School’s Board and administrators free from apparent conflicts of interest and in compliance with the CSL, the PSC, the Ethics Act, and the Sunshine Act?
  - To address this objective, auditors reviewed Statements of Financial Interest for all board members, IRS Form 990s, board meeting minutes, management company contract(s), and any known outside relationships with the Cyber Charter School and/or its authorizing school district for the period 2011-12 and 2013-14 school years.
- ✓ Were at least 75 percent of the Cyber Charter School’s teachers properly certified pursuant to Section 1724-A of the CSL, and did all of its noncertified teachers in core content subjects meet the “highly qualified teacher” requirements under the federal No Child Left Behind Act of 2001?
  - To address this objective, auditors reviewed and evaluated certification documentation and teacher course schedules for all 121 teachers and administrators who were newly hired during the period July 1, 2014 through May 28, 2015. We also systematically selected 8 of the 88 teachers and administrators who applied for the Instructional II certificate and reviewed documentation to determine if the three year

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<sup>12</sup> 65 Pa.C.S. § 1101 *et seq.*

service and semi-annual evaluation requirements were met.

- ✓ Did the Cyber Charter School transmit complete, accurate, valid, and reliable information to PDE through the Pennsylvania Information Management System for the most current year available?

To address this objective:

- Auditors randomly selected 5 out of 14,236 total registered students from the vendor software listing and verified that each child was appropriately registered with the Cyber Charter School.
  - In addition, auditors randomly selected two out of eight school terms reported on the Summary of Child Accounting and verified the school days reported on the Instructional Time Membership Report and matched them to the School Calendar Fact Template.
- ✓ Did the Cyber Charter School comply with the CSL's compulsory attendance provisions, and did the Cyber Charter School comply with its own policies regarding attendance in virtual classes?
    - To address this objective, auditors reviewed student attendance reports, notification letters, board policy, student progression procedures, and course catalogs and conducted interviews with student attendance officers and student attendance administrators for the 2012-13 through 2015-16 school years.
  - ✓ Did the Cyber Charter School provide its employees with a retirement plan, such as the Public School Employees' Retirement System (PSERS), as required by Section 1724-A(c) of the CSL, and were employees enrolled in PSERS eligible to receive plan benefits?

To address this objective:

- Auditors reviewed the approved charter and any amendments.
  - In addition, auditors reviewed board meeting minutes, personnel listings, payroll reports, and PSERS wage reports for all employees for the 2014-15 school year.
- ✓ Did the Cyber Charter School’s Board and administration maintain best practices in governing academics and student achievement by developing and executing a plan to improve student academic performance at its failing school building(s)?

To address this objective:

- Auditors considered a variety of school level academic results for the 2007-08 through 2012-13 school years to determine if the Cyber Charter School was meeting statewide academic standards established by PDE.<sup>13</sup>
- Once it was determined that the Cyber Charter School was an underperforming school and not meeting statewide standards, further review was conducted. This review consisted of conducting interviews with the current CEO and any other designated employees and reviewing required School Improvement Plans and/or optional School Level Plans for the 2014-2017 school years to determine if the Cyber Charter School had established goals for improving academic performance, was implementing those goals, and was appropriately monitoring the implementation of those goals.

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<sup>13</sup> Academic data for the District and its school buildings included a five year trend analysis of Adequate Yearly Progress results from 2007-08 through 2011-12. Pennsylvania System of School Assessment results in Math and Reading for the “all students” group for 2011-12 and 2012-13. School Performance Profile scores for 2012-13, and federal accountability designations (i.e. Priority, Focus, Reward, and No Designation) for Title I schools for 2012-13. All of the academic data standards and results we examined originated with PDE.

## Methodology

### *What are internal controls?*

Internal controls are processes designed by management to provide reasonable assurance of achieving objectives in areas such as:

- Effectiveness and efficiency of operations.
- Relevance and reliability of operational and financial information.
- Compliance with certain relevant state laws, regulations, contracts, and administrative procedures.

*Government Auditing Standards* require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our results and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our results and conclusions based on our audit objectives.

The Cyber Charter School's management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Cyber Charter School is in compliance with certain relevant state laws, regulations, contracts, and administrative procedures (relevant requirements). In conducting our audit, we obtained an understanding of the Cyber Charter School's internal controls, including any information technology controls, that we consider to be significant within the context of our audit objectives. We assessed whether those controls were properly designed and implemented. 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 report.

Our audit examined the following:

- Records pertaining to professional employee certification, state ethics compliance, and lease agreements and contracts.
- Items such as the approved charter and any amendments, board meeting minutes, IRS 990 forms, annual reports, and reimbursement applications.

Additionally, we interviewed select administrators and support personnel associated with the Cyber Charter School's operations.

To determine the status of our audit recommendations made in a prior audit report released on December 6, 2012, we reviewed the Cyber Charter School's response to PDE dated April 15, 2013. We then performed additional audit procedures targeting the previously reported matters.

## Findings and Observations

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### Finding No. 1

### The Board and the Administration Failed to Adequately Govern Numerous Related Party Transactions Involving Millions of Dollars of Public Funds

*Criteria relevant to the finding:*

Section 1715-A(11) of the CSL, 24 P.S. § 1715-A(11), states: “Trustees of a charter school shall be public officials.”

Section 1715-A(12) of the CSL, 24 P.S. § 1715-A(12), states, in part: “A person who serves as an administrator for a charter school shall be a public official under 65 Pa.C.S. Ch. 11 (relating to ethics standards and financial disclosure) . . .”

Section 1716-A(a) of the CSL, 24 P.S. § 1716-A(a), addresses the duties of the Board of Trustees by providing: “The board of trustees of a charter school shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school's charter. The board shall have the authority to employ, discharge and contract with necessary professional and nonprofessional employees subject to the school's charter and the provisions of this article.”

Several members of the Cyber Charter School’s Board, key administrators, and contracted vendors were involved in related party transactions that created potential conflicts of interest and a lack of public accountability. These transactions involved the use of millions of dollars of public funds during the three-year audit period ending June 30, 2014.

Because of the inordinate number of related party transactions, the Board and the administration had an even greater duty to govern all aspects of the Cyber Charter School’s management, but it failed to do so. As you will see in this finding and the rest of this audit report, this failure to govern resulted in reduced transparency, diminished accountability, and a lack of implementation of best business practices in the Cyber Charter School’s management of public funds. Additionally, some of these related party transactions may have constituted violations of the CSL and/or the Ethics Act.

#### Lack of Accountability

**Weak board oversight.** The Board did not exercise its required oversight of the Cyber Charter School because it failed to perform necessary checks and balances to the power of the Cyber Charter School’s Founder and former CEO and his influence over board-approved transactions, which may have violated certain provisions of the Ethics Act and contributed to the various Trustees and administrators’ lack of accountability to the public.<sup>14</sup> For instance, without implementing open and public processes, the Board contracted with many related entities, including other entities founded by the Founder and former CEO, which will be discussed later.

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<sup>14</sup> 65 Pa.C.S. §§ 1103(a) and (f).

*Criteria relevant to the finding (continued):*

Board responsibilities are further clarified by a Pennsylvania Supreme Court decision holding that a charter school is to be governed by an independent board of trustees who “retain ultimate authority over the general operation of the school.”

This means that once the board is in place, it must control the school and not the applicant, founder, or contracted management company.

*See West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).

The Ethics Act, 65 Pa.C.S. § 1102, defines the following term:

*A conflict of interest* is defined, in part, as: “Use by a public official or public employee of the authority of his office or employment...for the private pecuniary benefit of himself, a member of his immediate family or a business with which he or a member of his family is associated.”

*Business with which he is associated* is defined as “any business in which the person or a member of the person’s immediate family is a director, officer, owner, employee or has a financial interest.”

*Immediate family* is defined as a “parent, spouse, child, brother or sister.”

Section 1103(a) of the Ethics Act, 65 Pa.C.S. § 1103(a), states: “No public official or public employee shall engage in conduct that constitutes a conflict of interest.”

**Trustees with voting conflicts.** Regarding individual Trustees, we found instances where two Trustees who abstained from votes did not file required disclosure statements noting the reason for their vote abstentions, as required by the Ethics Act. We also found that a third Trustee, who co-owned a company with which the Cyber Charter School did business, was absent from a meeting where the Board voted to award his company a contract for over \$1 million.

In this situation, both the vote abstention and the required public disclosure never occurred because of the Trustee’s absence from that meeting. However, the current CEO said he believed all of the Trustees who voted to award the contract knew the absent Trustee co-owned the company receiving the contract. Although the Trustee was absent from the meeting, other board members should have at least acknowledged the Trustee’s relationship with the company prior to the vote. In addition, the absent Trustee who co-owned the company should have disclosed his relationship to the company as required after the meeting in a memorandum addressed to the Board Secretary and ensured that the memo was incorporated into the minutes of that particular meeting.

**Unanimous vote pattern.** Our audit found that for the three-year audit period, all Board votes were unanimous. The Board was comprised of seven voting members and two non-voting members. A unanimous Board voting pattern is not generally problematic in and of itself. However, this voting pattern coupled with the high number of related party transactions and the failures of three board members to disclose reasons for vote abstentions indicate poor governance by the Board, resulting in a lack of transparency.

The Board has an obligation to maintain ultimate control over the operations of the Cyber Charter School, including for example, general, academic, financial, personnel, and related policies needed for the proper administration of the Cyber Charter School. In addition, pursuant to the Nonprofit Corporation Law of 1988, the director of a nonprofit corporation (like a nonprofit Cyber Charter School) “shall stand in a fiduciary relation to the corporation and shall perform his duties as a director, including his duties as a member of any committee of the

*Criteria relevant to the finding  
(continued):*

Section 1103(f) of the Ethics Act, 65 Pa.C.S. § 1103(f), states, in part: “No public official or public employee or his spouse or child or any business in which the person or his spouse or child is associated shall enter into any contract . . . with the governmental body with which the public official or public employee is associated or any subcontract . . . unless the contract has been awarded **through an open and public process**, including prior public notice and subsequent public disclosure of all proposals considered and contracts awarded. In such a case, the public official or public employee shall not have any supervisory or overall responsibility for the implementation or administration of the contract . . .” [Emphasis added.]

Further, Section 1103(j) of the Ethics Act, 65 Pa.C.S. § 1103(j), states, “Any public official or public employee who in the discharge of his official duties would be required to vote on a matter that would result in a conflict of interest shall abstain from voting and, prior to the vote being taken, **publicly announce and disclose the nature of his interest** as a public record **in a written memorandum** filed with the person responsible for recording the minutes of the meeting at which the vote is taken, provided that whenever a governing body would be unable to take any action on a matter before it because the number of members of the body required to abstain from voting under the provisions of this section makes the majority or other legally required vote of approval unattainable, then such members shall be permitted to vote if disclosures are made as otherwise provided herein. . . .” [Emphasis added.]

board upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including **reasonable inquiry, skill and diligence**, as a person of ordinary prudence would use under similar circumstances.”<sup>15</sup>

According to several officials from the Cyber Charter School, the aforementioned issues occurred, in large part, due to the Cyber Charter School’s Founder and former CEO being very influential over the Cyber Charter School’s operations.

From a historical perspective, potential conflicts of interest existed since the Cyber Charter School was founded in 2000. For example, both the former and current CEOs of the Cyber Charter School simultaneously held key positions—Superintendent and school board director, respectively—with the local school district, which had authorized the original charter for the Cyber Charter School. Most of the questions raised, however, stemmed from the potential conflicts of interests and the relationships between the Cyber Charter School’s Founder and former CEO and his other related party entities with which the Cyber Charter School was conducting business. (See page 4, *Background Information on PA Cyber Charter School* for further information regarding the Governance Structure, Related Party Entities, and Related Party Timeline.)

#### Potential Conflicts of Interests and Related Party Transactions

**Related management company contract.** Current best business practices recommend increased transparency and public competitive bidding to help optimize pricing and quality for goods and services. The Cyber Charter School contracted with a related Management Company to provide curriculum services costing over \$110 million and management services costing over \$42.8 million for the three years ending June 30, 2014. Since the Cyber Charter School’s Founder and former CEO was also the founder and former executive of the Management Company, this raises possible concerns about the contract not being awarded through an open and public process pursuant to Section 1103(f) of the Ethics Act and not being awarded

<sup>15</sup> 15 Pa.C.S. § 5712(a). [Emphasis added.]

consistent with best business practices. Furthermore, we found significant contract flaws and poor Board oversight of the services provided and the corresponding costs (see Finding No. 2).

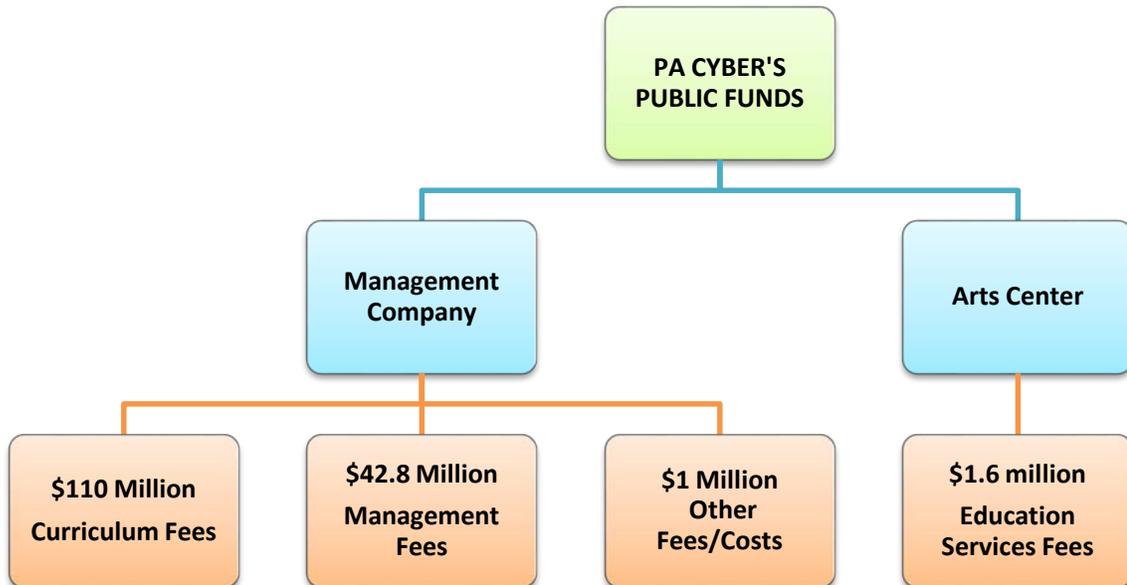
**Related arts services contract.** The Cyber Charter School contracted with a related performing arts center to provide arts education services to the Cyber Charter School. The Cyber Charter School paid over \$1.6 million to the Arts Center for services for the three years ended June 30, 2014, and has a \$6.8 million long-term note receivable as of June 30, 2014, from a questionable pre-paid lease agreement transaction, which occurred while the Arts Center was still under construction. Because the Founder and former CEO was also the founder of the Arts Center, and because of several other related parties, these transactions may have been a conflict of interest since they occurred without an open and public process to include opportunities for other arts education professionals. Further, there were concerns about the contract not being awarded consistent with best business practices (see Finding No. 3).

As illustrated in the following chart, more than \$155 million in public funds flowed from the Cyber Charter School to its Management Company and the Arts Center during the three-year audit period ending June 30, 2014. By not providing proper oversight and full public disclosure over these two contracts, we believe the Board failed to mitigate potential conflicts of interest and questionable related party transactions and did not follow best business practices.<sup>16</sup>

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<sup>16</sup> Another related party transaction involving a \$6.8 million long-term note receivable from the Arts Center as of June 30, 2014, is discussed in Finding No. 3.

Figure 2. Public Funds paid to Management Company & Arts Center during three years ending June 30, 2014.



#### Related Party Trustees & Administrators

The following Trustees and administrators served in their respective capacities during part or all of the three-year audit period ending June 30, 2014, and were related to other individuals or organizations doing business with the Cyber Charter School:

**Current CEO's Spouse.** During the audit period, the current CEO's spouse served as a compensated employee and as the board secretary for the Arts Center, another significant vendor of the Cyber Charter School, which may have presented a potential conflict of interest.

**Trustee #1 and His Son.** Trustee #1 first became a Trustee in 2005 and continued to serve throughout the audit period. Since 2005, this Trustee's son was employed as Director of Operations for the Management Company. The son is also the executive director of the Arts Center.<sup>17</sup> As such, potential conflicts of interest existed with these related party contracts because the Trustee's immediate family member holds key positions with two entities

<sup>17</sup> Lincoln Learning Solutions, Inc. (formerly National Network of Digital Schools). <http://lincolnlearningsolutions.org/About>. Trustee #1's son was listed as Director of Operations. Accessed on December 11, 2015.

providing services to the Cyber Charter School (see also Finding No. 2).

For the three-year audit period, we found that, although the Trustee abstained from all votes pertaining to contractors with whom his son was affiliated, we found only one instance where the required disclosure form was provided, and it did not state the reason for the abstention, as required by the Ethics Act. These repeated failures to disclose the family relationship appear to be in noncompliance with the Ethics Act.

**Trustee #2.** This Trustee was appointed to the Board in May 2014. He was also an executive director of a local community college, according to the college's website.<sup>18</sup> In August 2015, the Cyber Charter School entered into a contract with the community college for rental of one of its facilities for teacher in-service training. While the Trustee abstained from the vote, he failed to file the required disclosure statement to accompany the minutes. Furthermore, the Board approved this contract without an open and public process. Since the Trustee held an executive position with the community college and because other individuals were not given the opportunity to contract with the Cyber Charter School in an open and public process, this arrangement may have constituted a conflict of interest or at least a lack of public accountability even though the Trustee abstained from the vote.

**Trustee #3.** A former Trustee of the Cyber Charter School became a senior administrator at the local school district, which previously had been led by the former CEO and founder of the Cyber Charter School, as discussed earlier. The former Trustee also served as board president for the Cyber Charter School's Management Company from July 1, 2011, through August 2012, when she resigned. She also served as a board member for the Arts Center during two of the three years in the audit period.

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<sup>18</sup> Community College of Beaver County. <http://www.ccbc.edu/About>. Trustee #2 was listed as Director of Institutional Research. Accessed on December 15, 2015.

While this former Trustee's duties at each related entity may not have presented a direct conflict of interest, the movement from Trustee of the Cyber Charter School to employment at the local school district as a senior administrator, as well as her service as board president of the Management Company and her service on the board of another related contractor, further illustrates the close relationship between the Cyber Charter School and its contractors.

**Trustee #4 and His Daughter.** A former Trustee, who served as Board President during part of the audit period, may have been involved in a conflict of interest when his daughter received a tuition reimbursement benefit from the Cyber Charter School for concurrent college enrollment courses while she was a student of the Cyber Charter School. This benefit was afforded after a previous tuition reimbursement program ended, and the Trustee's daughter appears to be the only student who received the benefit (see also Finding No. 4).

**Trustee #5.** Trustee #5 served on the Board from April 2008 to June 2011. During that time period, the Cyber Charter School contracted with a computer equipment company (Company) co-owned by the Trustee. Board meeting minutes failed to disclose the Trustee's relationship to this Company. During the 2010-11 school year when the Trustee was still on the Board, the Cyber Charter School paid the Company over \$1.1 million. Payments to the Company continued through the 2013-14 school year after the Trustee resigned (see also Finding No. 5).

**Senior Administrators #1 and #2.** Senior Administrator #1 was an executive listed on the Cyber Charter School's IRS Form 990 in 2012 and 2013. In the 2014-15 school year, he became director of professional development and teacher certifications. His spouse, Senior Administrator #2, was appointed Board Secretary in 2012 and is also a Senior Administrator at the Cyber Charter School. She first served as director of employee relations and human resource policy administration. Then in September 2015, she was appointed director of human resources. Their positions, one as a senior administrator and the other as a senior administrator and non-voting board member, may present a conflict of interest.

**Senior Administrator #3.** This senior administrator was the special education director for the Cyber Charter School from the 2003-04 school year until her resignation on July 1, 2008. While still employed by the Cyber Charter School as the special education director, she was also appointed in February 2006 as CEO of a related brick and mortar charter school also founded by the former CEO, which opened in 2006. She served as CEO of that school until 2013.<sup>19</sup>

Her simultaneous duties at the two schools may have presented a conflict of interest. At a minimum, her executive roles at these related entities provide another example of the close relationship between the Cyber Charter School and the related entities founded by the former CEO.

**Accounting Firm.** The accounting firm provided audit services to the Cyber Charter School in three of its early years, prior to the current audit period. It prepared the Annual Financial Reports for the original, authorizing local school district between the 2006 and 2010 school years.<sup>20</sup> The same accounting firm prepared financial documents for the related party entities discussed in this audit report. Specifically, it prepared the IRS 990 forms for the Cyber Charter School, its Management Company, the Arts Center, and the related brick and mortar charter school for several years during the three-year audit period ending June 30, 2014. For at least two of the three years in the audit period, the accounting firm was listed among the five highest paid contractors of the Cyber Charter School's Management Company according to the IRS form 990.<sup>21</sup>

In October 2014, the Cyber Charter School's Management Company "absorbed" the accounting firm.<sup>22</sup> The current business manager of the local school district was previously employed by the accounting firm.

The relationship of the accounting firm to all of the related party entities founded by the Cyber Charter School's

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<sup>19</sup> According to the Cyber Charter School's board meeting minutes, senior administrator #3 resigned her post as Special Education Director effective July 1, 2008. According to the board meeting minutes of the Lincoln Park Performing Arts Charter School, she was appointed CEO as of February 16, 2006.

<sup>20</sup> Annual Financial Reports are filed annually with PDE.

<sup>21</sup> During the audit, we did not have access to the 2013-14 IRS form 990 for the Management Company.

<sup>22</sup> Bob Clements, "concerning the absorption of all Cottrill employees effective December 1, 2014," e-mail message, October 16, 2014.

Founder and former CEO further illustrates the close relationship between these entities and individuals.

### Summary

Because of the numerous related parties highlighted above, the Board should have implemented strict measures to ensure the Cyber Charter School maintained compliance with the CSL and the Ethics Act in order to avoid conflicts of interest and to mitigate any appearances of impropriety. It should have also implemented best business practices to optimize transparency and accountability in the conduct of all business on behalf of the Cyber Charter School.

Instead, the Board executed contracts and amendments with the Management Company, the Arts Center, and other related entities throughout the audit period without conducting open and public procedures. Then it failed to monitor the services and costs related to those contracts. In a further failure to be transparent, three Trustees did not file the necessary disclosure statements noting the reasons why they abstained from particular board votes. This lack of disclosure also may have constituted a failure to comply with the Ethics Act.

### **Recommendations**

The *Pennsylvania Cyber Charter School* should do the following:

1. Immediately take steps to identify all related parties and all potential conflicts of interest related to its Trustees, senior administrators, and contracted vendors. Any actual conflicts of interest should be transparently reported and promptly rectified.
2. Consult with its solicitor regarding legal requirements for compliance with the CSL and the Ethics Act specific to related parties and related party transactions.
3. Establish best business practices to ensure that the Cyber Charter School is engaging with vendors at arms-length with regard to the education of Commonwealth students and the management of operations, including the use of public funds. These

practices should include the establishment of policies addressing:

- a. Public procurement of professional services with a cost-basis approach to pricing and proposals. (Refer also to Finding No. 2 for additional recommendations regarding procurement and contracting.)
- b. Regular reporting by senior administrators to the Board regarding contract monitoring of professional services. This reporting should evaluate both the quality of services received and the corresponding costs. The Board should be required to publicly review and approve these reports as part of the Cyber Charter School's implementation of best business practices.

### **Management Response**

The Cyber Charter School's management disagreed with our finding and provided a lengthy response which can be found in Appendix A. The following is the management response to each recommendation:

Recommendation No. 1: "PA Cyber has instituted a robust Conflict of Interest Policy as it relates to Trustees and Administrators and requires Board members to attach a written memorandum to the meeting minutes memorializing abstention from any vote....The School also regularly and consistently seeks to obtain the best products and services at the best price through bids, RFPs, and obtaining quotes. Additionally, PA Cyber agrees that it will review its present contracts in an effort to identify any actual and/or potential conflicts of interest and will report the same."

Recommendation No. 2: "PA Cyber has worked extensively with counsel to develop and implement policies and best practices with respect to purchasing, contracting, financial reporting to the Board, and conflicts of interest....Both parties will continue to do so."

Recommendation No. 3: "With respect to Subsection (a), PA Cyber has already implemented a cost-based

approach to contracting and purchasing, as reflected in the RFP seeking new management services after the contract with the Management Company expired. The prior contract required payments based upon a percentage of revenue, but all new contracted-for services are now awarded and provided on a cost based approach.”

“With respect to [Recommendation No.3] Subsection (b), PA Cyber acknowledges that, under the CSL, the Board “shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school’s charter.” 24 P.S. § 17-1716A(1). PA Cyber disagrees, however, that it is either feasible or an efficient use of resources to provide the Board with reports and/or updates regarding every one of the hundreds of contracts PA Cyber enters into on a regular basis. Nevertheless, at every Board meeting, the School’s Management Company, Lincoln Learning Solutions, provides for the Board’s review of an extensive oral and PowerPoint report on performance of its professional services contracts. Such contracts represent a majority of the School’s contracted professional services. PA Cyber will also work with counsel to develop ways for the Administration to provide input and feedback to the Board with respect to contracted-for services.”

### **Auditor Conclusion**

While management disagreed with our finding, we are pleased that the Cyber Charter School has acknowledged a commitment to establishing best practices with regard to public contracting, including the establishment of policies and improved procedures to identify and properly disclose to the public related parties and to prevent conflicts of interest. We caution the Cyber Charter School and its Board, however, that with regard to governance of its contracts, it should ensure that its policies and procedures require appropriate routine monitoring of contracts to ensure proper delivery of goods and services, which will allow for timely recourse in the event of a vendor’s failure to deliver and which will aid in preventing waste of public funds.

## Finding No. 2

### Lack of Oversight Led to High Costs and Poor Accountability from a Related Management Company

*Criteria relevant to the finding:*

Section 1716-A(a) of the CSL, 24 P.S. § 17-1716-A(a), states: “The board of trustees shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school’s charter. The board shall have the authority to employ, discharge and contract with necessary professional and nonprofessional employee’s subject to the school’s charter and the provisions of this article.”

Section 1715-A(11) of the CSL, 24 P.S. § 17-1715-A(11), states: “Trustees of a charter school shall be public officials.”

Section 1715-A(12) of the CSL, 24 P.S. § 17-1715-A(12), states, in part: “. . . A person who serves as an administrator for a charter school shall be a public official under 65 Pa.C.S. Ch. 11 (relating to ethics standards and financial disclosure). A violation of this clause shall constitute a violation of 65 Pa.C.S § 1103(a) (relating to restricted activities), and the violator shall be subject to the penalties imposed under the jurisdiction of the State Ethics Commission.”

Charter schools, just like school districts, do not have any bidding requirements for the procurement of professional services. However, best practices for publicly-funded organizations commonly recommend competitive selection procedures for procurement of professional services.

The Board and the Cyber Charter School administrators failed to oversee the curriculum, management, and other services provided by the Management Company. Because this contractor was a related party and potential conflicts of interest existed, the need for appropriate governance was heightened in order to ensure both transparency and accountability connected to these services, which cost an average of \$51.3 million annually for the three years ending June 30, 2014. Instead, failed oversight resulted in poor delivery of curriculum services, inadequate accounting for management services, and an improper Board waiver of nonperformance penalties of at least \$4.2 million.

As noted in Finding No. 1, the Trustees have a responsibility for maintaining the ultimate control over the operations of the Cyber Charter School. In addition, the Trustees have the fiduciary duty of acting in good faith pertaining to the Cyber Charter School’s best interests at all times and utilizing reasonable inquiry, skill, and diligence in monitoring the Cyber Charter School’s operations pursuant to the Nonprofit Corporation Law of 1988.<sup>23</sup>

#### **Related Management Company is Highest Paid Contractor.**

The Cyber Charter School contracted with a related party Management Company to provide a wide range of services, from the leasing of curriculum to management services, which included accounting, legal assistance, human resources, maintenance, and information technology services. As a result, the Management Company was the Cyber Charter School’s highest paid contractor.

<sup>23</sup> 15 Pa.C.S. § 5712(a).

*Criteria relevant to the finding (continued):*

Section 1102 of the Ethics Act, 65 Pa.C.S. § 1102, defines the following terms:

*Business with which he is associated* is defined as “Any business in which the person or a member of the person’s immediate family is a director, officer, owner, employee or has a financial interest.”

*A conflict or conflict of interest* is defined, in part, as the “Use by a public official or public employee of the authority of his office or employment or any confidential information received through his holding public office or employment for the private pecuniary benefit of himself, a member of his immediate family or a business with which he or a member of his family is associated. . . .”

*Immediate family* is defined as “A parent, spouse, child, brother or sister.”

Section 1103(a) of the Ethics Act, 65 Pa.C.S. § 1103(a), states: “No public official or public employee shall engage in conduct that constitutes a conflict of interest.”

Payments totaling \$153 million over three years are illustrated in the following chart.<sup>24</sup>

PA CYBER MANAGEMENT COMPANY PAYMENTS				
School Year	Curriculum	Management Services	Other Costs <sup>25</sup>	Total
2011-12	\$ 37,061,877	\$11,718,836	\$510,812	\$ 49,291,525
2012-13	\$ 34,748,362	\$15,834,686	\$319,065	\$ 50,902,113
2013-14	\$ 38,225,641	\$15,234,768	\$149,744	\$ 53,610,153
<b>Total</b>	<b>\$110,035,880</b>	<b>\$42,788,290</b>	<b>\$979,621</b>	<b>\$153,803,791</b>

**Same founder of both entities.** Since both the Management Company and the Cyber Charter School were founded by the same person, who also served as the Cyber Charter School’s CEO until June 2012, it was even more incumbent upon the Board to closely scrutinize the terms of its contracts, amendments, and addendums thereto, in order to be more transparent and to hold the related Management Company accountable. The Board was also duty-bound to monitor all of these services and related costs to comply with the CSL and to implement best practices in governing the operations of the Cyber Charter School. Even though the Cyber Charter School contracted with a Management Company, both the CSL<sup>26</sup> and Pennsylvania case law<sup>27</sup> require the Board to retain ultimate authority over the general operations of the Cyber Charter School, and not a founder or any management company hired by the Board.

While the Ethics Act contains provisions for mitigating potential conflicts of interest through an open and public process, the Cyber Charter School did not solicit bids for management services or curriculum at any time prior to and including the three-year audit period ending June 30, 2014. The founder and former executive of the Management Company and the founding CEO of the Cyber Charter School were the same person. Therefore, we believe the

<sup>24</sup> The breakdown of costs paid to the Management Company was derived from the Cyber Charter School’s multi-year disbursements register, which we then compared the numbers to other consulting reports and/or local audit reports to determine data reliability. Also, per the Cyber Charter School’s IRS Form 990 for each year in the audit period, the Management Company is the Cyber Charter School’s highest paid contractor.

<sup>25</sup> These costs included postage, advertising, and rental of a wellness center at the local school district on behalf of the Cyber Charter School’s employees.

<sup>26</sup> 24 P.S. § 17-1716-A(a) is applicable to cyber charters by way of its incorporation through 24 P.S. § 17-1749-A(a)(1).

<sup>27</sup> *West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).

*Criteria relevant to the finding  
(continued):*

Section 1103(f) of the Ethics Act, 65 Pa.C.S. § 1103(f), states, in part: “No public official or public employee or his spouse or child or any business in which the person or his spouse or child is associated shall enter into any contract . . . with the governmental body with which the public official or public employee is associated or any subcontract . . . unless the contract has been awarded through **an open and public process**, including prior public notice and subsequent public disclosure of all proposals considered and contracts awarded. In such a case, the public official or public employee shall not have any supervisory or overall responsibility for the implementation or administration of the contract . . .” [Emphasis added.]

Cyber Charter School may not have been in compliance with the Ethics Act for at least the entire audit period because of potential conflicts of interest and potential impermissible “related party” transactions.

**Another related party concern.** During the three-year audit period ending June 30, 2014, the Board annually approved curriculum price lists and a one-page Memorandum of Understanding (MOU) in the summer months prior to the start of each school year. The son of a Trustee signed all three MOUs as a representative of the Management Company.<sup>28</sup>

In addition, the Trustee whose son was an executive with the Management Company served on the Cyber Charter School’s Board from 2005 to the present and served as Board President from July 30, 2007 to June 30, 2009, and again from July 21, 2014 until July 13, 2015. During the 2014-15 school year and his second term as Board President, the Cyber Charter School solicited bids for both curriculum and separate management services. The same Management Company was awarded all of the contracts. The terms of these contracts will be further discussed later in this finding.

As you will see from the rest of this finding, the related party concerns highlighted above obligated the Board and the Cyber Charter School’s administrators to provide sufficient oversight. Meanwhile, the cost of services provided by the Management Company comprised an increasing portion of the Cyber Charter School’s total expenses in the three-year audit period ending June 30, 2014, as demonstrated in the next table:

PA CYBER MANAGEMENT COMPANY COST ANALYSIS			
School Year	Management Company Costs	Total Expenses <sup>29</sup>	Costs as % of Total Expenses
2011-12	\$49,291,525	\$110,003,376	44.8%
2012-13	\$50,902,113	\$110,562,823	46.0%
2013-14	\$53,610,153	\$111,765,437	48.0%
<b>Total</b>	<b>\$153,803,790</b>	<b>\$332,331,636</b>	<b>46.2%</b>

<sup>28</sup> According to an amendment dated July 1, 2007, curriculum services would be provided “at the lowest prices for which the [Management Company] sells the same to any third party in the United States.” It also said, the Management Company “shall provide the Services and perform its obligations hereunder in good faith, in a diligent and timely manner.”

<sup>29</sup> Represents the Total Expenses from Governmental Activities per the Independent Auditor’s Report for each school year.

## Contract Terms Were Weak.

**Broad, vague menu of management services.** The management services agreement in place during the three-year audit period was built upon the terms of the original agreement signed in August 2005 and modified in subsequent years by two amendments and two addendums. The agreement governing the audit period enumerated a broad range of services to be provided, including general business advice, assistance with contract negotiations, accounting and legal assistance, professional development and human resources services, marketing, curriculum development, quality assurance, procurement, and technology and other services. The parameters of each of these types of services were not further specified in the contract, nor did the contract contain any performance measures or accountability requirements.

The initial term of this vague professional services agreement was for one year, but it allowed for automatic, unlimited one-year renewal terms. Best business practices discourage automatic renewal clauses because they do not foster competitive pricing and services.<sup>30</sup>

In addition, rather than a cost-based fee formula, the agreement stipulated that the Management Company would receive 12 percent of the Cyber Charter School's revenues received from the state and local school districts. This type of revenue-based fee structure further eroded the level of accountability required of the contractor, since fees were not based upon actual costs of services.<sup>31</sup>

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<sup>30</sup> One of several sources of best practices recommendations is from the IBM Center for the Business of Government. "Effectively Managing Professional Services Contracts: 12 Best Practices." 2006.

<sup>31</sup> The original agreement includes, as part of the fee formula, revenues from school districts "within or outside the Commonwealth of Pennsylvania." The CSL prohibits cyber charter schools from teaching students who reside outside the Commonwealth with state funds. The federal indictment cited in the first finding, however, alleged that out-of-state students were taught by the Cyber Charter School. The current CEO, employed in a senior administrative position since the Cyber Charter School's inception, said he was aware of the allegations in the indictment, but has no knowledge of the Cyber Charter School ever teaching out-of-state students and said the Cyber Charter School's residency requirements would have provided safeguards against that during the 3-year audit period ending June 30, 2014. We did not conduct testing to verify whether all students during the audit period had valid Pennsylvania residency. It should be noted that the CSL limits charter and cyber charter schools to those approved by a local board of directors in Pennsylvania or by PDE, respectively. *See* 24 P.S. § 17-1703-A.

**Curriculum contracts without substance.** The purchasing of curriculum from the Management Company was authorized by a one-page MOU approved by the Board in each year of the audit period.<sup>32</sup> Since the Cyber Charter School spent more than \$110 million on curriculum in the three-year audit period, best practices would have required substantive contracts that included detailed terms and conditions. For example, there were no nonperformance penalties provided in the MOUs in the event of the contractor’s failure to deliver, nor were there terms addressing recourse for the Cyber Charter School in the event the curriculum delivered was less than satisfactory.

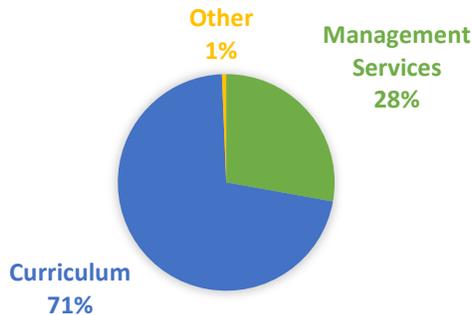
At no time during the audit period or prior did the Cyber Charter School solicit bids from other contractors for either curriculum or management services. As a result, the Cyber Charter School could not have appropriately determined whether the quality and cost of these services were appropriate.

**Contract Monitoring Procedures Were Weak.**

**Weaknesses in monitoring curriculum.** As demonstrated in the following chart, curriculum costs comprised about 71 percent, or \$110 million, of total payments of \$153.8 million to the Management Company for the three-year audit period ending June 30, 2014.

**PAYMENTS TO MANAGEMENT COMPANY  
3 YEARS ENDING JUNE 30, 2014**

YEARLY AVERAGE = \$51.3 MILLION



<sup>32</sup> Curriculum includes “courses and course services, course kits, and materials according to the pricing lists attached to this memorandum.” Curriculum costs were charged on a per-course/per-student basis. For physical education courses purchased from the Management Company, the course material included a Fitbit, which is an activity tracker that students can wear to measure steps, heart rate, and other data. They are not required to be returned by students once the course is completed.

We found there was no formal process for administrators in charge of curriculum or for teachers and students who used the curriculum to provide input or feedback on the curriculum's effectiveness or lack thereof. The only record of problems or concerns with curriculum would have been in the form of informal email correspondence. The Board did not receive or review reports on the delivery of curriculum or users' evaluations of it. We also found no evidence the Board formally reviewed its curriculum fee structure and compared it to other Cyber Charter Schools to determine whether the curriculum costs charged to the Cyber Charter School were appropriate and comparable to market prices.

**Poor oversight of management services.** In an interview with several senior administrators of the Cyber Charter School, one acknowledged that the reporting to the Board on the Management Company's work performance was "insufficient and perfunctory at best." We found that the Management Company provided monthly service reports to the Board; however, these reports were determined to contain insufficient details of staffing, resources, and services provided.

During the interview, we also learned that for the audit period, the Management Company's staff worked in the same premises as the Cyber Charter School's business staff, human resources staff, and other staff. One senior administrator said there were "distinct duties to what is performed" and some delineation existed. However, without a written agreement containing clearly defined roles and expectations for the Management Company's staff and the Cyber Charter School's staff, the Cyber Charter School could have been paying for services that its own staff were already providing.

We reviewed the board meeting minutes for the audit period and noted no evidence of discussion or approval of any Management Company reports on the services provided and the corresponding costs for the three-year audit period ending June 30, 2014. As noted earlier, these services, for which there was little to no oversight, comprised 48 percent of the Cyber Charter School's total expenses in the 2013-14 school year.

**Missed opportunities to make improvements.** The Cyber Charter School missed valuable opportunities to improve its management services when it received the results of independent reviews of its management contracts. In addition to the Department of the Auditor General’s prior audit report, which contained several recommendations, we also reviewed two consultant reports that analyzed the Cyber Charter School’s management costs.

**Prior audit recommendations.** The previous audit report from the Department of the Auditor General, dated December 2012, also observed a related party issue and included among others, a recommendation for the Cyber Charter School to reevaluate its management services fees so that they are not revenue-based and another recommendation to ensure the fees paid for management services do not duplicate job duties performed by the Cyber Charter School’s employees.

**The 2010 consultant report.** A March 26, 2010 report was issued by a CPA firm that performed a cost analysis of the management services paid by the Cyber Charter School in the school year ended June 30, 2009.<sup>33</sup> This report, if issued sooner, possibly could have been used by the Cyber Charter School to review its management services and costs *before* it signed a five-year amendment to the original agreement in February 2010.

While the report concluded that management costs paid for the year ended June 30, 2009, were “reasonable,” it also showed in all three exhibits that the Cyber Charter School incurred a higher percentage of management costs relative to revenues when compared to selected Pennsylvania school districts and other cyber charter schools.

We found no evidence in the board meeting minutes that this report was ever reviewed or discussed. We also could not confirm whether the Cyber Charter School or the Management Company paid for the report. The current CEO, who provided us with a copy of the report, did not

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<sup>33</sup> Herbein + Company, Inc. Certified Public Accountants. Letter to W. Timothy Barry & Associates, LLC. Re: “The First Amended and Restated Management Agreement between the Pennsylvania Cyber Charter School and National Network of Digital Cyber Charter Schools Management Foundation (the “Agreement”). March 26, 2010. W. Timothy Barry & Associates is listed as a Cyber Charter School vendor receiving fees through the 2012-13 school year. In 2010, the year the report was issued, the firm was paid over \$190,000 by the Cyber Charter School. The report did not analyze the curriculum costs.

know whether the Founder and Former CEO presented it to the Board at the time.

**The 2015 consultant report.** In January 2015, a second consulting firm issued a report on its review of the 2010 amended agreement with the Management Company, which is the management services agreement that was in effect over the three-year audit period ending June 30, 2014. Its scope was limited to two school years, 2012-13 and 2013-14, both of which are included in our audit period. The report had eight findings and two recommendations.<sup>34</sup>

Included in the eight was one finding that the scope of the contract lacked specificity regarding the Management Company's contractual obligations, and the scope did not reflect the "actual service delivery mode in place" at the Cyber Charter School. Another significant finding noted in the consultant's report was that the Management Company service reports did not contain "accurate staffing or service information" and the Management Company did not provide "documentation of the actual resources and services" provided.<sup>35</sup>

The recommendations in the report were commonly accepted best business practices and should have been implemented by the Cyber Charter School and its Board from the beginning of its relationship with the Management Company, particularly because of the numerous related parties and potential conflicts of interest.

### **Inadequate Improvements Resulted from 2014-15 Bids.**

After years of allowing automatic renewals of vague agreements with the Management Company, the Cyber Charter School finally solicited bids in the 2014-15 school year around the same time that the second consulting group was conducting its study of the Cyber Charter School's management services. Soliciting bids was important because it was an opportunity for the Cyber Charter School to potentially receive lower prices and improved services. The Board awarded all of its new contracts and agreements

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<sup>34</sup> ClarusGroup. "Review and Evaluation of the Management Contract Between PA Cyber Charter School and the National Network of Digital Schools Management Foundation." January 23, 2015.

<sup>35</sup> Ibid.

to the same related Management Company, and as you will see below, we still have concerns about the new agreements. In addition, the Cyber Charter School and its Board continue to fail to properly hold this contractor accountable.

**The management services bids.** Senior administrators of the Cyber Charter School said that when it solicited bids for separate management services during the 2014-15 school year, those bids yielded improved agreement terms and services on behalf of the Cyber Charter School. We reviewed these agreements, all of which were awarded to the same related Management Company. While we found improvements in the contract terms, including a more specific scope of services to be provided by the Management Company in each of the agreements, we also found language that may allow for renewal options without an open and public process. But the greater concern we have is that, without improved oversight by the Board and the administration, the effectiveness of these new agreements may be limited. As you will see later in the discussion of the new curriculum agreement, improved terms in an agreement may be rendered ineffective when the Board fails to enforce those terms.

**The curriculum bids.** According to the current CEO, the criteria for evaluation of the bids were developed by the current CEO, the Deputy Chief Academic Officer, and a board member. Thirteen bids were received for curriculum, and the Cyber Charter School ultimately selected the same related Management Company's bid. Thus, a new five-year curriculum agreement was awarded to the original related party Management Company on January 26, 2015.

Our review of the new curriculum agreement found that it contains more details than the previous one-page MOUs. It contains, for instance, a nonperformance clause, and it establishes a new cost structure based upon a per-seat fee with minimum and maximum enrollment ranges, as well as other fees. While the new curriculum agreement appeared to be a step in the right direction toward increased accountability, the Board continued its practice of poor governance with respect to public funds. Specifically, we found that the Board did not enforce the nonperformance clause when the Management Company failed to deliver

the curriculum timely. Details of this issue are discussed in the next section.

### **The Board Waives \$4.2 Million in Nonperformance Penalties.**

One of the most notable examples of the Board's poor stewardship of public funds involved a recent amendment passed in December 2015, which *retroactively* eliminated penalties for the Management Company's failure to deliver new curriculum on time. As further explained in the forthcoming paragraphs, this amendment may not have been in compliance with the Ethics Act.<sup>36</sup>

**Failure to deliver curriculum.** The most recently authorized curriculum agreement between the Cyber Charter School and the Management Company stipulated a new curriculum would be developed by the Management Company to replace the Legacy curriculum, which had been in use during the audit period. According to the agreement, the new curriculum would be fully implemented in time for the 2015-16 school year. The new agreement established a nonperformance clause with deadlines for different stages in the delivery of curriculum, and it levied penalties, in the form of price discounts, if deadlines were missed.

According to senior administrative officials, the Management Company missed at least three of the four deadlines established in the agreement. According to our calculations, which were corroborated by the administration, the Cyber Charter School should have received a discount of at least \$4.2 million for the Management Company's failure to deliver curriculum on time. Yet, the Cyber Charter School did not pursue the discounts for the Management Company's failure to deliver curriculum.

**Board waiver of nonperformance penalties.** Instead, in December 2015, the Board approved, by a vote of 5-0, an amendment to *retroactively* eliminate the nonperformance clauses. This amendment was approved well *after* the final August 31, 2015 deadline had been missed and those

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<sup>36</sup> See 65 Pa.C.S. § 1103(a) which provides, in part, as follows: "(a) Conflict of interest.--No public official or public employee shall engage in conduct that constitutes a conflict of interest."

penalties would have already been incurred and owed to the Cyber Charter School.<sup>37</sup>

**Another possible conflict of interest.** The aforementioned motion to amend the agreement eliminating the nonperformance penalties was introduced by the Trustee whose son was an executive of the Management Company and who signed all three MOUs approving curriculum price lists for the audit period ending June 30, 2014. He then voted unanimously with the other Trustees to eliminate the nonperformance penalties. This motion and the subsequent vote may have been a conflict of interest and may have resulted in the Cyber Charter School failing to comply with the Ethics Act.<sup>38</sup>

The board vote summarized in the previous paragraphs indicates that the Cyber Charter School and its Board, at a minimum, continued to ignore commonly accepted best business practices and disregarded any concern for the appearance of impropriety on behalf of its students and the taxpayers of the Commonwealth of Pennsylvania.

### **Summary**

The numerous related party issues and the resulting potential conflicts of interest connected with the Cyber Charter School and its Management Company required heightened oversight of the broad menu of services provided by this contractor. Yet, it appears as though the opposite occurred, and the Management Company was paid over \$153 million in the three-year audit period – nearly half of the Cyber Charter School’s annual expenditures for that period – with poor monitoring by the Cyber Charter School and its Board.

But the apparent failure to govern did not stop at the end of the three-year audit period of June 30, 2014. It persisted as exemplified by the December 2015 unanimous vote by the Board to waive nonperformance penalties of approximately \$4.2 million when the Management Company failed to

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<sup>37</sup> By the start of the 2015-16 school year, the Management Company had only delivered 5 elective courses, and for the upcoming 2016-17 school year, it had only provided 18 of over 140 courses that should have been delivered to the Cyber Charter School by the August 31, 2015 deadline. Even by the close of fieldwork in March 2016, the Management Company still had not delivered the curriculum that should have been delivered by August 2015.

<sup>38</sup> According to the Cyber Charter School’s administration, the son of the Trustee who made the motion was still employed by the Management Company at the time of the vote, but has subsequently left employment there to take a senior administrative position at the related Arts Center.

deliver curriculum. This waiver represented another failure by the Cyber Charter School and its Board in their stewardship of public funds, which were supposed to be designated for the education of Commonwealth students.

### **Recommendations**

The *Pennsylvania Cyber Charter School* should:

1. Immediately and publicly review its December 2015 amendment eliminating nonperformance penalties and consider rescinding this amendment and collecting the nonperformance penalties for the Management Company's failure to deliver curriculum on time.
2. Immediately review each of its board members' conflicts of interest and take action to mitigate all actual or apparent conflicts of interest related to the Cyber Charter School's Management Company.
3. Develop a standardized rubric for use by its administrators to evaluate each type of professional service it receives, including curriculum, and report to the Board monthly, or in some cases, quarterly on the receipt of these services. The Board should be required to review and approve these reports prior to making payments to contractors.
4. Enforce nonperformance clauses in all agreements and collect penalties not only to comply with its own contracts but also to foster the use of best practices by contractors.
5. Compare the types of services it receives from the Management Company, as well as the related fee structures, to other Pennsylvania public school entities and other cyber charter schools in other states, if necessary, including a thorough review of the curriculum leased from the Management Company. This comparison could help to determine whether the Cyber Charter School is receiving fair prices for the services it is receiving.

6. Revise all of its current agreements with the Management Company to include terms that will implement best business practices and impose checks on the power of the Management Company, such as:
  - a. Three-year term limits for services and elimination of any language that allows for renewal of agreements without an open and public process.
  - b. Establishment of routine reporting procedures on all contractors' work and required Board review and approval *prior* to payment.
  - c. Specific limitations on the Management Company's access to the Cyber Charter School and its records.

### **Management Response**

The Cyber Charter School's management disagreed with our finding and provided a lengthy response which can be found in Appendix A. The following is the management response, in part:

"The waiver of the nonperformance penalties resulted from a situation in which the School faced a need that only the Management Company could meet. It became clear during the curriculum development process that the School had expectations for a curriculum that the Management Company believed was in excess of the contract's requirements. The parties worked and continue to work to develop a curriculum that will satisfy student needs, but were unable to do so in time for the 2015-16 school year. Without the Management Company's agreement that the School could use the legacy curriculum, for which the School no longer had a license, the School would have been without any curriculum."

With regard to the waiver of the nonperformance penalties, Recommendation No. 1: "[t]he Board and Administration are currently reviewing possible courses of action. Rescission and renegotiation are under consideration."

Recommendation No. 2: "PA Cyber's Response to Finding 1, Recommendation 1 details the steps being taken to identify each members' possible conflicts and how those potential issues are being addressed."

Recommendation No. 3: “The Administration will work to develop contract rubrics that will make clear the School’s expectations with regard to the provided products or services. The rubrics will ensure that the Board has access to the most accurate performance information available.”

Recommendation No. 6: “The School and its management team have been reviewing its current contracts with the Management Company. However, these agreements were not made unilaterally. The School has been discussing internally as well as with the Management Company different ways to improve the curriculum and supply a product that meets our students’ needs. During these discussions, the School must balance the importance of maintaining financially responsible agreements with the need to avoid disrupting the essential services provided to our students. The Board will certainly ensure that any agreement renewal is achieved via an open and public process....School management is currently developing proper rubrics to review all contractor’s work.”

### **Auditor Conclusion**

We acknowledge the Cyber Charter School’s efforts to improve the management of its various contracts with the Management Company. However, the Cyber Charter School’s waiver of the nonperformance penalties—as recently as December 2015—related to the Management Company’s failure to deliver curriculum in accordance with its contract indicates that the Cyber Charter School still must improve its governance over its several contracts with this vendor.

Furthermore, management’s response that the Cyber Charter School’s waiver of the nonperformance penalties “resulted from a situation in which the School faced a need that only the Management Company could meet” raises concerns about the effectiveness of its bid solicitation process. Finally, this produces questions as to whether other vendors were provided sufficient information about curriculum development requirements and goals and/or whether other bidders’ prices may have been more realistic in relation to the bid requirements.

We are pleased that the Cyber Charter School is considering rescission and renegotiation of this contract and that it has agreed to “work to develop contract rubrics,” and that it is “reviewing its current contracts with the Management Company.” Further, while the Cyber Charter School has said that it is going to ensure that agreement renewals will occur in an open and public process, we believe it should eliminate all indefinite and automatic contract renewal clauses in its agreements, in order to actually achieve open and public procurement processes consistent with best practices.

### Finding No. 3

### The Cyber Charter School Conducted Transactions with a Related Performing Arts Center That May Have Been Financially Detrimental and Presented a Possible Conflict of Interest

*Criteria relevant to the finding:*

Section 1715-A(11) of the CSL, 24 P.S. § 1715-A(11), states: “Trustees of a charter school shall be public officials.”

Section 1715-A(12) of the CSL, 24 P.S. § 1715-A(12), states, in part: “A person who serves as an administrator for a charter school shall be a public official under 65 Pa.C.S. Ch. 11 (relating to ethics standards and financial disclosure). A violation of this clause shall constitute a violation of 65 Pa.C.S. § 1103(a) (relating to restricted activities), and the violator shall be subject to the penalties imposed under the jurisdiction of the State Ethics Commission.”

Section 1102 of the (Ethics Act, 65 Pa.C.S. § 1102, defines the terms public official, immediate family, and conflicts of interest.

Subsection 1103(a) of the Ethics Act, 65 Pa.C.S. § 1103(a), states: “No public official or public employee shall engage in conduct that constitutes a conflict of interest.”

Best practices for publicly-funded organizations commonly recommend competitive selection procedures for procurement of professional services.

In 2005, the Cyber Charter School provided \$10 million to a local performing arts center while it was under construction. The transaction was originally classified as a pre-paid lease even though the Arts Center was still under construction and not yet in use. In 2009, the Cyber Charter School converted the \$8.5 million balance of the pre-paid lease to a 25-year note receivable, of which \$6.8 million was receivable as of June 30, 2014. We found that both transactions—the initial \$10 million pre-paid lease and the subsequent conversion in 2009 to a long-term note receivable—were fiscally irresponsible actions by the Cyber Charter School and a poor use of public funds, which, at a minimum, deprived the Cyber Charter School of an estimated \$1.4 million interest on the loan funds.

The Cyber Charter School also paid the Arts Center for arts education services without ever utilizing an open and public process for soliciting a public request for proposals or bids. These transactions failed to implement best business practices and may have presented conflicts of interest or at least a lack of public accountability because of the related parties discussed in the next section.

#### **Related Parties**

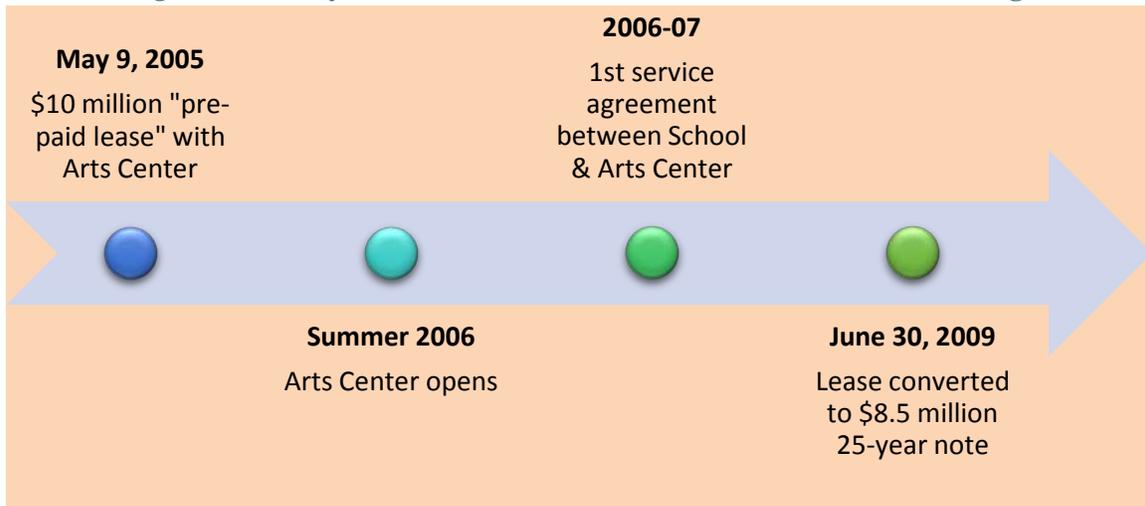
Transactions between the Cyber Charter School and the Arts Center may have constituted conflicts of interest due to the following related parties:

- The Founder and former CEO of the Cyber Charter School, who retired during the audit period, is also credited with founding the Arts Center, located in the same town as the Cyber Charter School’s central offices. He also served as executive director of the Arts Center in its early years, at times overlapping his duties as CEO of the Cyber Charter School and Superintendent of the local school district.

- One of the current Trustees on the Cyber Charter School’s Board is the father of the current executive director of the Arts Center.
- The spouse of the current CEO of the Cyber Charter School is the compensated, non-voting secretary to the Arts Center’s board.
- One of the Arts Center’s board members also served as a board member of the Cyber Charter School’s Management Company, and these roles overlapped during our three-year audit period ending June 30, 2014.

The timeline below highlights significant early transactions with the Arts Center, which we found, at a minimum, created potential conflicts of interest and which persisted throughout the audit period.

**Figure 3. PA Cyber Charter School & Arts Center Timeline of Significant**



Because of an appearance of impropriety and the negative financial impact which is discussed in further detail below, the Cyber Charter School should not have continued to carry a long-term note receivable from the Arts Center. To implement best business practices, the Cyber Charter School’s Board also should have sought proposals or bids for arts education services prior to awarding contracts to this related party organization. These two different financial issues are discussed further below.

## **The Note Receivable**

Two nearly identical pre-paid lease agreements with 20-year terms were signed on May 9, 2005 — one by the Cyber Charter School and the other by the local school district that granted the original charter for the Cyber Charter School. Except for the dollar amounts and signatories, the two leases were identical. Both leases were for the use of the same 88,000 square feet of the Arts Center, which was not yet available and under construction at the time of the lease signings. The Arts Center opened the following summer of 2006. The local school district pre-paid \$3 million and the Cyber Charter School pre-paid \$10 million for future use of the Arts Center. Four years later, on June 30, 2009, the Cyber Charter School’s Board approved the conversion of the \$8.5 million balance of the pre-paid lease to a 25-year note receivable requiring the Arts Center to pay the Cyber Charter School \$340,000 annually.<sup>39</sup>

By our estimate, if the \$8.5 million converted in 2009 to a 25-year long-term note receivable had instead been invested, it would have yielded more than \$1.4 million in interest income by the end of the 25 years.<sup>40</sup> This long-term note receivable is therefore a poor use of public funds, adding to the negative financial effect of the initial poor decision in 2005 to provide \$10 million to the Arts Center, classifying it as a so-called pre-paid lease while it was still under construction and while another school had entered a nearly identical arrangement for the same space.

Due to the negative financial impact, the Cyber Charter School should attempt to promptly collect the entire remaining balance owed from the Arts Center or else modify its education services agreements to offset fees paid to the Arts Center with an agreed-upon adjustment that will allow for an expedited reduction in the balance of the note receivable. In addition, we believe the pre-paid lease arrangement and the subsequent conversion to a note receivable, as recorded on the Cyber Charter School’s

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<sup>39</sup> The lease entered into by the local school district was also converted to a long-term note receivable in the 2013-14 school year and is addressed in the Department of the Auditor General’s report on Midland Borough School District dated August 22, 2016.

<sup>40</sup> We used the historical six-month LIBOR rates data table from [www.firstrepublic.com/finmkts/historical-interest-rates](http://www.firstrepublic.com/finmkts/historical-interest-rates). (LIBOR is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another.)

financial statements, may be in noncompliance with the Ethics Act in light of the number of related parties' transactions and potential conflicts of interest.

**Arts Education Services**

Beginning in the 2006-07 school year, the Cyber Charter School entered into arts education services agreements with the Arts Center. The courses provided by the Arts Center were non-credit, non-graded enrichment courses and programs provided to Cyber Charter School students. At no time between then and the end of our audit period did the Cyber Charter School publicly award these services through an open and public process. A public procurement process is especially important in this instance where there are so many related party transactions creating potential conflicts of interest and a lack of public accountability. A public bidding process not only creates potential competition, which can reduce the cost of services and increase the quality of these same services, it also increases transparency, openness, and public awareness of the contracts being awarded.

The following table illustrates the payment trends from the Cyber Charter School to the Arts Center over seven school years and totaling nearly \$3.2 million.<sup>41</sup>

<b>Payments from Cyber Charter School to Arts Center</b>	
<b>School year</b>	<b>Payments</b>
2008-09	\$ 377,636
2009-10	\$ 293,425
2010-11	\$ 406,356
2011-12	\$ 541,984
2012-13	\$ 519,054
2013-14	\$ 538,563
2014-15	\$ 506,406
<b>Total</b>	<b>\$3,183,424</b>

During the three-year audit period, the scope of services provided by the Arts Center varied slightly. For example, the 2013-14 agreement included tuition fees for ongoing

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<sup>41</sup> Payments to the Art Center were derived from the Cyber Charter School's multi-year disbursements register.

live classes, summer camps, and winter camps with varying per student/per week and per student/per day class rates depending upon the type of class.

If the Cyber Charter School itself provided the instructors for any of the arts programs, the Arts Center charged 40 percent of the per student fees. The Cyber Charter School was also required to pay an additional \$55 per class for each session, camp, workshop, etc. for additional services such as the generation of class descriptions, weekly syllabi, and lesson plans. The Cyber Charter School, rather than the Arts Center, was responsible for providing the facility space for classes. Therefore, rent and utilities were also included in the total amounts paid annually to the Arts Center. Because the Cyber Charter School did not award these services through an open and public process, we cannot determine whether the costs paid to the Arts Center were fair or appropriate.

In addition, the Cyber Charter School also agreed to pay \$600 per instructor per six-week class for one-hour per week enrichment courses for students in the Cyber Charter School's GATE/STARR program. It also agreed to pay \$4,500 for the Arts Center's provision of a music director and musicians at the Cyber Charter School's two graduation ceremonies. Again, without public procurement, we cannot determine whether such costs were fair or appropriate.

We believe the arts education services provided to the Cyber Charter School's students should have been competitively procured through an open and public bid or proposal solicitation process, in order to foster best business practices related to these services. When asked, Cyber Charter School administrators could not provide a reason for not having done so.

### **Recommendations**

The *Pennsylvania Cyber Charter School* should:

1. Renegotiate its agreement with the Arts Center regarding the long-term note receivable. At a minimum, it should seek to reduce payments to the Arts Center for arts education services by an agreed-upon percentage of the remaining note receivable in order to

reduce the negative financial impact of the long-term note receivable.

2. Develop and approve detailed procurement procedures for goods and services, including professional services, by establishing thresholds, restrictions regarding related parties, and other common best practices for awarding contracts using public funds.
3. Conduct an open and public procurement of arts education services in order to mitigate the effects of potential or actual conflicts of interest with the Arts Center.

### **Management Response**

The Cyber Charter School’s management disagreed with our finding and provided a detailed response which can be found in Appendix A. The following is the management response, in part:

“With respect to Recommendation 1, the note contains no provision allowing the parties to renegotiate its terms. As such, PA Cyber believes that it is not in its financial best interest to risk litigation and/or to incur the cost of such renegotiation at this time. PA Cyber also enjoys the security of the acceleration clause, which provides that if LPPAC fails to make payment of any installments of principal within 10 days of the due date, then the entire balance of the principal debt shall become immediately due and payable....Consequently, PA Cyber maintains that the note, as it is currently written, cannot and should not be amended....PA Cyber does, however, agree that adjustments to the cost of services provided by LPPAC could be explored in light of the long-term note obligation.”

Recommendation No. 2: The Cyber Charter School also stated that it had “developed and implemented rigorous procedures for obtaining goods and services that include safeguards designed to insure the disclosure of related-party relationships. Among those are a detailed Conflict of Interest and Code of Ethics Policy with respect to the Board of Trustees that tracks the requirements set forth in the Pennsylvania Ethics Act, 65 Pa. C.S. §§ 1102, 1103, as well as policies with respect to purchasing, contracting, and conflicts of interest....Additionally, bidders on professional

services have been required to provide a statement disclosing any relationship the potential vendor may have with PA Cyber or a member of its staff.”

Recommendation No. 3: “PA Cyber does intend to implement a public procurement bidding process for arts education services beginning in the 2017-2018 school year.”

### **Auditor Conclusion**

Since the Cyber Charter School acknowledges a close relationship with the Arts Center and since it previously agreed to terminate its lease agreement with the Arts Center, we again urge the Cyber Charter School to work with the Arts Center to renegotiate the terms of the note receivable in order to mitigate further negative financial effects on the Cyber Charter School and its public resources. We are pleased that it has agreed that it may alternatively adjust the cost of services provided by the Arts Center, and we recommend that it do so as soon as possible in order to mitigate further negative financial effects.

We are also pleased that the Cyber Charter School has implemented procedures to ensure proper disclosure of related parties and has stated its intention to implement “a public procurement bidding process for arts education services” in the 2017-18 school year. We will review that process and its results during our next audit of the Cyber Charter School.

#### Finding No. 4

### **The Cyber Charter School May Have Improperly Provided College Tuition Reimbursements of at Least \$32,328 on Behalf of a Board President’s Daughter and Have Offered a Formal Dual Enrollment Program in Noncompliance with the Public School Code Indicating Ineffective Governance and a Lack of Transparency**

*Criteria relevant to the finding:*

Subsection (a) of Section 1716-A (relating to Powers of the Board of Trustees) of the CSL, 24 P.S. § 1716-A(a), states: “The board of trustees shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school’s charter. The board shall have the authority to employ, discharge and contract with necessary professional and nonprofessional employee’s subject to the school’s charter and the provisions of this article.”

Section 1614-B(a)(2) of the PSC, 24 P.S. § 16-1614-B(a)(2), allows charter school students to enroll in secondary courses approved for college credit if the student’s school district of residence has an approved concurrent enrollment (also referred to as dual enrollment) program and if the charter school accepts the secondary courses for college credits.

Tuition reimbursements were provided directly from the Cyber Charter School on behalf of the daughter of a former Board President, a benefit not awarded to other students in the 2012-13 and 2013-14 school years.

As discussed in Finding No. 1, according to PDE’s Basic Education Circular (BEC) on charter schools, a charter school’s board of trustees has a responsibility to be a good and effective steward of public money.<sup>42</sup> The Cyber Charter School and its Board failed to fulfill this important role when it did not ensure that the college tuition reimbursements of at least \$32,328 on behalf of the Board President’s daughter were in the best interests of taxpayers. Further, the Cyber Charter School and its Board may have offered a formal dual enrollment program in noncompliance with the PSC.

#### **Dual Enrollment Programs**

Until it was defunded in 2011, the Commonwealth provided college tuition reimbursement grant funds to school districts operating dual enrollment programs.<sup>43</sup> These programs allow secondary students who meet certain criteria to take secondary courses approved for both college credit and high school course credit. Funding for the state program, called the Dual Enrollment Grant Program, ended in the 2010-11 school year and has not been restored.

The Cyber Charter School also previously operated a dual enrollment program called the Advanced Placement Alternatives Program (APAP). According to the current CEO of the Cyber Charter School, the program was initiated in 2008 and ran through the spring of 2014. Through that program, the Cyber Charter School’s

<sup>42</sup> PDE’s BEC on *Charter Schools*, 24 P.S. § 17-1701-A, October 1, 2004.

<sup>43</sup> To refer to students who are enrolled in high school while taking college courses for credit at both institutions, the term *dual* is used more often by school districts and some agencies, including PDE, while the PSC uses the term *concurrent*. Because of its more common usage, *dual* is used in this finding instead of *concurrent*.

*Criteria relevant to the finding  
(continued):*

Section 1615-B(d)(1) of the *PSC*, 24 P.S. § 16-1615-B(d)(1), provides: “(d) Postsecondary award. (1) If, after graduation from a secondary school, the concurrent student enrolls in the postsecondary institution at which the concurrent student took a concurrent course, that institution shall award postsecondary credit for any concurrent courses successfully completed by the concurrent student at the institution.” Section 1615-B(e) of the *PSC*, 24 P.S. § 16-1615-B(e), limits secondary students to 24 college credits per year as part of a dual enrollment program.

24 P.S. § 1715-A(11), states: Trustees of a charter school shall be public officials.

dually-enrolled students could apply for tuition scholarships from the Management Company. In 2013, according to a senior Cyber Charter School administration official, PDE advised the Cyber Charter School to stop offering scholarships for tuition reimbursement through its Management Company.<sup>44</sup>

### **Trustee’s Daughter’s Tuition Benefit**

In 2013-14 school year, a law firm was hired to conduct an internal investigation pertaining to allegations that the daughter of the former Board President benefitted from tuition reimbursements paid on her behalf by the Cyber Charter School itself for dual enrollment college courses. This particular benefit, which was not the same as the Management Company’s APAP, was provided only for the benefit of the Trustee’s daughter and not for other students. We were told the investigation resulted in a report; however, school officials stated that we could not obtain a copy because the report was confidential.<sup>45</sup>

According to our review of board meeting minutes, the firm was hired by the Cyber Charter School in September 2013, a month before the resignation of the Board President.<sup>46</sup> A review of the Cyber Charter School’s IRS 990 forms indicated that it paid a total of \$32,328 in tuition reimbursements in the 2012-13 and 2013-14 school years on behalf of the daughter of the Board President. The Cyber Charter School’s administration indicated the actual amount exceeded \$40,000 for the 2008-09 through 2013-14 school years. Because of the high dollar amount, we believe the tuition benefit also may have exceeded the Cyber Charter School’s tuition reimbursement policy as summarized in its handbook, which limited scholarship reimbursements to \$600 per course.

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<sup>44</sup> Some of the information in this background section came from a PowerPoint presentation of the Cyber Charter School, entitled “Advanced Placement Alternatives Program,” which appears to have been produced in or around 2011.

<sup>45</sup> Allegations concerning an Ethics Act violation(s) were reviewed by the State Ethics Commission. The Commission did not issue a Final Order and/or otherwise reach a formal determination as to the alleged misconduct, but rather terminated its inquiry due to lack of probable cause to continue and upon presentation of sufficient legal argument that a class/subclass exception applied.

<sup>46</sup> Fontaine, Tom. “Pa. Cyber Charter School board head resigns amid scrutiny.” TRIBLIVE. October 11, 2013. <http://triblive.com/news/adminpage/4867738-74/charter-jaskiewicz-resignation>. Accessed on February 17, 2016.

In addition, this particular student's dual enrollment coursework may have exceeded the PSC's limit of 24 credits per year.<sup>47</sup> We were unable to verify the number of college credits per year taken by the Board President's daughter due to the auditee's claim of confidentiality; however, we have reason to believe that the credits may have exceeded the 24 credits per year threshold.<sup>48</sup>

### **APAP and Noncompliance with the PSC**

Section 1602-B of the PSC explicitly excludes charter schools from being able to start their own dual enrollment programs.<sup>49</sup> Therefore, the Cyber Charter School's involvement with the APAP through its Management Company may have been in noncompliance with the PSC. Charter school students, according to the PSC, are supposed to enroll in dual enrollment programs through their school district of residence and only if that district operates such a program. According to a review of the 2012-13 handbook, *Getting Started @ PA Cyber*, two full pages are dedicated to describing the *Advanced Placement Alternatives Program* and how to enroll in it.

We believe this program may have constituted a formal dual enrollment program that was not permitted under the PSC. As a result, the Cyber Charter School and its Management Company, which provided the tuition reimbursement scholarships, may have provided a potentially publicly-funded benefit not enjoyed by other dual-enrolled students at other Commonwealth schools and school districts during the same period.

### Conclusion

As part of their key governance and management responsibilities, the District's governing Board and administrators have a responsibility to be good and effective stewards of public money. Adhering to these responsibilities will lead to improved governance and greater transparency with regard to taxpayer funds.

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<sup>47</sup> 24 P.S. § 16-1615-B(e). This section limits post-secondary credits to 24 per school year.

<sup>48</sup> The news article mentioned in footnote 4 above refers to the student taking more than 60 credits.

<sup>49</sup> 24 P.S. § 16-1602-B. A "Concurrent enrollment program" is defined as: "A program administered and developed by a school entity and an eligible postsecondary institution that allows students to concurrently enroll in postsecondary courses and to receive both secondary and postsecondary credit for that coursework...." The definition of "school entity" is limited to a school district or an area vocational-technical school.

## **Recommendations**

The *Pennsylvania Cyber Charter School* should:

Ensure that its Board takes more precaution in the utilization of taxpayer funds.

The *Pennsylvania Department of Education* should:

As the Cyber School's authorizer, review the Cyber Charter School's dual enrollment program which operated during and prior to the three-year audit period ending June 30, 2014. It should make a formal determination as to whether the program was properly authorized in accordance with the concurrent enrollment provisions of the PSC and whether funds used for scholarships were appropriate. More importantly, PDE should issue clear and concise statewide Cyber Charter School guidelines with regard to the dual enrollment program in terms of Cyber Schools' responsibilities and permissible actions under the PSC.

## **Management Response**

Management disagreed with the finding and provided a response that can be found in Appendix A. An excerpt of the management response is provided below:

“The School offered a Dual Enrollment program, the Advanced Placement Alternative Program (“APAP”), funded by a grant from its Management Company, until 2014, based upon a good faith belief that the School Code and PDE permitted it. In 2014 (not 2013), PDE advised our legal counsel otherwise, and we promptly terminated the program.”

“...the sections of Finding 4 that describe Trustee #4 and his child arise from a situation that the School itself investigated and put an end to in 2013. That Trustee resigned from the Board in 2013 as well, nearly three (3) years ago.”

### **Auditor Conclusion**

We reiterate our finding that, at the expense of Commonwealth taxpayers, a student who was the daughter of a Trustee derived a significant tuition reimbursement benefit of at least \$32,328 which was not enjoyed by other Cyber Charter School students. We caution the Cyber Charter School against providing such benefits to its Trustees and their relatives. We are pleased that the Cyber Charter School suspended the dual enrollment program once it was advised to do so by PDE.

## Finding No. 5

### **Members of the Board of Trustees May Have Had Potential Conflicts of Interests and Voting Conflicts in Possible Noncompliance with the Public Official and Employee Ethics Act When It Paid a Trustee-Owned Company for Computer Equipment and Services**

*Criteria relevant to the finding:*

Section 1715-A(11) of the CSL, 24 P.S. § 1715-A(11), states: “Trustees of a charter school shall be public officials.”

Section 1102 of the Ethics Act, 65 Pa.C.S. § 1102, defines the following terms:

*Business with which he is associated* is defined as: “any business in which the person or a member of the person’s immediate family is a director, officer, owner, employee or has a financial interest.”

*A conflict of interest* is defined, in part, as: “Use by a public official . . . of the authority of his office or employment . . . for the private pecuniary benefit of himself, a member of his immediate family or a business with which he or a member of his family is associated.”

The Cyber Charter School paid a related computer equipment and services company more than \$1.8 million over a seven-year period, and its board members may have been in noncompliance with the Ethics Act because it did not ensure that one of its Trustees made a prior public disclosure that he was an owner of the company when the Board approved payments to the vendor. As a result, the Cyber Charter School also failed to implement best practices by not fostering full transparency and public accountability.

#### **Payments to Trustee’s Company**

In April 2008, the Cyber Charter School appointed to its Board a person who co-owned a computer equipment company. The Company, which was a member of a Commonwealth cooperative purchasing program, provided videoconferencing equipment and maintenance services and had been a vendor of the Cyber Charter School prior to the Trustee’s appointment to the Board. During the 2007-08 school year, the year of the Trustee’s appointment, the Cyber Charter School had paid the Company over \$39,000. Payments to the Company increased significantly in subsequent years to a high of \$1.1 million in 2010-11, the year that the Trustee resigned.

*Criteria relevant to the finding (continued):*

Subsection 1103(a) of the Ethics Act, 65 Pa.C.S. § 1103(a), states: “No public official . . . shall engage in conduct that constitutes a conflict of interest.”

Subsection (j) of Section 1103 of the Ethics Act, 65 Pa.C.S. § 1103(j), states, in part: “. . . Any public official . . . who in the discharge of his official duties would be required to vote on a matter that would result in a conflict of interest **shall abstain from voting and, prior to the vote being taken, publicly announce and disclose the nature of his interest as a public record** in a written memorandum filed with the person responsible for recording the minutes of the meeting . . .” [Emphasis added.]

As shown in the following table, payments to the Company continued through the 2013-14 school year.<sup>50</sup>

PAYMENTS TO TRUSTEE’S COMPANY		
School Year	Payments	Trustee’s Term
2007-08	\$ 39,436	Appointed 4/14/08
2008-09	\$ 91,875	
2009-10	\$ 171,079	
2010-11	\$1,108,080	Resigned 6/13/11
2011-12	\$ 216,254	
2012-13	\$ 171,847	
2013-14	\$ 77,655	
<b>Total</b>	<b>\$1,876,226</b>	

### Potential Conflicts of Interest

The CSL designates members of a Charter School’s Board as public officials who are bound by the Ethics Act, which restricts them from engaging in conduct constituting conflicts of interest. A conflict of interest can occur when a public official uses the authority of his office to derive a pecuniary benefit for himself. The Ethics Act requires public officials who would have a conflict of interest in a vote on a matter to abstain from voting *and* to “disclose the nature of his interest as a public record in a written memorandum filed with the person responsible for recording the minutes of the meeting at which the vote is taken . . .”<sup>51</sup>

Our review of the minutes for the 2010-11 through 2013-14 school years revealed no disclosure of this former Trustee’s relationship to the vendor. We also found only one instance in that period where the Board actually voted on a transaction involving the Company, other than approving “the overall check runs.” In August 2010, the Board unanimously voted to approve payment of approximately \$819,000 to the Company for computer equipment and services.

<sup>50</sup> The payments were obtained from the Cyber Charter School’s multi-year disbursements register. It should be noted that an August 12, 2012 article in the *Pittsburgh Post-Gazette*, entitled, “PA Cyber Connections Prompt Inquiry”, states that the amount the Cyber Charter School paid the Company since 2005 was \$4 million.

<sup>51</sup> 65 Pa.C.S. § 1103(j).

Although the Trustee was absent from that meeting, other board members, who were aware of the relationship, should have at least acknowledged the Trustee's relationship with the vendor prior to the vote. In addition, the absent Trustee, who owned the Company, should have disclosed his relationship to the Company as required after the meeting in a memorandum (memo) addressed to the Board Secretary and ensured that the memo was incorporated into the minutes of that particular meeting. The Trustee's failure to file the necessary disclosure statement constituted a lack of compliance with the Ethics Act.

### **Recommendations**

The *Pennsylvania Cyber Charter School* should:

1. Conduct a thorough and public review of all related parties and actual or potential conflicts of interest, including any potential appearance of impropriety related to its Trustees, related party vendors, and others, as necessary, so that it can ensure that the Cyber Charter School and its governing Board are in compliance with the Ethics Act.
2. Establish clear and stringent policies related to eligibility requirements for membership as a Trustee of the Board. In conjunction with that policy, it should establish another policy that specifically prohibits any real or apparent conflicts of interest, and that policy should contain examples of such conflicts.

### **Management Response**

Management disagreed with the finding. (See Appendix A for the full response) In summary, the management response indicated that "the Trustee abstained from the voting. All evidence indicates that the prior board members who voted at the time were aware of the conflict." Management reiterated its "plan to thoroughly review and address all current and potential conflicts which may arise." It also highlighted its by-laws and conflict of interest and code of ethics policy.

## **Auditor Conclusion**

Management's response states that the Trustee who had an ownership interest in the Company abstained from the vote awarding the contract and that other Trustees were aware of his interest in the Company, but the failure to properly disclose the reason for the abstention deprived the *public* of the knowledge of this related party relationship and resulted in reduced transparency related to the use of public funds.

However, the Cyber Charter School now requires Trustees who abstain from votes to complete a vote abstention disclosure form, which requires disclosure of the *reason* for abstaining from a vote, and which will be filed with the corresponding board meeting minutes. This new form and filing requirement appears to provide an appropriate remedy to prevent this lack of transparency in the future.

## Finding No. 6

### The Cyber Charter School's Virtual Classroom Attendance Policy Was Not Monitored or Enforced

*Criteria relevant to the finding:*

#### Cyber Charter School Policy

The School's *Student Attendance Policy*, which is included in the *Board Policy and Procedures Manual*, refers to classroom attendance as *mandatory* for live virtual class sessions and the once weekly live blended class sessions. It also describes in detail an automated email alert system for classroom absences.

Best practices for cyber schools recommend close monitoring of student participation in courses in order to improve the likelihood of completion of school work and courses.

#### Charter School Law

Subsection (b) of Section 1749 (relating to Applicability of other provisions of this act and . . . regulations [to Cyber Charter Schools]) of the CSL, 24 P.S. § 17-1749-A(b), provides, in part, the following: "(b) Regulations.--Cyber charter schools shall be subject to the following provisions of 22 Pa. Code (relating to education):

\*\*\* (2) Chapter 11 (relating to pupil attendance)."

We found the Cyber Charter School did not monitor or enforce its own classroom attendance policy for its virtual classrooms from 2011-12 through the 2015-16 school years. Best practices for cyber schools recommend monitoring and enforcement of virtual classroom attendance in order to maximize students' chances for completion of coursework. By not monitoring virtual classroom attendance, the Cyber Charter School may have missed an opportunity to improve its students' chances for completing courses.<sup>52</sup>

#### The Student Attendance Policy

The Cyber Charter School's *Board Policy and Procedures Manual* includes a *Student Attendance Policy* that spells out requirements with regard to *daily attendance* as well as *classroom attendance*. The Cyber Charter School is a cyber school, and daily attendance is recorded when the student logs onto the *My School* portal each day. Once the student logs on, he or she is counted as present for the entire school day, and is then taken through the *My School* system to classes for that day. If the student logs off at any time during the day for any length of time, this does not count against the student's daily attendance. In general, cyber charter students can work at different paces with greater flexibility than students at brick-and-mortar schools in terms of timing the completion of school work.

#### Classroom Mode Options

During the three-year audit period ending June 30, 2014, students could take courses, including *core* courses, such as English, math, science, or social studies, in either a self-paced mode or a virtual classroom mode. For instance, a student could take English in a virtual classroom and math in a self-paced class. The virtual classroom courses contained live class sessions taught by a Cyber Charter School teacher. They also provided students with opportunities for class participation. Self-paced courses did

<sup>52</sup> The Center for Public Education. "Searching for the Reality of Virtual Schools." May 2012. One area of concern addressed in this report, which reviewed online schools nationwide, is the potential effect of lax oversight of participation in online classes on students' completion of courses.

*Criteria relevant to the finding (continued):*

**PDE Guidance**

*PDE's School Attendance Improvement & Truancy Reduction: A toolkit of resources and information supporting professionals working with students and families to increase student achievement and school success* issued in February 2015 contains the PDE's revised BEC regarding the *Compulsory Attendance and Truancy Elimination Plan*. The BEC provides, in part: "Parents/guardians and students should submit the written explanation within three calendar days of the absence and should be informed that if they fail to provide a written excuse within three days of the absence, the absence would be permanently counted as unlawful . . . Under Section 11.24, students who miss ten consecutive school days shall be dropped from the active membership roll unless the school is provided with evidence the excuse is legal or the school is pursuing compulsory attendance prosecution." Further, "For cyber charter schools, a school district may file truancy documents with the magisterial district judge in whose jurisdiction the charter school student resides, which is where the cause of action arose and where the parent/guardian may be served."

not have any live components and were led by teachers provided by the Cyber Charter School's Management Company (see Finding No. 2).

The rest of this finding addresses the classroom attendance requirements related to the virtual classroom courses. We did not test the daily attendance record-keeping system for this audit.

**Virtual Classroom Attendance**

For each year in the audit period, the Cyber Charter School maintained a policy addressing classroom attendance requirements for courses offered in the virtual classroom mode. The Cyber Charter School's handbook, *Getting Started @ PA Cyber*, devotes two pages to the virtual classroom attendance requirements for that mode. According to the attendance policy, its *Virtual Classroom Attendance Alert System* generated automated email alerts at varying intervals, depending on how many times per week a class met. If students were absent from the virtual classroom, the system purportedly alerted students, parents, instructional supervisors, virtual classroom teachers and, in some cases, the academy leader/principal. According to the policy, consequences for exceeding maximum allowable classroom absences included a possible disciplinary meeting with the academy leader and/or removal from the virtual classroom.

We found the Cyber Charter School did not enforce the classroom attendance policy. When we asked why, senior administrators indicated that the virtual classroom classes were recorded and archived, so that if a student missed a class, he or she could watch it at a later time. There was, however, no formal process in place for teachers or administrators to follow-up on whether the students who missed the live sessions actually "attended" later by watching the archived video of the class sessions.

In addition, the administrators indicated that, until the 2015-16 school year, many of the students' classes were taken in the self-paced mode rather than the virtual classroom mode. The administration was unable to provide us with any breakdown of student enrollment in classes by course mode for the school years in our audit period, so we were unable to determine the impact of the failure to

enforce its own virtual classroom attendance policy. Our review of minutes also revealed no evidence the Board addressed classroom attendance issues or monitored enrollment in courses offered in different modes.

According to a senior administrator, teachers were responsible for contacting the attendance officer *only* if a student's work was not being submitted timely. No formal reporting procedure was in place, and therefore, we could not review any records of any possible classroom attendance problems and their resolution.

Placing sole reliance on teachers to monitor classroom attendance and absences and to report them only when there were problems does not comport with the Cyber Charter School's own classroom attendance policy. Furthermore, it falls short of best practices for monitoring students' attendance. A report on national trends in virtual schools expressed a concern about wide variances in monitoring student participation. It said, "The lax oversight is a likely contributor to low completion rates."<sup>53</sup>

### **Change in Available Modes for Core Courses**

Beginning in the 2015-16 school year, the Cyber Charter School no longer allowed students to take *core* courses, such as English, math, science, and social studies, in the self-paced mode. This change resulted from conversations between the Cyber Charter School's administrators and PDE. According to the 2015-16 catalog, the Cyber Charter School now offered three different classroom modes: the virtual classroom mode, an asynchronous mode, formerly referred to as self-paced, and a blended classroom mode, which combined the virtual classroom and asynchronous modes with one live classroom experience per week.

The asynchronous mode was now limited to non-core courses in 2015-16. The Cyber Charter School's *Student Attendance Policy* refers to classroom attendance as *mandatory* for the live virtual classroom class sessions and the once weekly live blended classroom sessions and also provides for allowable exemptions and excused absences. Consequences for classroom absences from the live virtual classroom and blended classroom sessions, however, are not clearly defined in the most recent attendance policy and

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<sup>53</sup> Ibid., p. 8.

may render the term *mandatory* as meaningless. The administration confirmed it is still not monitoring classroom attendance and is relying on teachers to monitor and report classroom attendance issues.

### **Conclusion**

The Cyber Charter School’s student attendance policy as it related to classroom attendance was not enforced from the school years beginning 2011-12 through the current school year of 2015-16. We also found that even though the Cyber Charter School added the term “mandatory” to its current classroom attendance policy pertaining to the once weekly live sessions for the virtual classroom courses, it still did not monitor or enforce classroom attendance for these courses.

Since the virtual classroom and blended classroom modes are distinguished from the asynchronous classroom mode by their live components, which offer the student live interaction with the teacher and the class, we believe the Cyber Charter School should strengthen its classroom attendance policies and procedures for those modes. The Cyber Charter School should then enforce those policies by requiring the administration to provide routine monitoring of and reporting on classroom attendance consistent with state regulations, PDE guidance, and the Cyber Charter School’s policies.

### **Recommendations**

The *Pennsylvania Cyber Charter School* should:

1. Revise its current classroom attendance policy for the virtual classroom and blended classroom modes to provide students with clear consequences for absences from these types of classes. It should also clarify exemption criteria, if it decides to allow exemptions. An improved classroom attendance policy is more imperative now that the Cyber Charter School has apparently worked with PDE to strengthen its core courses by limiting them to the virtual and blended classroom modes.
2. Enforce its attendance policy by monitoring classroom attendance on a daily basis and following up with

teachers whose students have absence issues, as well as with the students themselves. It should document its monitoring and communication processes.

3. Require attendance officers to prepare routine classroom and daily attendance reports and provide students, parents, teachers, management, and the Board with attendance data relevant to their respective roles in the Cyber Charter School.

### **Management Response**

(See Appendix A for the complete management response)

While the Cyber Charter School disagreed with our finding, it stated that it “now requires teachers who provide live instruction in Blended Classroom and Virtual Classroom classes to take daily attendance and to report absences via the student attendance system. Because each live class session is recorded, students can view any live session they may have missed and use those playbacks as a study tool at any time. While this offers flexibility to PA Cyber’s students, it poses a challenge for tracking student attendance. Unfortunately, the technology does not yet allow for tracking attendance when students use pre-recorded classes to make up the class after an absence. To monitor student work, classroom teachers will continue to provide feedback to administrators when students who have missed class appear to be falling behind in their work. This information, in turn, can be passed on to the Attendance Department for remedial measures when necessary.”

“PA Cyber created an Attendance Department during the 2014-15 school year to oversee the school’s attendance policy and enforcement. A total of eleven (11) staff members work in Harrisburg and Midland, including two (2) Directors of Attendance, three (3) Supervisors of Student Attendance, one (1) Special Education Supervisor of Student Attendance, and five (5) Administrative Assistants.” The Cyber Charter School’s response further addressed daily attendance procedures, which were not part of the scope of this audit and this finding, which addressed attendance policies and procedures related to the virtual courses that provided live instruction.

## **Auditor Conclusion**

We are pleased that the Cyber Charter School created an attendance department in the 2014-15 school year and has acknowledged it is making efforts to improve its monitoring of daily attendance. But, monitoring its students' once-daily log-on to the Cyber Charter School's system is not enough to meet best practices related to cyber school attendance and in particular virtual classroom attendance, which offers the live classroom experience.

We reiterate our caution to the Cyber Charter School about its flawed policies and practices regarding the monitoring and enforcement of virtual classroom attendance—particularly since core courses are now required to be taken in this mode—and recommend that it implement our recommendations to improve virtual classroom attendance policies and the procedures for monitoring students' attendance in these types of courses.

## Finding No. 7

### The Cyber Charter School Failed to Maintain Sufficient Documentation to Support Teacher Certifications

*Criteria relevant to the finding:*

PDE's Certification Staffing Policies and Guidelines #7 require the following of each educator seeking Instructional II certification:

- Achieved three years of satisfactory service on an Instructional I certificate. Satisfactory service equates to full-time teaching for three years on the Instructional I certificate.
- Received at least six semi-annual evaluations of satisfactory performance on the Instructional I certificate in the area for which the certificate was issued.

Superintendents of schools or their designees are required to certify that individual educators have obtained the above requirements, and they do so by attesting on an electronic form, called the *Work Experience Affirmation* page on PDE's Teacher Information Management System website.

Note: Prior to 2011, the hard copy attestation form was the PDE 338P. This form was actually used by the Cyber Charter School through the 2011-12 school year for the CEO or his/her designee.

The Cyber Charter School's attestations regarding its evaluation of service for educators' Instructional II certificates may be unreliable because of incomplete or missing required evaluations in educators' personnel files. As a result, its educators may have received Instructional II certificates without having first met the evaluation requirements of PDE. This deficiency represents another effect of the Board's failure to monitor the Management Company, which was responsible for providing a wide range of management services, including the maintenance of employees' personnel files (see Finding No.2).

We determined that 88 educators had applied for their Instructional II certification in the 2012-13 and 2013-14 school years. We selected eight educators and reviewed personnel files and teaching schedules to determine if the three-year service requirement was met, and then if the Cyber Charter School maintained the appropriate documentation to support the required six semi-annual evaluations for each educator to receive the Instructional II certificate.<sup>54</sup>

Five of the eight educators selected obtained their service requirements by co-teaching with virtual classroom teachers. According to separate emails from PDE to the Cyber Charter School and to our Department, co-teaching is a common and acceptable type of service for meeting the Instructional II experience requirement. We reviewed teaching schedules and work experience in PDE's *Teacher Information Management System* to verify that all eight educators met the three-year service requirement.

**Deficiencies were found in 75 percent of the evaluation records we tested.** We also reviewed personnel files for all eight educators selected for review to determine whether the Cyber Charter School had dutifully evaluated whether each educator's service was deemed satisfactory. Each educator should have had the required six semi-annual evaluations in his or her file for the three-year period of

<sup>54</sup> Five of the eight educators obtained Administrative I certificates during the three-year audit period, after first receiving their Instructional II teaching certificates. Three of the eight educators obtained Instructional II certificates for teaching sometime between the three-year audit period through early 2014-15.

providing service on the Instructional I certificate. We found that six of the eight files, or 75 percent of those reviewed, contained deficiencies related to the evaluations. Five of the six deficient files lacked the required total of six semi-annual evaluations, while three of the six deficient files contained evaluations lacking required signatures attesting that the evaluations actually occurred. As a result, we were unable to confirm that the required evaluations actually occurred prior to the attestation by the CEO or his designee on each of the six educators' *Work Experience Affirmation* form.

**The Management Company failed to maintain records.** During the audit period and prior, employee personnel files were maintained by the Management Company. According to senior administrative officials at the Cyber Charter School, these files were maintained off site and away from the Cyber Charter School's offices until 2015 when the Management Company returned the files. The Cyber Charter School's administration said the files were incomplete because of the Management Company's failure to maintain them properly. When we asked administrative officials about other personnel files, they indicated that they believed other educators' personnel files might also be incomplete with regard to the evaluations.

This testimony from Cyber Charter School administrators coupled with the high percentage of missing or incomplete evaluations for those educators selected for review resulted in our conclusion that the Cyber Charter School's attestations to PDE about the evaluation of experience required for Instructional II certifications may be unreliable.

**The Board failed to adequately monitor the Management Company.** This finding represents another effect of the Board's unquestioned reliance on the Management Company for so many aspects of the Cyber Charter School's operations, including human resources, resulting in the apparently poor maintenance of its employees' records of professional development and certifications.

## **Recommendations**

The *Pennsylvania Cyber Charter School* should:

Establish written, Board-approved procedures to:

- a. Ensure it maintains complete records in its employees' personnel files to support its role related to the attestation of the satisfactory service requirements for Instructional II certificate applicants.
- b. Restrict access to personnel files to its own human resources staff and disallow any contractor from maintaining its personnel files.
- c. Prohibit anyone, even Cyber Charter School employees, from removing personnel files from the Cyber Charter School's premises.

The *Pennsylvania Department of Education* should:

Determine whether it should follow through with the Cyber Charter School to make sure that its educators have in fact met the satisfactory experience requirements to obtain the Instructional II certifications issued during the 2011-12 through 2014-15 school years.

## **Management Response**

(See Appendix A for the complete management response)

Management disagreed with the finding, and excerpts of its response are included below:

“PA Cyber has terminated the use of outside contractors to maintain the documentation in support of its teacher certifications and has transferred all maintenance of its teacher certification documentation to its in-house Human Resources Department. With these services being performed in-house, there will be increased oversight, and PA Cyber can ensure that teacher certifications are supported by employee records.”

“The Board of Trustees and management team determined during the 2013-2014 school year that Human Resources

services should be transferred from the outside Management Company to an in-house Human Resources Department during the 2014-2015 school year, and the transition was completed for the start of the 2015-2016 school year. All personnel files are now maintained on school property in the offices of the Human Resources Department. The School received assurance from the Management Company that, to the best of their knowledge, all files had been transferred to PA Cyber, none had been destroyed, and that the Management Company has no remaining School Human Resources files in its possession. The School no longer contracts with any management company for HR-related services or file storage and maintenance. The School has taken proper steps to restrict access to personal files only to authorized staff.”

“The School established the in-house Human Resources Department to maintain employee personnel files on premises and prevent their removal by any unauthorized personnel. As previously detailed, the School received all personnel files from the previous Management Company and no longer externally contracts these services through any other entity. Files are accessible only to Human Resources Department staff or by employees, as permitted by law, with proper request and supervision by the Human Resources staff to prevent any potential removal from the School’s premises.”

### **Auditor Conclusion**

Although management disagreed with our finding, we are pleased that the Cyber Charter School has indicated in its response that it has implemented procedures that will bring it into compliance with our recommendations to properly document its attestations regarding service requirements for teachers receiving Level II certifications and to safeguard those records in-house.

## Finding No. 8

### The Cyber Charter School Did Not Collect All of the Computer Equipment Provided to Students When They Withdrew or Graduated

*Criteria relevant to the finding:*

Section 1743-A(e) of the CSL, 24 P.S. § 1743-A(e), states, in part, “. . . a cyber charter school shall:

- (1) Provide all instructional materials;
- (2) Provide all equipment, including, but not limited to, a computer, computer monitor, and printer . . .”

The term “provide” is used in the PSC, for instance in Section 803 (relating to Time and manner of adopting and furnishing textbooks and supplementary books), 24 P.S. § 8-803, to indicate that certain school-owned property, such as textbooks, should be provided to students for use in their academic work. Therefore, the ownership of the property does not transfer to the student.

The School’s *Parent/Guardian and Student Contract* states, in part:

“As a student, I agree...To ensure PA Cyber’s materials and equipment remain in the condition they are received and to follow the Acceptable Use Policy.”

“As a parent, I agree . . . To adhere to the PA Cyber Computer Acceptable Use Policy and to understand that all equipment and materials I receive from the school are the property of PA Cyber . . . I agree to return equipment and materials within two weeks of the student’s withdrawal or graduation.”

Students of the Cyber Charter School are provided with information technology (IT) equipment. Parents/guardians and students are required to sign the *Parent/Guardian and Student Contract*, which requires the return of the equipment provided to students within two weeks of their withdrawal or graduation. We found that the Cyber Charter School has sufficient procedures in place to collect laptops from students who graduate or withdraw from the Cyber Charter School, but it did not collect the other IT equipment.<sup>55</sup>

This practice of not ensuring the return of all IT equipment not only contradicts best practices, it also may be in noncompliance with both the CSL and the Cyber Charter School’s own *Acceptable Use Policy* and *Parent/Guardian and Student Contract* because both indicate that IT equipment remains the property of the Cyber Charter School. In addition, the Cyber Charter School may have incurred unnecessary additional costs for the purchase of new equipment by not refurbishing and reissuing equipment or returning it to its equipment vendor for possible discounts on new equipment purchases.

#### Cost Analysis of IT Equipment

A review of invoices for the 2013-14 school year indicated the following cost of IT equipment per student:

Per-Student Cost Analysis IT Equipment	
Equipment	Cost
Laptop	\$839.00
All-in-One Printer	69.70
Digital Tablet	32.00
Headphones	18.58
Carrying Case	15.00
Black Ink	14.50
<b>Total</b>	<b>\$988.78</b>

<sup>55</sup> For physical education course curriculum purchased from the Cyber Charter School’s Management Company, the course material included a Fitbit, which is an activity tracker that students can wear to measure steps, heart rate, and other data. They were not required to be returned by students once the course was completed.

In 2013-14, the Cyber Charter School's enrollment, according to PDE, was 10,389. Student IT equipment costs based on that number would have approximated over \$10.3 million for that year. While 85 percent of that cost was attributable to the laptops, which do get collected by the Cyber Charter School, 15 percent or approximately \$1.5 million would have been attributed to the other equipment for that year. Factoring in depreciation and other costs, such as shipping equipment back to the Cyber Charter School, we recognize the value of the other IT equipment likely would have been reduced once it had been issued to and used by students. However, the Cyber Charter School could have collected this equipment back from students either to refurbish and reissue it or to return it to the vendor for a possible discount on new equipment. Either of these options potentially could have saved public funds.

### **Requirements of the Parent/Guardian Student Contract**

Parents/guardians and students sign a contract acknowledging all equipment provided to students is the property of the Pennsylvania Cyber Charter School, and they agree to return it—not just the laptops—upon the students' withdrawal or graduation. The *Parent/Guardian and Student Contract* requires that all issued IT equipment be returned within two weeks of the student's withdrawal or graduation. The Cyber Charter School's failure to enforce compliance with its own contract has resulted in IT equipment not being returned as required.

### **Failure to Collect IT Equipment**

When we asked why it didn't collect the other IT equipment, administrators from the Cyber Charter School stated that the shipping costs outweighed the benefit of collecting the other equipment and that the state of the returned equipment may not have been usable, but we disagree. The refurbishment and reissuance of used equipment to other students and employees in an organization is a commonly implemented best practice.

According to the Cyber Charter School's records, FedEx shipping costs for 2013-14, for instance, totaled \$538,025. This cost would have included, but not have been limited to, the shipping costs for all equipment provided to new

students, including laptops and the other equipment discussed above. It also would have included costs incurred to collect the laptops from students who graduated or withdrew, as well as other school shipping costs. The incremental cost of shipping the other IT equipment back to the Cyber Charter School probably would not have exceeded its value for either reissuance to other students or for returning it to the vendor for discounts on new equipment purchases.

### **Recommendations**

The *Pennsylvania Cyber Charter School* should:

1. Revise and formalize its equipment return procedures in order to ensure compliance with its own IT contract with parents/guardians and students and to collect *all* equipment provided to students upon withdrawal or graduation.
2. Work with its own IT staff to develop procedures for refurbishing IT equipment so that it can be reissued, and/or work with its IT equipment vendor to obtain a discount for returned equipment.

### **Management Response**

(See Appendix A for the complete management response)

Management disagreed with the finding and responded as follows, in part:

“The School does not have a statutory or contractual obligation to seek such return; therefore, it has chosen to save itself and the Commonwealth money and parents and students the burden, except when doing so would result in an overall savings to the school and to the Commonwealth (as is the case with laptops).”

“The contract parents and students sign at enrollment, along with the School’s IT Policy, reserve PA Cyber’s right to request the return or collect damages for school property based on withdrawal or violation of the school’s Acceptable Use Policy, but do not require PA Cyber to obtain return at a loss...PA Cyber shared with the auditors that, excluding laptop computers, the school not only has

concerns regarding the costs and benefits of collecting such equipment, but also has legitimate hygiene and health safety concerns regarding reuse and distribution of such equipment.... Additionally, the finding...fails to account for the substantial and necessary costs of staffing these endeavors, recovering the equipment, refurbishing the equipment, and returning the equipment to the vendor, as well as the fact that much of the non-laptop equipment quickly becomes obsolete, and thus, of little to no financial value.”

“PA Cyber strongly disagrees with the statement that the school may be in noncompliance with the Charter School Law (“CSL”). Nothing in the CSL requires the return of equipment when it would cost the school more to do so, as it only requires cyber charter schools to ‘provide all equipment’ to students. 24 P.S. § 17-1743-A. Moreover, Finding #8 also cites to 24 P.S. § 8-803, which relates only to the purchase of textbooks and makes no mention of ‘the ownership of the property,’ as stated in the finding.”

### **Auditor Conclusion**

While management disagreed with our finding, our Department asserts that requiring the return of school-owned property is not an unusual or cost prohibitive endeavor and should be undertaken in order to comply with the CSL and best business practices. Taxpayer funded digital tablets, printers, carrying cases, and other equipment can be returned similarly to the process by which students return laptops.

We caution the Cyber Charter School against the potential further waste of public funds by not pursuing the collection of equipment when students graduate or otherwise withdraw.

## Status of Prior Audit Findings and Observations

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Our prior audit of the Charter School released on December 6, 2012, resulted in five observations, as shown below. As part of our current audit, we determined the status of corrective action taken by the Charter School to implement our prior recommendations. We performed audit procedures and interviewed the Charter School's personnel regarding the prior observations.

### Auditor General Performance Audit Report Released on December 6, 2012

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#### **Observation No. 1: May Have Improperly Received Tax Benefits Without Applying for Tax-Exempt Status with the IRS**

Observation Summary:

Our prior audit of the Cyber Charter School's records found the Cyber Charter School was incorporated as a public, nonprofit corporation with the Pennsylvania Department of State, Bureau of Corporations, and may have been operating and receiving benefits of a tax-exempt, nonprofit organization without applying for and being granted a tax-exempt status from the IRS. As a result, we further found that the Cyber Charter School was not filing a Form IRS 990, a publically available tax return required to be filed annually by tax-exempt organizations that do not meet a filing exception.

Recommendations: Our prior audit observation recommended that the Charter School:

1. File for a tax-exempt status with the IRS to determine whether it is eligible to receive the benefits of a tax-exempt organization, particularly since it is using a management company.
2. File Form IRS 990 for the school years ending 2009-10 and 2008-09 and each subsequent year, if the IRS grants the Cyber Charter School a tax-exempt status.
3. Request its solicitor to provide a summary of all the Cyber Charter School's legal requirements under the CSL, the Nonprofit Corporations Law of 1988, and the Internal Revenue Code.

We also recommended that PDE, as authorizer of cyber charter schools, should:

Provide the Cyber Charter School and all cyber charter school with proper guidance regarding their formation, treatment under local, state, and federal laws, filing requirements, and use of a management company.

Current Status: During our current audit, we found that the Charter School did implement the recommendations. Tax-exempt status was granted by the IRS on November 15, 2010, and we found that the Cyber Charter School filed IRS Form 990s for the three school years ending June 30, 2014.

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## **Observation No. 2: Logical Control Access Weaknesses**

### Observation Summary:

Our prior audit of the Cyber Charter School found that the Cyber Charter School used software purchased from an outside vendor for its critical student accounting application. We determined that the Cyber Charter School had manual compensating controls in place to verify the integrity of the membership and attendance information in its database. Reliance on manual compensating controls becomes increasingly problematic if the Cyber Charter School would ever experience personnel and/or procedure changes that could reduce the effectiveness of the manual controls.

Recommendations: Our prior audit observation recommended that the Charter School:

Implement a security policy and system parameter settings to require all users, including the vendor, to change their passwords on a regular basis (i.e., every 30 days). Passwords should be a minimum length of eight characters and include alpha, numeric, and special characters. Also, the Cyber Charter School should maintain a password history that will prevent the use of a repetitive password (i.e., last ten passwords), and lock out users after three unsuccessful attempts.

Current Status: During our current audit, we found that the Charter School did implement the recommendations.

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**Observation No. 3: Pennsylvania Cyber Charter School Operated with a \$13 Million Unreserved General Fund Balance**

Observation

Summary:

Our prior audit of the Cyber Charter School found that the Cyber Charter School operated with an unreserved general fund balance in excess of \$13 million and \$11 million for the 2009-10 and 2008-09 school years respectively, the highest amounts among all operating charters and cyber charters.

Recommendations:

Our prior audit observation recommended that the Charter School:

Ensure that taxpayer dollars transferred to the Cyber Charter School's unreserved general fund account were properly expended for an educational purpose.

Current Status:

During our current audit, we found that the Charter School did implement some of our recommendations and designated a portion of the unreserved fund balance for specific purposes. The Cyber Charter School still maintained assigned fund balances of over \$10 million and an unassigned fund balance of \$8 million as of June 30, 2014.

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**Observation No. 4: Pennsylvania Cyber Charter School Should Reevaluate its Advertising Expenses, Which Totaled \$3.5 Million.**

Observation

Summary:

Our prior audit of the Cyber Charter School found that the Cyber Charter School had higher than average administrative and business costs when compared to other public school entities, including \$2 million and \$1.5 million in advertising expenses for the 2009-10 and 2008-09 school years, respectively.

Recommendations:

Our prior audit observation recommended that the Charter School:

1. Consider re-evaluating its marketing strategies aimed at increasing student enrollment and total revenue of cyber similar to for-profit business models, and instead, develop more cost effective ways other than television and radio advertisements to communicate its programs to parents and students.
2. Consider alternative ways to communicate the availability of its programs to all students across the state, including the use of the Internet, to ensure that public education dollars are being spent for their intended purpose.

Current Status: We found that the Cyber Charter School maintained that it is following best business practices for a cyber charter school, which is trying to reach as many potential students as possible throughout the Commonwealth. As part of our current audit, we found the Cyber Charter School expended \$2,003,532 in the 2013-14 school year on public outreach and advertising, which was comparable to previous years.

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**Observation No. 5: Poorly Constructed Management Company Service Contract Creates Inefficient Spending and Duplication**

Observation Summary:

Our prior audit of the Cyber Charter School found that the Cyber Charter School contracts with a private, nonprofit management company, the National Network of Digital Schools Management Foundation (NNDS), and pays fees based on a percentage of the Cyber Charter School's total revenue and not on the management services provided.

Recommendations: Our prior audit observation recommended that the Charter School:

1. Reevaluate the terms of its contract for management services to ensure fees are based on the services provided and not the revenue received by the Cyber Charter School.
2. Avoid entering into new contracts or contract renewals for any services that involve paying a percentage of the Cyber Charter School's revenues to the contractor.
3. Request its solicitor to review the management agreement to ensure the Cyber Charter School's is receiving the full management services entitled.
4. Ensure the Cyber Charter School funds expended for management services are prudent, necessary, and do not duplicate the job duties performed by the Cyber Charter School employees.

Current Status: During our current audit, we found that the Charter School implemented some, but not all, of the recommendations. The Charter School revised its management services fee structure when it awarded separate agreements for different types of services to the Management Company in 2015, but we found several persistent flaws with the new agreements and their implementation. See Finding No. 2, which addresses not only management services but also curriculum provided by the Management Company.

## **Appendix A – Management Response**

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*The following is the Cyber Charter School management response in its entirety.*

The Board and administration of the Pennsylvania Cyber Charter School (PA Cyber) recognize the essential role and solemn responsibility the Office of Auditor General has in assuring that public resources are being utilized in a proper, prudent, and efficient manner. Over the past 18 months, PA Cyber has cooperated fully in your regular audit of our school by providing all of the information and documentation requested in a responsive and proactive manner. We appreciate your willingness to discuss the findings and recommendations contained in this audit, and are grateful for the opportunity to provide a detailed Management Response to each of the issues identified.

Since 2012, our school has undergone significant structural changes at both the Board and administrative levels. During this time, PA Cyber has carried out an extensive review of our policies and procedures, and have instituted a variety of reforms and improvements aimed at further enhancing our ability to promote and sustain good governance. As you know, many of the issues raised concerning this audit period (which dates back to 2011) have already been addressed and corrected. To the extent that you have identified other valid issues and offered appropriate recommendations, we will continue to assess and modify our policies and procedures as necessary. Even in those areas where we have raised legitimate and reasonable disagreements with your findings (as detailed in our Management Response), please know that we take your recommendations seriously and in the spirit with which they are offered, and that we will implement additional best practices with all due diligence.

As a public school, PA Cyber understands and embraces our responsibility to operate with the highest degrees of transparency, accountability, and efficiency as we strive to provide our students with an excellent education. Over the last four years, the unstinting commitment and tireless hard work of our faculty, staff, administration and Board have positively transformed our school, setting it on course for long-term stability and success. While the pursuit of quality improvement within any organization must be a continuous one, we take pride in the progress we have made, and we look to the future with confidence and resolve.

## **RESPONSE TO AUDIT FINDING #1**

The finding lays blame for perceived conflicts on the PA Cyber’s former CEO and Founder and the influence he supposedly had over the Board. But, the former CEO has had nothing to do with PA Cyber since 2012, nearly four years ago. He awaits trial on a federal indictment, a status that has eliminated any possible influence he might have had. PA Cyber has moved on. So too should the Auditor General.

Accordingly, PA Cyber provides its responses to the Auditor’s findings and recommendations below.

### **Lack of Accountability**

PA Cyber agrees with the statement that “[m]ost of the questions raised [in Finding #1] stemmed from the potential conflicts of interests and the relationships between [PA Cyber’s] Founder and former CEO and his other related party entities.” Most of those mentioned—including the former CEO, several administrators, and several members of the Board—have since left PA Cyber and are no longer associated with the School or other Beaver County educational entities. Since then, PA Cyber has taken great steps toward increasing transparency and accountability.<sup>1</sup>

As discussed throughout this Response, the current Administration, in conjunction with the Board, has implemented and used a variety of processes and policies to ensure that the School obtains the best services at the best possible price. Among those processes and policies are open bidding, requests for proposals (“RFPs”), and the practice of obtaining multiple quotes on products and services.

### **Potential Conflicts of Interest and Related Party Transactions**

PA Cyber did have a contract with a Management Company<sup>2</sup> for both curriculum and management services, as permitted by the Charter School Law (“CSL”). *See Carbondale Area Sch. Dist. v. Fell Charter Sch.*, 829 A.2d 400, 407 (Pa. Commw. Ct. 2003) (“the CSL does not prohibit charter schools from contracting out certain management and administrative responsibilities to a for-profit corporation”). Importantly, however, the Board always maintained control over the operations of the school, as required by the CSL. 24 P.S. § 17-1716-A.

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<sup>1</sup> Although the current CEO did serve as an elected member of the Board of the School’s original authorizer, he was not on the Board when PA Cyber was originally authorized, nor did he participate in any votes favorable to PA Cyber, other than those considered ministerial in nature.

<sup>2</sup> As discussed throughout this Response, PA Cyber’s management contract with the Management Company expired in 2015 and was replaced by separate service contracts. For consistency’s sake, this Response will continue to refer to use the term Management Company, but PA Cyber would emphasize that the company now provides PA Cyber with separate services on a per-contract basis.

The management contract has since expired, however, and the School subsequently issued RFPs for all services it formerly received from the Management Company, including technology services, curriculum, building maintenance and warehouse management, marketing and communications. Due to the specific and unique nature of these services, PA Cyber awarded separate contracts to the Management Company based on its RFP responses. Some services, such as human resources, the School took in-house.

PA Cyber will address the arts services finding in its response to Finding #3.

### **Related Party Trustees & Administrators**

Finding #1 references a number of trustees and administrators and indicates that certain transactions between PA Cyber and other entities may have involved “potential” conflicts of interest in light of the parties’ affiliations. Several of the transactions, however, including those involving Trustee #3, Trustee #4 and his Daughter,<sup>3</sup> Trustee #5,<sup>4</sup> and Senior Administrator #3 all involve individuals who are no longer associated with PA Cyber. Some—such as Senior Administrator #3—are known to have had close ties with the former CEO, but the former CEO is no longer affiliated with the school. PA Cyber emphasizes that it is unable to change events dating back to 2008 and earlier. As such, PA Cyber’s focus is on establishing best practices moving forward to ensure that such problems do not arise in the future.

With respect to the Trustees and administrators who still work at PA Cyber, the School responds as follows:

PA Cyber disagrees that there is a “potential conflict of interest” with respect to the current CEO<sup>5</sup> and his Spouse, who recently retired from her position as the Board Secretary for the Arts Center. The Arts Center first hired the current CEO’s Spouse in approximately 2003 as an administrative assistant—long before the current CEO took his position with PA Cyber. Moreover, as discussed elsewhere in this Response, PA Cyber’s relationship with the Arts Center began before either entity employed the Current CEO or his Spouse. Because that relationship predated either individual’s tenure, there is little likelihood of a conflict of interest.

PA Cyber’s response to Finding #2 addresses Trustee #1 and his son, and details the improvements and policy changes that the school has implemented with respect to contracting, purchasing, financial reporting to the Board, and conflicts of interest. (PA Cyber Ex. 1, 2, 3). By way of additional information, however, PA Cyber emphasizes that Trustee #1 complied with the spirit of the voting requirements set forth in 65 Pa. C.S. § 1103(j) to the extent that he “abstained from all votes pertaining to contractors with whom his son was affiliated.” Moreover, PA Cyber believes that at the time of the votes in question, the remaining Board members were aware of Trustee #1’s potential conflict (to the extent any such conflict existed). That knowledge, combined with Trustee #1’s abstention, demonstrates the efforts taken to comply with the Ethics

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<sup>3</sup> PA Cyber will provide its response with respect to Trustee #4 and his Daughter in its Response to Finding #4.

<sup>4</sup> PA Cyber will provide its response with respect to Trustee #5 in its Response to Finding #5.

<sup>5</sup> The current CEO, Dr. Michael Conti, resigned his position at a Board meeting on July 18, 2016, and an acting CEO assumed his duties at that time. For purposes of consistency, however, this Response will continue to refer to Dr. Conti as the “current CEO.”

Act. Moreover, PA Cyber will work with counsel to ensure that its employees and Board members comply with all policies related to conflicts of interest going forward, and has already implemented an abstention form which will be completed and attached to the Board minutes by any Board member who abstains from a vote. (PA Cyber Ex. 4).

With respect to the finding involving Trustee #2, the contract in question was between PA Cyber and the Community College of Beaver County (“CCBC”). (PA Cyber Ex. 5). The agreement was for rental of the CCBC Athletic and Events Center for purposes of conducting a teacher in-service training.

As with Trustee #1 above, Trustee #2 abstained from voting to approve the contract with CCBC, and PA Cyber believes that the remainder of the Board was aware of the potential conflict at the time of the vote. Moreover, PA Cyber had an ongoing relationship with CCBC and had rented space from the college for similar trainings prior to Trustee #2’s appointment to the Board.<sup>6</sup> In light of these factors, PA Cyber believes that the agreement with CCBC was sufficiently open and transparent. Going forward, however, PA Cyber will continue with its efforts to utilize best practices with respect to contracting.<sup>7</sup>

PA Cyber disagrees that the relationship between Senior Administrators #1 and 2 “may present a conflict of interest.” The CSL provides that a charter school’s board of trustees “shall have the authority to decide matters related to the operation of the school including . . . the authority to employ, discharge and contract with necessary professional and nonprofessional employees subject to the school’s charter . . . .” 24 P.S. § 17-1716-A. As a *non-voting* member of the Board, however, Senior Administrator #2 is unable to vote to influence the operations of the School and to obtain a “private pecuniary benefit [for] a member of [her] immediate family,” that is, her spouse Senior Administrator #1. 65 Pa. C.S. § 1103.

Finally, with respect to the Finding related to the Accounting Firm, PA Cyber notes that it last utilized the Accounting Firm’s services in approximately June 2015, and notes that, following a RFP process conducted in 2015, PA Cyber made the decision to transfer such accounting in-house and has continued to operate accordingly.

*Recommendation 1: Identifying all Related Parties and Potential Conflicts*

PA Cyber has instituted a robust Conflict of Interest Policy as it relates to Trustees and Administrators and requires Board members to attach a written memorandum to the meeting minutes memorializing abstention from any vote. (PA Cyber Ex. 3, 4). The School also regularly and consistently seeks to obtain the best products and services at the best price through bids, RFPs, and obtaining quotes. Additionally, PA Cyber agrees that it will review its present contracts in an effort to identify any actual and/or potential conflicts of interest and will report the same.

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<sup>6</sup> PA Cyber had initially decided to enter into a rental agreement with CCBC because it was less expensive than the hotel conference rooms that PA Cyber had been using previously to conduct in-service teacher trainings.

<sup>7</sup> It should be noted that, due to the structure of the payments to CCBC, the financially prudent course is to comply with the contract because PA Cyber will receive a substantial discount on use of the facility in both 2016 and 2017 (only \$3,000 per year).

*Recommendation 2: Consult with Counsel Regarding CSL and Ethics Act*

PA Cyber has worked extensively with counsel to develop and implement policies and best practices with respect to purchasing, contracting, financial reporting to the Board, and conflicts of interest. (PA Cyber Ex. 1, 2, 3, 4). Both parties will continue to do so.

*Recommendation 3: Develop Best Practices*

With respect to Subsection (a), PA Cyber has already implemented a cost-based approach to contracting and purchasing, as reflected in the RFP seeking new management services after the contract with the Management Company expired. The prior contract required payments based upon a percentage of revenue, but all new contracted-for services are now awarded and provided on a cost based approach.

With respect to Subsection (b), PA Cyber acknowledges that, under the CSL, the Board “shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school’s charter.” 24 P.S. § 17-1716A(1). PA Cyber disagrees, however, that it is either feasible or an efficient use of resources to provide the Board with reports and/or updates regarding every one of the hundreds of contracts PA Cyber enters into on a regular basis. Nevertheless, at every Board meeting, the School’s Management Company, Lincoln Learning Solutions, provides for the Board’s review of an extensive oral and PowerPoint report on performance of its professional services contracts. Such contracts represent a majority of the School’s contracted professional services. PA Cyber will also work with counsel to develop ways for the Administration to provide input and feedback to the Board with respect to contracted-for services.

**RESPONSE TO AUDIT FINDING #2**

Whatever controls and oversight the previous contract with the Management Company<sup>8</sup> lacked, those issues do not apply to the current contracts, entered in 2015.

**The Previous Contract and New Contract**

For the 2014-2015 school year, the School separated the previous contracted services into several smaller contracts, including management services and curriculum, and began an RFP process. These separate contracts were awarded to the Management Company due to their unique ability to provide services to the School at the most affordable rate. By contracting through the use of an open RFP system, the School received more advantageous contract terms compared to those previously obtained from the Management Company. The School eliminated any link between contract price and revenue percentage and turned to a new cost structure based upon a per-seat

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<sup>8</sup> As discussed throughout this Response, PA Cyber’s management contract with the Management Company expired in 2015 and has been replaced by separate service contracts. For consistency’s sake, this Response will continue to refer to use the term Management Company, but PA Cyber would emphasize that the company now provides PA Cyber with separate services on a per-contract basis.

fee as a means of curtailing costs. Also eliminated were any clauses that allowed for automatic renewals of the current contract.

The new terms have significantly lowered total expenditures associated with the Management Company, as shown by the table below:

PA CYBER MANAGEMENT COMPANY PAYMENTS				
Fiscal Year	Curriculum	Management Services	Other Costs	Total
2011-12	\$37,061,877	\$11,718,836	\$510,812	\$49,291,525
2012-13	\$34,748,362	\$15,834,686	\$319,065	\$50,902,113
2013-14	\$38,225,641	\$15,234,768	\$149,744	\$53,610,153
2014-15	\$28,116,925	\$13,520,000	\$1,821,758	\$43,458,683
2015-16	\$33,267,486	\$12,873,687	\$1,317,396	\$47,458,569

The total amount paid to the Management Company has been reduced considerably since the fiscal years spanning from 2011-2014. The costs for different services have decreased or increased in varying degree due to the change in the contract structure with the Management Company. PA Cyber's new bidding process resulted in decreased costs, and with its continued oversight of these services, PA Cyber anticipates further savings. This has led to an overall decrease in the total cost of the management as a percentage of total expenses over the past two (2) years, as exhibited below:

PA CYBER MANAGEMENT COMPANY COST ANALYSIS			
School Year	Management Company Costs	Total Expenses	Costs as % of Total Expenses
2011-12	\$49,291,525	\$110,003,376	44.8%
2012-13	\$50,902,113	\$110,562,823	46.0%
2013-14	\$53,610,153	\$111,765,437	48.0%
2014-15	\$43,458,683	\$122,338,815	35.5%
2015-16	\$47,458,569	\$124,350,000 <sup>9</sup>	38.2%

The Auditors' finding regarding the previous contract have been addressed in the current contracts. First and foremost, the former CEO and founder of both entities no longer has any involvement with the School or the Management Company. The audit admits that the current contract terms are stronger, but worries that it will not be properly monitored. The School is in the process of establishing a standardized rubric so that administrators will be able to receive

<sup>9</sup> This total is estimate as the 2015-2016 accounting has not yet closed. Accordingly, the total percentage is also an estimate.

input from all interested parties and evaluate contractors' performance. As suggested by the previous audit, PA Cyber no longer issues contracts on a revenue based system.

### **The Amendment**

The waiver of the nonperformance penalties resulted from a situation in which the School faced a need that only the Management Company could meet. It became clear during the curriculum development process that the School had expectations for a curriculum that the Management Company believed was in excess of the contract's requirements. The parties worked and continue to work to develop a curriculum that will satisfy student needs, but were unable to do so in time for the 2015-16 school year. Without the Management Company's agreement that the School could use the legacy curriculum, for which the School no longer had a license, the School would have been without any curriculum.

The School and the Management Company are in the process of completing the curriculum, specifying more precisely the School's expectations, and negotiating an accommodation in price. The Curriculum Agreement is a contract; the School cannot unilaterally re-write or terminate it without incurring a substantial financial penalty. Absent a mutually agreeable resolution of the parties' differing understandings, lengthy and expensive litigation would be necessary, which would plunge the School into uncertainty about its ability to use the legacy curriculum and/or to modify the new curriculum.

The Board's waiver of the nonperformance penalty did not result from a possible conflict of interest. Although the motion to amend was introduced by the Trustee whose son was an executive for the Management Company, the amendment was introduced and subsequently passed after lengthy and extensive discussions by the School's management team.

The bid process yielded thirteen (13) bids for the School's curriculum. This contract was a step in the right direction toward increased accountability.

#### *Recommendation 1: Review the December 2015 amendment*

The Board and Administration are currently reviewing possible courses of action. Rescission and renegotiation are under consideration.

#### *Recommendation 2: Review each members' possible conflicts of interest*

PA Cyber's Response to Finding 1, Recommendation 1 details the steps being taken to identify each members' possible conflicts and how those potential issues are being addressed.

#### *Recommendation 3: Develop a rubric for evaluating professional services*

The Administration will work to develop contract rubrics that will make clear the School's expectations with regard to the provided products or services. The rubrics will ensure that the Board has access to the most accurate performance information available.

*Recommendation 4: Enforce nonperformance clauses*

As stated in response to Recommendation 1, rescission and renegotiation are under consideration.

*Recommendation 5: Compare the Management Company's fees to similar entities*

The current contracts with the Management Company are the product of lengthy and involved RFP processes that improved accountability and cut costs. In the past, the School retained outside consultants to evaluate earlier contracts with the Management Company, and even those contracts were found to be fair and reasonable in scope and price by the consultants. The comparison and review process the Audit contemplates would entail considerable time and expense and the need for an outside vendor to evaluate these contracts. In any event, most of them are in the middle of five-year terms, and the School cannot breach them without substantial litigation and associated cost.

*Recommendation 6: Revise its current agreements with the Management Company*

The School and its management team have been reviewing its current contracts with the Management Company. However, these agreements were not made unilaterally. The School has been discussing internally as well as with the Management Company different ways to improve the curriculum and supply a product that meets our students' needs. During these discussions, the School must balance the importance of maintaining financially responsible agreements with the need to avoid disrupting the essential services provided to our students. The Board will certainly ensure that any agreement renewal is achieved via an open and public process. As listed in more detail previously, School management is currently developing proper rubrics to review all contractor's work.

**RESPONSE TO AUDIT FINDING #3**

The relationship between PA Cyber and the Lincoln Park Performance Arts Center ("LPPAC") has a lengthy history that is unique in the Commonwealth. On July 22, 2005, Governor Rendell's Administration, along with the Department of Community and Economic Development, secured \$2 million in economic assistance funds to support the construction of LPPAC in Midland, PA. At that time, PA Cyber provided additional money to fund the construction through a pre-paid lease. The lease contemplated PA Cyber's use of 88,000 square feet of space to accommodate additional staffing needs for its growing student population, as there was no other commercial space in the Borough of Midland to accommodate PA Cyber's needs. Since that time, both PA Cyber and LPPAC have grown substantially. PA Cyber continues to be the largest cyber charter school in Pennsylvania, and LPPAC has become a model of arts education both in the Commonwealth and across the country, bringing world-class education to Midland.

Historically, PA Cyber has made an effort to consolidate its operations within the Borough of Midland. The lease and subsequent note both reflect PA Cyber's commitment to doing so. PA Cyber deems this to be a best practice because it allows for economies of scale and the sharing of resources amongst departments and entities. This centralization of and consolidation of common functions has increased operational efficiency and ultimately results in cost savings to PA Cyber. It has also been a driver of the economy in Midland, which has suffered greatly in recent decades as a result of the collapse of the steel and manufacturing industry in the Ohio River Valley. The lease, as originally conceived, was intended to continue that consolidation and to increase efficiency for PA Cyber.

*Recommendation 1: Long-term note*

In June 2009, the Boards of both organizations jointly agreed to terminate the lease agreement that had been in place between PA Cyber and LPPAC. Although neither of the current executive teams of PA Cyber or LPPAC were involved in that specific negotiation, PA Cyber currently understands that the decision was based upon an unanticipated increase in enrollment at the Lincoln Park Performing Arts Charter School ("LPPACS"). LPPACS required the space occupied by PA Cyber to accommodate and provide educational services for LPPACS students. Because the leased space was no longer available to PA Cyber, the fiscally responsible decision was made at that time<sup>10</sup> to convert the lease into the note receivable.

With respect to Recommendation 1, the note contains no provision allowing the parties to renegotiate its terms. As such, PA Cyber believes that it is not in its financial best interest to risk litigation and/or to incur the cost of such renegotiation at this time. PA Cyber also enjoys the security of the acceleration clause, which provides that if LPPAC fails to make payment of any installments of principal within 10 days of the due date, then the entire balance of the principal debt shall become immediately due and payable. Moreover, PA Cyber believes that the findings related to the note also fail to acknowledge the benefit that LPPAC has brought to PA Cyber by providing world-class arts education to PA Cyber students, and to Midland by bringing world-class arts programming to the community. These benefits were made possible by PA Cyber's initial investment in LPPAC. Consequently, PA Cyber maintains that the note, as it is currently written, cannot and should not be amended.<sup>11</sup> PA Cyber does, however, agree that adjustments to the cost of services provided by LPPAC could be explored in light of the long-term note obligation.

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<sup>10</sup> It is PA Cyber's understanding that PDE was made aware of this decision at the time, and both the lease and the promissory note have subsequently been disclosed in the school's independent audit on a yearly basis.

<sup>11</sup> PA Cyber respectfully disagrees with the finding that it will have forfeited \$1.4 million in interest income by the end of the note's term. This finding relied upon the historical six-month LIBOR rates data to calculate the rate of interest. LIBOR is a benchmark rate that some of the world's leading banks charge each other for short-term loans. Section 440.1 of the PSC, however, provides that school district funds are to be invested in such instruments as United States Treasury bills. The rate for such investments is historically less than the LIBOR rate. In any event, the note was negotiated seven years ago, and PA Cyber does not have the authority to revise it unilaterally, at the expense of another public school.

### *Recommendation 2: Related parties*

With respect to the findings addressing related parties, PA Cyber notes at the outset that the most recent event at issue (the conversion of the lease into the note) took place more than six (6) years ago, and predominantly involved individuals who are no longer affiliated with either LPPAC or PA Cyber. Consistent with Recommendation 2, however, PA Cyber has subsequently developed and implemented rigorous procedures for obtaining goods and services that include safeguards designed to insure the disclosure of related-party relationships. Among those are a detailed Conflict of Interest and Code of Ethics Policy with respect to the Board of Trustees that tracks the requirements set forth in the Pennsylvania Ethics Act, 65 Pa. C.S. §§ 1102, 1103, as well as policies with respect to purchasing, contracting, and conflicts of interest. (PA Cyber Ex. 1, 2, 3). Additionally, bidders on professional services have been required to provide a statement disclosing any relationship the potential vendor may have with PA Cyber or a member of its staff.

### *Recommendation 3: Arts education services*

With respect to Recommendation 3, PA Cyber agrees with the finding to the extent that it recommends best practice. However, because the 2016-2017 school year is already underway, there is insufficient time for PA Cyber to implement a public procurement bidding process for arts education services for the current school year. PA Cyber does intend to implement a public procurement bidding process for arts education services beginning in the 2017-2018 school year.

## **RESPONSE TO AUDIT FINDING #4**

PA Cyber believes that Finding #4 should be stricken from the Auditor's findings because it is inaccurate and contrary to an explicit finding rendered by the Pennsylvania Ethics Commission. As an initial matter, the former Board President (referred to elsewhere in the Auditor's Findings as Trustee #4) and his daughter are no longer affiliated with PA Cyber. The Ethics Commission investigated possible Ethics Act issues related to tuition benefits allegedly provided to [the former Board President's] daughter and concluded that they were unfounded. Notably, the Executive Director of the Ethics Commission, stated the following in a February 2, 2015 letter to [the former Board President]:

Specifically, the Commission concluded, based on recommendations made by the Investigative Division, that there was a lack of probable cause to proceed further in the investigation regarding the allegation that you [Dr. Jaskiewicz] used the authority of your office to direct that your daughter be enrolled in college level courses at the expense of the PA Cyber Charter School. In addition, the Commission determined that your participation in PA Cyber Charter School actions to authorize payments to college where your daughter was taking college level credits would be covered by the class/subclass exemption of the State Ethics Act. Therefore, pursuant the [sic] provisions to [sic] the State Ethics Act and Commission regulations, *these matters are closed*.

(PA Cyber Ex. 6) (emphasis added). Given the above facts, PA Cyber responds to the recommendations in Finding #4 as follows:

*Recommendation 1: Seeking reimbursement*

PA Cyber strongly disagrees that tuition reimbursements to former Board President's daughter were "improper," given the Ethics Commission's determination that the payments were exempt under the Ethics Act. As such, PA Cyber believes that it has no basis for seeking reimbursement for such tuition payments.

*Recommendation 2: Recommendations to PDE*

PA Cyber has no control over the actions of PDE, and to the extent that this Recommendation is made to a third-party state agency, it does not require a response. PA Cyber would note, however, that the program addressed in Recommendation 2 ended in the spring of 2014 and has not been reinstated, because grant funding has not been restored.

**RESPONSE TO AUDIT FINDING #5**

Finding 5 arises from the School's procurement and use of video conferencing equipment, and the identified former Trustee was a principle in the company that supplied such goods. However, the company provided a state-wide bid to Costars, Pennsylvania's cooperative purchasing program, which serves as a conduit for state entities to efficiently identify suppliers. Only then did PA Cyber accept the company's service as a low cost provider of computer equipment. The former Trustee did not leverage his authority as a public official for the private pecuniary benefit of his business. Instead, the School selected the computer services contract based upon competitive bidding. Further, the Trustee abstained from the voting. All evidence indicates that the prior Board members who voted at the time were aware of the conflict.

*Recommendation 1: Conduct thorough review of all potential conflicts; and*

Please reference Finding 1, Recommendation 1 as to the School's plan to thoroughly review and address all current and potential conflicts which may arise.

*Recommendation 2: Establish policies related to Trustee eligibility and potential conflicts.*

The School's Bylaws have already established clear and stringent policies that details the qualifications of potential Board of Trustee members and addresses all real and potential conflicts of interest. (PA Cyber Ex. 7). The Bylaws require that each potential Board member, "before entering into office, shall file a statement of financial interests pursuant to the State Ethics Law." Additionally, there exists a separate Conflict of Interest and Code of Ethics Policy ("Policy") that has been approved by the Board of Trustees. (PA Cyber Ex. 3). This Policy directs that "all Trustees, Officers, and other representatives must avoid potential conflicts of interest." Even where a voting conflict is not addressed by any law, rule, regulation, order or ordinance, the Policy requires the Trustee to abstain from voting and publicly disclose the nature

of the conflict via a written memorandum to be filed with the board minutes. The Policy further details potential conflicts of interest. In the event that a question of conflict or the appearance of conflict of interest arises, the Policy requires the submission of a Conflict of Interest Disclosure Form to the Board President, who reports the investigation to the CEO and the Board for resolution. Penalties are then delineated by the Policy, subjecting the offender to disciplinary action as well as any penalties as prescribed by law, including the Ethics Act.

## **RESPONSE TO AUDIT FINDING #6**

The nature of the cyber charter school environment imposes practical and technological challenges regarding attendance issues that do not exist in traditional brick-and-mortar schools. PA Cyber has consistently worked to address those challenges. Toward that end, PA Cyber recently examined its attendance policy and procedures and implemented an aggressive plan to improve student attendance. These have resulted in measurable improvements over the past two (2) school years.

### *Recommendation 1: Attendance Policy*

PA Cyber disagrees that further modification of the student attendance policy is necessary because the School's recent focus on reporting and enforcement has resulted in substantial positive effects in student attendance.

### *Recommendation 2: Attendance Reporting*

PA Cyber now requires teachers who provide live instruction in Blended Classroom and Virtual Classroom classes to take daily attendance and to report absences via the student attendance system. Because each live class session is recorded, students can view any live session they may have missed and use those playbacks as a study tool at any time. While this offers flexibility to PA Cyber's students, it poses a challenge for tracking student attendance. Unfortunately, the technology does not yet allow for tracking attendance when students use pre-recorded classes to make up the class after an absence. To monitor student work, classroom teachers will continue to provide feedback to administrators when students who have missed class appear to be falling behind in their work. This information, in turn, can be passed on to the Attendance Department for remedial measures when necessary.

### *Recommendation 3: Attendance Enforcement*

PA Cyber created an Attendance Department during the 2014-15 school year to oversee the school's attendance policy and enforcement. A total of eleven (11) staff members work in Harrisburg and Midland, including two (2) Directors of Attendance, three (3) Supervisors of Student Attendance, one (1) Special Education Supervisor of Student Attendance, and five (5) Administrative Assistants.

Working in conjunction with the school administration, the Attendance Department has implemented procedures for parents to report absences and to submit medical and other excuse documentation directly to the school. Additionally, students and parents now receive automated daily notifications of any absences (by phone and email), as well as notices of absences in excess of three (3) days. The Attendance Department has also implemented a system aimed at streamlining communication between the attendance staff and particular school administrators, allowing attendance issues to be addressed quickly through Truancy Elimination Plans (“TEP”).<sup>12</sup>

TEPs are conferences conducted between the school and a student’s family, the purpose of which is to address chronic absences and academic difficulties. The participants take an in-depth look at the student’s academic needs, as well as other social, emotional, physical, mental and behavioral health factors that can affect a student’s attendance. Students can be recommended for a TEP by the Supervisor of Attendance, a teacher, or other school staff. During the 2015-16 school year, the Attendance Department conducted 276 informal TEPs, 298 mandatory formal TEPs, and 120 follow-up meetings.

As a result of these efforts, PA Cyber has seen a 30% reduction in truancy issues as of January 2016, along with a 40% reduction in the number of 3-day unexcused absence letters sent to families between the 2014-15 and 2015-16 school years. In addition to TEPs, PA Cyber has also undertaken to enforce existing attendance issues, resulting in a 12.9% increase in the number of students removed for ten (10) consecutive unexcused absences between the 2014-15 and the 2015-16 school years. These statistics demonstrate how seriously PA Cyber takes student attendance, and the effect those improvements have had in tracking and enforcement.

While student attendance is an issue facing all schools in the Commonwealth of Pennsylvania, PA Cyber believes it has made systemic and quantifiable changes in an effort to better its attendance recording and enforcement mechanisms.

#### **RESPONSE TO AUDIT FINDING #7**

PA Cyber has terminated the use of outside contractors to maintain the documentation in support of its teacher certifications and has transferred all maintenance of its teacher certification documentation to its in-house Human Resources Department. With these services being performed in-house, there will be increased oversight, and PA Cyber can ensure that teacher certifications are supported by employee records.

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<sup>12</sup> Beginning with the 2016-17 school years, TEPs will be referred to as School Attendance Improvement Plans. For purposes of consistency, and because the new term has not gone into effect yet, this Response will continue to refer to TEPs.

*Recommendation 1a: Maintaining complete records of personnel files*

In order to maintain complete and accurate records in employees' personnel files, PA Cyber management has taken the following action:

In September 2012, management created the PA Cyber Induction Handbook and Professional Development Handbook to document specific requirements and processes for Level I to Level II conversion. The teacher Handbooks were part of PA Cyber's Comprehensive Plan, which was submitted to the PDE in November 2013 and then approved. PA Cyber also purchased a license for the Pennsylvania Electronic Teacher Evaluation Portal ("PA ETEP"), an electronic teacher and supervisor evaluation portal used by the school to manage the evaluation process beginning with the 2014-2015 school year. The PA ETEP files are also maintained physically in the in-house Human Resources Department.

This framework allows PA Cyber to monitor accurately staff's Level II certification. The Level II applicant submits his/her work experience into the PDE Teacher Information Management System ("TIMS"), whereupon the PA Cyber Director or Assistant Director of Professional Development and Teacher Certification verifies the information with Human Resources. Additional checks are made to confirm the employee has maintained good moral character pursuant to 24 P.S. § 12-1209, completed the approved Induction Program and received satisfactory ratings on PA ETEP.

*Recommendation 1b: Restricting access to personnel files*

The Board of Trustees and management team determined during the 2013-2014 school year that Human Resources services should be transferred from the outside Management Company<sup>13</sup> to an in-house Human Resources Department during the 2014-2015 school year, and the transition was completed for the start of the 2015-2016 school year. All personnel files are now maintained on school property in the offices of the Human Resources Department. The School received assurance from the Management Company that, to the best of their knowledge, all files had been transferred to PA Cyber, none had been destroyed, and that the Management Company has no remaining School Human Resources files in its possession. The School no longer contracts with any management company for HR-related services or file storage and maintenance. The School has taken proper steps to restrict access to personal files only to authorized staff.

*Recommendation 1c: Prohibiting the removal of personnel files from the School's Premises*

The School established the in-house Human Resources Department to maintain employee personnel files on premises and prevent their removal by any unauthorized personnel. As previously detailed, the School received all personnel files from the previous Management Company and no longer externally contracts these services through any other entity. Files are accessible only to Human Resources Department staff or by employees, as permitted by law,

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<sup>13</sup> As discussed throughout this Response, PA Cyber's management contract with the Management Company expired in 2015 and was replaced by separate service contracts. For consistency's sake, this Response will continue to refer to use the term Management Company, but PA Cyber would emphasize that the company now provides PA Cyber with separate services on a per-contract basis.

with proper request and supervision by the Human Resources staff to prevent any potential removal from the School's premises.

*Recommendation 2: The PDE reviewing Instructional II certifications*

The School is confident that all of its educators have met the experience requirements to obtain the Instructional II certification during the time period in question. Staff and management has continued its ongoing efforts working with all possible parties to support these certifications with proper documentation.

**RESPONSE TO AUDIT FINDING #8**

PA Cyber must balance the costs and benefits of seeking the return of all student-issued IT equipment. However, seeking return of all non-laptop IT equipment has not been economically feasible, and consequently has not been pursued. The School does not have a statutory or contractual obligation to seek such return; therefore, it has chosen to save itself and the Commonwealth money and parents and students the burden, except when doing so would result in an overall savings to the school and to the Commonwealth (as is the case with laptops).

The contract parents and students sign at enrollment, along with the School's IT Policy, reserve PA Cyber's right to request the return or collect damages for school property based on withdrawal or violation of the school's Acceptable Use Policy, but do not require PA Cyber to obtain return at a loss. (PA Cyber Ex. 8, 9). PA Cyber vigorously pursues the return of laptop computers once a student withdraws or graduates, and has filed complaints with district justices throughout the Commonwealth, who have, in turn, issued arrest warrants for both parents and students. (PA Cyber Ex. 10). The cost of pursuing such legal remedies against those who fail to return other less valuable IT equipment is, however, a factor PA Cyber must consider in its cost-benefit analysis in this area.

PA Cyber shared with the auditors that, excluding laptop computers, the school not only has concerns regarding the costs and benefits of collecting such equipment, but also has legitimate hygiene and health safety concerns regarding reuse and distribution of such equipment. Headsets, for example, should not be reused. Additionally, the finding relies only upon the return shipping costs in stating that "[t]he incremental cost of shipping the other IT equipment back to [PA Cyber] probably would not have exceeded its value . . ." (emphasis added). This statement fails to account for the substantial and necessary costs of staffing these endeavors, recovering the equipment, refurbishing the equipment, and returning the equipment to the vendor, as well as the fact that much of the non-laptop equipment quickly becomes obsolete, and thus, of little to no financial value.

PA Cyber strongly disagrees with the statement that the school may be in noncompliance with the Charter School Law ("CSL"). Nothing in the CSL requires the return of equipment when it would cost the school more to do so, as it only requires cyber charter schools to "provide all equipment" to students. 24 P.S. § 17-1743-A. Moreover, Finding #8 also cites to 24 P.S. § 8-803,

which relates only to the purchase of textbooks and makes no mention of “the ownership of the property,” as stated in the finding.

In light of these facts, PA Cyber believes that its current practices are sufficient to ensure that funds are being prudently used with respect to IT equipment. PA Cyber will, however, continue to monitor the costs and benefits of its current practices and will make adjustments as necessary.

## **Distribution List**

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This report was initially distributed to the Chief Executive Officer of the Charter School, the Board of Trustees, and the following stakeholders:

**The Honorable Tom W. Wolf**

Governor  
Commonwealth of Pennsylvania  
Harrisburg, PA 17120

**The Honorable Pedro A. Rivera**

Secretary of Education  
1010 Harristown Building #2  
333 Market Street  
Harrisburg, PA 17126

**The Honorable Timothy Reese**

State Treasurer  
Room 129 - Finance Building  
Harrisburg, PA 17120

**Mrs. Danielle Mariano**

Director  
Bureau of Budget and Fiscal Management  
Pennsylvania Department of Education  
4th Floor, 333 Market Street  
Harrisburg, PA 17126

**Dr. David Wazeter**

Research Manager  
Pennsylvania State Education Association  
400 North Third Street - Box 1724  
Harrisburg, PA 17105

**Mr. Nathan Mains**

Executive Director  
Pennsylvania School Boards Association  
400 Bent Creek Boulevard  
Mechanicsburg, PA 17050

**Ms. Pam Sherts**

Executive Secretary  
Attention: Charter and Cyber Charter  
Schools  
1010 Harristown Building #2  
333 Market Street  
Harrisburg, PA 17126

**Mr. Robert Caruso**

Executive Director  
State Ethics Commission  
309 Finance Building  
P.O. Box 11470  
Harrisburg, PA 17108

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