# COMMONWEALTH OF PENNSYLVANIA

A SPECIAL INVESTIGATION OF
CHESTER COUNTY INTERMEDIATE UNIT
DOWNINGTOWN, PENNSYLVANIA

September 2010

JACK WAGNER, AUDITOR GENERAL

PENNSYLVANIA DEPARTMENT OF THE AUDITOR GENERAL

September 1, 2010

Bonnie J. Wolff
President, Board of Directors
CHESTER COUNTY INTERMEDIATE UNIT
455 Boot Road
Downingtown, Pennsylvania 19335

Dear Mrs.Wolff:

In July 2007, the Pennsylvania Department of the Auditor General's Office of Special Investigations received allegations of misuse and abuse of state funds at the Chester County Intermediate Unit ("CCIU"). This report contains the results of our special investigation. The period under review generally covered the 2006-07 school year, unless otherwise specified.

During the course of this investigation, we found the following:

- CCIU improperly employed its former executive director under an emergency return to work contract covering the period January 8, 2007 through June 30, 2007;

- CCIU improperly used federal Medicaid funds administered by the Pennsylvania Department of Education to make capital improvements to the Downingtown Education Center;

- CCIU employees used CCIU credit cards to make improper purchases; and

- CCIU failed to properly report $12,000 per year that it paid to its former executive director as supplemental income and failed to withhold and pay taxes on such income.

A draft copy of this report was provided to CCIU on August 25, 2008, for its review and response. On September 9, 2008, CCIU submitted its written response, which is reproduced in its entirety following the report. However, litigation had already at that time been commenced by the former executive director over the issue that is the subject of Finding I. The purpose of the litigation was to attempt to overturn the decision by PSERS (a decision in accord with Finding I of this report) to nullify his purported retirement and emergency return-to-work at CCIU. Because of the significance of this litigation to Finding I of this report, we decided to delay the issuance of this report until that litigation was resolved. On April 30, 2010, the Commonwealth Court of Pennsylvania issued a decision which has vindicated our position as is set forth more fully and at length in Finding I of the report.

We urge CCIU to implement the recommendations made in this report. The Department of the Auditor General will follow-up at the appropriate time to determine whether our recommendations have been implemented.

We are also forwarding copies of this report to the Pennsylvania Public School Employees' Retirement System, the Pennsylvania Department of Education, the Pennsylvania Department of Public Welfare, the U.S. Department of Education, the U.S. Department of Health and Human Services, the Centers for Medicare and Medicaid Services, the Internal Revenue Service, and the Pennsylvania Department of Revenue for their review and whatever action they may deem appropriate.

This report is a public document and its distribution is not limited. Additional copies may be obtained through the Department of the Auditor General's website, *www.auditorgen.state.pa.us*.

Sincerely,

**/S/**

**JACK WAGNER**
Auditor General

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| **<u>FINDING I</u>:**<br>CCIU improperly employed its former executive director under an emergency return to work contract covering the period January 8, 2007 through June 30, 2007. | We recommend that CCIU:<br><br>• Reconfigure its cabinet to provide for an assistant executive director position similar to other intermediate units in Pennsylvania. This would enhance CCIU's succession plans by providing for a credentialed professional ready to assume the executive director's duties in the event of a prolonged absence or an unexpected retirement;<br><br>• Publicly advertise all future administrative vacancies. This could be accomplished by using the administrator search services of the Pennsylvania School Boards Association and/or similar organizations; and<br><br>• Seek the approval of the Public School Employees' Retirement System ("PSERS") before entering into any future emergency return to work contracts.<br><br>We recommend that PSERS:<br><br>• Expand the wording in Item 13, Member Certification on Form 8, Application For Retirement, requiring applicants to certify whether they are ***anticipating*** working pursuant to an emergency contract prior to the commencement of their annuity. This would give PSERS an opportunity to evaluate the contract as it relates to the provisions of Section 8346 of the Public School Employees' Retirement Code; and<br><br>• Periodically remind employers, active members, and retired members of the |

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| | requirements of Section 8346(b) of the Public School Employees' Retirement Code, and periodically remind school districts of the necessity to make a "good faith" attempt to hire non-retired school personnel as required by the PSERS *Retired Members' Handbook.*<br><br>We are forwarding copies of this report to the Pennsylvania Department of Education and the Pennsylvania Public School Employees' Retirement System for their review and whatever action they may deem appropriate. |
| **FINDING II:**<br>CCIU improperly used federal Medicaid funds administered by the Pennsylvania Department of Education to make capital improvements to the Downingtown Education Center. | We recommend that CCIU:<br><br>• Strictly adhere to the regulations published by PDE on the use of federal Medicaid School Based Access Program ("ACCESS") funds; and<br><br>• Seek PDE approval before making any questionable expenditures with ACCESS funds.<br><br>We recommend that PDE:<br><br>• Seek payment from CCIU of all ACCESS funds used to make capital improvements at the Downingtown Education Center, together with interest;<br><br>• Review all CCIU ACCESS expenditures to determine their compliance with the remaining program regulations; and<br><br>• Review all ACCESS program expenditures made by each local education agency at the end of each fiscal year to determine compliance with program guidelines.<br><br>We are forwarding copies of this report to the Pennsylvania Department of Education, the U.S. Department of Education, the Pennsylvania Department of Public Welfare, the U.S. Department |

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|---|---|
| | of Health and Human Services, and the Centers for Medicare and Medicaid Services for their review and whatever action they may deem appropriate. |
| **FINDING III:**<br>CCIU employees used CCIU credit cards to make improper purchases. | We recommend that CCIU:<br><br>• Amend Section 3.2 of CCIU's Statement of Procedure No. 0419.05 to include an annual recertification by all employees who are issued CCIU credit cards indicating they understand the rules governing the use of CCIU credit cards;<br><br>• Amend its Statement of Procedure No. 0419.05 to make it clear that purchase orders are the preferred method of procurement and that employees may be held personally liable for any personal use or other misuse of a CCIU-issued credit card; and<br><br>• Establish a policy prohibiting the use of CCIU funds for entertainment purposes, such as luncheons, dinners, parties, receptions, and similar social events, and especially for the purchase of alcoholic beverages. |
| **FINDING IV**:<br>CCIU failed to properly report $12,000 per year that it paid to its former executive director as supplemental income and failed to withhold and pay taxes on such income. | We recommend that CCIU:<br><br>• Issue corrected IRS Forms W-2 to its former executive director for 2006 and file the corrected Forms W-2 with the Internal Revenue Service, the Pennsylvania Department of Revenue, and the appropriate local taxing authority; and<br><br>• Treat all other CCIU employees with employment contracts containing this benefit in the same fashion.<br><br>We are forwarding copies of this report to the Pennsylvania Department of Revenue and the U.S. Internal Revenue Service for their review and whatever action they may deem appropriate. |

# BACKGROUND AND INTRODUCTION

In July 2007, the Department of the Auditor General's ("Department") Office of Special Investigations ("OSI") received allegations of misuse and abuse of state funds at the Chester County Intermediate Unit ("CCIU"), 455 Boot Road, Downingtown, Pennsylvania. This report contains the results of our special investigation. The period under review generally covered the 2006-07 school year, unless otherwise specified.

The allegations were that the following improprieties had occurred at CCIU:

- **Allegation No. 1:** CCIU improperly employed its former executive director, Dr. John K. Baillie ("Baillie"), under an emergency return to work contract covering the period January 8, 2007 through June 30, 2007.

- **Allegation No. 2:** CCIU employees used ACCESS[1] funds administered by the Pennsylvania Department of Education ("PDE") to make capital improvements to the Downingtown Education Center ("DEC").

- **Allegation No. 3:** CCIU employees used CCIU credit cards to make improper purchases.

To address the allegations, OSI did the following:

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[1] The following description of the ACCESS program is found on the Pennsylvania Department of Education's website under "Special Education Medical ACCESS," *www.able.state.pa.us/special_edu/cwp/view.asp?a=177&Q=61414* (accessed on July 31, 2007):

> The School Based Access (ACCESS) program is a system that can be used by school districts, intermediate units, state-owned schools, or approved private schools (APS) to obtain funding for health-related services for special education students.
>
> Program Description
>
> - Supports Local Education Agency (LEA) health and special educational programs.
> - Authorized by the Medicare Catastrophic Coverage Act of 1988 which made State Educational Agencies eligible for federal reimbursement for the related services they provide to students who have Medical Assistance (MA).
> - Is a streamlined process to gain MA reimbursements for the cost of providing related services to students.
> - Is a cooperative effort between PDE, the Pennsylvania Department of Public Welfare (DPW), the Centers for Medicare and Medicaid Services (CMS), and PDE's contractor, Leader Services (LS).
> - Funds may be used to enhance or enlarge special education and health services.
> - Training, support services, and data processing are supplied through the contractor, LS.
>
> Restrictions on Funding
>
> - For programs or services outside the LEA special education program
> - To make capital improvements to property
> - To supplant programs or personnel

- Interviewed Baillie by telephone on June 28, 2007, June 29, 2007, and August 6, 2008;
- Interviewed CCIU's current Executive Director, Dr. Joseph O'Brien ("O'Brien");
- Interviewed CCIU's Director of Administration, Joseph Lubitsky ("Lubitsky");
- Interviewed CCIU's former Director of Finance, Sharon Jones ("Jones");
- Interviewed the following members of the CCIU Board of Directors ("Board"): Katherine A. Pettiss ("Pettiss"), Peter J. Mango ("Mango"), and Paul L. Johnson ("Johnson")[2];
- Reviewed employment contracts between CCIU and Baillie covering the period 2002 through 2010;
- Reviewed an emergency return to work contract between CCIU and Baillie covering the period January 8, 2007 through June 30, 2007;
- Reviewed CCIU Board meeting minutes for the period July, 2005 through May 2007;
- Reviewed contracts between CCIU and CCRES for the period July 1, 2005 through July 2007;
- Reviewed resumes, evaluation sheets, notes, and memoranda created by CCIU's Board regarding appraisal of candidates for the position of executive director;
- Reviewed succession plans submitted by Baillie and CCIU department heads;
- Reviewed selected CCIU credit card statements for the period June 2006 through September 2007;
- Reviewed Public Official and Employee Ethics Act ("Ethics Act") "Statement of Financial Interests" forms on file at CCIU;
- Reviewed invoices and supporting documentation for billable hours submitted by CCIU's legal counsel during the period January 1, 2006 through the present;
- Reviewed documents relating to the receipt and distribution of funds from the ACCESS program by CCIU for the period July 1, 2005 through September 2007;
- Interviewed Downingtown Area School District ("DASD") Chief Financial Officer Richard A. Fazio ("Fazio")**;**
- Met with representatives of the Pennsylvania Public School Employees' Retirement System ("PSERS");
- Met with representatives of PDE;
- Reviewed CCIU's Statement of Procedure No. 0419.05 titled "Use of IU Credit Cards";
- Interviewed selected vendors where CCIU credit cards were used to purchase goods and services;

[2] Pettiss and Mango are no longer members of CCIU's Board of Directors.

- Interviewed selected CCIU employees to determine the nature of purchases made with CCIU credit cards; and
- Reviewed evidence of remuneration made to Baillie by CCIU during the period 2002 to 2006.

Our investigation resulted in the four findings set forth in this report.

Two additional allegations were received, but the investigation in each case failed to produce evidence to support a finding. The first allegation was that CCIU entered into an agreement with Chester County Regional Education Services, Inc. ("CCRES") to provide Behavioral Health Rehabilitation Services, a Medicaid-funded program administered by PDE, at an excessive rate, which negatively affected other student services. OSI's investigation into the agreement failed to produce any evidence of improprieties.

The second allegation was that a CCIU Board member was receiving $40,000 per year for consulting services from CCRES when Baillie was a member of the CCRES Board of Directors.

On June 29, 2007, Baillie was interviewed by OSI in his capacity as Chairman of the Board of Directors of CCRES by telephone. Baillie was asked to provide copies of the Forms 1099 issued to a CCIU Board member for the years 2003, 2004, 2005, and 2006 by CCRESS. During this telephone conversation, Baillie stated CCRESS received a favorable opinion from counsel relative to the legality of the contract for the consulting services.

OSI was able to verify that a member of the CCIU Board of Directors received from CCRES the amounts shown in **Table 1**.

**Table 1**
***Payments to CCIU Board Member by CCRES***

| YEAR | AMOUNT |
|---|---|
| 2004 | $36,725 |
| 2005 | $45,000 |
| 2006 | $45,000 |
| **TOTAL** | **$126,725** |

However, the source of the subject income was disclosed by this Board member on the Ethics Act "Statement of Financial Interests" forms for each of the years in question. Furthermore, OSI's review of the minutes of CCIU Board meetings from July 2005 through June 2007, revealed that, during the November 2006, meeting, when Baillie's emergency return to work contract was approved, this Board member abstained from voting on the contract, as is evidenced by a Conflict of Interest, Abstention Memorandum, citing "My association with Dr. Baillie through CCRES."

CCIU was provided with a draft copy of this report for its review and comment. CCIU's response is included at the end of this report, followed by the Department's comments on CCIU's response.[3]

[3]A draft copy of this report was also provided to Baillie for his review and comment, and his attorney submitted a response on his behalf which largely expresses the same criticisms of Finding I as CCIU's response. However, his separate response also takes issue with the way some of Baillie's specific statements in his interview of August 6, 2008, are characterized in the report. Rather than reproduce Baillie's response in its entirety, we have added footnotes at the appropriate places in the report to address the points he raised.

## FINDINGS AND RECOMMENDATIONS

**FINDING I: CCIU Improperly Employed Its Former Executive Director Under An Emergency Return To Work Contract Covering The Period January 8, 2007 Through June 30, 2007.**

The first allegation was that CCIU improperly employed its former executive director, Dr. John K. Baillie, under an emergency return to work contract subsequent to his retirement from CCIU on or about January 1, 2007, and that he also began collecting a Public School Employees' Retirement System ("PSERS") pension benefit.

It was alleged that Baillie continued working at CCIU as a "Substitute Executive Director" until his successor was named, even though it was alleged that only two conditions allow a PSERS annuitant to return to his position: (1) To provide extra-curricular activities, such as athletic coaching, or (2) a declared emergency, approved by PDE, such as the inability to find a certified chemistry or physics teacher. It was alleged that no emergency existed because three CCIU employees were qualified to be executive director.

The Public School Employees' Retirement Code provides, in pertinent part, as follows:

> **§ 8346 Termination of annuities**
>
> * * *
>
> (b) Return to school service during emergency. -- When, in the judgment of the employer, an emergency creates an increase in the work load such that there is serious impairment of service to the public or in the event of a shortage of appropriate subject certified teachers or other personnel, an annuitant may be returned to school service for a period not to extend beyond the school year during which the emergency or shortage occurs, without loss of his annuity. . . .[4]

Also pertinent in this regard is the following entry from the PSERS *Retired Member Handbook*:[5]

> **Employment Due To Emergency or Shortage of Personnel**
>
> Whenever a school employer determines there has been an increase in workload that creates a serious impairment of service to the

[4] Act of October 2, 1975, P.L. 298, No. 96, as amended, 24 Pa.C.S. § 8346(b) (referred to in this report as "Section 8346").

[5] PSERS website, *Retired Member Handbook*, revised May 2007, page 31.

public or there is a shortage of personnel, a retiree may return to Pennsylvania school service for a period not to extend beyond the school year during which the emergency or shortage occurs.

The employer makes the determination that these elements have been satisfied. Employers are expected to make a "good faith" effort to secure non-retired school personnel. PSERS, however, reserves the right to review an employer's determination that a qualifying emergency or shortage exists.

On June 25, 2007, OSI requested the following documents from CCIU:

- All contracts existing between CCIU and Baillie for the period July 1, 2005 through the present; and
- CCIU Board meeting minutes for the period July 1, 2005 through the date of the request, including, but not limited to, regular and executive sessions.

On June 28, 2007, Baillie was interviewed by OSI by telephone and expressed his intention to cooperate in OSI's investigation. During this interview, Baillie also provided the following information:

- He was retiring effective Friday, June 29, 2007, and he wanted our request complied with before he left, because his successor was scheduled to assume the position of Executive Director on or about July, 15, 2007.

- This was the third complaint dealing with his contract with CCIU. The first came from the *Philadelphia Inquirer* in March 2007. The second was in June 2007 and resulted from a "Right to Know" request submitted to PSERS.

- He speculated that the allegations originated with a member of CCIU's Special Education Department because personnel in this department had specific knowledge about the ACCESS program.

- He also described in detail an employee disciplinary problem at CCIU which may have caused the injured parties to make a complaint about him to OSI.

- When asked by OSI to instruct Joseph Lubitsky, CCIU's Director of Administrative Services, to comply with further OSI document requests, he stated that he would do so.

Under cover of correspondence dated July 2, 2007, Baillie provided OSI with copies of the minutes and three contracts between CCIU and himself covering the following periods:

- "Contract for the period 2002-2006 – plus addendums"
- "Contract for the period 2006-2010"

- “Emergency Contract (sec. 8346(b)) – January 8, 2007 to June 30, 2007”

These contracts and addendums provided for annual salary increases of 3%, which resulted in the annual salary levels and required number of annual workdays as summarized in **Table 2**.

**Table 2**
***Employment Agreements Between CCIU and Baillie***

| PERIOD | SALARY | REQUIRED WORK DAYS |
|---|---|---|
| 2002-2003 School Year | $203,310 | 245 |
| 2003-2004 School Year | $209,409 | 245 |
| 2004-2005 School Year | $215,691 | 230 |
| 2005-2006 School Year | $222,161 | 230 |
| 2006-2007 School Year | $228,826 | 230 |
| January 8, 2007 – June 30, 2007* | $109,439 | 110 |

** “Emergency Contract” for the period January 8, 2007 through June 30, 2007, during which Baillie was receiving a PSERS pension.*

The contract for the period 2002 through 2006 states that Baillie “may work up to an additional fifteen (15) days per year beyond those required for this two hundred forty five (245) day contract and shall be paid his per diem rate for each day worked and reported as part of his salary.” The contract for the period 2006 through 2010 states that Baillie “may work up to an additional thirty (30) days per year beyond those required for this two hundred thirty (230) day contract and shall be paid his per diem rate for each day worked.”

The minutes of the CCIU Board meeting on November 15, 2006 contain the following entries:

- “The letter of resignation submitted by John K. Baillie, effective as of January 5, 2007, as set forth in the letter is hereby accepted.”

- “Last, the Board hereby approves and authorized the execution of the new emergency [24 PACS 8346(b)] Employment Agreement between the Intermediate Unit and Dr. Baillie…effective as of January 8, 2007, through June 30, 2007, in the form attached to this Resolution.”

The minutes of the CCIU Board meeting on April 18, 2007 contain the following entry: “Dr. Joseph J. O’Brien was appointed Executive Director of CCIU for a four year term beginning on or after July 1, 2007.”

On July 11, 2007, OSI requested the following documents from PSERS:

- All yearly PSERS Member Statements of Account or similar statements rendered to Baillie during the period 2002 through the present;

- All Personal Statements of Retirement Benefits or similar statements rendered to Baillie;
- All documentation submitted by CCIU and/or Baillie to PSERS regarding an Emergency Employment Agreement between CCIU and Baillie; and
- All documentation submitted by PSERS to CCIU and/or Baillie regarding an Emergency Employment Agreement between CCIU and Baillie.

On July 19, 2007, OSI requested the following documents from PSERS:

- All "Requests for Retirement Estimate" forms (PSERS-151) submitted by Baillie;
- Sign-in sheets or other documents evidencing Baillie's attendance at a "Foundations For Your Future Program" counseling session and the topics discussed during this counseling; and
- Sign-in sheets or other documents evidencing Baillie's attendance at "Retirement Exit Counseling" and the topics discussed during this counseling.

Under cover of correspondence dated July 20, 2007, PSERS provided OSI with the following:

- Statements of Account rendered to Baillie during the period 2002 through the present. Information from these statements is summarized in **Table 3**.

**Table 3**
***PSERS Statements of Account***

| PERIOD ENDING | TOTAL CONTRIBUTIONS | TOTAL INTEREST | ACCOUNT BALANCE | MAXIMUM SINGLE LIFE MONTHLY ANNUITY |
|---|---|---|---|---|
| June 30, 2002 | $139,821.53 | $78,297.42 | $218,118.95 | $13,914.32 |
| June 30, 2003 | $154,120.01 | $87,308.13 | $241,428.14 | $15,386.36 |
| June 30, 2004 | $169,580.20 | $97,274.45 | $266,854.65 | $17,171.94 |
| June 30, 2005 | $187,784.46 | $108,312.72 | $296,097.18 | $19,692.46 |
| June 30, 2006 | $202,437.11 | $120,335.05 | $322,772.15 | $20,354.13 |

- A "Normal Retirement Estimate" dated March 21, 2007, utilizing a retirement date of January 6, 2007, and illustrating single life annuities and joint survivor annuities;
- A re-computation of Baillie's retirement based on his option selection and final information from employer dated April 3, 2007, which indicated that Baillie's gross monthly PSERS pension check would be $13,607.41,[6] effective April 30, 2007;

[6] Baillie's monthly benefit was reduced in accordance with Section 415(b) of the Internal Revenue Code, which currently provides that no annual benefit shall exceed $180,000. The actual amount of pension benefits that he was paid between January 5 and June 30, 2007 was $79,083.79. See footnote 8.

- The following statement: "Neither CCIU nor Mr. Baillie submitted any documentation to PSERS regarding an emergency employment agreement. Under Section 8346(b), an employer is not required to do so, although PSERS will review an emergency employment request in advance if requested to do so. Accordingly, in this case, when the information came to PSERS' attention, it initiated its own investigation."[7]; and
- The following statement: "Mr. Baillie attended a retirement counseling session on Nov. 30, 2006."

In a letter dated August 7, 2007, PSERS advised OSI that, with regard to retirement counseling, "an open session at Fleetwood [was held] on October 26, 2006. This, however, was a public session at which no attendance was taken or kept." However, it was alleged that Baillie did in fact attend this meeting at a PSERS regional office in Fleetwood, Pennsylvania.

On June 25, 2007, OSI requested the following documents and information from CCIU:

- Evidence that an emergency situation existed pursuant to the provisions of Section 8346 providing for an emergency employment contract between Baillie and CCIU;
- Evidence that CCIU made a good faith effort to secure non-retired personnel to fill the position of executive director pursuant to Section 8346 and/or the PSERS *Retired Member Handbook*;
- Evidence to support the advertisement of the executive director position at CCIU during the period July 1, 2006 through June 30, 2007;
- All applications and resumes received for the executive director position at CCIU during the period July 1, 2006 through June 30, 2007;
- All evaluation sheets, notes, and memoranda created by CCIU employees or Board members regarding the appraisal of candidates for the executive director position during the period July 1, 2006 through June 30, 2007; and
- Succession plans submitted by all CCIU department heads and Baillie during the period July 1, 2002 through June 30, 2007.

On August 10, 2007, Dr. Joseph O'Brien, CCIU's new executive director, provided OSI with the following:

- A letter dated August 3, 2007 from Katherine A. Pettiss, President of CCIU's Board, to OSI, which contained the following statements:
    - In October, 2007, John K. Baillie notified the CCIU Board of Directors of his intentions to retire on January 5, 2007.
    - This gave the CCIU Board of Directors two months to find either a suitable temporary or permanent replacement.

[7] We note that the matter was brought to the attention of PSERS by OSI.

- After much discussion, it was determined that in two months' time neither a permanent nor an interim executive director could be found, for the following reasons:

    - The only current employee of CCIU deemed qualified to fill in during the interim, Mr. Joseph Lubitsky, did not have the proper certification.
    - Unlike school districts, of which there are 501, there are only 29 IUs, so the pool of qualified, certified applicants is extremely limited.
    - CCIU was in the midst of several major projects, contract negotiations, and was investigating complaints of employee misconduct.
    - All of these issues required strong leadership and, in the judgment of the Board, were so critical to the financial stability of the organization that the mishandling of any one could lead to irreparable financial harm to the intermediate unit and its member school districts.
    - Therefore, the Board of Directors believed it vital that the IU continue to maintain strong, capable leadership to make the numerous day-to-day decisions that each of these projects required; and, without that leadership the IU would be in a state of emergency.

- As a result of the above conditions and factors, the Board of Directors directed IU administration to determine if it would be able to retain John K. Baillie on an emergency basis.
- The administration checked with its counsel . . . [and] concluded that the Board of Directors had the authority to enter into an emergency contract with John K. Baillie for the period January 5, 2007, through June 30, 2007.

- Cover letters and resumes submitted by six applicants;
- Interview questions by all CCIU Board Members for each applicant and responses; and
- CCIU's Organizational Succession Plan, dated July 2005, which identifies potential candidates for all positions.

Dr. O'Brien also stated that he holds Letters of Eligibility to serve as a superintendent and as an intermediate unit executive director, and that a person certified to be a school superintendent is also certified to be an intermediate unit executive director.

Also on August 10, 2007, immediately after receiving from Dr. O'Brien the above-described letter by Pettiss, OSI interviewed Pettiss at her residence. During this interview, in response to questions, she provided the following information:

- The executive director position at CCIU was not advertised internally or externally;
- The Board never asked the Pennsylvania School Boards Association for assistance in finding a replacement;
- She thought Baillie would always be in his position as executive director of CCIU;
- She recalled that Baillie did say, possibly during the July 2006, reorganization meeting, that he was going to retire someday;
- She knew that Baillie had turned 62 in the summer of 2006;
- The Board held CCIU's Director of Administrative Services, Joseph Lubitsky, in high regard for Baillie's position; and
- Lubitsky filled in for Baillie when he was on vacation in Maine for 5 weeks in the summer of 2006, but the board felt that it would be unfair to name Lubitsky as Acting Executive Director because other candidates may feel that he had an advantage.

OSI received from CCIU a copy of a letter dated July 18, 2007, from PSERS' Bureau of Benefits Administration to CCIU, which stated, in pertinent part, the following:

> We have conducted a review of this matter and, at this time we have tentatively concluded that Dr. Baillie's employment from January 8, 2007 through June 29, 2007 does not meet the emergency provisions based on the following:
>
> - You have admitted in your letter that there was a qualified candidate who could have been appointed to this interim position. In our view, there was no need to have Dr. Baillie return in an emergency capacity.
> - The Board knew, at least as early as November, of Dr. Baillie's intent to retire, and he could have agreed to stay on until his replacement was hired. In fact, he was under contract at the time. Moreover, the fact that his January 2007 retirement was not announced is a further indication that this emergency return was a planned manipulation of the system.
> - The Employment Agreement between Chester County Intermediate unit and John K. Baillie, made and entered on July 20, 2005 provides that Dr. Baillie was under contract in the capacity of Executive Director for a term of four (4) years, commencing on the 1st day of July, 2006, and ending on the 30th day of June, 2010.
> - An April 2007 email, in which Dr. Baillie announced he was retiring and his last day at the IU would be no later than June 30, 2007, is certainly misleading, if not inaccurate, indicating an effort to hide the fact of retirement.

- Dr. Baillie's decision to retire in January 2007 was not based on illness or injury that would have prevented him from serving his full term. As a result, his decision to retire was completely a voluntary decision, and more than likely a breach of his contract. In effect, Dr. Baillie attempted to artificially create his own emergency by retiring in the middle of his contract.

On October 7, 2007, OSI interviewed Peter J. Mango, a member of CCIU's Board, who provided the following information:

- In 2003, he was elected to the Octorara School District School Board, which is located in Atglen, Pennsylvania.
- He immediately became a member of the CCIU Board, because his predecessor had held the position.
- Soon after he joined CCIU's Board, Baillie's employment contract was being negotiated.
- During the course of that that process, Baillie indicated that he was going to retire before the end of the contract period.

On November 6, 2007, OSI met in Harrisburg with representatives of PSERS, who advised OSI as follows:

- PSERS' position on Baillie's emergency return to work contract remained as stated in the letter of July 18, 2007.
- PSERS has presented the facts in this matter to an actuary to re-compute Baillie's pension.
- Baillie's situation has to be viewed from the following perspectives:
    - Baillie did not retire, but instead continued to work pursuant to his last contract, and did not have a break in service as it relates to PSERS' retirement formula.
    - In this case, Baillie would have to return all PSERS retirement payments received while working for CCIU.
    - If Baillie did retire, he may not collect a salary from CCIU.

In a letter dated December 17, 2007, PSERS informed Baillie as follows:

- As outlined in a letter dated May 2, 2007, the Chester County Intermediate Unit (CCIU) admitted there was a qualified candidate who could have been appointed to this interim position. Therefore, there was no emergency creating a need for your return.
- The *Employment agreement between Chester County Intermediate Unit and John K. Baillie*, made and entered July 20, 2005, provides that you were under contract in the capacity of Executive Director for a term of four (4) years, commencing on the 1st day of July, 2006, and ending on the 30th day of June, 2010.

- The CCIU Board knew, at least as early as November, 2006, of your intent to retire, and you could have agreed to simply stay on until your replacement was hired. In fact, you were under contract at the time. Moreover, the fact that your January, 2007 retirement was not announced is a further indication that your return was a planned manipulation of the system.
- At the November 15, 2006 meeting that you informed the CCIU Board of your retirement, the CCIU Board also approved an emergency contract for you. Obviously, there were internal discussions before November 15 about your retirement, and there is no evidence that the CCIU Board made a good faith effort to find an interim or temporary replacement prior to this announcement, further indicating that this action was a pre-planned agreement to enter into the emergency contract.
- The April 12, 2007 e-mail, in which you announced you were retiring and your last day at the CCIU would be no later then June 30, 2007, is certainly misleading, if not inaccurate, indicating an effort to hide the fact of retirement.
- Your decision to retire in January 2007 was not based on an illness or injury that would have prevented you from serving your full term (obvious from the fact that you did work until your replacement was hired on July 1). As a result, your decision to retire was completely a voluntary decision, and probably a breach of your contract (there is no provision in the contract allowing you to retire before completing the term of the contract). In effect, you and the CCIU Board attempted to artificially create an emergency by allowing you to retire in the middle of your contract.
- Based on our determination that you [Baillie] continued regular employment through June 29, 2007, PSERS has decided to nullify your January 6, 2007, retirement, and replace that retirement with an effective retirement date of June 30, 2007. As a result, you will be credited with a slightly higher final average salary and receive slightly more service credit, but must also repay the monthly annuity payments you received from January through June.

During an interview with OSI on August 6, 2008, Baillie provided the following information:

- He decided to retire after vacationing at his retirement home in Maine during the summer of 2006. He had 40 years of service, he would receive 100% of his salary, and he and his family had medical problems.

- In October 2006, he advised CCIU's Board that he was going to retire effective January 1, 2007. CCIU's Board created an "Exit Committee" for the purpose of finding a successor.

- He felt that he gave CCIU ample notice of his retirement.

- CCIU's Board asked him to undertake a "targeted or expedited search" for his replacement.

- This meant securing six to nine applicants for the job from which CCIU's Board could make their selection.

- The position was not advertised and not posted with the Pennsylvania School Board's Association ("PSBA") which, according to Baillie, has a poor reputation in school superintendent and IU executive director searches.

- He never requested a written opinion from PSERS regarding his emergency return to work contract.

- He did receive verbal approval from PSERS and from CCIU's legal counsel who opined that the emergency return to work contract was "perfectly legal."

- CCIU's Board felt that Lubitsky was qualified for the position of executive director, but lacked the appropriate Letters of Eligibility.

- The succession plan which Baillie prepared included another CCIU employee, who lacked the required Letters of Eligibility, and Joseph O'Brien, who was employed as a superintendent by a New Jersey school district and was not available for the position until after July 15, 2007.

- A hearing was held before PSERS representatives in July 2008, regarding his emergency return to work contract, and a decision should be rendered by PSERS before year-end.[8]

**<u>Conclusions and Recommendations</u>**

Former CCIU Executive Director Dr. John K. Baillie's emergency return to work contract does not meet the requirements set forth in Section 8346(b) of the Public School

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[8] An administrative hearing was held before a PSERS Hearing Examiner on July 23, 2008, which resulted in an Opinion and Recommendation of the Hearing Examiner to the PSERS Board. The PSERS Board, after an independent review of the entire record of the proceeding, rendered a decision on June 17, 2009 ruling against Baillie on all issues, and ordering him to return to PSERS the $79,083.79 in pension benefits he had received between January 5 and June 30, 2007. Baillie filed an appeal with the Commonwealth Court of Pennsylvania, and on April 30, 2010, the Court affirmed the PSERS Board's adjudication in its entirety. As no further appeal has been taken, the decision of the Commonwealth Court is the final disposition of the matter.

In his separate response, Baillie's attorney took specific exception to many of the factual and legal positions set forth in this finding. However, the decision of the Commonwealth Court has resolved those issues against Baillie, so there is no need to address them further in this report.

Employees' Retirement Code and the regulations promulgated thereunder. Our conclusion is based on the following reasons:

First, CCIU's Board should have anticipated Baillie's retirement, given his age and his statements of intention to Board members Pettiss and Mango. Therefore, the Board had ample advance notice of the need to find a successor, a fact that Baillie confirmed to OSI in his interview of August 6, 2008.

Second, we find that CCIU's Board greatly exaggerated the impact of losing Baillie's services in the middle of a school year. Any increase in workload caused by his retirement could have been divided among other CCIU department heads as delineated in CCIU's pre-existing succession plans. Furthermore, the fact that Lubitsky's service as Acting Executive Director during Baillie's extended vacation in the summer of 2006 did not impair CCIU's ability to deliver services to its customers further demonstrates that CCIU could have continued to deliver adequate services to its customers in Baillie's absence. We also note that the Board was ultimately able to find a replacement for Baillie quickly and without much difficulty, which also suggests that allowing Baillie's position to become vacant would not have been unduly disruptive to the operations of CCIU.

Third, we find that the Board's contention that the appointment of Lubitsky as an Acting Executive Director would have given him an unfair advantage and discouraged other applicants from applying is not persuasive. Lubitsky's prior service in that capacity in the summer of 2006 could arguably have had the same effect, but it did not negatively affect the number or quality of the applicants Baillie was able to give to the Board for consideration as his replacement. In addition, Lubitsky's lack of the proper credentials for the position actually placed him at a disadvantage when compared to other candidates.

Finally, we note that Baillie's purported reasons for retiring as executive director of CCIU on January 5, 2007, apparently were not significant enough to keep him from returning to work three days later and continuing to work in that same capacity through July of that year.

Accordingly, we conclude that there was no "emergency" within the meaning of Section 8346(b) of the Public School Employees' Retirement Code that would justify Baillie returning to work for CCIU while drawing a retirement annuity from PSERS. We further conclude that the Board failed to make a good faith effort to secure non-retired school personnel to fill the vacancy caused by Baillie's impending retirement, or, in the alternative, it failed to insist that Baillie honor his employment contract for the period 2006-2010 until a successor could be found.[9]

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[9] Our position as stated in this finding has been vindicated by the decision of the Commonwealth Court of Pennsylvania in its Opinion dated April 30, 2010 affirming the adjudication of the PSERS Board, in which the Court held:

> As explained in the adjudication, PSERS would breach its fiduciary duty if it allowed a member to receive an annuity after returning to school service under circumstances that do not constitute an "emergency." The Intermediate Unit made the initial determination that an emergency existed; however, the final decision for matters

In light of the foregoing, we recommend that CCIU:

- Reconfigure its cabinet to provide for an assistant executive director position similar to other intermediate units in Pennsylvania. This would enhance CCIU's succession plans by providing for a credentialed professional ready to assume the executive director's duties in the event of a prolonged absence or an unexpected retirement;

- Publicly advertise all future administrative vacancies. This could be accomplished by using the administrator search services of the Pennsylvania School Boards Association and/or similar organizations; and

- Seek the written approval of PSERS before entering into any future emergency return to work contracts.

We recommend that PSERS:

- Expand the wording in Item 13, Member Certification on Form 8, Application For Retirement, requiring applicants to certify whether they are ***anticipating*** working pursuant to an emergency contract prior to the commencement of their annuity. This would give PSERS an opportunity to evaluate the contract as it relates to the provisions of Section 8346 of the Public School Employees' Retirement Code; and

- Periodically remind employers, active members, and retired members of the requirements of Section 8346(b) of the Public School Employees' Retirement Code, and periodically remind school districts of the necessity to make a "good faith" attempt to hire non-retired school personnel as required by the PSERS *Retired Members' Handbook*.

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affecting disbursements to annuitants must rest with PSERS. Otherwise, public school employers would have the final say in matters that have statewide implication and can affect the solvency of the fund. Accordingly, we hold that PSERS has the authority to review whether a public employer's decision to return a retired employee to work was, in fact, done on the basis of an emergency as defined in Section 8346(b) of the Retirement Code. [slip opinion at pp10-11]

* * *

We hold that PSERS' construction and application of the Retirement Code to Baillie's retirement were correct. Baillie never separated from service, and he was not an annuitant when hired on an emergency basis. The dispositive issue is not whether the challenges facing the Intermediate Unit constituted a true emergency but, rather whether a public school employee can effect a phony retirement in the middle of a contract period to achieve an increase in payouts by PSERS, Such retirement pre-planning has implications for all public school employers and the solvency of PSERS. [slip opinion at p 13]

We are forwarding copies of this report to the Pennsylvania Department of Education and the Pennsylvania Public School Employees' Retirement System for their review and whatever action they may deem appropriate.

**FINDING II:** **CCIU Improperly Used Federal Medicaid Funds Administered By The Pennsylvania Department Of Education To Make Capital Improvements To The Downingtown Education Center.**

The second allegation was that CCIU improperly used CCIU's federal Medicaid School Based Access Program ("ACCESS")[10] funds to make capital improvements at the Downingtown Education Center ("DEC").

On June 25, 2007, OSI requested all documents relating to the receipt and disposition of funds from the ACCESS program by CCIU for the period July 1, 2005, through the present.

Under cover of correspondence dated July 2, 2007, Baillie provided OSI with the following documents:

- ACCESS Program Status Reports for the period October, 2005, through May 2007, rendered by Leader Services ("LS");[11]
- ACCESS Program Status Reports for the period October 2005 through May 2007, annotated "Early Intervention" rendered by LS;
- PDE Forms 352 and Student Based ACCESS Program ("SBAP") Funds Request Forms for the period July 2005 through June 2007. These forms were signed by Baillie as "Chief Executive Officer" and directed to PDE's Bureau of Special Education ("BSE") via a cover letter which states that CCIU will use the funds for the following:
  - New professional and paraprofessional special education staff;
  - ACCESS coordination and clerical staff;
  - Personal Care Assistants;
  - IEP (Individual Education Plan) writers;
  - Materials and supplies to supplement and enhance our services to students with disabilities;
  - Computers and assistive technology devices;
  - Staff Training; and
  - Contracted Services including our cutting edge autism clinic; and
- CCIU Accounts Payable Check Register for the period July 1, 2005 through May 31, 2007, annotated "expenditures."

OSI reviewed the Forms 352 and found no requests to use the ACCESS funds for capital improvements at the DEC or any other CCIU facility.

OSI also reviewed the Accounts Payable Check Register for disbursements that supported the allegation that capital improvements were made at the DEC with ACCESS funds. This review yielded payment descriptions such as "cabling," "windows," and "HVAC [Heating, Ventilation, Air Conditioning]."

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[10] A description of the ACCESS program is set forth in footnote 1.

[11] Leader Services is an organization under contract to PDE to provide training, support services, and data processing for the ACCESS program.

On July 25, 2007, OSI interviewed Sharon Jones, who retired as CCIU's Director of Finance in June, 2007. In response to questions, she stated the following:

- It was her understanding that CCIU's ACCESS funds were to be used by CCIU for "supplemental services" for special education children.
- If a question came up about the proper use of ACCESS funds, she would use the PDE website to research the ACCESS Guidelines maintained there.
- She felt that CCIU's use of ACCESS funds was in compliance with the PDE guidelines.

On August 3, 2007, OSI interviewed Richard A. Fazio, Chief Financial Officer for Downingtown Area School District ("DASD"), regarding the use of the DEC by CCIU. In response to questions, Fazio provided the following information:

- CCIU had operated an Alternative Education Center at the former Emeryville State Hospital ("ESH"). Due to its configuration, all of the hospital's buildings were powered by an onsite generation system. Conversion of the system was cost prohibitive and CCIU opted to abandon ESH in favor of the facility. Parts of the ESH are now operated by the West Bradford Township;
- The facility that is now known as the DEC was originally the Downingtown High School, and it is located at 335 Manor Avenue, Downingtown, Pennsylvania.
- He and CCIU's Director of Administrative Services, Joseph Lubitsky, worked out a lease agreement whereby CCIU would lease the facility from DASD for thirty months effective January 1, 2007.
- DASD desired to retain possession of the facility because its student enrollment continues to increase. Particulars of the lease are as follows:
  - The rent was set at $1 per year.
  - DASD retained eight classrooms on the second floor of the facility, paying CCIU $1.91 per square foot annually.
  - DASD would continue use the gymnasium for wrestling practice and matches.
  - CCIU was to make all necessary alterations, additions, or improvements to the facility.
  - All improvements made to the eight classrooms were to be the responsibility of DASD, but could not exceed $10,000 per classroom;
  - All usual and customary utility and maintenance costs were to be the responsibility of CCIU.
  - CCIU has the option of purchasing the facility during the term of the lease, provided that DASD approves.
  - The lease was signed by Joseph Lubitsky for CCIU and Dr. Alice Johnson, President, DASD Board of School Directors.

- Lubitsky told him that CCIU had $2 million dollars available for renovations at the facility.
- CCIU made the following improvements to the DEC:

- Power washing the exterior;
- Interior cleaning;
- Interior painting;
- New windows; and
- HVAC installations.

On September 11, 2007, OSI interviewed Joseph P. Lubitsky, CCIU's Director of Administrative Services, who, in response to questions, provided the following information:

- The DEC houses CCIU's Center for Alternative Secondary Education ("CASE"), which is a program for students with discipline problems at member schools.
- The DEC also houses CCIU's Steps Program[12], which is a program for middle school students with discipline problems, and CCIU's Reach Program[13], which is a licensed program for students with mental health disorders.
- The total student population at DEC for these CCIU programs would range from 150-225 students depending on the time of year. The population would be low at the beginning of the school year because the expulsion process takes time to complete.
- CCIU leases DEC from DASD for $1 per year.
- In the lease, which was dated January 2007, DASD reserved eight classrooms and the gymnasium.
- CCIU did not receive approval from PDE to use ACCESS funds for capital improvements at DEC.
- He relied upon the PDE guidelines and input from Dr. Joseph Coleman, CCIU's Director of Student Services.
- At the end of the fiscal year, he would meet with Baillie to determine if programs were self supporting.
- If they were, the balance was transferred to the Building Improvement Fund ("BIF").
- In accordance with ACCESS guidelines, the balance in the ACCESS account was left standing and was never transferred to the BIF.
- He provided OSI with a copy of his memorandum dated March 22, 2007, to Baillie in which he sought Baillie's approval to use ACCESS funds at the DEC.

[12] "This program works with students who experience mental health issues who demonstrate an interest and desire to learn, but who are reluctant to participate in mental health services. Students are provided with the tools to work cooperatively with their peers. They learn the skills to deal with everyday issues at their ability level. Educational staff provides individual attention when dealing with academic and behavioral issues." CCIU website, *www.cciu.org/ServicesAtoZ/s.html/view?searchterm+stepsprogram* (accessed on August 12, 2008).

[13] "The Reach program is a school-based, partial hospitalization program that provides a clinical and alternative education environment for students who have been diagnosed with significant mental health disorders such as oppositional defiant disorders, conduct disorders, mood disorders and anxiety disorders." CCIU website, *www.cciu.org/Departments/StudentsServices/reachprogram/reach.html* (accessed on August 12, 2008).

- Baillie approved the use of the funds.
- CCIU's Board did not participate in this decision making process.

Under cover of correspondence dated September 21, 2007, Lubitsky forwarded the following records to OSI which evidence the use of ACCESS funds at the DEC:

- Copies of CCIU Purchase Order Nos. 184875, 184874, 184871, 184878, and 184877;
- Copies of Atlantic Coast Communications, NJ, Inc. invoices;
- Copies of Hobbs & Company, Inc. invoices;
- Copies of Johnstone Supply invoices;
- Copies of R.E. Michaels Company, Inc. invoices; and
- Account Detail between July 1, 2006, and September 18, 2007, for Program 037, School Based ACCESS Program.

The information contained on the purchase orders is summarized in **Table 4**.

**Table 4**
***Summary of CCIU Purchase Order Information***

| PURCHASE ORDER NUMBER | VENDOR | DESCRIPTION ON PURCHASE ORDER | ACCESS FUNDS ALLOCATED |
|---|---|---|---|
| 184875 | Adelphia Window Contractors | Windows for Downingtown Education Center | $273,214.74 |
| 184874* | Atlantic Coast Communications | Voice/Data Structured Cabling Project Downingtown Education Center | $153,290.00 |
| 184871* | Hobbs and Company | Fire Alarm System-Life Safety Upgrade Project Downingtown Education Center | $136,400.00 |
| 184878* | Johnstone Supply | HVAC Equipment – Downingtown Education Center Delivery to be completed by 4/20/07 | $72,563.40 |
| 184877* | R.E. Michael Company | HVAC Equipment Downingtown Education Center | $17,821.86 |

** Originally charged to BIF and changed to ACCESS program fund on March 26, 2007. This change occurred four days after Lubitsky's memorandum to Baillie wherein Lubitsky sought approval from Baillie to use the ACCESS funds at the DEC.*

The information contained in the Account Detail between July 1, 2006 and September 18, 2007 for Program 037, School Based ACCESS Program, attributable to "Construction Services" at the DEC is summarized in **Table 5**.

**Table 5**
**Summary of CCIU payments made with ACCESS funds at DEC**

| DATE | VENDOR | INVOICE # | CCIU CHECK # | AMOUNT |
|---|---|---|---|---|
| 5/9/2007 | Adelphia Window | 184875.1 | 414981 | $26,325.00 |
| 6/29/2007 | Adelphia Window | 184875.2 | 418746 | $134,100.00 |
| 8/29/2007 | Adelphia Window | 184875.3 | 420997 | $112,789.74 |
| 5/16/2007 | Atlantic Coast | 184874 | 415373 | $64,261.25 |
| 6/13/2007 | Atlantic Coast | 184874-2 | 417430 | $23,076.95 |
| 6/28/2007 | Atlantic Coast | 184874JUNE28 | 418784 | $33,083.51 |
| 8/1/2007 | Atlantic Coast | 184874AUG1 | 419955 | $11,665.02 |
| 8/1/2007 | Atlantic Coast | 184874AUG1 | 419955 | $32,868.29 |
| 8/29/2007 | Atlantic Coast | 184874.1 | 421029 | $24,780.60 |
| 6/20/2007 | Hobbs & Co. | 184871 | 418015 | $77,567.85 |
| 8/1/2007 | Hobbs & Co. | 184871AUG1 | 420024 | $52,940.83 |
| 4/18/2007 | Johnstone Supply | 29916 | 413617 | $39,415.11 |
| 5/23/2007 | Johnstone Supply | 32865 | 416156 | $33,148.29 |
| 6/6/2007 | R. E. Michaels Co. | 53151400 | 416998 | $17,821.86 |
| | | | **TOTAL** | **$683,853.30** |

On October 17, 2007, OSI met with representatives of PDE-BSE in Harrisburg, during which the following occurred:

- OSI advised PDE-BSE that CCIU had entered into a lease agreement on or about January 1, 2007 with DASD to lease the DEC.
- OSI provided the evidence delineated above to PDE-BSE to support the finding that CCIU used $683,853.30 in School Based ACCESS funds to make capital improvements at the DEC during the period April 18, 2007 through August 29, 2007.
- OSI advised PDE-BSE that CCIU had a balance in the ACCESS Program fund prior to the construction period which was used for the "construction services" at the DEC.
- PDE-BSE advised OSI of the following:
    - LEAs[14] are allowed to maintain a balance in the ACCESS program funds because they generate the funds.
    - LEAs are reimbursed approximately $.55 for every $1.00 they spend on ACCESS program related activities and services.
    - The funding is similar to a "continuing appropriation," and PDE does not audit the use of the funds once they are approved.
    - LEAs must receive prior approval to use ACCESS funds for a capital improvement mandated by an IEP.
    - PDE-BSE questioned the amount of IEP students who would be present at an Alternative Education Center which is typically used to educate students with discipline problems.

[14] "LEA" stands for local education agency (i.e., a public school district, intermediate unit, area vocational-technical school, etc.).

    - LEAs must submit a yearly special education program plan which should include the movement of programs using ACCESS funds from one facility to another.
    - PDE-BSE agreed to review the plans submitted by CCIU to determine if the move to the DEC was recorded and to provide copies of the reports to OSI.
    - LEAs are offered training each year on the appropriate use of special education funds in general and ACCESS funds in particular.
    - CCIU employees were present for this training (PDE-BSE agreed to check attendance rosters to verify this point).
- OSI asked PDE-BSE to review all of the information having a bearing on this issue and to respond in writing to OSI with their opinion on the use of the ACCESS funds by CCIU at the DEC.

On November 6, 2007, OSI met again with representatives of PDE-BSE in Harrisburg, during which the following occurred:

- PDE-BSE provided a letter to OSI dated October 30, 2007, which stated, in pertinent part that PDE-BSE "did not approve expenditures at any time for capital improvements for the Downingtown Education Center," and CCIU "did not notify the Bureau of any anticipated expenditures of ACCESS funds for capital improvements." PDE-BSE characterized the use of ACCESS funds by CCIU at the DEC as "not normal" and "very unusual."
- PDE-BSE provided copies of a document titled "ACCESS Training Sign-In Sheets" for October 28, 2003, October 8, 2004, September 22, 2005, and September 14, 2006, which show that CCIU employees were in attendance for ACCESS training, including a general overview of the ACCESS program discussion of expenses that would not be allowable under ACCESS program guidelines; and an open question and answer period for participants.
- PDE-BSE provided copies of CCIU's Special Education Plan Document for the school years 2005-06, 2006-07, and 2007-08. These plans did not include the movement of any programs using ACCESS funds from one facility to another.

On August 6, 2008, in response to questions, Baillie offered the following information to OSI regarding this finding:

- He was advised by a CCIU employee that ACCESS funds could not be used for capital improvements; however, he did not provide that employee's name.

- Joseph Lubitsky wanted to use the funds for the DEC, and he (Baillie) was willing to use the money as long as it was within PDE guidelines.

- He did not know the balance in the ACCESS fund on June 30, 2006.

- He and Lubitsky would evaluate fund balances and would "sweep" balances from productive funds into the BIF. The ACCESS fund was not touched in this process.

- He denied giving Lubitsky approval to use ACCESS funds at the DEC via a memorandum dated March 22, 2007. He also stated he did not tell Lubitsky to prepare this memorandum.[15]

- He attempted to control the use of ACCESS funds at the DEC by requiring his signature on purchase orders utilizing these funds.[16]

- He never sought approval from PDE to use the funds and did not disclose the anticipated DEC expenditures on PDE Form 352.

## **Conclusions and Recommendations**

CCIU improperly used $683,853.30 of ACCESS funds to make capital improvements at the DEC. PDE's program description[17] expressly states that ACCESS funds may not be used to make capital improvements to property, and PDE-BSE stated that it never received a request from CCIU or authorized the use of ACCESS funds by CCIU for capital improvements at the DEC.

Accordingly, we recommend that CCIU:

- Strictly adhere to the regulations published by PDE on the use of ACCESS funds; and

- Seek PDE approval before making for any questionable expenditure with ACCESS funds.

We also recommend that PDE:

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[15] In his separate response to a draft copy of this report, Baillie's attorney contends that this is not an accurate reflection of what Baillie stated in the interview. He contends, rather, that Baillie stated that he did not remember giving Lubitsky approval nor did he remember giving Lubitsky the memorandum. OSI believes that the bullet point above accurately and fairly reflects what Baillie stated in the interview.

[16] In his separate response, Baillie's attorney states that it should be noted that Dr. Baillie attempted to control the use of the ACCESS funds not at the DEC, but by requiring that any purchase order seeking to commit the use of those funds be signed personally by Dr. Baillie.

[17] ACCESS funding is provided by the federal government pursuant to the Medicare Catastrophic Coverage Act of 1988 (PL 100-360), and the ACCESS program is administered by the Pennsylvania Department of Education and its contractor, Leader Services, Inc., in cooperation with the Pennsylvania Department of Public Welfare and the Centers for Medicare and Medicaid Services. The program description, including restrictions on the use of ACCESS grant funds, is set forth under footnote 1, and additional information about the program may be found on the PDE website under Pre K-12, Special Education, Grants and Funding, *www.able.state.pa.us/special-edu/cwp/view.asp?a=177&Q=61414* (accessed on July 31, 2007).

- Seek repayment from CCIU of all ACCESS funds used to make capital improvements at the DEC, together with interest.
- Review all CCIU ACCESS expenditures to determine their compliance with the remaining program regulations; and
- Review all ACCESS program expenditures made by each LEA at the end of each fiscal year to determine compliance with program guidelines.

We are forwarding copies of this report to the Pennsylvania Department of Education, the U.S. Department of Education, the Pennsylvania Department of Public Welfare, the U.S. Department of Health and Human Services, and the Centers for Medicare and Medicaid Services for their review and whatever action they may deem appropriate.

## FINDING III: CCIU Employees Used CCIU Credit Cards To Make Improper Purchases.

The third allegation was that a long-time CCIU employee had received a lavish retirement gift paid for with CCIU funds. It was also alleged that fellow CCIU employees considered giving the retiree a “gag gift” consisting of an old set of golf clubs, but, when Baillie heard of the idea, he directed Lubitsky to purchase a new set of golf clubs for the retiree. The cost of the golf clubs was $1,600. It was further alleged that gifts of this monetary value were not typically purchased by CCIU for retiring employees.

On August 21, 2007, OSI requested monthly statements, all supporting receipts, and cancelled checks evidencing payments made by CCIU for all credit cards issued to CCIU employees during the period July 1, 2006 through the date of the request.

When informed that at least 48 CCIU employees had been issued credit cards, OSI modified the request to include only department heads. On November 11, 2007, OSI received supporting documentation for the credit card transactions of approximately twenty department heads.

On November 11, 2007, OSI received copies of the monthly credit card statements rendered by the financial institution that issued the credit cards to CCIU and its employees for the period June 2006 through September 2007, and supporting documentation. From these statements, OSI prepared compilations utilizing the following information:

- Card Number
- Card Holder
- Transaction Date
- Posting Date
- Transaction Description
- Amount

Pertinent information from these compilations is summarized below in **Table 6**.

**Table 6**
***Summary of CCIU Credit Card Transactions***

| PERIOD | TRANSACTIONS | TOTAL VALUE OF TRANSACTIONS |
|---|---|---|
| June 21, 2006 – December 4, 2006 | 920 | $145,366.54 |
| December 8, 2006 – June 27, 2007 | 1058 | $203,668.72 |
| **TOTALS** | **1,978** | **$349,035.26** |

On September 11, 2007, OSI interviewed Joseph P. Lubitsky, CCIU's Director of Administrative Services, who provided the following information:

- He was directed by Baillie in June 2007 to purchase a set of golf clubs for a retiring CCIU employee.
- He purchased the clubs at a sporting goods store in Downingtown with a CCIU credit card.
- He directed that the expense be charged to CCIU's maintenance/supplies account.

On October 9, 2007, OSI interviewed CCIU Board Member Paul L.Johnson and advised him that a retiring CCIU maintenance employee received a set of golf clubs valued at approximately $1,600 which were purchased with a CCIU credit card by Lubitsky at Baillie's direction. Johnson stated that he never voted to approve this expenditure and considered it excessive and improper.

On October 10, 2007, Dr. Joseph O'Brien, CCIU's new executive director, contacted OSI and related the following:

- On or about September 25, 2007, he encountered Baillie, who gave him an envelope.
- They agreed to have lunch on October 3, 2007, to discuss the envelope's contents.
- On October 3, 2007, during lunch, Baillie asked him if he had looked in the envelope.
- He responded in the negative, and then opened the envelope to find $1,500 in cash.
- Baillie told him that the cash was for the golf clubs purchased for the retiring CCIU employee by Lubitsky using a CCIU credit card.
- Baillie told him that any money left over should be given to a charity operated by or affiliated with CCIU.

On October 30, 2007, OSI requested the following:

- The sales receipt and/or the invoice supporting the purchase made by Lubitsky on June 20, 2007, at a sporting goods store in Downingtown, in the amount of $1,600.49 and charged to Lubitsky's IU-provided credit card; and
- Evidence to support the receipt of currency by O'Brien from Baillie, why the currency was tendered to O'Brien, and the disposition of the currency by CCIU.

Under cover of correspondence dated November 15, 2007, O'Brien forwarded the following records to OSI:

- The monthly credit card statement rendered to CCIU by its financial institution for the period ending July 6, 2007 for Lubitsky's credit card styled

"Chester County IU Joseph P. Lubitsky," which showed a $1,600.49 purchase on June 20, 2007, at the sporting goods store identified by Lubitsky in his interview;

- The statement is annotated "IU Employee Recognition Award (Spec. Ed)"; and
- A "Chester County Intermediate Unit #24 Deposit Transmittal Form" containing the following information:
    - Date: 10/8/07
    - Program Name: Sp. Ed.
    - Program Number: 030
    - Person Submitting Deposit: Joe Lubitsky
    - Currency $1,500
    - 100s= 5
    - 50s= 10
    - 20s= 25
    - Total Amount Deposited $1,500
    - Brief description of what monies were received for: "Funds rec'vd for emp. recognition award."

In the letter, O'Brien stated the following:

- "If you want to know why Dr. Baillie tendered the currency, I honestly think you need to ask Dr. Baillie his reasons."
- "I was told he wanted to make the reimbursement anonymously – and this is why he gave cash – but he did not give his reason."

In light of this improper use of public funds and the number of credit card transactions by CCIU employees, OSI contacted selected vendors identified in the compilations described above to get details regarding the purchases. OSI then interviewed the CCIU employees who made the suspect purchases to determine the purpose and justification for the expenditures. The results of this investigative step are summarized below:

- A CCIU employee purchased 20 cases of wine from an out-of-state liquor store totaling $1,707.72 with his CCIU credit card on June 20, 2006. This employee stated that two bottles of wine were given to each participant in a golf tournament benefitting the CCIU Children's Fund, and that the credit card transaction was charged to this fund.
- A CCIU employee used her CCIU credit card to purchase meals at a local restaurant for an unknown number of guests totaling $840.99 on October 20, 2006. She stated that it was an event for a guest speaker, and that all attendees other than the guest speaker reimbursed her for the expense incurred on her credit card.
- A CCIU employee used his CCIU credit card to purchase lunch at a local golf club restaurant on December 13, 2006, to host a "Christmas Luncheon" for a group of vendors. He stated that another CCIU employee collected money

from each of the guests to reimburse CCIU for the $922.90 charged to his CCIU credit card, and that the cash collected was remitted to the CCIU business office.

- A CCIU employee used his CCIU credit card to purchase lunches at a local golf club restaurant totaling $840.99 on December 14, 2006. He stated that the expenditure was for a holiday luncheon for the human resources directors of the IU's member school districts and that the expense was borne completely by CCIU.
- A CCIU employee used his CCIU credit card to purchase dinners and alcoholic beverages at a local restaurant for 35 guests totaling $997.14 on December 21, 2006. He stated that the expenditure was for a holiday party/staff meeting, the inclusion of alcoholic beverages on the restaurant check was a mistake by the waitress, another CCIU employee collected cash from each of the attendees to reimburse CCIU for the expense of the party, and the money was remitted to the business office;
- A CCIU employee used his CCIU credit card to purchase lunches at a local golf club restaurant for 35 guests totaling $704.25 on December 21, 2006. He stated that it was a working holiday luncheon for teachers and staff of a cyber school affiliated with CCIU, and that none of the attendees contributed toward the cost of the luncheon.
- A CCIU employee used his CCIU credit card to purchase dinners at a local golf club restaurant for an unknown number of guests totaling $1,421.00 on May 9, 2007. He stated that this was a "new teacher banquet" and was "a teachers' version of an athletic banquet." The expense was borne entirely by CCIU, with no contribution by the attendees.
- A CCIU employee used his CCIU credit card to purchase dinners at a local golf club restaurant for 40 guests totaling $922.90 on June 21, 2007. He stated that the participants reimbursed CCIU in full.
- A CCIU employee used her CCIU credit card to purchase dinners at a private club restaurant for 86 guests totaling $1,920.40 on June 21, 2007. She stated that this was a retirement party for a former CCIU employee, and that another CCIU employee collected money from the attendees equal to the amount charged. She also stated that the money was remitted to a CCIU accounts receivable clerk and was deposited in a CCIU account.
- A CCIU employee used his CCIU credit card to purchase cocktails, hors d'oeuvres, and the services of a bartender at a local restaurant totaling $2,472.14 on June 11, 2007. He stated that this was a reception hosted by CCRES to introduce the new CCIU executive director to representatives of member school districts. He stated that he used his CCIU credit card even though he also carried a CCRES credit card. He also stated that CCIU was subsequently reimbursed by CCRES for this expenditure.

Regarding employee recognition awards, a CCIU employee stated that Baillie established a policy to recognize employees who attained certain milestones in their careers. Thirty-five years of service was recognized with the presentation of a watch valued at approximately $100. Retirement was recognized with the presentation of an artistic print tailored to the employee at a value of approximately $100.

Under cover of correspondence dated February 11, 2008, O'Brien forwarded the following documentation to OSI:

- Evidence of reimbursement in the amount of $154.25 with respect to the Christmas party held at a local restaurant on December 21, 2006 at a cost of $997.14, which represents the cost for alcoholic beverages and spouses only;
- Evidence of reimbursement totaling $3,491 associated with the retirement party held at a private club restaurant on June 21, 2007, which included reimbursement of the credit card charge of $1,920.40 and reimbursement of a CCIU check in the amount of $1,570.60 issued pursuant to a purchase order;
- Evidence of reimbursement to cover $900 of the $922.90 expense associated with the Christmas party for vendors held at a local golf club restaurant on December 13, 2006; and
- Evidence of reimbursement to cover all of the expenses associated with the reception for the new CCIU executive director on June 11, 2007. This reimbursement was made by a check from CCRES in the amount of $2,472.14.

On January 22, 2008, OSI received a copy of CCIU's Statement of Procedure No. 0419.05, captioned "Use of IU Credit Cards," which states:

> In conduct of its operations, it is necessary for CCIU to issue credit cards to administrators and certain project staff for business related expenses only. CCIU credit cards are <u>not</u> to be used for any personal expenses or personal business. All purchases and reconciliation of invoices shall be executed consistent with the school laws and laws governing procurement for public entities and CCIU policies and procedures.[18]

CCIU's Statement of Policy and Procedure on Staff Travel provides in Section 0818.07, "Alcoholic beverages are not eligible for reimbursement."

On August 6, 2008, in response to questions, Baillie offered the following information to OSI:

- He did not think he should have personally paid for the golf clubs for the retiring CCIU employee.
- He learned of the employee's retirement and asked Lubitsky to arrange for a retirement party.

[18] CCIU Statement of Procedure No. 0419.05, dated October 18, 2004, p. 1.

- Prior to the party, Baillie learned that a set of used golf clubs was assembled by the retiring employee's colleagues, and he did not think this was a fitting gift for "an outstanding, 35 year employee."
- He directed Lubitsky to purchase a new set of clubs for the retiring employee.
- He thought that the golf clubs cost CCIU $1,200.
- He was later told that the cost was closer to $1,500.
- When OSI's investigation into this matter caused concern within CCIU, Baillie elected to pay for the golf clubs, but he wanted the payment to be anonymous, which is why he gave O'Brien $1,500 in U.S. currency.[19]
- Baillie later learned that the golf clubs cost $1,600.

## <u>Conclusions and Recommendations</u>

The use of CCIU funds to purchase lavish retirement gifts is improper. The purchase of a $1,600[20] golf set clearly exceeds the employee recognition policy promulgated by CCIU. CCIU's employees used poor judgment when using CCIU credit cards to purchase alcoholic beverages, holiday parties, and a reception in honor of the new executive director.

We recommend that CCIU:

- Amend Section 3.2 of CCIU's Statement of Procedure No. 0419.05 to include an annual recertification by all employees who are issued CCIU credit cards indicating they understand the rules governing the use of CCIU credit cards;

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[19] In his separate response to a draft copy of this report, Baillie's attorney states the following:

> In our view [this bullet point] is at worse [sic] incorrect and at best misleading. In summary, when Dr. Baillie learned of the concern regarding the payment for the golf clubs, he elected to simply pay for them out of his personal funds in order to allay any concern, even though in his view the initial expenditure was entirely appropriate given the context of these clubs being given as a retirement gift to a loyal and dedicated employee with over 35 years of CCIU service. Part of Dr. Baillie's motivation in doing this despite his view that the expenditure was entirely appropriate was because numerous CCIU staff members had advised him that based on their interaction with [OSI investigators], it was their view that [OSI] was doing whatever it could "to get" Dr. Baillie. There was never any attempt whatsoever to conceal any impropriety whatsoever and any implication of such derived from the reference [sic] bullet point is wholly without merit.

In reply to this criticism, we believe that the bullet point accurately and fairly summarizes what was stated in the interview, and it appears to us that the response is really an expansion or elaboration upon what was stated in the interview. In fairness, we have printed it in its entirety, including the purported comments of unnamed staff members that impugn the motives of the OSI investigators. Suffice it to say that we deny that OSI was out "to get" Dr. Baillie or anyone else. The sole purpose of the investigation was to get to the truth.

[20] We recognize that Baillie directed Lubitsky to purchase a golf club set without setting a specific price.

- Amend its Statement of Procedure No. 0419.05 to make it clear that purchase orders are the preferred method of procurement and that employees may be held personally liable for any personal use or other misuse of a CCIU-issued credit card; and

- Establish a policy prohibiting the use of CCIU funds for entertainment purposes, such as luncheons, dinners, parties, receptions, and similar social events, and especially for the purchase of alcoholic beverages.

## <u>FINDING IV</u>: CCIU Failed To Properly Report $12,000 Per Year That It Paid To Its Former Executive Director As Supplemental Income And Failed To Withhold And Pay Taxes On Such Income.

The uniqueness of Baillie's employment agreements with CCIU prompted OSI to investigate:

- The amount of reimbursement made to Baillie by CCIU for his contributions to PSERS for fiscal years 2002 through 2006, and whether it was properly reported to the Internal Revenue Service ("IRS"); and
- The amount of reimbursement made to Baillie by CCIU "for expenses of the office" as described in his Employment Contracts for the years 2002 through 2006, and whether it was properly reported to the IRS.

On December 17, 2007, OSI asked CCIU to produce the following items:

- Copies of IRS Forms W-2, Wage and Tax Statement, issued to Baillie for 2002, 2003, 2004, 2005, and 2006;
- Reimbursements made to Baillie for his contributions to the PSERS for 2002, 2003, 2004, 2005, and 2006, and how it was reported to the IRS; and
- Reimbursement made to Baillie "for expenses of the office" as described in his Employment Contracts for 2002, 2003, 2004, 2005, and 2006, and how it was reported to the IRS.

On January 23, 2008, CCIU produced the following:

- Copies of IRS Forms W-2, Wage and Tax Statement, issued to Baillie for 2002, 2003, 2004, 2005, and 2006.
- A spreadsheet prepared by O'Brien listing reimbursements made to Baillie for his contributions to PSERS for 2002, 2003, 2004, 2005, and 2006.
- Copies of Baillie's Earnings Statements for the periods ending December 24, 2004, July 15, 2005, September 1, 2006, and February 1, 2007.
- Copies of travel vouchers submitted by Baillie for the following periods:
    - May, 2001 – August, 2001
    - July 1, 2002 – June 30, 2003
    - July 1, 2003 – June 30, 2004
    - July 1, 2004 – June 30, 2005
    - July 1, 2005 – June 30, 2006
    - July 1, 2006 – June 30, 2007
- A copy of a letter dated November 22, 2004, from Katherine A. Pettiss, President, CCIU Board, to Joseph Lubitsky, which states: "Effective July 1, 2004, [Baillie] should be issued a check at the beginning of each month in the amount of $1,000 for business related travel and expense within the Commonwealth of Pennsylvania."

OSI compared O'Brien's spreadsheet to Statements of Account rendered to Baillie by PSERS. This comparison indicated that the amounts listed on Baillie's Earning Statements as reimbursements for his contributions to PSERS agree with the amounts listed on his PSERS statements. Furthermore, OSI has determined that the reimbursements Baille received for his contributions to PSERS also have been included as "other income" on the IRS Forms W-2 issued to Baillie for the subject years in question.

In his letter to OSI dated February 11, 2008, O'Brien stated:

> In 2006, Dr. Baillie's contract was amended to make Dr. Baillie personally responsible for paying all taxes on his expense reimbursement. This was done, effective 2006, at the direction of our board. Prior to 2006, taxes were withheld by the IU and transferred to the IRS. After 2006, Dr. Baillie received a check, and no taxes were taken from the check – Dr. Baillie was responsible for paying all the taxes, as indicated in the contract. Please note this is <u>not</u> how it is handled in my contract.

The 2008 Instructions for reporting employee business expense reimbursements on IRS Forms W-2 and W-3 provide, in pertinent part:

> **Employee business expense reimbursements**.
> Reimbursements to employees for business expenses must be reported as follows:
> Payments made under a nonaccountable plan are reported as wages on Form W-2 and are subject to federal income tax withholding and social security and Medicare taxes.[21]

"Nonaccountable plan" is defined as follows:

> **Nonaccountable plan.** Payments to your employee for travel and other necessary expenses of your business under a nonaccountable plan are wages and are treated as supplemental wages and subject to income tax withholding and payment of social security, Medicare, and FUTA taxes. Your payments are treated as paid under a nonaccountable plan if:
> - Your employee is not required to or does not substantiate timely those expenses to you with receipts or other documentation,
> - You advance an amount to your employee for business expenses and your employee is not required to or does not return timely any amount he or she does not use for business expenses, or
> - You advance or pay an amount to your employee without regard for anticipated or incurred business expenses.[22]

[21] IRS website, 2008 Instructions for Forms W-2 and W-3, p. 5 (the instructions were essentially the same for tax years 2006 and 2007).

During his interview by OSI on August 6, 2008, Baillie provided the following information:

- He was entitled to $1,000 per month for "Expenses of the Office" from January to June of 2007, but CCIU never paid him this entitlement.[23]
- He did report the $12,000 of supplemental income he received in 2006 on his 2006 tax returns.

## Conclusion and Recommendations

Based on OSI's review of Baillie's employment contracts, Pettis' directive set forth in her letter dated November 22, 2004, to Lubitsky, and Baillie's statements, OSI finds that the advancement of anticipated business expenses to Baille in the amount of $1,000 per month was made pursuant to a "nonaccountable plan" as the term is defined by the IRS.

Accordingly, we find that CCIU should have reported the $1,000 monthly payments made to Baille as supplemental wages on Baillie's 2006 Form W-2, and CCIU should have withheld federal, state, and local income taxes, and paid Social Security taxes, Medicare taxes and Federal Unemployment Tax Act taxes on said supplemental income at the rates required by law.

We recommend that CCIU:

- Issue corrected IRS Forms W-2 to its former executive director for 2006 and file the corrected Forms W-2 with the Internal Revenue Service, the Pennsylvania Department of Revenue, and the appropriate local taxing authority; and

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[22] IRS website, 2008 Circular E, Employer's Tax Guide, Section 5 (the definition of a nonaccountable plan was essentially the same for tax years 2006 and 2007).

[23] In his separate response to a draft copy of this report, Baillie's attorney states the following:

> . . . [I]t is inaccurate to say that although Dr. Baillie was entitled to $1,000.00 per month for expenses from January to June of 2007, CCIU never paid him this entitlement. Rather, this entitlement, though not paid in 2007, was paid by CCIU to Dr. Baillie in 2008. In this context it should also be noted that Dr. Baillie produced a written statement signed by his certified public accountant confirming that these amounts were reported on his income tax returns. In that regard, we think it more appropriate that [the footnote in the draft report acknowledging that this was done] be included in the body of the report as opposed to a footnote so as to accurately and fairly describe Dr. Baillie's actions in this regard.

In reply to this criticism, we acknowledge that CCIU reported the supplemental income paid to Baillie for 2006 on an IRS Form 1099. Our finding is that this method of reporting the income was erroneous, i.e., the supplemental income should have been reported on his Form W-2. Furthermore, we did not find, and do not mean to imply, that Baillie failed to report the supplemental income on his tax returns for the year in question. However, as this information is peripheral to the finding, it is more appropriate to include it in a footnote rather than in the body of the report.

- Treat all other CCIU employees with employment contracts containing this benefit in the same fashion.

We are forwarding copies of this report to the U.S. Internal Revenue Service and the Pennsylvania Department of Revenue for their review and whatever action they may deem appropriate.

## CHESTER COUNTY INTERMEDIATE UNIT'S RESPONSE TO DRAFT REPORT

An educational service agency

# Chester County Intermediate Unit

September 9, 2008

Jack Wagner
Auditor General, Commonwealth of Pennsylvania
Department of the Auditor General
Finance Building
Harrisburg, PA 17120-0018

Dear Mr. Wagner:

The Chester County Intermediate Unit (CCIU) Board of Directors (Board) appreciates the opportunity to respond to the findings of the Auditor General's special investigation of the Chester County Intermediate Unit.

On July 2, 2008, the CCIU Board of Directors held a special meeting to review a draft of the report. Although each finding is addressed fully in the attached report, below please find a brief response along with the action to be taken to each of OSI's findings. (A full response is included in the attached report.)

- **OSI Finding I**: CCIU improperly employed its former executive director under an emergency return to work contract covering the period January 8, 2007 through June 30, 2007.

  **CCIU Response**: CCIU respectfully disagrees with this finding. In point of fact, the Chester County Intermediate Unit believes it did follow Section 8346 of the Retirement Code in this case. The CCIU Board of Directors did its due diligence. The Board secured the opinion of its legal counsel (the firms of Lamb McErlane PC; and Sweet, Stevens, Katz & Williams) before entering into an emergency contract to employ John K. Baillie. Also, Baillie reported that he contacted PSERS and that he received verbal approval from a Ms. Joyce Batliwala that his emergency employment with the CCIU was permissible. Therefore, both CCIU's legal counsel and a PSERS representative have opined that John K. Baillie could return to service on an emergency contract basis under PSERS current regulations and stipulations for a retiree's return to service.

  **CCIU Action to be taken:** CCIU will continue to comply with Section 8346 of the Retirement Code as written and/or as amended and CCIU will take into consideration the Auditor General's recommendations (See the attached full response.)

- **OSI Finding II:** CCIU improperly used federal Medicaid funds administered by the Pennsylvania Department of Education to make capital improvements to the Downingtown Education Center.

  **CCIU Response:** The CCIU respectfully disagrees with this finding. CCIU administration believed that the use of federal Medicaid School Based Access Program ("ACCESS") funds to make capital improvements to the Downingtown Educational Center to house programs for up to 250 children with a diagnosed mental illness or an emotional, social and/or behavioral disorder (the vast majority of whom have an individualized education plan (IEP) indicating a need for special education services) was in keeping with the guidelines of the acceptable use of funds to move programs as stipulated on PDE's web site as interpreted by CCIU's director of administrative services.

  **Please note**: The program's move was necessitated by the Pennsylvania Department of Welfare's sale of the property on which these programs were located. This forced closing of CCIU's program in Embreeville, Pennsylvania necessitated the CCIU relocating the programs for up to 250 children in less than twelve months. The lease arrangement with Downingtown Area School District provided cost-effective, high-quality facilities for our students, and presented the most viable of all options for relocation at the time.

Educational Service Center, 455 Boot Road, Downingtown, PA 19335
Phone: (484) 237-5000 • TDD: (484) 237-5528 • FAX: (484) 237-5154 • www.cciu.org

**CCIU Action to be taken:** CCIU will implement the Auditor General's recommendations. (See full response and action in attachment.)

- **OSI Finding III:** CCIU employees used CCIU credit cards to make improper purchases.

  **CCIU Response:** CCIU respectfully disagrees with this finding. After reviewing the purchases in question, the CCIU concludes that it is not a question of improper purchases but of the inadvisable use of credit cards to pay for legitimate expenses. While credit cards were used for valid expenditures, there were other, more preferred, methods of payment available, i.e. purchase orders or direct billing of a third party.

  **CCIU Action to be taken:** CCIU will implement the Auditor General's recommendations. (See full response and action in attachment.)

- **OSI Finding IV:** CCIU failed to report $12,000 per year that it paid to its former executive director as supplemental income and failed to withhold and pay taxes on such income.

  **CCIU Response:** CCIU respectfully disagrees with this finding. In 2005 and 2006, CCIU issued a 1099 Form to John K. Baillie for the compensation in question and a 1096 Form to the IRS. It did not do so in 2007 because Baillie did not receive the compensation in 2007. Baillie declared the income on his 2005 and 2006 income tax schedule.

  **CCIU Action to be taken:** CCIU will implement the Auditor General's recommendations. (See full response and action in attachment.)

Although CCIU does **not** agree with the findings of the Auditor General's office, it does believe the recommendations made by the Auditor General to be sound business and accounting practices and are ones which will only enhance the CCIU's procedures and policies. Therefore, CCIU will take under advisement all of the recommendations and implement them in whole or in part as set forth above in order to promote confidence in the CCIU's practices and to ensure compliance with the policies and procedures of the Chester County Intermediate Unit Board of Directors, the Pennsylvania Department of Education, the Pennsylvania State Employees Retirement System, and the laws of the Commonwealth of Pennsylvania.

Sincerely,

Katherine A. Pettiss

Katherine A. Pettiss
President, Board of Directors

Enclosure
KP/mjc

## Chester County Intermediate Unit's Response to the Auditor General's Report

### Background and Introduction

The CCIU Board of Directors and the CCIU administration acted in good faith in carrying out the laws of the Commonwealth of Pennsylvania, the policies and procedures of the Chester County Intermediate Unit, the Pennsylvania Department of Education, and the Pennsylvania State Employee Retirement System as outlined in CCIU's response to the draft report regarding the Chester County Intermediate Unit by the Office of Special Investigation (OSI).

The CCIU believes that in July 2007, after receiving unsubstantiated allegations against former CCIU Executive Director John K. Baillie, the Department of the Auditor General's ("Department") OSI launched a one-year investigation of the Chester County Intermediate Unit. The OSI's failure to take into account the motivation of the confidential sources cost the taxpayers of Pennsylvania considerable time and money in OSI and CCIU staff time and resources.

However, the CCIU appreciates the opportunity to respond. In the following pages, the CCIU will address each of the allegations by responding to the OSI's findings and outlining corrective actions, if any, to be taken including the implementation of the OSI's recommendations in whole or in part.

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On July 2, 2008, the CCIU Board of Directors (Board) held a special meeting to address the report. The Board's full response to each finding and the action to be taken is detailed below:

- **OSI Finding I**: CCIU improperly employed its former executive director under an emergency return to work contract covering the period January 8, 2007 through June 30, 2007.

  **CCIU Response:** The CCIU respectfully disagrees with this finding. The CCIU Board of Directors did its due diligence and secured the opinion of its counsel firms (Lamb McErlane PC; and Sweet, Stevens, Katz & Williams) before entering into an emergency contract to employ John K. Baillie. Also, Baillie reported that he contacted PSERS and that he received verbal approval from Ms. Joyce Batliwala that his emergency employment with the CCIU was permissible.

  Therefore, both a PSERS representative and CCIU's legal counsel have opined that John K. Baillie could return to service on an emergency contract under PSERS current regulations and stipulations for a retiree's return to service, as defined by 24 Pa.C.S. § 8346 of the Pennsylvania Retirement Code.

  Additionally, the CCIU maintains that it has the right, and the obligation under 24 Pa.C.S. § 8346 (b), to hire a retired employee in the event an emergency creates an increase in the work load such that there is serious impairment of service to the public or in the event of a shortage of appropriate personnel without a Commonwealth agency acting as a "super-IU Board" or second-guessing the sound exercise of the CCIU's discretion.

  On page 7 of the OSI draft report, it is correctly stated by the OSI that "... only two conditions allow a PSERS annuitant to return to his position: ...(2) a declared emergency, ***approved by PDE***, such as the inability to find a certified chemistry or physics teacher." (emphasis added) The concept that PDE must approve an emergency that exists in the judgment of the employer is not contained in Section 8346 of the Retirement Code, and neither PSERS nor the Auditor General can add it to the statute.

The statement in the letter dated December 17, 2007, reproduced on page 14 of the OSI draft report, which reads "as outlined in a letter dated May 2, 2007, the Chester County Intermediate Unit (CCIU) admitted there was a qualified candidate who could have been appointed to this interim position. Therefore, there was no emergency creating a need for your return," is one that we believe to be factually incorrect and results in faulty reasoning.

The individual to whom PSERS and the OSI refer, Mr. Joseph Lubitsky (Lubitsky), is not certified to be a superintendent or an executive director, and, therefore, cannot and could not have been appointed as an interim executive director. If so, that undercuts PSERS position in the letter of December 17, 2007 severely. If the premise of their argument is incorrect, which it is, then the Auditor General cannot properly state it as fact, and then reason from it.

Also, in response to Lubitsky's capacity to serve as an interim executive director: Even if Lubitsky could have been appointed interim executive, which he could not, it would have only shifted the staffing shortage. The CCIU then would have had to appoint an acting director of administrative services. Again, PSERS, in its conclusions, is second-guessing the judgment of the CCIU Board in fulfilling its obligations as stated in 24 Pa.C.S. § 8346 (b), to hire a retired employee in the event an emergency creates an increase in the workload such that there is serious impairment of service to the public.

Additionally, John K. Baillie has appealed the PSERS decision and the matter is currently before that agency. CCIU has been granted the right to intervene in this hearing, as the matter involved questions the judgment of the Chester County Intermediate Unit Board in its determination of an emergency situation.

Chester County Intermediate Unit reserves the right to accept or reject the Auditor General's recommendations based upon the agency's decision or a subsequent court's decision, which will have the final say in the matter.

**Action to be taken:** CCIU will comply with Section 8346 of the Retirement Code as written and/or as amended. In addition, CCIU will implement the spirit of the Auditor General's recommendations as follows, and with the right to revisit the recommendations depending upon the court's ultimate decision:

- **OSI Recommendation:** Reconfigure CCIU cabinet to provide for an assistant executive director, as is the practice in other intermediate units in Pennsylvania.

  **CCIU Plan of Action:** Re-examine and re-evaluate CCIU's current administrative configuration during its 2008-09 strategic planning process. Instead of creating a new position of assistant executive director, which would involve an unnecessary expenditure of public moneys to hire a new administrative employee, Chester County Intermediate Unit will:

  - Identify CCIU administrative staff members who are both certificated and qualified to be an interim executive director or acting executive director in an emergency or during the prolonged absence of an executive director.
  - Identify CCIU administrative staff who are capable and qualified, but not certificated, who could temporarily serve as an acting executive director on a short-term basis (long vacation; short hospitalization; etc.)
  - Maintain and update this list annually in the CCIU succession plan.

- **OSI Recommendation:** Publicly advertise all future administrative vacancies.

  **CCIU Plan of Action:** CCIU will fully consider this recommendation in any future case.

- **OSI Recommendation:** Seek the approval of PSERS before entering into any future emergency return to work contracts.

  **CCIU Plan of Action:** CCIU will comply with Section 8346 as written and/or as amended. On page 10 of the OSI report (fourth bullet), PSERS, itself, confirms for OSI that CCIU is not obligated to contact PSERS:

  "neither CCIU nor Mr. Baillie submitted any documentation to PSERS relative to an emergency employment agreement. However, under Section 8346(b), an employer is not required to do so."

  Therefore, the OSI's recommendation that CCIU "seek the approval of PSERS before entering into any future emergency return to work contracts" overrides Section 8346 and seeks to place obligations upon intermediate units and school districts which appear to circumvent the discretion statutorily granted to intermediate units and school districts by the code. The notion that either PSERS or PDE must approve an emergency that exists in the judgment of the employer is incorrect. No such requirement is contained in Section 8346 of the Retirement Code, and neither PSERS nor the Auditor General can change the law or enforce provisions that do not exist.

Therefore, the CCIU Board maintains that it has the right, and the obligation, under 24 Pa.C.S. § 8346 (b), to hire a retired employee in the event an emergency creates an increase in the work load such that there is serious impairment of service to the public or in the event of a under shortage of appropriate personnel without a commonwealth agency (PSERS) acting as a "super-Board" or second-guessing the sound exercise of the school district's or intermediate unit's board of directors' discretion. As a result, CCIU will continue to comply with Section 8346 as written or amended.

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- **OSI Finding II:** CCIU improperly used federal Medicaid funds administered by the Pennsylvania Department of Education to make capital improvements to the Downingtown Education Center.

  **CCIU Response:** CCIU respectfully disagrees with this finding. CCIU administration believed that the use of federal Medicaid School Based Access Program ("ACCESS") funds to make capital improvements to the Downingtown Educational Center to house programs for up to 250 children with a diagnosed mental illness or an emotional, social and/or behavioral disorder (the vast majority of whom have an individualized education plan (IEP) that indicates the need for special education services) was in keeping with the guidelines of the acceptable use of funds to move programs as stipulated on PDE's web site and as interpreted by CCIU's director of administrative services and as supported by CCIU staff interviews with OSI special agents.

  **Please note:** The program's move was necessitated by the Pennsylvania Department of Welfare's sale of the property on which these programs were formerly located. This forced closing of CCIU's program in Embreeville, Pennsylvania necessitated the CCIU relocating the programs for up to 250 children in less than a year, and presented the most viable of all options for relocation at the time.

**CCIU Plan of Action:** CCIU will fully implement the Auditor General's recommendations as follows:

- **OSI Recommendation:**
  - CCIU will strictly adhere to the regulations published by PDE on the use of ACCESS funds.
  - CCIU will seek approval before making any unusual expenditure with ACCESS funds.

**CCIU Action taken**

- The CCIU has transferred the $638,853.30 in question from the Building Improvement Fund (account number 146460045081) to the ACCESS Fund (account number 037460045081). This was done by the Chester County Intermediate Unit Board at its July Board meeting.
- CCIU will adhere to the regulations published by PDE on the use of ACCESS funds.
- In the future, CCIU will seek PDE's approval before making any unusual expenditures of ACCESS funds.

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- **OSI Finding III:** CCIU employees used CCIU credit cards to make improper purchases.

**CCIU Response:** CCIU respectfully disagrees with this finding. After reviewing the purchases in question, the CCIU concludes that it is not a question of improper purchases but of the inadvisable use of credit cards to pay for legitimate expenditures. While credit cards were used for legitimate expenditures, there were other, more appropriate, methods of payment available, i.e. purchase orders or direct billing of a third party.

For example, after investigating the eleven items questioned by the Auditor General in which CCIU staff used credit cards, the CCIU determined that seven purchases were reimbursed from funds collected prior to and at the time of the event by participants or event sponsor. However, the preferred method of payment would have been to either issue a purchase order for the items or have the corporate sponsor billed directly instead of using a CCIU credit card. Two were legitimate business expenses that also should have been paid by issuing a purchase order.

While Baillie inappropriately authorized an expenditure of $1,600.49, Baillie did later reimburse CCIU for $1,500 of that expense.

The CCIU has concluded that only one other credit card charge questioned by the Auditor General is not a proper expenditure. As a result, the staff member has been reprimanded and CCIU is taking steps to ensure that the misuse of credit cards does not happen again.

**CCIU Plan of Action:** CCIU will fully implement all the Auditor General's recommendations including, but not limited to:

- CCIU will amend Section 3.2 of CCIU's Statement of Procedure No. 0419.05 to include an annual recertification by all employees who are issued CCIU credit cards indicating they understand the rules of governing the use of CCIU credit cards.
- CCIU will amend Section 3.2 of CCIU's Statement of Procedure No. 0419.05 to include language to make it clear that purchase orders are the preferred method of procurement and that employees may be held personally liable for any personal use or other misuse of a CCIU-issued credit card.

- CCIU will establish a policy to prohibit the use of any CCIU funds for the purchase of the alcoholic beverages, or the reimbursement for such purchases.
- CCIU will establish a policy to prohibit the use of CCIU credit cards for entertainment purposes such as social luncheons, dinners, parties, receptions and similar social events. CCIU, however, retains the right to provide meals and refreshments at work meetings and workshops as deemed appropriate by the length of the meeting, and to host annual retirement/recognition events.

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**OSI Finding IV:** CCIU failed to report $12,000 per year that it paid to its former executive director as supplemental income and failed to withhold and pay taxes on such income.

**CCIU Response:** CCIU respectfully disagrees with this finding. CCIU believed that it properly reported the $12,000 to IRS by issuing an IRS 1099 Form to Baillie and an IRS 1096 Form to the IRS for the compensation in question (see back-up materials). Baillie declared the income on his 2005 and 2006 income tax schedules, as noted in a letter from Baillie's accountant, Mr. Jeffrey Lehman (see back-up materials).

During the 2007-08 school year, the CCIU did report the $12,000 properly and as stated by the OSI. The current executive director's (O'Brien) contract also has the $12,000 "expenses of the office" compensation correctly reported as payments made under a non-accountable plan and it was reported to all taxing authorities on O'Brien's 2007 W-2.

**CCIU Plan of Action:** CCIU will fully implement the Auditor General's recommendations as follows:

- CCIU will issue corrected IRS Forms W-2 to Baillie for 2006 and file the corrected forms with the IRS, the Pennsylvania Department of Revenue, and the appropriate local taxing authority.
- As noted above, CCIU changed this procedure and employees with this same benefit had the income reported on their 2007 W-2 Forms.

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**Conclusion**

Although the Chester County Intermediate Unit does **not** agree with the findings of the Auditor General's office, it believes the recommendations made by the Auditor General to be sound business and accounting practices and are ones which will enhance CCIU's procedures and policies. Therefore, CCIU will take under advisement all of the recommendations and implement them in whole or in part as set forth above in order to promote confidence in the CCIU's practices and to ensure compliance with the policies and procedures of the Chester County Intermediate Unit Board of Directors, the Pennsylvania Department of Education, the Pennsylvania State Employees Retirement System, and the laws of the Commonwealth of Pennsylvania.

# DEPARTMENT OF THE AUDITOR GENERAL'S COMMENTS ON CHESTER COUNTY INTERMEDIATE UNIT'S RESPONSE TO DRAFT REPORT

Although we commend CCIU for agreeing to implement most of our recommendations, we are disappointed that CCIU has expressed disagreement with our findings. In fairness to CCIU, we have reproduced its response in full in the preceding section of this report.[24] However, we have not been persuaded that the positions stated in CCIU's response warrant any material revisions or modification of the findings and discussion in the draft report that was sent to CCIU for comment, so this final version of the report is virtually identical to said draft. What follows is a rebuttal of the major points raised in CCIU's response.

The gist of CCIU's disagreement with Finding I is that its board has discretion under Section 8346 of the Public School Employees' Retirement Code to decide whether a true emergency exists that would justify the hiring of a retired employee, and that it should be able to exercise that discretion "without a Commonwealth agency acting as a 'super-IU Board' or second-guessing the sound exercise of the CCIU's discretion."

However, any exercise of discretion is always subject to review for soundness or abuse. The mere fact that the board sought the advice of its legal counsel and that the former Executive Director sought the verbal approval of a PSERS employee does not insulate the board's decision from later scrutiny. Quite obviously, PSERS, upon review of the facts and circumstances, decided to challenge the board's decision. In doing so, PSERS was not acting as a "super IU Board" nor was it "second-guessing" the exercise of the board's discretion. PSERS was merely carrying out its duty under the statute it is responsible for enforcing.

At the time that CCIU submitted its response to the draft report, litigation over the issue had already been commenced by Baillie to attempt to overturn the decision by PSERS to nullify Baillie's purported retirement and emergency return-to-work at CCIU. Because of the significance of this litigation to Finding I of this report, we decided to delay the issuance of this report until that litigation was resolved. The litigation has

[24] A draft copy of this report was also provided to Baillie for his review and comment, and his attorney submitted a separate response on his behalf. The bulk of his response takes issue with the factual and legal basis for Finding I. Because these issues have been resolved against Baillie by the decision of the Commonwealth Court dated April 30, 2010, they have been rendered moot, and we see no need to reproduce them or discuss them further. However, his separate response also takes issue with the manner in which some of Baillie's specific statements in his interview of August 6, 2008, are characterized in this report. We have addressed each of these criticisms by inserting footnotes at the appropriate places throughout the report. Accordingly, in the interest of brevity, we have not deemed it necessary to reproduce his separate response in its entirety.

recently reached a conclusion. The Commonwealth Court of Pennsylvania has vindicated our position in an opinion issued on April 30, 2010,[25] in which the Court held as follows:

> As explained in the [PSERS'] adjudication, PSERS would breach its fiduciary duty if it allowed a member to receive an annuity after returning to school service under circumstances that do not constitute an "emergency." The Intermediate Unit made the initial determination that an emergency existed; however, the final decision for matters affecting disbursements to annuitants must rest with PSERS. Otherwise, public school employers would have the final say in matters that have statewide implication and can affect the solvency of the fund. Accordingly, we hold that PSERS has the authority to review whether a public employer's decision to return a retired employee to work was, in fact, done on the basis of an emergency as defined in Section 8346(b) of the Retirement Code.[26]
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> * * *
>
> We hold that PSERS' construction and application of the Retirement Code to Baillie's retirement were correct. Baillie never separated from service, and he was not an annuitant when hired on an emergency basis. The dispositive issue is not whether the challenges facing the Intermediate Unit constituted a true emergency but, rather, whether a public school employee can effect a phony retirement in the middle of a contract period to achieve an increase in payouts by PSERS. Such retirement pre-planning has implications for all public school employers and the solvency of PSERS.[27]

Regarding our specific recommendation that CCIU should reconfigure its cabinet to provide for an assistant executive director, as is the practice in other intermediate units in Pennsylvania, we commend CCIU for its Plan of Action which is designed to accomplish the objective of the recommendation by alternative means. We also commend CCIU for its willingness to consider publicly advertising all future administrative vacancies. We regard these proposed measures, if exercised in good faith, as being within the spirit of our recommendations.

We are disappointed, however, that CCIU has balked at our recommendation that it should seek advance approval from PSERS before entering into any future emergency return-to-work contracts. Although the opinion of the Court does not address this issue, and the statute does not require it, it is obvious that the failure to obtain such advance approval from PSERS puts the employer at risk of having its decision to hire a retired employee challenged by PSERS after the fact, which is precisely what happened in this case. We believe that the better practice is to seek advance approval.

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[25] As no further appeal has been taken, the decision of the Commonwealth Court is the final disposition of the matter.

[26] *Dr. John K. Baillie v. Public School Employees' Retirement Board*, Commonwealth Court of Pennsylvania, No. 1306 C. D. 2009, decided April 30, 2010, slip opinion at pp. 10-11.

[27] Ibid., at p. 13.

The response to Finding II is puzzling in that CCIU contends that it disagrees with the finding that the use of $638,853.30 of ACCESS funds to make capital improvements is improper, yet it indicates that it has transferred that same amount of money from its Building Improvement Fund to reimburse its ACCESS Fund. By so doing, CCIU appears to be conceding that its use of the ACCESS funds was improper, while at the same time arguing that what it did was reasonable under the circumstances. We regard this as an argument that its use of the ACCESS funds for capital improvements should be forgiven due to extenuating and mitigating circumstances, not that such use of the funds was not improper. In any event, we commend CCIU for its commitment to strictly adhere in the future to the regulations published by PDE on the use of ACCESS funds and to seek PDE's approval before making any unusual expenditures of ACCESS funds.

In its response to Finding III, CCIU expresses disagreement with the characterization of the purchases in question as "improper" based on its further review of the specific instances set forth in the finding. CCIU contends that ". . . it is not a question of improper purchases but of the inadvisable use of credit cards to pay for legitimate expenditures." We have no desire to quibble over semantics, but the gist of the finding is that it is improper to use a CCIU credit card to pay for non-business related expenses even if CCIU is eventually reimbursed by the user of the credit card or other participants in an event. The better practice is to prohibit the use of CCIU-issued credit cards for such purchases altogether. By its pledge to fully implement all of our recommendations, we believe that CCIU has essentially agreed to prohibit the practice in the future.

Finally, CCIU's response to Finding IV expresses disagreement with the finding based on its interpretation of tax law to the effect that issuing an IRS Form 1099 is an acceptable substitute for reporting the questioned compensation on a W-2 form and withholding the appropriate taxes. We believe that our interpretation of the law as expressed in the finding is correct, and we commend CCIU for changing its procedure to conform with that interpretation.

Finally, we are gratified that CCIU has recognized that our recommendations reflect sound business and accounting practices, and we commend CCIU for its commitment to implement most of them or to institute other measures having an equivalent effect. The Department of the Auditor General will follow up at the appropriate time to ensure that our recommendations have been implemented.

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