

PERFORMANCE AUDIT

Perseus House Charter School of Excellence Erie County, Pennsylvania

June 2016



Commonwealth of Pennsylvania
Department of the Auditor General
Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

Dr. Nick Viglione, CEO/Director
Perseus House Charter School of Excellence
1511 Peach Street
Erie, Pennsylvania 16501

Dr. Thomas Fortin, Board President
Perseus House Charter School of Excellence
1511 Peach Street
Erie, Pennsylvania 16501

Dear Dr. Viglione and Dr. Fortin:

We conducted a performance audit of the Perseus House Charter School of Excellence (Charter School) to determine its compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures (relevant requirements). We also evaluated the application of best practices in the area of school safety. Our audit covered the period January 26, 2011 through March 15, 2016, except as otherwise indicated in the report. Additionally, compliance specific to state subsidies and reimbursements was determined for the school years ended July 1, 2010 through June 30, 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, as detailed in the four audit findings within our report. A summary of the results is presented in the Executive Summary section of the audit report. These findings include recommendations aimed at the Charter School and a number of different government entities, including the Pennsylvania Department of Education (PDE) and the State Ethics Commission.

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

Sincerely,

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

Eugene A. DePasquale
Auditor General

June 2, 2016

cc: **PERSEUS HOUSE CHARTER SCHOOL OF EXCELLENCE** Board of Trustees

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Executive Summary

Audit Work

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

Our audit scope covered the period January 26, 2011 through March 15, 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 2010-11, 2011-12, 2012-13, and 2013-14 school years.

Charter School Background

The Charter School, located in Erie County, Pennsylvania, opened in September 2003. It was originally chartered on February 12, 2003, for a period of five years by the School District of the City of Erie and has continued to be renewed. The Charter School's mission states: "The Mission of the Perseus House Charter School of Excellence is to provide a variety of educational opportunities to foster academic excellence through partnerships with family, community and school."

During the 2013-14 school year, the Charter School provided educational services to 732 pupils from 10 sending school districts through the employment of 43 teachers,

36 full-time and part-time support personnel, and 8 administrators. The Charter School received more than \$5.9 million in tuition payments from school districts required to pay for their students attending the Charter School in the 2013-14 school year.

Academic Performance

The Charter School's academic performance is considered underperforming, as demonstrated by its low School Performance Profile (SPP) score of 50.1 percent in the 2012-13 school year. 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 50.1 would be considered an "F" 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.

Previously, the Charter School did not make Adequate Yearly Progress (AYP) for the 2011-12 school year and was in a Corrective Action II status. AYP was a key measure of school performance established by the federal No Child Left Behind Act (NCLB) of 2001 requiring that all students reach proficiency in Reading and Math by 2014. For a school to meet AYP measures, students in the school needed to meet goals or targets in three areas: (1) Attendance (for schools that did not have a graduating class) or Graduation (for schools that had a high school graduating class), (2) Academic Performance, which was based on tested students' performance on the Pennsylvania

System of School Assessment (PSSA), and (3) Test Participation, which was based on the number of students that participated in the PSSA. Schools were evaluated for test performance and test participation for all students in the tested grades (3-8 and 11) in the school. AYP measures determined whether a school was making sufficient annual progress towards statewide proficiency goals. On August 20, 2013, Pennsylvania was granted a waiver from the NCLB's requirement of achieving 100 percent proficiency in Reading and Math by 2014, so AYP measures were discontinued beginning with the 2012-13 school year.

Audit Conclusion and Results

Our audit found significant noncompliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures, as detailed in the four audit findings within this report.

Finding No. 1: Perseus House Charter School of Excellence May Have Improperly Received \$56,368 in State Lease Reimbursement Calculation. Our audit found that the Charter School may have improperly received \$56,368 in state lease reimbursements for the 2010-11 through 2013-14 school years. We found that the Charter School shares an executive director, board members, and administrative staff with a related non-profit, which also owns a building where the Charter School leases space. The close connection between these two entities created a related party landlord and tenant agreement and, therefore, made the Charter School's rental payments to the related non-profit entity highly questionable for state lease reimbursement (see page 13).

Finding No. 2: Certification Deficiencies.

Our review of the Charter School's professional employees' certification and assignments for the period August 26, 2013 through June 12, 2014, (2013-14 school year) was performed in order to determine compliance with the requirements of the Charter School Law (CSL), the Public School Code (PSC), the federal NCLB, and Certification and Staffing Policies and Guidelines (CSPG) issued by PDE. We found several certification deficiencies for the 2013-14 school year (see page 21).

Finding No. 3: Weaknesses in Board of Trustees' Minutes and Noncompliance with the Sunshine Act and Its By-Laws.

In an effort to gain an understanding of governance and operations of the Charter School, our review of the Charter School's board meeting minutes from August 17, 2010 through December 17, 2013, found inadequacies in the recording and documenting of actions of the Board of Trustees (Board) (see page 24).

Finding No. 4: Board Secretary and Treasurer Did Not Obtain Surety Bonds as Required by the Public School Code.

Our audit of the Charter School revealed that neither the Board Secretary nor the Board Treasurer is appropriately bonded as required by the CSL and the PSC (see page 27).

Status of Prior Audit Findings and Observations. With regard to the status of our prior audit recommendations to the Charter School, we found the Charter School had taken appropriate corrective action in implementing our recommendations pertaining to the Memorandum of Understanding (MOU) with local law enforcement not being updated timely (see page 29).

Background Information on Pennsylvania Charter Schools

Description of Pennsylvania Charter Schools:

Charter and cyber charter schools are taxpayer-funded public schools, just like traditional public schools. There is no additional cost to the student associated with attending a charter or cyber charter school. Charter and cyber charter schools operate free from many educational mandates, except for those concerning nondiscrimination, health and safety, and accountability.

Pennsylvania ranks high compared to other states in the number of charter schools:

According to the Center for Education Reform, Pennsylvania has the 7th highest charter school student enrollment, and the 10th largest number of operating charter schools, in the United States.

Source: "National Charter School and Enrollment Statistics 2010." October, 2010.

Pennsylvania Charter School Law

Pennsylvania's charter schools were established by the CSL, enacted through Act 22 of 1997, as amended. In the preamble of the CSL, the General Assembly stated its intent to provide teachers, parents, students, and community members with the opportunity to establish schools that were independent of the existing school district structure.¹ In addition, the preamble provides that charter schools are intended to, among other things, improve student learning, encourage the use of different and innovative teaching methods, and offer parents and students expanded educational choices.²

The CSL permits the establishment of charter schools by a variety of persons and entities, including, among others, an individual; a parent or guardian of a student who will attend the school; any nonsectarian corporation not-for-profit; and any nonsectarian college, university or museum.³

Applications must be submitted to the local school board where the charter school will be located by November 15th of the school year preceding the school year in which the charter school will be established,⁴ and that board must hold at least one public hearing before approving or rejecting the application.⁵ If the local school board denies the application, the applicant can appeal the decision to the State Charter School Appeal Board,⁶ which is comprised of the Secretary of Education and six members appointed by the Governor with the consent of a majority of all of the members of the Senate.⁷

¹ 24 P.S. § 17-1702-A.

² *Id.*

³ 24 P.S. § 17-1717-A(a).

⁴ *Id.* § 17-1717-A(c).

⁵ *Id.* § 17-1717-A(d).

⁶ *Id.* § 17-1717-A(f).

⁷ 24 P.S. § 17-1721-A(a).

With certain exceptions for charter schools within the School District of Philadelphia, initial charters are valid for a period of no less than three years and no more than five years.⁸ After that, the local school board can choose to renew a school's charter every five years, based on a variety of information, such as the charter school's most recent annual report, financial audits, and standardized test scores. The board can immediately revoke a charter if the school has endangered the health and welfare of its students and/or faculty. However, under those circumstances, the board must hold a public hearing on the issue before it makes its final decision.⁹

Act 88 of 2002 amended the CSL to distinguish cyber charter schools, which conduct a significant portion of their curriculum and instruction through the Internet or other electronic means, from brick-and-mortar charter schools that operate in buildings similar to school districts.¹⁰ Unlike brick-and-mortar charter schools, cyber charter schools must submit their application to the PDE, which determines whether the application for a charter should be granted or denied.¹¹ However, if PDE denies the application, the applicant can still appeal the decision to the State Charter School Appeal Board.¹² In addition, PDE is responsible for renewing and revoking the charters of cyber charter schools.¹³ Cyber charter schools that had their charter initially approved by a local school district prior to August 15, 2002, must seek renewal of their charter from PDE.¹⁴

Funding of Pennsylvania Charter Schools:

Brick-and-mortar charter schools and cyber charter schools are funded in the same manner, which is primarily through tuition payments made by school districts for students who have transferred to a charter or cyber charter school.

The CSL requires a school district to pay a per-pupil tuition rate for its students attending a charter or cyber charter school.

Pennsylvania Charter School Funding

The Commonwealth bases the funding for charter schools on the principle that the state's subsidies should follow the students, regardless of whether they choose to attend traditional public schools or charter schools. According to the CSL, the sending school district must pay the charter/cyber charter school a per-pupil tuition rate based on its own budgeted costs, minus specified expenditures,

⁸ 24 P.S. § 17-1720-A.

⁹ PDE, Basic Education Circular, "Charter Schools," Issued 10/1/2004.

¹⁰ 24 P.S. §§ 17-1703-A, 17-1741-A *et seq.*

¹¹ 24 P.S. § 17-1745-A(d).

¹² *Id.* § 17-1745-A(f)(4).

¹³ 24 P.S. § 17-1741-A(a)(3).

¹⁴ 24 P.S. § 17-1750-A(e).

for the prior school year.¹⁵ For special education students, the same funding formula applies, plus an additional per-pupil amount based upon the sending district's special education expenditures divided by a state determined percentage specific to the 1996-97 school year.¹⁶ The CSL also requires that charter schools bill each sending school district on a monthly basis for students attending the Charter School.¹⁷

Typically, charter schools provide educational services to students from multiple school districts throughout the Commonwealth. For example, a charter school may receive students from ten neighboring, but different, sending school districts. Moreover, students from numerous districts across Pennsylvania attend cyber charter schools.

Under the PSC of 1949, as amended, the Commonwealth also pays a reimbursement to each sending school district with students attending a charter school that amounts to a mandatory percentage rate of total charter school costs.¹⁸ Commonwealth reimbursements for charter school costs are funded through an education appropriation in the state's annual budget. However, the enacted state budget for the 2011-12 fiscal year eliminated funding of the Charter School reimbursement previously paid to sending school districts.¹⁹

¹⁵ See 24 P.S. § 17-1725-A(a)(2).

¹⁶ See *Id.* §§ 17-1725-A(a)(3); 25-2509.5(k).

¹⁷ See 24 P.S. § 17-1725-A(a)(5).

¹⁸ See 24 P.S. § 25-2591.1. Please note that this provision is contained in the general funding provisions of the PSC and not in the CSL.

¹⁹ Please note that the general funding provision referenced above (24 P.S. § 25-2591.1) has not been repealed from the PSC and states the following: "For the fiscal year 2003-2004 and each fiscal year thereafter, if insufficient funds are appropriated to make Commonwealth payments pursuant to this section, such payments shall be made on a pro rata basis." Therefore, it appears that state funding could be restored in future years.

Audit Scope, Objectives, and Methodology

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 January 26, 2011 through March 15, 2016. In addition, the scope of each individual audit objective is detailed below.

Regarding state subsidies and reimbursements, our audit covered the 2010-11 through 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

What is the difference between a finding and an observation?

Our performance audits may contain findings and/or observations related to our audit objectives. Findings describe noncompliance with a statute, regulation, policy, contract, grant requirement, or administrative procedure. Observations are reported when we believe corrective action should be taken to remedy a potential problem not rising to the level of noncompliance with specific criteria.

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 Charter School's compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures. Our audit focused primarily on whether the Charter School was in compliance with the PSC¹ and CSL.² More specifically, we sought to determine answers to the following questions, which serve as our audit objectives:

- ü Was the 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.

¹ 24 P.S. § 1-101 *et seq.*

² 24 P.S. § 17-1701-A *et seq.*

- In addition, auditors reviewed board policies and procedures and vendor contracts for the 2010-11 and 2011-12 school years, IRS 990 forms for the 2010, 2011, and 2012 calendar years, and charter school annual reports for the 2010-11, 2011-12, and 2012-13 school years.

- ü Did the Charter School receive state reimbursement for its building lease under the Charter School Lease Reimbursement Program administered by PDE, was its lease agreement approved by its Board, and did its lease process comply with the provisions of the Public Official and Employee Ethics Act?³
 - To address this objective, auditors reviewed building ownership documentation, the lease agreements, lease payments, and the Charter School’s lease documentation filed with PDE to obtain state reimbursement for the 2010-11, 2011-12, 2012-13, and 2013-14 school years.

- ü Were the Charter School’s Board and administrators free from apparent conflicts of interest and in compliance with the CSL, the PSC, the Public Official and Employee Ethics Act, and the Sunshine Act?
 - To address this objective, auditors reviewed Statements of Financial Interest for all board members and administrators, board meeting minutes, and any known outside relationships with the Charter School and/or its authorizing school district for the 2010, 2011, and 2012 calendar years.

- ü Were at least 75 percent of the 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 NCLB Act of 2001?

³ 65 Pa.C.S. § 1101 *et seq.*

- To address this objective, auditors reviewed and evaluated certification documentation and teacher course schedules for all 58 teachers and administrators for the 2013-14 school year.

ü Did the Charter School require its non-certified professional employees to provide evidence that they are at least 18 years of age and a U.S. citizen pursuant to Section 1724-A(b) of the CSL and that they have a pre-employment medical examination certificate pursuant to Section 1418(a) of the PSC?

- To address this objective, auditors reviewed personnel files and supporting documentation for all 15 non-certified professional employees for the 2013-14 school year.

ü Did the Charter School accurately report its membership numbers to PDE, and were its average daily membership and tuition billings accurate?

To address this objective:

- Auditors reviewed charter school tuition rates and tuition billings for all ten sending school districts for the 2011-12 school year.
- In addition, auditors reviewed the Charter School's membership reports, instructional time summaries, entry/withdrawal procedures, and supporting documentation for the 2011-12 school year.

ü Did the Charter School ensure that the membership data it reported to PDE through the Pennsylvania Information Management System was complete, accurate, valid, and reliable for the most current year available?

To address this objective:

- For the 2011-12 school year, the auditors randomly selected 10 out of 636 total registered students from the vendor software listing and verified that each child was appropriately registered with the Charter School.
- In addition, the auditors verified the school days reported on the Instructional Time Membership Report and matched them to the School Calendar Fact Template.

Ü Did the Charter School comply with the CSL's compulsory attendance provisions and, if not, did the Charter School remove days in excess of ten consecutive unexcused absences from the Charter School's reported membership totals pursuant to the regulations?⁴

To address this objective:

- Auditors reviewed student attendance reports, notification letters, and supporting documentation for the 2011-12 school year.
- The auditors also tested five out of ten students that had more than ten consecutive days of unexcused absences to verify that students are in fact removed from rolls or that the Charter School is actively pursuing removing the students from the rolls.

Ü Did the 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.

⁴ 22 Pa. Code § 11.24.

- In addition, auditors reviewed board meeting minutes, personnel listings, payroll reports, and PSERS wage reports for all 87 employees for the 2011-12 school year.

- ü Did the Charter School take appropriate steps to ensure school safety, including maintaining a current MOU with local law enforcement?
 - To address this objective, for the 2013-14 school year, the auditors reviewed a variety of documentation including MOU(s), safety plans, training schedules, anti-bullying policies, and after action reports to assess whether the Charter School is in compliance with relevant safe schools requirements in the PSC⁵ and with best practices for ensuring school safety.

- ü Did the Charter School provide the services required for its special education students through outside agencies and/or through properly certified professional staff with the required instructional hours and/or training pursuant to Chapter 711 of Pennsylvania’s Special Education Regulations?⁶
 - To address this objective, auditors reviewed the approved Charter and any amendments, relevant policies and procedures, special education service contracts for the 2011-12 school year, special education certification results for the 2013-14 school year and charter school annual reports for the 2010-11, 2011-12, and 2012-13 school years.

- ü Did the Charter School have policies and procedures regarding the requirements to maintain student health records, perform required health services, and keep accurate documentation supporting its annual health services report filed with the Pennsylvania Department

⁵ 24 P.S. § 13-1301-A *et seq.*

⁶ 22 Pa. Code § 711 *et seq.*

of Health to receive state reimbursement as required by law?⁷

- To address this objective, auditors reviewed the Charter School’s annual health services reports and supporting documentation, policies and procedures regarding student health services, and wellness policy for the 2011-12 school year.

Ü Did the Charter School comply with the open enrollment and lottery provisions under Section 1723-A of the CSL?

- To address this objective, auditors reviewed the approved Charter and any amendments, admission policies and procedures, wait lists, lottery results, and other supporting documentation for the 2011-12 school year.

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, grant requirements, 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 Charter School’s management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Charter School is in compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures (relevant requirements). In conducting our audit, we obtained an understanding of the Charter School’s internal controls, including any information technology controls, as they relate to the Charter School’s compliance with relevant requirements 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.

⁷ Article XIV, School Health Services, 24 P.S. § 14-1401 (2006), is applicable to charters and cyber charters in its entirety through its incorporation in 24 P.S. § 17-1732-A(a) and 24 P.S. § 17-1749-A(a)(1), respectively, of the CSL.

Our audit examined the following:

- Records pertaining to professional employee certification, state ethics compliance, student health services, special education, lease agreements, open enrollment, vendor contracts, and student enrollment.
- Items such as board meeting minutes, pupil membership records, IRS 990 forms, and reimbursement applications.
- Tuition receipts and deposited state funds.

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

To determine the status of our audit recommendations made in a prior audit report released on January 23, 2012, we performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1

Perseus House Charter School of Excellence May Have Improperly Received \$56,368 in State Lease Reimbursement Calculation

Criteria relevant to the finding:

Section 2574.3(a) of the PSC, 24 P.S. § 25-2574.3(a), states as follows:

“For leases of buildings or portions of buildings for charter school use which have been approved by the Secretary of Education on or after July 1, 2001, the Department of Education shall calculate an approved reimbursable annual rental change.”

“Approved reimbursable annual rental for such approved leases of buildings or portions of buildings for charter school use shall be the lesser of (i) the annual rental payable under the provisions of the approved lease agreement, or (ii) the product of the enrollment, as determined by the Department of Education, times one hundred sixty dollars (\$160) for elementary schools, two hundred twenty dollars (\$220) for secondary schools, or two hundred seventy dollars (\$270) for area-vocational-technical schools.”

“The Commonwealth shall pay, annually, for the school year 2001-2002 and each school year thereafter, to each charter school which leases, with the approval of . . . [PDE], buildings or portions of buildings for charter school use under these provisions, an amount determined by multiplying the aid ratio of the charter school by the approved reimbursable annual rental.”

We found that the Charter School may have improperly received \$56,368 in state lease reimbursements for the 2010-11 through 2013-14 school years. Our review revealed that the Charter School shares an executive director, board members, and administrative staff with a related non-profit, which also owns the building where the Charter School leases space. The close connection between these two entities created a related party landlord and tenant agreement and, therefore, made the Charter School’s rental payments to the related non-profit entity highly questionable for state lease reimbursement.

The Charter School applied for and received payments from the Commonwealth’s Charter School Lease Reimbursement Program as follows:

<i>Charter School Lease Reimbursement</i>	
School Year	Reimbursement Amount
2010-11	\$13,492
2011-12	\$13,039
2012-13	\$15,270
2013-14	<u>\$14,567</u>
Total	<u>\$56,368</u>

In 2006, the Charter School entered into a five year lease agreement with the related non-profit entity for 14,603 square feet of space within the non-profit’s main office building. When the lease was renewed in 2011 for another five years, the renewal included an additional 2,000 square feet of space within the same office building. Both of these lease agreements were signed by the executive director of the related non-profit entity, who was also simultaneously the executive director of the Charter School. The 2011 lease renewal was signed by a board member of the Charter School and by a Charter School administrator for the 2006 lease.

Criteria relevant to the finding (continued):

Charter School Lease Reimbursement Program Directives provided by the Bureau of Budget and Fiscal Management and PDE states, in part:

“Buildings owned by the charter school are not eligible for reimbursement under this program. Payments related to the acquisition of a building do not qualify for reimbursement under the program.”

Related parties are defined by accounting principles to include:

“Other parties that can significantly influence **the management of operating policies of the transacting parties or that have an ownership interest** in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.”

Source: Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 850-10-50.

In fact, the Charter School’s By-Laws state that:

“The Executive Director of the [Charter School] shall be the individual serving as the Executive Director of [Related Non-Profit]. The Executive Director shall be the Chief Executive Officer of the Corporation.”

“The Board shall consist of nine Trustees.”

Furthermore, in addition to sharing an executive director and board members, the Charter School and the related non-profit entity also share a Board Treasurer, Board Secretary, and employees in their finance and human resources departments.

In Conclusion

Under PDE’s eligibility requirements, which are based on Section 2574.3(a) of the PSC, buildings owned by the charter school do not qualify for compensation under the Charter School Lease Reimbursement Program. Our audit work clearly demonstrated that there was a related party landlord and tenant agreement between the Charter School and the related non-profit entity. Therefore, the Charter School was essentially leasing space in the non-profit’s headquarters to itself, and its lease payments for that shared space were most likely not eligible for Commonwealth reimbursement. The Charter School may have improperly received rental reimbursement for this building space for the four years.

Recommendations

The *Perseus House Charter School of Excellence* should:

1. Ask its solicitor to review the terms of any reimbursement and/or grant program prior to submitting an application for reimbursement.
2. Request that its solicitor provide a summary of all the Charter School’s legal requirements under the PSC and the CSL.

The *Pennsylvania Department of Education* should:

3. Require the Charter School to pay back the \$56,368 owed to the Commonwealth for the improper reimbursement it received from the Reimbursement for Charter Schools Lease Program.

Management Response

Management stated the following:

“The Management of Perseus House Charter School of Excellence adamantly disagrees with this finding, which is based solely on the sharing of some (but not all) administrative employees and some (but not all) board members.

The Charter School Law grants charter schools authority to enter into leases in 24 P.S. § 17-1714-A. (3) which states that a charter school may: ‘Acquire real property from public or private sources by purchase, lease, lease with an option to purchase or gift for use as a Charter School facility.’ It is pursuant to this authority that the Charter School of Excellence has entered into the lease with the related party.

The core of the Charter School’s disagreement can be found in the conclusion of Finding No. 1 where the following sentences are found:

Our audit work clearly demonstrated that there was a related party landlord and tenant agreement between the Charter School and the related non-profit entity. Therefore, the Charter School was essentially leasing space in the non-profit’s headquarters to itself and its lease payments for that shared space were most likely not eligible for Commonwealth reimbursement.

(emphasis added.) Thus, from the relation between the Charter School and the lessor this finding makes the quantum leap to the conclusion that the Charter School is leasing to itself. It is an unsubstantiated and legally unsustainable conclusion that because the Charter School was renting space from a related non-profit that the Charter School is essentially leasing the space to itself.

The Charter School and the related non-profit entity are separate Pennsylvania non-profit corporations. While the report notes overlapping of administrative staff and board members, it overstates the extent and significance of the common administrative and board members. Each entity also has administrative employees employed solely by either the Charter School or the related non-profit and board members who are not on the other organization's board. They maintain separate minutes, separate financial records, separate bank accounts and are in all regards legally distinct entities. The Internal Revenue Service has also recognized that the Charter School and the related non-profit are distinct entities by granting separate tax exemptions to the organizations.

Further, the Charter School does not share to any extent in the ownership of the building which it leases.

This finding also overlooks a critical distinction between the two organizations. The Charter School is just that, a charter school. Once it is granted a charter, it becomes an ' . . . independent public school . . . ' 24 P.S. § 17-1703-A. As such, it is a component part of the Pennsylvania System of Public Education. This is in contrast to the related party which is a private non-profit organization. As a public school, the Charter School bears many responsibilities and powers inapplicable to a private organization. This gives the Charter School unique attributes which do not attach to the related party from which the Charter School leases. By way of a partial list; the Charter School enjoys limited tort liability (24 P.S. § 17-1727-A), its Trustees are designated as public officials (24 P.S. § 17-1715-A. (11)), it is subject to Pennsylvania law governing public employees (24 P.S. § 17-1724-A), its employees are participants in the Public School Employees Retirement System; the Charter School must comply with Pennsylvania and federal law governing special education, the Charter School is subject to the Right To Know Law, the Sunshine Act and the Ethics Act, and charged with compliance with the No Child Left Behind Act, now replaced by the Every Student Succeeds Act, and Pennsylvania assessment requirements. This list is hardly exhaustive, it is only representative of a number of the powers and responsibilities imposed upon the Charter School which serve to distinguish the Charter School from the related non-profit from which it leases space.

Essentially, this finding represents an application of the practice of piercing the corporate veil. Piercing of the corporate veil is reserved for very limited circumstances. Our courts apply a strong presumption against piercing a corporate veil. Corporate forms are disregarded only when the corporate entity is used to defeat public convenience, justify wrong, protect fraud or defend crime. *Mosaica Ed. v. Prevailing Wage Appeals Board*, 925 A.2d (176 (Pa. Cmwlth. 2007)). The mere fact of the relation between the entities is insufficient evidence to justify the piercing of the corporate veils where, as described above, they maintain independent operations. It is incongruous to pierce the corporate veil between a private non-profit and a public school entity.

The Charter School must submit an application for lease reimbursement on an annual basis. This is a three step process, requiring first that there be an application submitted by the Charter School, followed by approval of PDE, followed by an application for payment. Virtually every year with which this audit is concerned (as well as prior and subsequent years) PDE has approved the application. The application identifies both the related party as the lessor and the Charter School as the lessee. The names alone would advise PDE of the relationship. Further, in 2009 PDE was supplied with a list of directors and administrators making it even more obvious that there is a relationship between the two organizations. PDE has never suggested that this relationship disqualifies the Charter School for reimbursement.

This finding is based solely upon the fact that the Charter School and the lessor are related. These entities have been legally and operationally separate and distinct since the founding of the Charter School through to the present time. The conclusion that the Charter School is leasing space to itself is unfounded.

Any concern that the Charter School is, in any way whatsoever, at a disadvantage in leasing from the related non-profit is unfounded. The related non-profit is the beneficiary of a tax exemption for the real estate which is in question. In order to preserve that tax exemption, the rental amount has been determined on the basis of cost to the related non-profit of maintaining the building and not upon fair market value. Thus, the Charter School benefits

by receiving a rental rate which is less than fair market rental rate.”

Auditor Conclusion

In response to the Charter School’s “core” disagreement with our finding, we maintain that our determination that the Charter School is essentially leasing space in the non-profit’s headquarters back to itself, and therefore is ineligible to receive state lease reimbursements, is based on our solid facts presented and the evidence we found. We caution the Charter School that this type of circular leasing arrangement among related parties was recently addressed in the State Ethics Commission’s ruling when it determined that a violation of the Ethics Act occurred when a former charter school executive director approved rental payments as both the president of the charter school board and as president of the private for-profit entity.⁸

As to management’s other statements, we assert the following:

First, we acknowledge that the Charter School and the related non-profit entity are separate Pennsylvania non-profit organizations incorporated under the Nonprofit Corporation Law of 1988, as amended, and are distinct tax exempt entities as recognized by the Internal Revenue Service. We note, however, that there are other substantial differences between the Charter School and the non-profit organization. The Charter School is a **public** school funded primarily by taxpayer dollars. Further, the school, as well as its board members and officers are subject not only to the provisions of the CSL, but also specified provisions of the PSC (and its associated regulations) and **all** of the provisions of the Public Official and Employee Ethics Act (Ethics Act), the Sunshine Act, the Right-to-Know Law, the Pennsylvania Fair Educational Opportunities Act, the Pennsylvania Prevailing Wage Act, and the Steel Products Procurement Act – to name but a few, as well as important provisions of federal law. In contrast, the related non-profit organization is a **private** non-profit organization (and its board members and its officers) are subject to very few other provisions of law beyond the Nonprofit Corporation Law.

⁸ See the Pennsylvania Ethics Commission’s Final Order *In Re: James Gentile*, Order 1661, January 28, 2013.

Second, we disagree with management that our report in any way “overstates” the relationship between the administrative staff and board members of the two entities. The executive director of the related non-profit entity executed both the initial lease and renewal lease with the Charter School while serving simultaneously as the executive director of the Charter School. At the very least, this presented an appearance of a conflict of interest (if not in fact) under the Ethics Act. Further, the two entities shared certain board members, board treasurers, board secretaries, and administrative staff in finance and human resources, all of whom had operational control over the two entities. We note that the public Charter School’s sharing persons in positions of authority with the private non-profit organization is disturbing, no matter what the extent of the overlapping may be.

Third, we disagree that this finding has anything whatsoever to do with the legal concept of “piercing the corporate veil” (which in some very restricted circumstances may disregard the corporate nature of an organization to hold shareholders or directors personally liable). Instead, this finding demonstrates the importance of a public Charter School being cognizant of its duties under the CSL, the PSC, and the Ethics Act to not have any conflicts (either in appearance or in fact) and to be transparent in all its dealings with private entities.

Fourth, we disagree that PDE’s “approval” of the application submitted for lease reimbursement in any manner serves as an approval of the terms and conditions of the lease. By its own admission, PDE’s approval process is a ministerial function that simply confirms receipt of the required documentation, instead of our post-audit function involving an in-depth review and audit of the documentation. In fact, PDE’s guidelines state, “Appropriate documentation must be maintained for review by the Auditor General’s Office to support the charter school’s submission of the PDE-418, PDE-419 and Verification Statement for the Charter School Facility Lease Reimbursement Program.”

Therefore, for all the reasons cited above, the Charter School clearly should not qualify for the state lease reimbursements and this finding must stand as presented.

Further, this finding will be forwarded to PDE's Division of School Facilities for its review and final determination regarding the Charter School's eligibility to receive state lease reimbursements.

Finding No. 2

Certification Deficiencies

Criteria relevant to the finding:

Section 17-1732-A(a) of the CSL, 24 P.S. § 17-1732-A(a), requires charter schools to comply with Section 1109 of the PSC, 24 P.S. § 11-1109, which provides, in part:

“Every principal . . . who devotes one-half or more of his time to supervision and administration shall be properly certified by the Department of Public Instruction in accordance with such standards as the State Board of Education may establish.”

Section 7801 (23) of the NCLB, 20 U.S.C. § 6301 *et. seq.*, requires that all teachers who teach core academic subjects in public schools be “highly qualified.”

“Highly qualified” teacher status applies to all charter school teachers of “core content” subjects at all grade levels, including noncertified teachers allowed at charter and cyber charter schools.

Our review of professional employees’ certification and assignments for the period August 26, 2013 through June 12, 2014, (2013-14 school year) were performed in order to determine compliance with the requirements of the CSL, the PSC, the federal NCLB, and Certification and Staffing Policies and Guidelines issued by PDE. We found several certification deficiencies for the 2013-14 school year as noted below.

Principals Were Not Properly Certified

Two out of five of the Charter School’s principals/assistant principals were not properly certified as required by the State Board of Education. One of the two assistant principals did obtain an emergency permit from PDE on March 1, 2014, near the end of the 2013-14 school year. Under the CSL, all principals must be properly State certified and cannot be included in the 25 percent of noncertified professional staff allowed at charter and cyber charter schools.

Teachers Providing Core Content Instruction Were Not Highly Qualified

One of the Charter School’s teachers did not meet the definition of “highly qualified” teacher under the federal NCLB, because they did not have the proper credentials for their teaching assignments. Specifically, one individual taught mathematics and science but had a State certificate in special education.

Although the CSL allows up to 25 percent of noncertified teachers at charters, the NCLB “highly qualified” teacher status requires that charter school teachers teaching core content subjects must hold at least a bachelor’s degree in that core content area and have demonstrated subject matter competency in each core content area at all grade levels taught. The Charter School was unable to provide evidence that this individual was “highly qualified” as required for the 2013-14 school year.

Criteria relevant to the finding (continued):

In Pennsylvania, the NCLB **core content** subjects include English, reading/language arts, mathematics, sciences, foreign languages, music and art, and social studies (history, economics, geography, and civics, and government).

PDE is responsible for establishing the methods for Pennsylvania teachers to obtain “highly qualified” status.

Section 17-1732-A(b) of the CSL, 24 P.S. § 1732-A(b) requires charter schools to comply with the provisions of the *22 Pa Code*, specifically Chapter 12 regarding Student Services.

Chapter 12 of the Pa Code incorporates the Health Services Law in its entirety (Article XIV of the PSC, 24 P.S. §§ 14-1401 et seq). Section 14-1401(8) defines School Nurse as a licensed registered nurse properly certificated by the Superintendent of Public Instruction.

The Charter School’s failure to employ certified school principals, could result in the students not receiving the quality education to which they are entitled. In addition, noncompliance with certification requirements may result in the chartering school district deciding to revoke or not renew a charter because the charter school has not fulfilled its obligations.

PDE is responsible for regulating State certification requirements and “highly qualified” teacher credentials. As such, these deficiencies have been submitted to PDE’s Bureau of School Leadership and Teacher Quality for review and final determination. On February 20, 2016, PDE confirmed the irregularities; however, the Charter School would not be subject to any monetary sanctions as the CSL does not hold charter schools accountable for certification deficiencies in the same manner as traditional schools, which are subject to a monetary fine for certification violations.

Recommendations

The *Perseus House Charter School of Excellence* should ensure that:

1. All of the Charter School’s principals hold the proper State certification for the grades served by the Charter School, as required.
2. Noncertified teachers are “highly qualified” for their teaching assignments, as required.

As the authorizing school district, the *School District of the City of Erie* should:

3. Follow up with the Charter School regarding these individuals’ future assignments and certification status.
4. Ensure that the Charter School’s teachers who are not certified are “highly qualified.”
5. Review the charter of the Charter School and determine whether the Charter School is violating certification terms of its approved charter with the school district.

Management Response

Management stated the following:

“1. Emergency permits were engaged with PDE on the two staff identified in this finding.

A. One was requested on July 1, and only issued for 30 days. Consequently CSE [Charter School] re-applied for emergency certification in March after noticing this timeframe, as they are usually done for 1 year.

B. One was identified as ready for review by PDE on Oct. 7, 2013

Note: Both identified staff currently hold PDE Principal Certification, resolving this issue.

2. A long term sub for the 12-13 sy was placed in the role for instruction due to not-being able to find a qualified Employee to teach the 13-14 sy.

Note: This staff has not been employed since the conclusion of the 13-14 sy., resolving this issue.”

Auditor Conclusion

Certification deficiencies are not determined by our Department. The concerns were submitted to PDE who made the final determination on the employees noted in the finding.

Finding No. 3

Weaknesses in Board of Trustees' Minutes and Noncompliance with the Sunshine Act and Its By-Laws

Criteria relevant to the finding:

Section 17-1732-A(a) of the CSL, 24 § 17-1732-A(a), requires charter schools to comply with specific provisions of the PSC, including Section 518 of the PSC, 24 P.S. § 5-518, which requires the Board of Trustees to retain as **permanent record** of a charter school, **the minute book**, each annual auditor's report, and each annual financial report.

Additionally, Section 17-1716-A(c) of the CSL, 24 § 17-1716-A(c), requires charter schools to comply with the Sunshine Act, 65 Pa.C.S. § 701 *et seq.*, which requires written minutes to be kept of all open meetings of agencies and that the minutes shall include the **substance of all official actions** and a record by individual member of the roll call votes taken.

Chapter 4 - Preparing Board Minutes of *The School Board Secretary's Handbook* published by the Pennsylvania School Board Secretaries Association identifies items that should be included in official minutes, including:

- Monthly bills, with an account code number and what was/is to be paid.
- Election of all members, who were elected and length of term.
- Secretary must sign all minutes, regular, adjourned, and special meetings.

In an effort to gain an understanding of governance and operations of the Charter School, we reviewed the Charter School's board meeting minutes from August 17, 2010 through December 17, 2013, found inadequacies in the recording and documenting of actions of the Board, as follows:

- A total of 35 meetings were scheduled, and a quorum was not present for four of these meetings, as required by the Charter School's By-Laws.
- On two occasions, a board member resigned and a replacement was not made until 11 months had passed, leaving the Board with only eight members when the Charter School's By-Laws require nine members.
- The minutes from the December 29, 2011 meeting were inaccurate because they did not note an approved change to a board member's status. Specifically, the minutes were approved on January 17, 2012, with the addition of a change to the attendance of one board member's status from absent to present. However, the official signed minutes did not include the approved change noting the board member as absent.
- The minutes for the meetings on December 21, 2010, January 18, 2011, and February 15, 2011, were never approved by the Board.
- Minutes were maintained in a three-ring binder and were not permanently bound.
- Minutes did not have sequentially numbered pages.

As required by Section 518 of the PSC, the Charter School should retain permanent and accurate records of the Board's actions. The Sunshine Act also requires that written minutes be maintained, including the substance of all official board actions and a record by individual member of the roll call votes. This documentation is important to accountability because it helps to assure the public that the Board is approving activities and its

*Criteria relevant to the finding
(continued):*

Charter School By-Laws:

Article 3.03 of the Charter School By-Laws states, “The Board shall consist of nine trustees.”

Article 3.15 of the Charter School By-Laws:

A majority of the Trustees in office of the Corporation shall be necessary to constitute a quorum for the transaction of business and the acts of a majority of the Trustees present and voting at a meeting at which a quorum is present shall be the acts of the Board of Trustees.

members are appropriately involved in the operations of the Charter School.

Moreover, according to *The School Board Secretary’s Handbook*, best practices for keeping board minutes include permanent binding and sequential page numbering. For example, permanently binding minutes ensures that pages cannot be removed and replaced. Sequential page numbering ensures the minutes are complete and that nothing has been removed. Without these internal controls, there is an increased risk that this important information will not be maintained completely and accurately.

As such, the Charter School’s failure to adequately and accurately record and document board actions resulted in violations of the CSL, PSC, and the Sunshine Act. Furthermore, the Charter School failed to follow its own By-Laws regarding having quorum votes and nine board members and best practices regarding the maintenance of records. These inadequacies may lessen the Charter School’s transparency and accountability to the public.

According to the Charter School, the Board Secretary is an employee that is shared with the non-profit entity that started and currently manages the Charter School. This individual was not provided appropriate training as to the requirements of the position she was given.

Recommendations

The *Perseus House Charter School of Excellence* should:

1. Follow its By-Laws regarding board votes and board composition.
2. Comply with the CSL, the PSC, and the Sunshine Act by accurately documenting board activity, maintaining permanent record, and recording official actions by individual member of the roll call votes taken.
3. Follow best practices for sequential page numbering and permanent binding of board meeting minutes.
4. Provide the Board Secretary with training to ensure that the Charter School has a correct and proper record of the minutes.

Management Response

Management stated the following:

“The description within the audit is clearly articulated and the cause is an error that occurred.

1. CSE [Charter School] will follow by-laws regarding board votes and board composition.
2. CSE [Charter School] has changed previous practice by identifying the voting procedure in a more clearly articulated manner.
3. CSE [Charter School] has begun to sequential number pages and permanently bind meeting minutes.
4. CSE [Charter School] Board Secretary has met with the Board Secretary from the chartering district, Erie School District, to review best practice for correct and proper record of the minutes.”

Auditor’s Conclusion

We are pleased that the Charter School has put into place actions to correct the concerns noted in the finding. We will determine the effectiveness of those corrective actions during our next audit.

Finding No. 4

Board Secretary and Board Treasurer Did Not Obtain Surety Bonds as Required by the Public School Code

Criteria relevant to the finding:

Sections 1732-A of the CSL, 24 P.S. § 17-1732-A, subjects charter schools to specified provisions of the PSC, including Sections 24 P.S. §§ 4-431 and 4-436.

Section 24 P.S. § 4-431 of the PSC states, in part:

“Before he enters upon duties of his office the secretary of the board of school directors shall furnish to the school district, for the faithful performance of his duties, a bond, in such amount and with such surety or sureties as may be required of him, and approved by the board of directors. . . .”

Section 436 of the PSC, 24 P.S. § 4-436, states in part:

“Every person elected treasurer . . . shall, before entering the duties of his office, furnish the school district a proper bond, in such amount and with such corporate surety as the board of school directors therein may approve, conditioned for the faithful performance of his duties as school treasurer. . . .”

Our audit of the Charter School revealed that neither the Board Secretary nor the Board Treasurer is appropriately bonded, as required by the CSL and the PSC.

While board members at charter and cyber charter schools are appointed, the positions of Board Secretary and Board Treasurer are elected by fellow board members. Since these officer positions require the faithful performance of specific duties, the CSL and PSC require a surety bond for the Board Secretary and Board Treasurer. The purpose of a surety bond is to protect these two officers and the Charter School from liabilities resulting from intentional or non-intentional financial mismanagement. However, we found that the Charter School failed to properly bond its Board Secretary and Board Treasurer as required.

By not having the positions properly bonded, the Charter School may not be able to recoup any financial loss to the Charter School as a result of improper conduct by the individuals serving in these positions.

The failure to have these two positions appropriately bonded was due to the Charter School’s belief that the positions could be covered by provisions included in their commercial crime insurance policy and that no other insurance requirement was needed.

Recommendations

The *Perseus House Charter School of Excellence* should:

Obtain the required bonds for the Board Secretary and Board Treasurer in accordance with the CSL and the PSC.

Management Response

Management stated the following:

“This finding is one that has not been noted in previous Audits and is a practice that has been applied since the inception of CSE [Charter School] in 2003. As a direct result this practice has been maintained.

1. CSE [Charter School] has had since the inception of the Charter School coverages that includes: Employee theft, forgery or alteration, inside the premises, theft of money and securities, inside the premises of robbery and safe burglary of other property, outside the premises, computer fraud, funds transfer fraud, money orders and counterfeit fraud. Board Secretary and Board Treasurer are named as insured.
2. CSE [Charter School] will assure that the required bonds for Board Secretary and Board Treasurer are in accordance with CSL and PSC, resolving this issue.”

Auditor Conclusion

We are pleased that the Charter School is taking corrective action to ensure that the Board Secretary and Board Treasurer are appropriately bonded as required by the PSC and the CSL.

Status of Prior Audit Findings and Observations

Our prior audit of the Charter School released on January 23, 2012, resulted in one observation. The observation pertained to the Memorandum of Understanding (MOU) not being updated timely. 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 observation. As shown below, we found that the Charter School did implement recommendations related to the MOU.

Auditor General Performance Audit Report Released on January 23, 2012

Observation: **Memorandum of Understanding with Local Law Enforcement Not Updated Timely**

Prior Observation Summary:

Our prior audit found that the MOU between the Charter School and the local law enforcement agency's jurisdiction over school property has not been updated since February 22, 2008. The MOU sets forth agreed upon procedures to be followed should an incident involving an act of violence or possession of a weapon occur on school property. The PSC requires public schools to update and re-execute MOUs with local law enforcement every two years.

Prior

Recommendations:

Our prior audit finding recommended that the Charter School should:

1. In consultation with the Charter School's solicitor, review, update, and re-execute each MOU between the Charter School and all the local law enforcement agencies having jurisdiction over school property and file a copy with PDE's Office of Safe Schools on a biennial basis pursuant to the terms prescribed by the PSC.
2. In consultation with the Charter School's solicitor, review new requirements for MOUs and other school safety areas under the PSC to ensure compliance with amended Safe Schools provisions enacted November 17, 2010, effective February 15, 2011.
3. Adopt a policy requiring the Charter School's administration to biennially update and re-execute each MOU with local law enforcement agencies having jurisdiction over school property and file a copy with PDE's Office of Safe Schools on a biennial basis as required by the PSC.

Current Status:

During our current audit, we found that the Charter School did implement the recommendations. The Charter School updated their MOU with the City of Erie Police Department on August 14, 2013, and again on August 14, 2015.

Distribution List

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

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