

# PERFORMANCE AUDIT

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## Keystone Education Center Charter School Mercer County, Pennsylvania

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November 2015



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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EUGENE A. DePASQUALE  
AUDITOR GENERAL

Mr. Mike Gentile, Chief Executive Officer  
Keystone Education Center Charter School  
425 South Good Hope Road  
Greenville, Pennsylvania 16125

Mr. Todd Hedderick, Board President  
Keystone Education Center Charter School  
425 South Good Hope Road  
Greenville, Pennsylvania 16125

Dear Mr. Gentile and Mr. Hedderick:

We conducted a performance audit of the Keystone Education Center Charter School (Charter School) to determine its compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures (relevant requirements). We also evaluated the application of best practices in the areas of school safety and governing academics/student achievement. Our audit covered the period December 9, 2011 through September 10, 2015, except as otherwise indicated in the report. Additionally, compliance specific to state subsidies and reimbursements was determined for the school years ended June 30, 2011, 2012, 2013, and 2014. Our audit was conducted pursuant to Section 403 of The Fiscal Code, 72 P.S. § 403, and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found that the Charter School applied best practices and complied, in all significant respects, with relevant requirements, except as detailed in one finding noted in this report. A summary of the results is presented in the Executive Summary section of the audit report.

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

Mr. Mike Gentile  
Mr. Todd Hedderick  
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This is the second consecutive audit where we have questioned the Charter School's eligibility for state lease reimbursement. We urge the Pennsylvania Department of Education (PDE) to take immediate action and make a final written determination on related party lease agreements and whether this type of leasing arrangement is eligible for state reimbursement.

Sincerely,



Eugene A. DePasquale  
Auditor General

November 5, 2015

cc: **KEYSTONE EDUCATION CENTER CHARTER SCHOOL** Board of Trustees

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## **Executive Summary**

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### **Audit Work**

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

Our audit scope covered the period December 9, 2011 through September 10, 2015, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidies and reimbursements was determined for the 2011-12, 2012-13, and 2013-14 school years.

### **Charter School Background**

The Charter School, located in Mercer County, Pennsylvania, opened in August 1997. It was originally chartered on July 9, 1997, for a period of five years by the Greenville Area School District and Reynolds Area School District.

During the 2013-14 school year, the Charter School provided educational services to 251 pupils from 61 sending school districts through the employment of 26 teachers, 17 full-time and part-time support personnel, and 3 administrators. The Charter School received \$3,450,167 in tuition payments from school districts required to pay for their students attending the Charter School in the 2013-14 school year.

### **Charter School's Mission Statement**

The Charter School's mission states: "The Keystone Education Center was established to provide educational alternatives that address the needs of a variety of students who have difficulty functioning in the traditional public school environment. The intent of the Keystone Education Center Charter School is to afford students the opportunity to gain positive educational experiences, to earn a high school diploma, develop marketable skills, and develop the necessary work ethic needed for post high school success. The school will also address the behavioral and emotional need of each child."

### **Academic Performance**

The Charter School's academic performance is considered failing, as demonstrated by its low School Performance Profile (SPP) score of 36.3 in the 2013-14 school year. SPP is PDE's current method of providing a quantitative, academic score based upon a 100-point scale for all public schools. A score of 36.3 would be considered an "F" if using a letter grade system. Weighted data factors included in the SPP score are indicators of academic achievement, indicators of closing the achievement gap, indicators of academic growth, and other academic indicators such as attendance and graduation rates.

Previously, the Charter School did not make Adequate Yearly Progress (AYP) for the 2011-12 school year and was in a "Corrective Action II" status. AYP was a key measure of school performance established by the federal No Child Left Behind Act (NCLB) of 2001 requiring that all students reach proficiency in Reading

and Math by 2014. For a school to meet AYP measures, students in the school needed to meet goals or targets in three areas: (1) Attendance (for schools that did not have a graduating class) or Graduation (for schools that had a high school graduating class), (2) Academic Performance, which was based on tested students' performance on the Pennsylvania System of School Assessment (PSSA), and (3) Test Participation, which was based on the number of students that participated in the PSSA. Schools were evaluated for test performance and test participation for all students in the tested grades (3-8 and 11) in the school. AYP measures determined whether a school was making sufficient annual progress towards statewide proficiency goals. On August 20, 2013, Pennsylvania was granted a waiver from the NCLB's requirement of achieving 100 percent proficiency in Reading and Math by 2014, so AYP measures were discontinued beginning with the 2012-13 school year.

### **Audit Conclusion and Results**

Our audit found that the Charter School applied best practices and complied, in all significant respects, with relevant requirements, except for one compliance related matter reported as a finding.

**Finding: Charter School May Have Improperly Received \$155,411 in State Lease Reimbursements in Violation of the Public School Code.** Our audit found that between July 1, 2010 and June 30, 2014, the Charter School may have improperly received \$155,411 in state lease

reimbursements resulting from related party landlord/tenant agreements between the Charter School and a for-profit entity that the Charter School's former Executive Director founded and was simultaneously holding the position of President (see page 12).

**Status of Prior Audit Findings and Observations.** With regard to the status of our prior audit recommendations to the Charter School, we found the Charter School had not taken appropriate corrective action in implementing our recommendations pertaining to the lease reimbursement subsidies (see page 16) and the reporting of special education (see page 17). The Charter School did not implement our recommendations regarding the failure to approve Board of Trustees' (Board) salaries (see page 18), as well as the recommendations made regarding the possible violations of the Public Official and Employee Ethics Act (Ethics Act) (see page 18) and the controls over its student record data (see page 20).<sup>1</sup>

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<sup>1</sup> In February 2013, Pennsylvania was one of many states that applied for flexibility from NCLB standards, which was granted by the U.S. Department of Education on August 20, 2013. The waiver eliminates AYP for all public schools and replaces it with a federal accountability system specific to Title I schools only (those with a high percentage of low-income students), which identifies Title I schools as "Priority," "Focus," "Reward," or "No Designation" schools. Beginning in 2012-13, all public school buildings received a SPP score.

## Background Information on Pennsylvania Charter Schools

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### *Description of Pennsylvania Charter Schools:*

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

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

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

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

### **Pennsylvania Charter School Law**

Pennsylvania's charter schools were established by the Charter School Law (CSL), enacted through Act 22 of 1997, as amended. In the preamble of the CSL, the General Assembly stated its intent to provide teachers, parents, students, and community members with the opportunity to establish schools that were independent of the existing school district structure.<sup>2</sup> In addition, the preamble provides that charter schools are intended to, among other things, improve student learning, encourage the use of different and innovative teaching methods, and offer parents and students expanded educational choices.<sup>3</sup>

The CSL permits the establishment of charter schools by a variety of persons and entities, including, among others, an individual; a parent or guardian of a student who will attend the school; any nonsectarian corporation not-for-profit; and any nonsectarian college, university or museum.<sup>4</sup>

Applications must be submitted to the local school board where the charter school will be located by November 15 of the school year preceding the school year in which the charter school will be established,<sup>5</sup> and that board must hold at least one public hearing before approving or rejecting the application.<sup>6</sup> If the local school board denies the application, the applicant can appeal the decision to the State Charter School Appeal Board,<sup>7</sup> which is comprised of the Secretary of Education and six members appointed by the Governor with the consent of a majority of all of the members of the Senate.<sup>8</sup>

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<sup>2</sup> 24 P.S. § 17-1702-A.

<sup>3</sup> *Id.*

<sup>4</sup> 24 P.S. § 17-1717-A(a).

<sup>5</sup> *Id.* § 17-1717-A(c).

<sup>6</sup> *Id.* § 17-1717-A(d).

<sup>7</sup> *Id.* § 17-1717-A(f).

<sup>8</sup> 24 P.S. § 17-1721-A(a).

With certain exceptions for charter schools within the School District of Philadelphia, initial charters are valid for a period of no less than three years and no more than five years.<sup>9</sup> After that, the local school board can choose to renew a school's charter every five years, based on a variety of information, such as the charter school's most recent annual report, financial audits, and standardized test scores. The board can immediately revoke a charter if the school has endangered the health and welfare of its students and/or faculty. However, under those circumstances, the board must hold a public hearing on the issue before it makes its final decision.<sup>10</sup>

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

*Funding of Pennsylvania Charter Schools:*

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

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

### **Pennsylvania Charter School Funding**

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

<sup>9</sup> 24 P.S. § 17-1720-A.

<sup>10</sup> PDE, Basic Education Circular, "Charter Schools," Issued 10/1/2004.

<sup>11</sup> 24 P.S. §§ 17-1703-A, 17-1741-A *et seq.*

<sup>12</sup> 24 P.S. § 17-1745-A(d).

<sup>13</sup> *Id.* § 17-1745-A(f)(4).

<sup>14</sup> 24 P.S. § 17-1741-A(a)(3).

<sup>15</sup> 24 P.S. § 17-1750-A(e).



for the prior school year.<sup>16</sup> For special education students, the same funding formula applies, plus an additional per-pupil amount based upon the sending district's special education expenditures divided by a state determined percentage specific to the 1996-97 school year.<sup>17</sup> The CSL also requires that charter schools bill each sending school district on a monthly basis for students attending the Charter School.<sup>18</sup>

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

Under the Public School Code (PSC) of 1949, as amended, the Commonwealth also pays a reimbursement to each sending school district with students attending a charter school that amounts to a mandatory percentage rate of total charter school costs.<sup>19</sup> Commonwealth reimbursements for charter school costs were funded through an education appropriation in the state's annual budget. However, the enacted state budget for the 2011-12 fiscal year eliminated funding of the Charter School reimbursement previously paid to sending school districts.<sup>20</sup>

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<sup>16</sup> See 24 P.S. § 17-1725-A(a)(2).

<sup>17</sup> See *Id.* §§ 17-1725-A(a)(3); 25-2509.5(k).

<sup>18</sup> See 24 P.S. § 17-1725-A(a)(5).

<sup>19</sup> See 24 P.S. § 25-2591.1. Please note that this provision is contained in the general funding provisions of the PSC and not in the CSL.

<sup>20</sup> Please note that the general funding provision referenced above (24 P.S. § 25-2591.1) has not been repealed from the PSC and states the following: "For the fiscal year 2003-2004 and each fiscal year thereafter, if insufficient funds are appropriated to make Commonwealth payments pursuant to this section, such payments shall be made on a pro rata basis." Therefore, it appears that state funding could be restored in future years.

## Audit Scope, Objectives, and Methodology

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### Scope

*What is a school performance audit?*

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

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

Our audit covered the period December 9, 2011 through September 10, 2015. In addition, the scope of each individual audit objective is detailed below.

Regarding state subsidies and reimbursements, our audit covered the 2010-11, 2011-12, 2012-13, and 2013-14 school years.

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

### Objectives

*What is the difference between a finding and an observation?*

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

Performance audits draw conclusions based on an evaluation of sufficient, appropriate evidence. Evidence is measured against criteria, such as laws, regulations, third-party studies and best business practices. Our audit focused on assessing the Charter School's compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures. Our audit focused primarily on whether the Charter School was in compliance with the PSC<sup>21</sup> and the CSL.<sup>22</sup> More specifically, we sought to determine answers to the following questions, which serve as our audit objectives:

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

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<sup>21</sup> 24 P.S. § 1-101 *et seq.*

<sup>22</sup> 24 P.S. § 17-1701-A *et seq.*

To address this objective:

- Auditors reviewed the approved charter and any amendments.
- In addition, auditors reviewed board policies and procedures, IRS 990 forms for the 2011 and 2012 calendar years, and charter school annual reports for the 2011-12, 2012- 13, and 2013-14 school years.

Ü Did the Charter School receive state reimbursement for its building lease under the Charter School Lease Reimbursement Program administered by PDE, was its lease agreement approved by its Board, and did its lease process comply with the provisions of the Ethics Act?<sup>23</sup>

- To address this objective, auditors reviewed building ownership documentation, the lease agreement, lease payments, and the Charter School's lease documentation filed with PDE to obtain state reimbursement for the 2010-11, 2011-12, 2012-13, and 2013-14 school years.

Ü Were the Charter School's Board and administrators free from apparent conflicts of interest and in compliance with the CSL, the PSC, the Ethics Act, and the Sunshine Act?

- To address this objective, auditors reviewed Statements of Financial Interest for all board members and administrators, board meeting minutes, management company contract(s), and any known outside relationships with the Charter School and/or its authorizing school districts for the 2011 through 2014 calendar years.

Ü Were at least 75 percent of the Charter School's teachers properly certified pursuant to Section 1724-A of the CSL, and did all of its noncertified teachers in core content subjects meet the "highly qualified teacher" requirements under the federal NCLB Act of 2001?

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<sup>23</sup> 65 Pa.C.S. § 1101 *et seq.*

- To address this objective, auditors reviewed and evaluated certification documentation and teacher course schedules for all teachers and administrators for the period August 2014 through June 2015.

ü Did the Charter School require its non-certified professional employees to provide evidence that they are at least 18 years of age, a U.S. citizen, and certified by a licensed Pennsylvania physician to be neither mentally nor physically disqualified from successful performance of the duties of a professional employee of the Charter School?

- To address this objective, auditors reviewed personnel files and supporting documentation for all non-certified professional employees for the 2014-15 school year.

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

To address this objective:

- Auditors selected 6 out of the 61 sending school districts to review charter school tuition rates and tuition billings for the 2013-14 school year.
- In addition, auditors reviewed the Charter School's membership reports, instructional time summaries, entry/withdrawal procedures, and supporting documentation for the 2013-14 school year.
- Furthermore, auditors conducted interviews, completed an internal control questionnaire, and reviewed documentation to determine whether the stated controls regarding membership data reported to PDE through the Pennsylvania Information Management System (PIMS) were implemented as part of our membership review for the 2013-14 school year.

- Ü Did the Charter School provide its employees with a retirement plan, such as the Public School Employees' Retirement System (PSERS), as required by Section 1724-A(c) of the CSL,<sup>24</sup> and were employees enrolled in PSERS eligible to receive plan benefits?

To address this objective:

- Auditors reviewed the approved charter and any amendments.
- In addition, auditors reviewed board meeting minutes, personnel listings, payroll reports, and PSERS wage reports for all employees for the 2013-14 school year.

- Ü Did the Charter School take appropriate steps to ensure school safety?

- To address this objective, auditors reviewed deficiencies found in the last audit and determined whether they had been addressed.

- Ü Did the Charter School's Board and administration maintain best practices in governing academics and student achievement by developing and executing a plan to improve student academic performance at its failing school building(s)?

To address this objective:

- Auditors considered a variety of school level academic results for the 2007-08 through 2012-13 school years to determine if the Charter School is meeting statewide academic standards established by PDE.<sup>25</sup>
- Once it was determined that the Charter School was not meeting statewide standards

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<sup>24</sup> 24 P.S. § 17-1724-A(c).

<sup>25</sup> Academic data for the District and its school buildings included a five year trend analysis of AYP results from 2007-08 through 2011-12. PSSA results in Math and Reading for the "all students" group for 2011-12 and 2012-13. School Performance Profile scores for 2012-13, and federal accountability designations (i.e. Priority, Focus, Reward, and No Designation) for Title I schools for 2012-13. All of the academic data standards and results we examined originated with PDE.

and was considered failing, further review was conducted. This review consisted of conducting interviews with the Chief Executive Officer and any other designated employees and reviewing required School Improvement Plans for the 2014-17 school years to determine if the Charter School has established goals for improving academic performance, is implementing those goals, and is appropriately monitoring the implementation of those goals.

Ü Did the Charter School take appropriate corrective action to address recommendations made in our prior audit?

To address this objective:

- Auditors interviewed Charter School administrators to determine whether they had taken corrective action.
- Auditors then reviewed documentation to verify that the administration had implemented the prior audit report's recommendations and/or physically observed these changes in person.

## Methodology

### *What are internal controls?*

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

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

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

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

implemented. Any deficiencies in internal controls that were identified during the conduct of our audit and determined to be significant within the context of our audit objectives are included in this report.

Our audit examined the following:

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

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

To determine the status of our audit recommendations made in a prior audit report released on June 7, 2013, we reviewed the Charter School's response to PDE dated June 13, 2013. We then performed additional audit procedures targeting the previously reported matters.

## Findings and Observations

### Finding

### **Charter School May Have Improperly Received \$155,411 in State Lease Reimbursements in Violation of the Public School Code which includes a possible related-party transaction. This is a repeat finding that resulted in the Ethics Commission’s Determination of Noncompliance with the state’s Ethics Act in 2013.**

*Criteria relevant to the finding:*

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

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

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

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

Our audit of the Charter School found that between July 1, 2010 and June 30, 2014, the Charter School may have improperly received \$155,411 in state lease reimbursements resulting from related-party landlord/tenant agreements between the Charter School and a for-profit entity that the Charter School’s former Executive Director founded and was simultaneously holding the position of President (hereinafter referred to as “Landlord”). In addition, the Charter School’s Director of Finance simultaneously holds the position as Secretary for the Landlord.

Under PDE’s eligibility requirements, which are based on Section 2574.3(a) of the PSC, buildings owned by a charter school do not qualify for compensation under the Reimbursement for Charter School Program. Because the Charter School’s former Executive Director and Director of Finance were simultaneously holding positions with the Landlord from which the Charter School was leasing educational space during the audit period, we conclude that the landlord/tenant agreements between related parties resulted in the Charter School having ownership interest in the building, which would make the Charter School ineligible to receive state lease reimbursements, detailed as follows:

<b>School Year</b>	<b>Amount Received</b>
2010-11	\$ 42,589
2011-12	36,603
2012-13	38,351
2013-14	<u>37,868</u>
<b>Total</b>	<b><u>\$155,411</u></b>



*Criteria relevant to the finding (continued):*

Charter School Lease Reimbursement Program directives from Bureau of Budget and Fiscal Management, PDE, state, in part:

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

This issue is an ongoing concern from our prior audit. After our prior audit, the State Ethics Commission determined, on January 28, 2013, that a violation of the Public Official and Employee Ethics Act occurred when the former Executive Director approved rental payments as both President of the Charter School Board and as President of the for-profit entity.

We found that the former Executive Director resigned as a member of the Charter School’s Board during a meeting on January 14, 2010. At the same meeting, the Charter School’s Executive Director position was eliminated with an effective date of September 30, 2014; however, he remained as President of the for-profit entity.

Furthermore, we found that these landlord/tenant agreements may have been improperly awarded by the Charter School because of potential conflicts of interest and the reasonable likelihood that these transactions could result in direct or indirect financial benefits received by the Charter School’s former Executive Director and Secretary individually, as well as the Landlord, a business entity with which they were associated.

While the Charter School applied for and received state reimbursement under the Commonwealth’s Lease Reimbursement Program, our audit found that the Charter School may not have been eligible to receive these state reimbursements for the following reasons: (1) potential conflicts of interest surrounding the Charter School’s process for approving and awarding its lease agreements to a related-party; (2) the possibility of a direct and/or indirect financial gain and/or ownership interest by the Charter School’s former Executive Director and/or Director of Finance, two individuals holding key roles with both the Charter School and the Landlord; and (3) ownership interest in the building due to the fact that two individuals holding key roles with both the Charter School and the Landlord also act as decision makers for both entities.

### **Recommendations**

The *Keystone Education Center Charter School* should:

1. End the practice of leasing its permanent education buildings to itself and cease applying for payment from

the Reimbursement for Charter School Lease Program for these buildings.

2. Request that its solicitor provide a detailed summary of all the Charter School's legal requirements under the PSC and CSL.

The *Pennsylvania Department of Education* should:

3. Take immediate steps to require the Charter School to repay the \$155,411 owed to the Commonwealth for the improper reimbursement it received from the Reimbursement for Charter School Lease Program.
4. Cease from making future payments to the Charter School under the Reimbursement for Charter School Lease Program if the Charter School continues to lease space from a related-party entity for which it shares ownership interest and common officers.

### **Management Response**

Management stated the following:

“Management does not concur with the finding and will continue to apply for these funds until written documentation is provided from the Pennsylvania Department of Education stating that the Charter School does not qualify for reimbursement. Section 2574.3 of the Public School Code of 1949, as amended, provides that rent payments on leases of buildings or portions of buildings for a charter school use, which have been approved by the Secretary of Education, shall have the annual rent payable to the lease, reimbursed. For a charter school to qualify for the reimbursement under the legislation the school must be a Pennsylvania approved charter school and have a signed lease agreement for rent of a building and the building is used for educational purposes.

In accordance with the requirements of the Department of Education's lease reimbursement program, Keystone completed forms PDE-418 and 419 for years 2012-13 and 2013-14 and 2014-15, to obtain reimbursement for rent paid. The Auditor General was provided copies of Keystone's PDE-418 and 419 for all three years. Consequently, the Auditor General is fully aware that the

lease agreements were submitted to the Department of Education along with the copy of the deed for the leased premises and the names of every Keystone Board member. Based upon all the information provided by Keystone to the Department of Education's review of the information, the rent reimbursement was approved. The parties to the lease agreement were at times extensively disclosed in the documents submitted to the Department of Education as well in Keystone's records including those provided to the Auditor General and numerous other state and federal government agencies since our inception. At no time in the history of Keystone did the Charter School "improperly receive" any funds including lease reimbursements."

### **Auditor Conclusion**

We understand that PDE has not made a final determination regarding the rental reimbursement funding for the Charter School. Until such time, that PDE provides a final determination, our Department will continue to question the appropriateness of such funding due to the less than arm's length relationship between the Charter School and the Landlord. More specifically, the Director of Finance for the Charter School continues to be employed by the landlord.

## Status of Prior Audit Findings and Observations

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Our prior audit of the Charter School released on June 7, 2013, resulted in three reported findings and two observations. As part of our current audit, we determined the status of corrective action taken by the Charter School to implement our prior recommendations. We performed audit procedures and interviewed the Charter School's personnel regarding the prior findings and observations. As shown below, we found that the Charter School did implement some recommendations but didn't implement others.

### Auditor General Performance Audit Report Released on June 7, 2013

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**Prior Finding No. 1: Charter School May Have Improperly Received \$85,375 in State Lease Reimbursements in Violation of the Public School Code for the 2008-09 and 2009-10 School Years**

Prior Finding Summary:

Our prior audit finding found that the Charter School may not have been eligible to receive these reimbursements because of possible conflicts of interest surrounding the Charter School's process for approving and awarding its lease agreements to a related party and the possibility of a direct and/or indirect financial gain and/or ownership interest by two individuals holding key roles with both the Charter School and Landlord.

Prior Recommendations:

Our prior audit finding recommended that the Charter School:

1. End the practice of leasing its permanent education buildings to itself and cease applying for payment from the Reimbursement for Charter School Lease Program for these buildings.
2. Ensure that its solicitor review and approve the terms of all and any reimbursement prior to submitting an application.
3. Request that its solicitor provide a detailed summary of all the Charter School's legal requirements under the PSC and CSL.

We also recommended that the *Pennsylvania Department of Education*:

4. Take immediate steps to require the Charter School to repay the \$83,670 owed to the Commonwealth for the improper reimbursement it received from the Reimbursement for Charter School Lease Program.

5. Cease from making future payments to the Charter School under the Reimbursement for Charter School Lease Program if the Charter School continues to lease space from a related party entity for which it shares ownership interest and common officers.

Current Status:

During our current audit, we found that the Charter School did not implement the first recommendation because their solicitor considers the reimbursement to be allowable. The second and third recommendations were followed as the solicitor reviewed the arrangement and considered the arrangement to be proper (as discussed in a letter to the Superintendent of Reynolds School District) and discussed these issues with the Board at the meeting of June 13, 2013.

PDE did not follow our recommendations as they did not demand repayment from the Charter School and have continued to make lease reimbursements to the school.

Refer to the finding in this report for additional information.

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**Prior Finding No. 2:**

**Failure to Report Special Education Student Information in the Annual Report**

Prior Finding Summary:

Our prior audit finding found that the Charter School failed to include the required special education student information as prescribed by Chapter 711 Special Education Regulations in its annual charter school report required to be filed with PDE for the 2008-09, 2009-10, and 2010-11 school years.

Prior Recommendations:

Our prior audit finding recommended that the Charter School:

Ensure that all required special education information is included in its annual report.

We also recommended that the *Pennsylvania Department of Education*:

Revise the electronic form called eStrat Planner Tool to specifically address the submission of the student data as required under 711.6(c).

Current Status:

During our current audit, we found that neither the Charter School nor PDE implemented our recommendations. The Charter School did not provide all the information again in the 2013-14, 2012-13, and 2011-12 Annual Reports. However, the Charter School's Administrative Assistant who inputs the information indicated that PDE still does not require the information to be reported in that particular manner and PDE's Bureau of Special Education has no issues with the Charter School's reporting. We again recommend that PDE change their template to have charter schools include the required information.

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**Prior Finding No. 3:**

**Failure to Approve Professional Salaries by Board of Trustees**

Prior Finding Summary:

Our prior audit of professional salaries for the 2009-10 school year found that the compensation for professional employees was not approved by the Charter School's Board as required by the CSL.

Prior Recommendations:

Our prior audit finding recommended that the Charter School:  
  
Ensure that the Board approves individual professional salaries at an open board meeting.

Current Status:

During our current audit, we found that the Charter School did implement our recommendation. A sample of the board meeting minutes from the May 9, 2013, meeting is included in the work papers.

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**Prior Observation No. 1**

**Possible Conflict of Interest Violations of the Ethics Act**

Prior Observation Summary:

Our prior audit observation found that the Executive Director of the Charter School was president of the company which rents classroom space to the Charter School. Also, the Charter School employs various members of the Executive Director's family in different professional capacities. In addition, the Charter School purchased meals for its food service program from the Reynolds School District. One of the Charter School's board members is the superintendent of that school district and did not abstain from voting on this decision.

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Prior Recommendations:

Our prior audit observation recommended that the Charter School:

1. Ensure that all contracts involving potential conflicts of interest are properly disclosed and awarded pursuant to the requirements of the Ethics Act.
2. Ensure that all contracts valued at \$500 or more with a business for which officials or employees of the Charter School are associated be reviewed and approved by the Board with proper documentation for potential conflicts of interest.
3. Establish policies and procedures regarding the Board's responsibilities for the approval and disclosure process related to contracts with businesses for which the Charter School's officials or employees are associated.
4. Ensure public disclosure of all contracts awarded during board meetings.

We also recommended that the *State Ethics Commission* should determine if the Ethics Act has been violated by:

5. Reviewing the Charter School Executive Director's influence over contracts for lease agreements and rental payments between the Charter School and the Landlord.
6. Reviewing the employment status of various members of the Executive Director's immediate family at the Charter School.

Current Status:

During our current audit, we found that the Charter School did implement our recommendations. All contracts are discussed and approved by the Board (sample from board meeting of June 13, 2013, included in work papers) and the Charter School does have a conflict of interest policy.

The Ethics Commission also followed our recommendations, and their report is included.

Regarding the food service issue, we reiterate that it is our position that the Reynolds School District's Superintendent should abstain from voting on issues involving that school district.

**Prior Observation No. 2      Keystone Education Center Charter School Lacks Sufficient Internal Controls Over Its Student Record Data**

Prior Observation Summary:

Our prior audit observation found that Charter School personnel exported student membership information to PIMS by school, instead of a blanket membership export via the PIMS Export Utility. As a result, membership days for a specific program were unintentionally excluded from this export to PIMS and school districts whose students are enrolled in this program were not given proper credit for membership days while they were in the program.

Prior Recommendations:

Our prior audit observation recommended that the Charter School: Perform an internal audit of its subsequent years' PIMS data submissions to ensure adequate procedures are in place to verify all student membership days are reported to PIMS and to make adjustments as needed.

Current Status:

During our current audit, Charter School staff indicated that the Charter School implemented procedures to have two employees enter the data to check each other and have each district confirm membership on a monthly basis.



## Distribution List

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

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Harrisburg, PA 17120

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