LIMITED PROCEDURES ENGAGEMENT

ASPIRA-Managed Charter Schools

Philadelphia County, Pennsylvania

May 2018

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

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Ms. Andrea Gonzalez-Kirwin
Superintendent
ASPIRA-Managed Charter Schools
4322 North 5th Street, 3rd Floor
Philadelphia, Pennsylvania 19140

Ms. Jennifer Albandoz
Chairman of the Board
ASPIRA-Managed Charter Schools
4322 North 5th Street, 3rd Floor
Philadelphia, Pennsylvania 19140

Dear Ms. Gonzalez-Kirwin and Ms. Albandoz:

We conducted a Limited Procedures Engagement (LPE) of the ASPIRA-Managed Charter Schools (Charter Schools) to evaluate the application of best practices in the areas of governance and finances and to determine their compliance with certain relevant state laws, regulations, policies, and administrative procedures (relevant requirements).[1] The LPE covers the period July 1, 2013, through June 30, 2016, except as otherwise indicated in the scope, objective, and methodology section of the report. The engagement was conducted pursuant to authority derived from Article VIII, Section 10 of the Constitution of the Commonwealth of Pennsylvania and The Fiscal Code (72 P.S. §§ 402 and 403), but was not conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our LPE procedures included a review of the following areas: governance, financial stability, contracting, lease agreements, and payments for senior administrators and to the Public School Employees' Retirement System (PSERS) and for buyouts for senior administrators. The results of our review are detailed in our eight findings noted in this audit report. A summary of the results is presented in the Executive Summary section of the report.

[1] Including Antonia Pantoja Charter School, Aspira Bilingual Cyber Charter School, Eugenio Maria de Hostos Charter School, John B. Stetson Charter School, and Olney Charter High School.

Our eight findings and related recommendations have been discussed with the Charter School's management, and their responses are included after each finding. Additional management comments can be found in Appendix B of this report. We believe the implementation of our recommendations will improve the Charter School's operations and facilitate compliance with legal and other relevant requirements. We appreciate the Charter School's cooperation during the course of the review.

Sincerely,

Eugene A. DePasquale
Auditor General

May 21, 2018

cc: **ASPIRA-MANAGED CHARTER SCHOOLS** Board of Trustees

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EXECUTIVE SUMMARY Aspira-Managed Charter Schools July 1, 2013 through June 30, 2016	
Finding No. 1 ***Lack of Governance***	***The Boards did not fulfill their duty to govern the Charter Schools, allowing Aspira, Inc. to manage their public school funds without sufficient accountability.*** • The Boards provided weak to non-existent oversight of contracts, did not solicit bids, and did not properly approve or monitor budgets. • In 2015 and 2016, other than the management agreements with Aspira, Inc., no vendor contracts were approved by the Boards in open and public board meetings. • The Boards were nearly identical, held one meeting for all five schools, and lacked independence from Aspira, Inc. and each other. • Required Pennsylvania Ethics Commission's financial disclosure forms were not filed for most board members and senior administrators. Those that were filed were not timely. • The Charter Schools lacked transparency about financial activities and budgets on the schools' shared website.
Finding No. 2 ***Declining Financial Position***	***Reduced revenues, persistent operating deficits, poor cash flow, & overspent budgets caused the Charter Schools' combined General Fund Balance to plummet from $7.7 million in 2014 to $(419,000) in 2016.*** • Because of downward adjustments in both fiscal years 2015 and 2016 to the per-student tuition rates paid by the School District of Philadelphia, revenues dipped slightly despite steady or slightly increased enrollments. • From fiscal years 2014 to 2016, the Charter Schools realized a sharp drop in their collective General Fund balances from positive $7.7 million to negative $419,000. • In fiscal years 2015 and 2016, the Charter Schools' operations yielded collective net deficits of $2.3 million and $4.7 million, respectively. • Although revenues decreased in fiscal year 2016, payments for fees, costs, and expenses to Aspira, Inc. for management services spiked nearly 80 percent from $7 million in 2015 to $13 million in 2016.

	• In all three years, most of the Charter Schools overspent their budgeted expenditures. In fiscal year 2016, 4 of 5 schools overspent their budgeted expenditures netting a total over-expenditure for the five schools of approximately $5.3 million. • By June 30, 2016, all five Charter Schools had poor liquidity, with a current ratio ranging from 0.2 to 1.6, and were at risk of having insufficient funds to meet their current obligations. • With a current ratio of 0.2, Aspira, Inc.'s liquidity was even worse than the Charter Schools, and the schools' financial risks were exacerbated by their ties to the management company, including their pledged collateral to secure the management company's delinquent debt.
Finding No. 3 ***Weak Management Agreements & Poor Record-Keeping***	***A poor organizational structure, weak management agreements, and lack of board oversight allowed Aspira, Inc. to control all school revenues and expenditures—including payments to itself—with little documentation to support charges to the schools.*** • Broad, vague management agreements did not require accountability of the management company, allowing Aspira, Inc. to control all of the Charter Schools' revenues and expenditures, including payments to itself for fees, costs, and expenses that it charged for management services. • While the Charter Schools' collective financial position declined, the fees, costs, and expenses charged for management services spiked. In just one year, payments for management services increased from $7.2 million to $12.9 million from 2015 to 2016. • The Superintendent was an employee of Aspira, Inc. and occupied offices at its own headquarters. Unlike senior officials at other public charter schools and school districts, Aspira Inc.'s Superintendent was not a public official and was not required to be as accountable to the public. • In 2016, total fees, costs, and expenses for management services charged to each Charter School ranged between 19.3 percent and 28.8 percent of their respective revenues. • Numerous charges to the schools, including intercompany transactions, **lacked supporting documentation to verify whether charges to the schools were valid, appropriate, and accurate**. • One component of the management fees, called *direct services*, included allocations of the salaries and benefits of more than 100 Aspira, Inc. employees, and these allocations were not

	sufficiently documented and monitored by the schools, leaving the schools vulnerable to paying for costs they did not directly incur. • Because the Superintendent and all senior administrators were employees of Aspira, Inc. and not the charter schools, they were not bound by the CSL, were not public officials, and were therefore able to circumvent certain provisions of the CSL and other pertinent statutory provisions governing school officials and their activities. • Because all senior administrators were employees of Aspira, Inc. AND because of the poor accounting records maintained by Aspira, Inc. on behalf of the schools, there was no way to verify whether the schools directly or indirectly paid for contract buyouts or other types of settlements with Aspira, Inc. employees.
Finding No. 4 ***Risky Collateralization of Aspira, Inc.'s Delinquent Debt***	***The charter schools pledged revenues and net assets to secure Aspira, Inc.'s debt, and most of that debt was unpaid and past due.*** • As of June 30, 2016, Aspira, Inc. and its subsidiaries owed more than $17 million in long-term debt, and most of it was past due and in forbearance. By December 2017, the forbearance deadline had expired and the debt was at risk of foreclosure, although management said the bank had extended the forbearance deadline to December 31, 2018. • More than $14 million, or 81.7 percent, of that debt was secured with pledged collateral of the Charter Schools, putting their own revenues and net assets at risk if the borrowers defaulted. • In their own financial statements, the Charter Schools did not publicly disclose their collateralization of the related party debt. • There were no records of the Boards' authorizing the Charter Schools to pledge their collateral—public school resources—to secure the debt of Aspira, Inc. • Aspira, Inc.'s debt was largely mortgage debt on school buildings, which were leased by the Charter Schools. While most of the lease costs paid by the schools were based on Aspira Inc.'s debt service, the management company was not required to use the lease payments received to pay down the debt. • A promissory note owed by Aspira, Inc. to Olney with a balance of $2.3 million on June 30, 2016, was signed by the CEO of Aspira, Inc., but it was not signed by any school officials, nor was it authorized by the Board.

Finding No. 5 ***Lawsuit Settlement & Nonpublic Payout with Public Funds***	***A lump sum of $210,000 paid by Pantoja Charter School to a former administrator was not properly board authorized, not part of an employment contract, and may have been part of a lawsuit settlement involving Aspira, Inc.'s CEO.*** • According to Pantoja's accounting records, a $210,000 lump sum payment to a former administrator—shortly after Aspira, Inc. settled a lawsuit with the same former administrator for $350,000—could not be explained by officials other than to say that the school's insurance company paid for the lump sum payment. • Because of a new organizational structure effective in fiscal year 2015, all senior administrators beyond principals were employees of Aspira, Inc. rather than the Charter Schools. Because of this new, less transparent structure ***and*** Aspira, Inc.'s poor record-keeping practices, it will be impossible to determine whether public funds are being used to pay senior administrators or other employees of the management company to settle lawsuits.
Finding No. 6 ***Poor Procurement & Monitoring of Educational Program Contracts***	***Olney's Board and Administration failed to meet their fiduciary duties by ineffectively procuring and monitoring related party contracts for educational services.*** • When an educational support program for Olney high school students was moved to the Campus building where Hostos (grades K-8) and Cyber (K-12) operated, none of the Boards were notified or provided authorization. • In fiscal year 2016, Olney started paying rent for space at the Campus building, even though its charter expired as of June 30, 2016. The lease for the Campus space extended until at least 2021. Therefore, the school itself might still have been obligated to pay Aspira, Inc. even if its charter wasn't renewed. • The contracts governing two educational support programs were not board-authorized and contained flawed terms, resulting in a lack of transparency about the costs borne by Olney. • The procurement of the contracts related to two educational support programs, which cost $5.2 million in the three-year review period, was not open and public, resulting in significant cost fluctuations. Also, because of related-party issues, the contracts may have resulted in conflicts of interest.

Finding No. 7 ***Executive Sessions Not in Compliance with Sunshine Act***	***The Charter Schools' Boards may have repeatedly failed to comply with the Sunshine Act when conducting their executive sessions.*** • In the three-year period ending June 30, 2016, 63 percent of the executive sessions did not comply with the Sunshine Act because they were held without the required public announcement. • Of those executive sessions that were announced, the stated reasons for several of those sessions were not allowable under the Sunshine Act.
Finding No. 8 ***Financial Reporting Errors***	***The Charter Schools' Audited Annual Financial Statements Contained Errors, Omissions, and Inconsistencies.*** • In its fiscal year 2016 financial statements, Stetson mistakenly overstated its beginning General Fund balance by more than \$550,000 by erroneously using fiscal year 2015's beginning fund balance rather than its ending balance. • In fiscal year 2016, four of the five schools failed to fully disclose in the notes to the financial statements what they paid to Aspira for management services by more than \$1.3 million, or 10 percent of total management fees of \$13 million. • Olney failed to disclose its related party lease, costing \$320,000 annually, to rent part of the third floor at the Campus building. • In all three years' annual financial statements, each Charter School, except for Stetson, failed to disclose that it had pledged revenues and net assets to secure a \$12.75 million related party mortgage loan. • Pantoja was a guarantor of two separate loans on its school building; however, it failed to disclose its guarantee of one of the loans, which had a balance of \$1.2 million on June 30, 2016.

Background Information

What are the Aspira-Managed Charter Schools?

The following five charter schools (Charter Schools), which are the subject of this report, were managed by Aspira, Inc. of PA, a community organization operating in North Philadelphia:

- ❖ Antonia Pantoja Charter School (Pantoja) – *Grades K-8*
- ❖ Aspira Bilingual Cyber Charter School (Cyber) – *Grades K-12*
- ❖ Eugenio Maria de Hostos Charter School (Hostos) – *Grades K-8*
- ❖ John B. Stetson Charter School (Stetson) – *Grades 5-8*
- ❖ Olney Charter High School (Olney) – *Grades 9-12*

According to Aspira, Inc.'s website, which was shared by the five Charter Schools:

> **Our Community**
>
> ASPIRA of PA and its Charter Schools are located in three neighboring communities in North Philadelphia: Hunting Park, Olney, and Kensington. As some of Philadelphia's most impoverished areas, each of these neighborhoods faces huge socioeconomic challenges which bring about high levels of crime, poor public health and a range of other issues that burden children and families. We believe that education is the most fundamental determinant in the mission to inspire growth and improvement in future generations . . . . As we continue to invest in the education and leadership development of the youth, we are certain these children will find more and more opportunities for success.[2]
>
> **Our Work**
>
> In addition to the management of schools and community programs, ASPIRA of PA works for:
>
> - Advocacy at local, state and federal levels
> - Public policy and civic engagement
> - Research on nonprofit education trends as well as tax and budget issues
> - Education and professional development for employees
> - Cost-saving partnerships between vital organizations and community stakeholders[3]

[2] http://www.aspirapa.org/. Accessed December 20, 2017 and March 9, 2018.
[3] Ibid.

Our Goals

After 55 years of service, our mission remains the same: to empower youth and members of underprivileged communities through education and the inspiration to take action. Today, this means we still vow to:

- Grow and develop our schools and programs, and the way they educate and affect people
- Strengthen nonprofit community engagement for greater reach
- Deepen the relationships between member organizations to increase knowledge, effectiveness, and capacity for collective action
- Build bridges between nonprofits and key institutions (business, local government, philanthropy, etc.) to increase partnerships and cooperation
- Increase opportunities for effective cost-saving programs and services[4]

Enrollment

Figure 1 below provides the Charter Schools' enrollments as of June 30, 2016, according to the Pennsylvania Department of Education (PDE). Enrollments overall had remained stable throughout the three-year review period ending June 30, 2016.

Figure 1

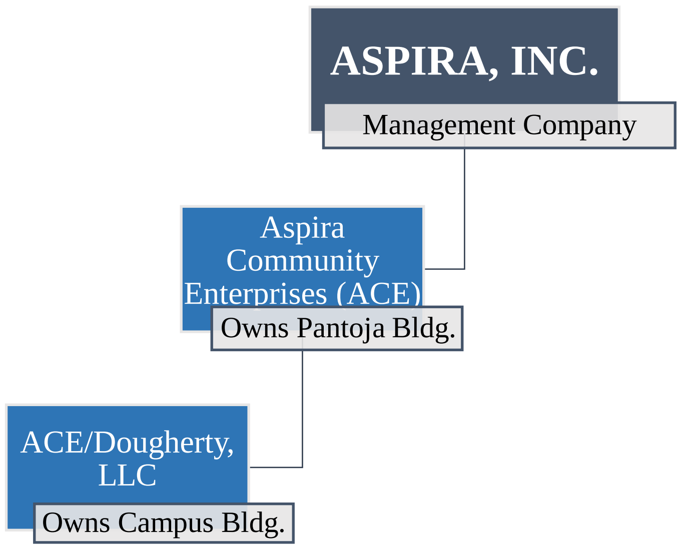
Aspira-Managed Charter Schools Fiscal Year 2016 Enrollment Per PDE	
School	Enrollment
Cyber	239
Hostos	487
Olney	1757
Pantoja	707
Stetson	879
Total	4,069

The Aspira, Inc. Organization

Figure 2 below illustrates the organizational structure of Aspira, Inc. and its related companies. Aspira, Inc. had a property-holding subsidiary called Aspira Community Enterprises (ACE), which owned the Pantoja school building. ACE had a property-holding subsidiary called ACE Dougherty, LLC (ACE/D), which owned the Campus building, which formerly housed a large former Catholic high school. Under ACE/D's ownership, the Campus building housed Cyber, Hostos, a preschool, and an Olney educational program for high school students who were behind on their credits.

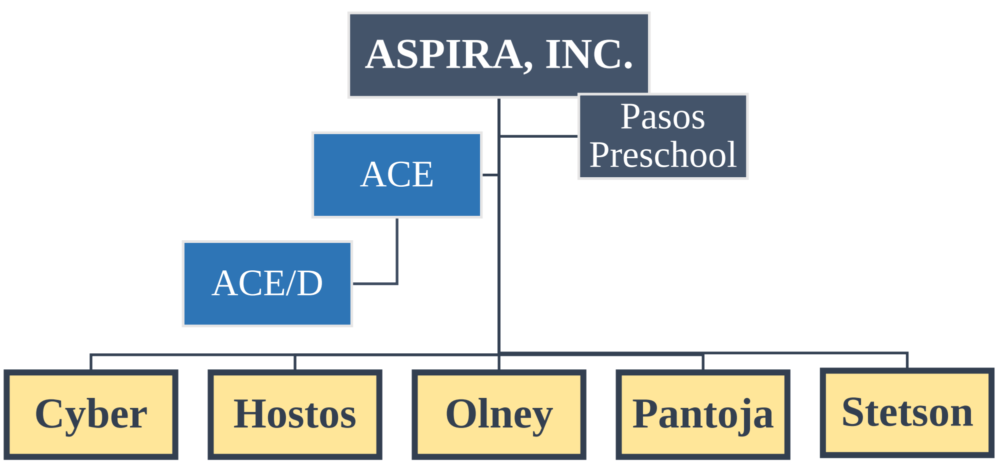
[4] Ibid.

Figure 2 – Aspira, Inc. and Its Subsidiaries



The Charter Schools not only paid Aspira, Inc. for management services covering a broad range of financial and educational services, they also paid Aspira-related companies for rent and other services. Pantoja paid rent to ACE, while Cyber, Hostos, and Olney had leases with ACE/D for space that each of them occupied at the Campus building. Aspira, Inc. also operated the Pequeńos Pasos Preschool (preschool), which was not included as part of our review. The preschool also paid rent to ACE/D for the space it occupied at the Campus building. Figure 3 below illustrates the relationship between the five Charter Schools and the management organization.

Figure 3



Status of the Charters

The School District of Philadelphia (SDP) authorized the charters of all of the schools, except for Cyber, which was authorized by PDE. The most recent charter terms for each of the five Charter Schools are shown in Figure 4 below. Three of the Charter Schools are operating beyond their charter expiration dates. As of the end of our review, Cyber's charter renewal was pending with PDE. As of December 2017, the SDP's School Reform Commission (SRC), which serves as the governing body of SDP, recommended that Olney and Stetson's Charter not be renewed because of financial problems and poor academics.[5]

Figure 4[6]

The Aspira-Managed Charter Schools Most Recent Charter Status			
Charter School	**Charter or Renewal Date**	**Expiration Date (Expired)**	**Status**
Cyber	July 1, 2010	June 30, 2015	Pending
Hostos	July 1, 2013	June 30, 2018	Renewal application in process
Olney	July 1, 2011	June 30, 2016	Nonrenewal recommendation by SRC
Pantoja	July 1, 2013	June 30, 2018	Renewal application in process
Stetson	July 1, 2010	June 30, 2015	Nonrenewal recommendation by SRC

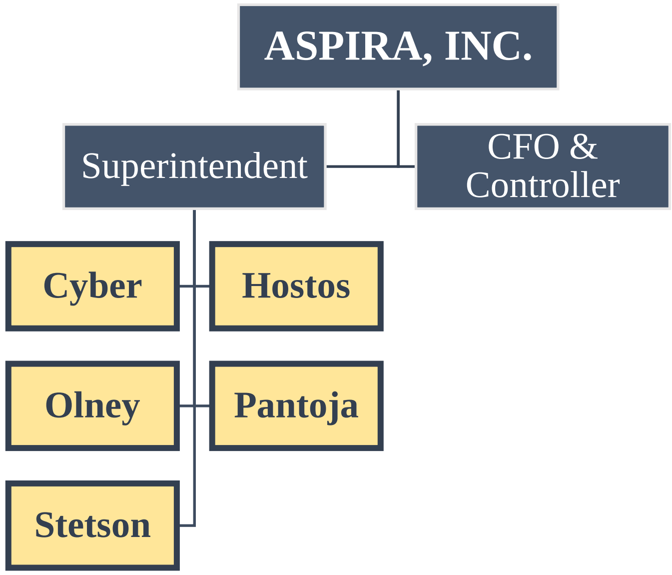
Financial and Educational Organization

Each Charter School's highest level administrator was the principal. Fiscal operations and other administrative functions were managed by Aspira, Inc. The schools had no business offices. Figure 5 below, an abridged organization chart, shows that the most senior administrators of the schools were actually employees of Aspira, Inc., which was the schools' primary vendor.

[5] According to the SDP's 2017 annual financial report, on November 16, 2017, the SRC voted to disband effective June 30, 2018 by adopting "a resolution recommending that the [PDE] Secretary issue a declaration that the School Reform Commission dissolve effective June 30, 2018, as the School District is no longer distressed… The Secretary was required to make a dissolution determination at least 180 days prior to the end of the current school year, i.e. by December 31, 2017, which he did on December 27, 2017…[A] new Board of Education, whose members will be appointed by the Mayor of the City [of] Philadelphia, [is] to assume governance of the School District on **July 1, 2018**." (Emphasis added.) http://www.phila.gov/finance/pdfs/2017%20Comprehensive%20Annual%20Financial%20Report%20(CAFR).pdf, page 155 accessed on May 14, 2018.

[6] Source: The respective charter or most recent charter renewal authorization for each school.

Figure 5 – The Administration of the Charter Schools



Board Governance & the Charter School Law

The board of a charter or cyber charter school is responsible for governance of the school. Specifically, under the Charter School Law (CSL), the board has the authority to decide matters related to the operation of the school, including, but not limited to budgeting, curriculum, and operating procedures, subject to the school's charter.[7] In addition, the Pennsylvania Supreme Court has clarified that a charter board must retain "ultimate authority" over the general operations of the school, not the founder or any management company hired by the board.[8]

The CSL also designates board members and administrators not only with management or operational oversight responsibilities of charter and cyber charter schools, but also as public officials subject to the Pennsylvania Public Official and Employee Ethics Act (Ethics Act).[9] Moreover, the CSL requires board members and board meetings to comply with the Sunshine Act and open meeting requirements.[10]

The by-laws of each of the Aspira-managed Charter Schools require a minimum of five members and a maximum of nine. During the three-year review period, the Charter Schools' Boards were each comprised of five or six members. In November 2016, the by-laws were amended to prohibit Aspira, Inc. from appointing board members for the Charter Schools, which it had previously done in the past.

[7] Sections 1716-A(c) of the CSL which is also applicable to cyber charter schools by way of its incorporation through CSL Section 1749-A(a)(1). *See* 24 P.S. §§ 17-1716-A(c) and 17-1749-A(a)(1).
[8] *West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).
[9] The Ethics Act, 65 Pa.C.S. 1101 *et seq*., is applicable to charter schools and cyber charter schools pursuant to Sections 1715-A(11) and (12) and 1749-A(a)(1) of the CSL. *See* 24 P.S. §§ 17-1715-A(11)-(12) and 17-1749-A(a)(1).
[10] The Sunshine Act, 65 P.S. § 701 *et seq*., is incorporated through Sections 1716-A(c) and 1749-A(a)(1) of the CSL. *See* 24 P.S. §§ 17-1716-A(c) and 17-1749-A(a)(1).

The Ethics Act

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

The application of the Ethics Act to charter and cyber charter schools means that board members and administrators, as public officials, are also subject to the responsibilities specified under this law. Additionally, the Ethics Act defines related parties and conflicts of interest and prohibits public officials and public employees from engaging in conflicts of interest.[11]

Academic Information

The graphs on the following pages present School Performance Profile (SPP) scores, Pennsylvania System of School Assessment (PSSA), Keystone Exam results, and 4-Year Cohort Graduation Rates for the Charter Schools obtained from PDE's data files for the 2014-15 and 2015-16 school years.[12] These scores are provided in the Charter Schools' audit report for **informational purposes only**, and they were not audited by our Department. Please note that if one of the Charter Schools' schools did not receive a score in a particular category and year presented below, the school will not be listed in the corresponding chart.[13] Finally, benchmarks noted in the following graphs represent the statewide average of all public school buildings in the Commonwealth that received a score in the category and year noted.[14]

What is a SPP score?

A SPP score serves as a benchmark for schools to reflect on successes, achievements, and yearly growth. PDE issues a SPP score using a 0-100 scale for all school buildings in the Commonwealth annually, which is calculated based on standardized testing (i.e., PSSA and Keystone exams), student improvement, advance course offerings, and attendance and graduation rates. Generally speaking, a SPP score of 70 or above is considered to be a passing rate.

PDE started issuing a SPP score for all public school buildings beginning with the 2012-13 school year. For the 2014-15 school year, PDE only issued SPP scores for high schools taking the Keystone Exams as scores for elementary and middle school scores were put on hold due to

[11] 65 Pa.C.S. §§ 1102 and 1103(a).
[12] PDE is the sole source of academic data presented in this report. All academic data was obtained from PDE's publically available website.
[13] PDE's data does not provide any further information regarding the reason a score was not published for a specific school. However, readers can refer to PDE's website for general information regarding the issuance of academic scores.
[14] Statewide averages were calculated by our Department based on individual school building scores for all public schools in the Commonwealth, including district schools, charters schools, and cyber charter schools.

changes with PSSA testing.[15] PDE resumed issuing a SPP score for all schools for the 2015-16 school year.

What is the PSSA?

The PSSA is an annual, standardized test given across the Commonwealth to students in grades 3 through 8 in core subject areas, including English and Math. The PSSAs help Pennsylvania meet federal and state requirements and inform instructional practices, as well as provide educators, stakeholders, and policymakers with important information about the state's students and schools.

The 2014-15 school year marked the first year that PSSA testing was aligned to the more rigorous PA Core Standards.[16] The state uses a grading system with scoring ranges that place an individual student's performance into one of four performance levels: Below Basic, Basic, Proficient, and Advanced. The state's goal is for students to score Proficient or Advanced on the exam in each subject area.

What is the Keystone Exam?

The Keystone Exam measures student proficiency at the end of specific courses, such as Algebra I, Literature, and Biology. The Keystone Exam was intended to be a graduation requirement starting with the class of 2017, but that requirement has been put on hold until at least 2020. In the meantime, the exam is still given as a standardized assessment and results are included in the calculation of SPP scores. The Keystone Exam is scored using the same four performance levels as the PSSAs, and the goal is to score Proficient or Advanced for each course requiring the test.

What is a 4-Year Cohort Graduation Rate?

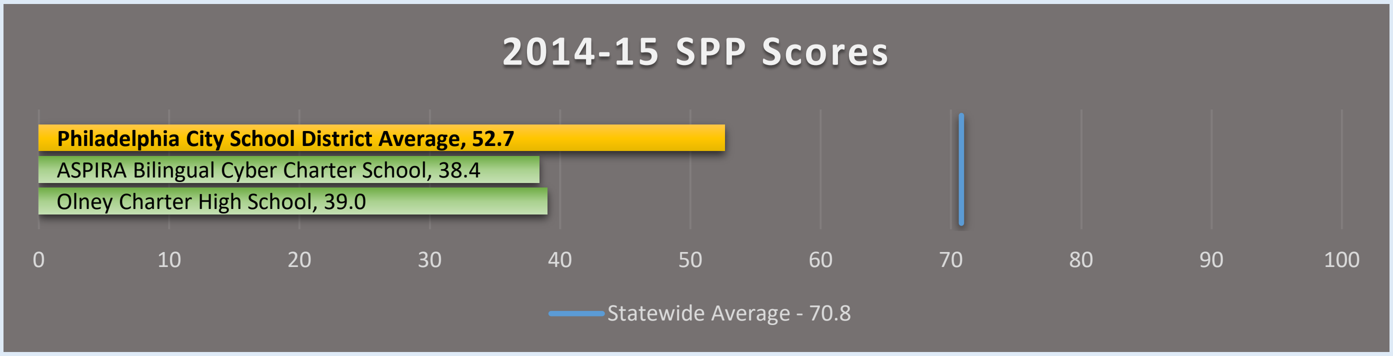
PDE collects enrollment and graduate data for all Pennsylvania public schools, which is used to calculate graduation rates. Cohort graduation rates are a calculation of the percentage of students who have graduated with a regular high school diploma within a designated number of years since the student first entered high school. The rate is determined for a cohort of students who have all entered high school for the first time during the same school year. Data specific to the 4-year cohort graduation rate is presented in the graph.[17]

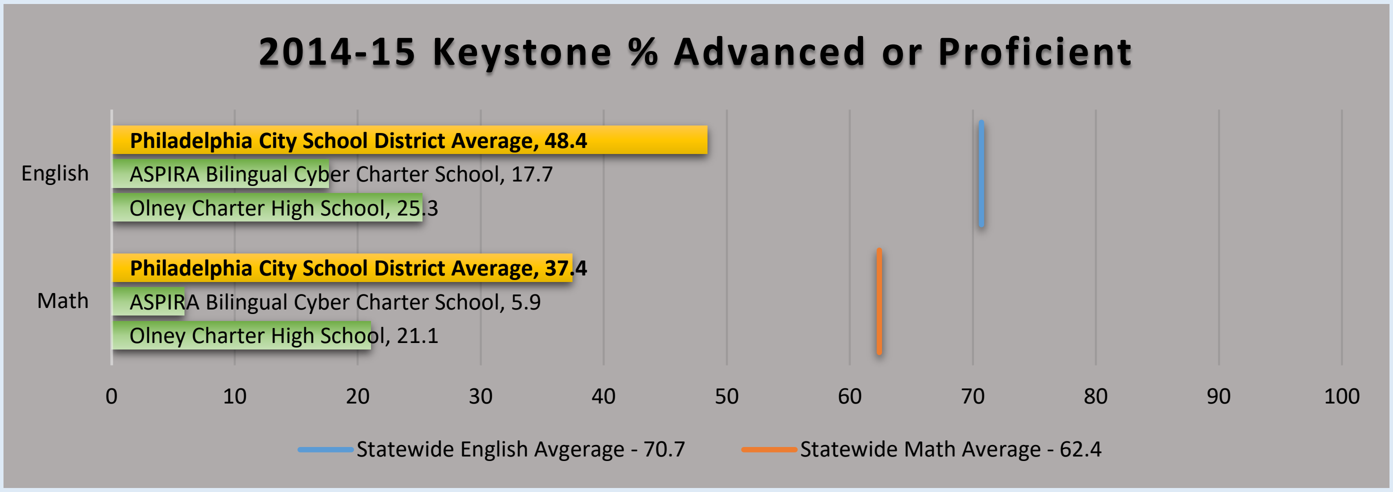
[15] According to PDE, SPP scores for elementary and middle schools were put on hold for the 2014-15 school year due to the state's major overhaul of PSSA exams to align with state Common Core standards and an unprecedented drop in public schools' PSSA scores that year. Since PSSA scores are an important factor in the SPP calculation, the state decided not to use PSSA scores to calculate a SPP score for elementary and middle schools for the 2014-15 school year. Only high schools using the Keystone Exam as the standardized testing component received a SPP score.

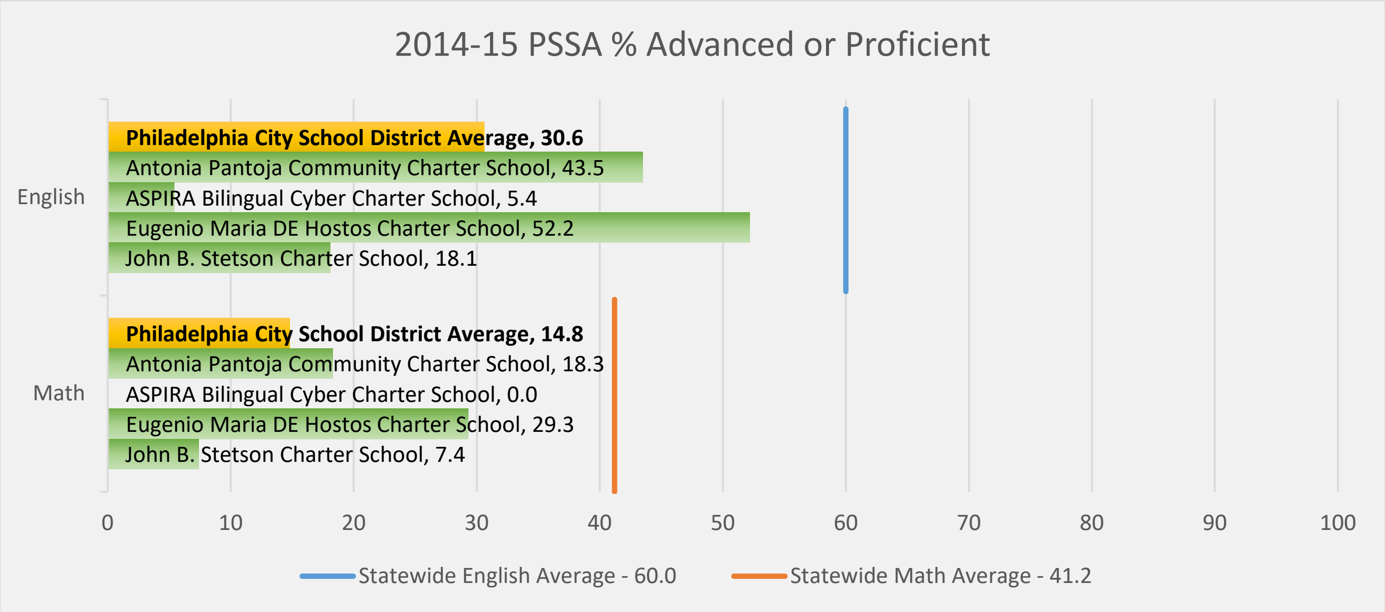
[16] PDE has determined that PSSA scores issued beginning with the 2014-15 school year and after are not comparable to prior years due to restructuring of the exam. (Also, see footnote 4).

[17] PDE also calculates 5-year and 6-year cohort graduation rates. Please visit PDE's website for additional information: http://www.education.pa.gov/Data-and-Statistics/Pages/Cohort-Graduation-Rate-.aspx.

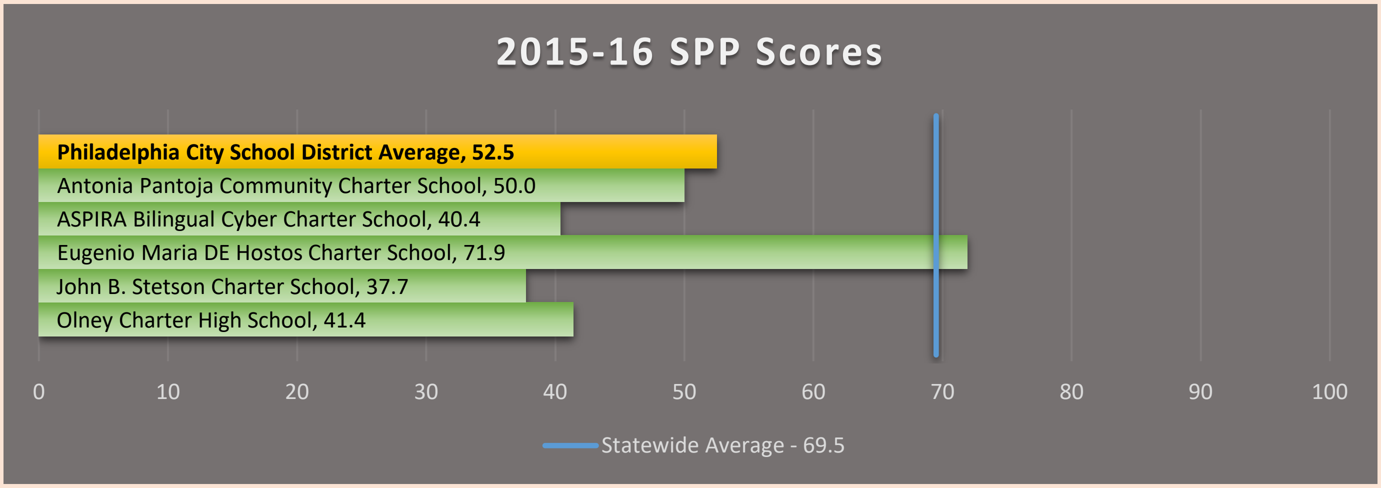
2014-15 Academic Data
School Scores Compared to Philadelphia City SD and Statewide Averages

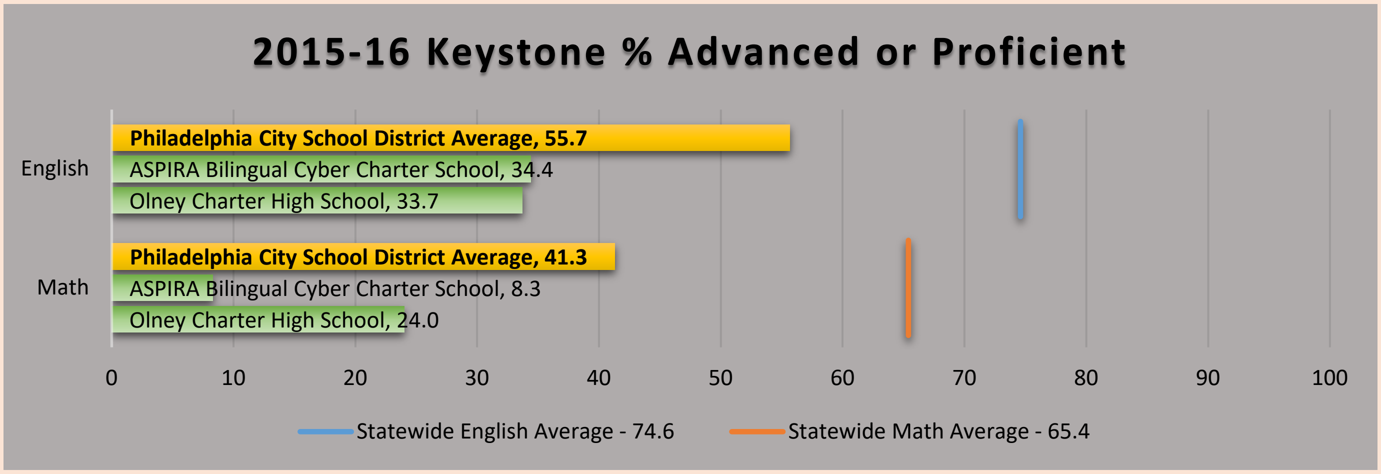


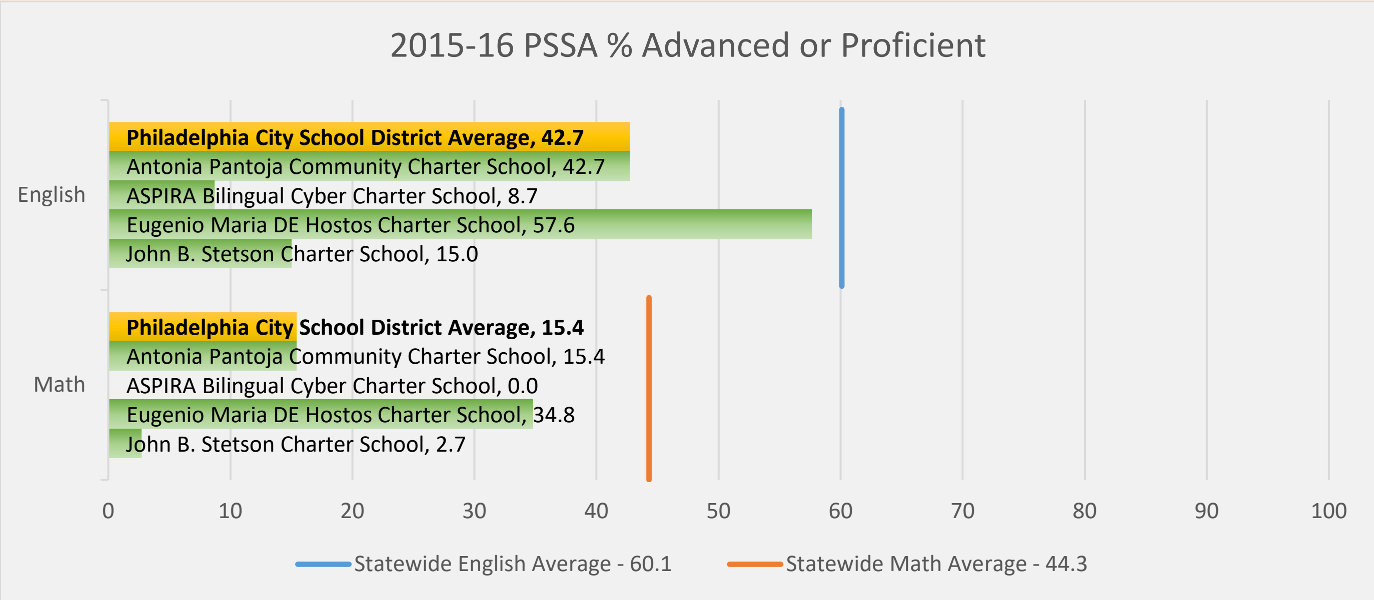




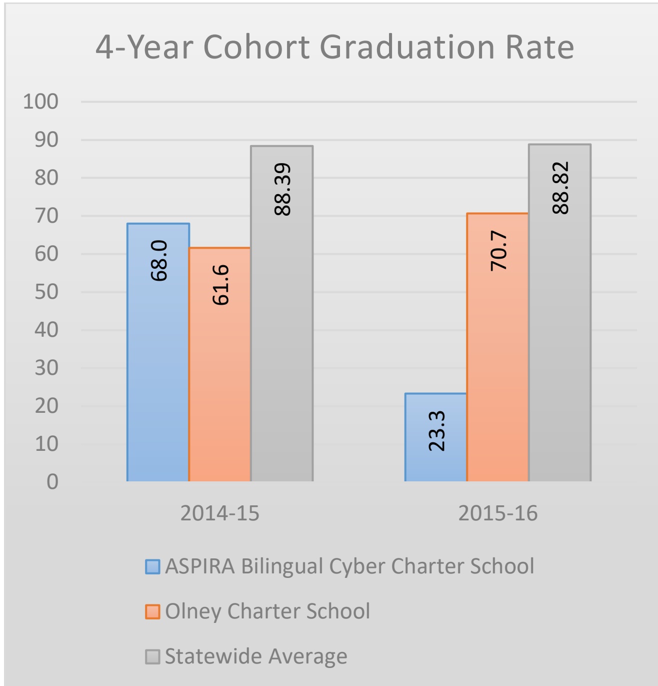
2015-16 Academic Data
School Scores Compared to Philadelphia City SD and Statewide Averages







4-Year Cohort Graduation Rate



Findings

Finding No. 1

The Boards Did Not Fulfill Their Duty to Govern the Charter Schools, Allowing Aspira, Inc. to Manage Their Public School Funds Without Sufficient Accountability

Criteria relevant to the finding:

The charters and bylaws of the five Aspira-managed charter schools require them to comply with the Charter School Law (CSL), the Public Official and Employee Ethics Act (Ethics Act), and the Pennsylvania Nonprofit Corporation Law of 1988 (e.g., *Charter for Maria de Hostos Charter School, July 1, 2013, Article I, H,* Conditions for Renewal, *1*.). In addition, the CSL requires charter schools to comply with certain, specific sections of the Public School Code (PSC). Excerpts of these laws and regulations follow.

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

Board responsibilities were further clarified by a 2002 Pennsylvania Supreme Court decision holding that a charter school is to be governed by an independent board of trustees who retains "ultimate authority over the general operation of the school." We interpret the court's observation that once the Board is in place, it has the authority and responsibility for the control of the school, rather than the applicant, founder, or contracted management company. *See West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).

We found that the Charter Schools' Boards of Trustees failed to provide sufficient oversight of the management company, Aspira, Inc., which provided a wide range of management and administrative services to the schools. The Boards' failure to perform their governance duties likely fostered Aspira, Inc.'s own failure to provide sufficient accountability for how it utilized the charter schools' public funds. This was particularly significant in light of the schools' overall decreased financial standing.

The Boards each had clear obligations under the Charter School Law (CSL) and also under each school's charter to govern independently each school's operations, budgets, and curricula. Additionally, the Boards had the vital responsibility to ensure that each school properly contracted with and closely monitored the services provided by Aspira, Inc. The Boards failed to fulfill these obligations.

As a result, the Boards and the public were insufficiently aware of the inadequate internal controls over the use of the Charter Schools' public funds, all of which were handled by Aspira, Inc. So too, the schools and their respective Boards were insufficiently aware of the actual fiscal standing of each charter school and what they were actually paying Aspira, Inc.

We identified the following issues related to the charter schools' Boards, which are discussed in the sections that follow:

- Nearly identical board composition.
- No separate board meetings for each charter school.

Criteria relevant to the finding (continued):

Section 1715-A(11) of the CSL states:

"Trustees of a Charter School shall be public officials." *See* 24 P.S. § 17-1715-A(11).

Subsection (a) of Section 1104 (relating to Statements of Financial Interest required to be filed) of the Ethics Act provides, as follows:

"Each public official of the Commonwealth shall file a statement of financial interests for the preceding calendar year with the commission no later than May 1 of each year that he holds such a position and of the year after he leaves such a position. Each public employee and public official of the Commonwealth shall file a statement of financial interests for the preceding calendar year with the department, agency, body or bureau in which he is employed or to which he is appointed or elected no later than May 1 of each year that he holds such a position and of the year after he leaves such a position. Any other public employee or public official shall file a statement of financial interests with the governing authority of the political subdivision by which he is employed or within which he is appointed or elected no later than May 1 of each year that he holds such a position and of the year after he leaves such a position. Persons who are full-time or part-time solicitors for political subdivisions are required to file under this section." *See* 65 Pa.C.S. § 1104(a).

- Lax oversight of budgets, contracts, and other charter school business.
- Failure to file required Statements of Financial Interest.[18]
- Lack of transparency about financial activities and budgets on the schools' shared website.

Nearly Identical Boards

For the entire three-year period, each Board of Trustees was comprised of five or six members. Each Board was composed of the same four or five members, plus one respective Charter School parent member, who was usually the president of the respective school's parent organization. Having only one different board member out of a total of five or six members for each school's Board did not create sufficient independence for each school.

In addition, prior to an amendment to each of the Charter Schools' bylaws in November 2016, Aspira, Inc. appointed the board members. The last Aspira-appointed Board member resigned in February 2017.

Also, since all schools shared four or five of the same board members, decisions about education and financial matters may not have been made with each school's best interest in mind. A decision benefiting one school may have been detrimental to another. Therefore, the Boards' overlapping composition resulted in an ineffective check on the wide-ranging influence of both Aspira, Inc. and the Aspira-appointed members.

One Board Meeting for Five Charter Schools

We reviewed board meeting minutes for the three-year review period and found that for each of the Charter Schools' board meetings, there was only one call to order, one approval of prior meeting minutes, one financial report presentation, and one adjournment. The financial reports presented at the

[18] Annual filing of the Statements of Financial Interest are required by the Ethics Act. *See* 65 Pa.C.S. §§ 1104-1105.

Criteria relevant to the finding (continued):

Section 1716-A(c) of the Charter School Law states in part:

"(c) The board of trustees shall comply with the act . . . known as the "Sunshine Act." *See* 24 P.S. § 17-1716-A(c).

Article IV. Operations and Management of the Eugenio Maria De Hostos Charter Contract states, in part:

". . . the Charter Board shall be responsible for the operation of the Charter School and shall decide all matters relating to the Charter School, including but not limited to the following: budgeting, curriculum development, testing, operating procedures, hiring and firing of Charter School staff, contracting with necessary professional and nonprofessional employees and all other powers provided by Applicable Laws."

Article IV Section J. regarding Management Contracts also states, in part:

"Prior to the execution of any agreement for the management or operation of all or substantially all of the Charter School's functions, or all or substantially all of the Charter School's instructional, curricular and senior administrative functions, including without limitation, special education or behavioral support services (any such agreement, a 'Management Agreement'), the Charter Board shall submit a copy of the proposed Management Agreement to the School District."

meetings provided each schools' data in separate columns.

Management company officials stated that, after April or May 2016, the Charter Schools' meetings were held independently of each other. However, we reviewed all minutes through fiscal year 2017 and found that the Charter Schools still held only one meeting with the exact same open and close times, same executive session times, and same reconvening times, even though the schools maintained separate sets of minutes. Thus, the Charter Schools still had only one meeting for all five schools and, therefore, clearly lacked independence from each other.

Although we believe this is not a valid comparison, Aspira, Inc. officials explained that the schools were operated similarly to how a school district runs. For instance, Aspira, Inc. provided services to each of the Charter Schools like a school district administration office would provide services to each of its school buildings. However, the CSL and each individual school's charter require the schools to be operated independently. Further, the services of the private management company, Aspira, Inc., should not be likened to the services provided by a public school district's administrative office because management companies are not subject to the same level of transparency as required by the CSL and the Public Official and Employee Ethics Act (Ethics Act) and other laws and regulations that foster transparency.

<u>Lack of Oversight of Budgets, Contracts, and Other Business</u>

We found lax oversight regarding the Charter Schools' budgets. There was no evidence of any monitoring of budgets during the fiscal year. While financial reports presented to the Board showed budget-to-actual variances for broad cost categories, such as salaries or professional fees, the variances were unexplained. Also, there was no documentation of any Board discussions about the financial reports, nor were there any budget adjustments during the year.

In addition, we found no evidence in the meeting minutes that the Boards ever approved the fiscal year 2014 budgets. We also found that the fiscal year 2015 budget was not approved until November 17, 2015, well after the June 30 deadline and after the schools would have had to begin using their resources to operate.

We also found no evidence that the Board approved bids and proposals for the procurement of goods and services. Further, very few contracts were publicly approved at board meetings. In the few instances when the Board did publicly approve contracts, the board minutes did not identify the vendors, the types of contracts, or the dollar amounts involved. For example, the minutes for a July 2014 meeting recorded a vote to renew Stetson's "Contract 001," but no other specific information about the contract was provided. **In 2015 and 2016, other than the management services agreements with Aspira, Inc., no vendor contracts were approved by the Boards in open and public board meetings.**

Aspira, Inc. officials claimed that the schools' contracts with outside vendors were essentially approved as part of the Charter Schools' budgets, since expenditure amounts for certain goods and services would have been authorized in the budgets. This process is not comparable to a Charter School's Board procuring bids or proposals and reviewing, approving, and monitoring contracts, which in some cases could span more than one budgetary year. The CSL and the Pennsylvania Supreme Court have made clear that a Charter School is to be governed by an independent Board of Trustees that retains "ultimate authority over the general operation of the school."[19]

We also found that the Boards did not authorize the relocation to the Campus building of two educational services programs—an accelerated services program and an emotional support program.[20] These programs supported older students and students with behavioral

[19] *See West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).
[20] Section 1716-A(a) of the CSL states: "The Board of trustees shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school's charter." *See* 24 P.S. § 17-1716-A(a).

Criteria relevant to the finding (continued):

The Nonprofit Corporation Law of 1988 addresses fiduciary duties of nonprofit corporations:

Subsection (a) of Section 5712 (relating to Standard of care and justifiable reliance) of the Nonprofit Corporation Law of 1988, to which the charter schools are subject, provides for the fiduciary duties of board members as follows:

"(a) Directors.--A director of a nonprofit corporation shall stand in a fiduciary relation to the corporation and shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, **in good faith**, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including **reasonable inquiry, skill and diligence**, as a person of ordinary prudence would use under similar circumstances. In performing his duties, a director shall be entitled to rely in good faith on information, opinions, reports or statements, including financial statements and other financial data . . ." (Emphases added.) *See* 15 Pa.C.S. § 5712(a).

issues who were from other Aspira-managed charter schools, not the schools that were already operating at that building. The relocation of these programs in the Campus building came to light publicly at a board meeting only after parents and other members of the public expressed concerns about the programs operating in the same building as an elementary school. The Boards' failure to publicly discuss a significant operational decision allowed Aspira, Inc. to independently make a decision that impacted hundreds of students.

We also believe that the Boards failed to meet their fiduciary duties as outlined in the Nonprofit Corporation Law of 1988 requiring board members to serve "in good faith" with the "best interests" of the charter schools in mind and to monitor the affairs of the schools with all "reasonable inquiry, skill and diligence."[21] (See Finding No. 6 for further information.)

Problems with Statements of Financial Interest

The Charter Schools and their Boards failed to comply with the CSL and the Ethics Act related to public officials and financial interest disclosures. Under the Ethics Act, Board members, senior administrators, and charter school employees are required annually to file *Statements of Financial Interest* (SFIs) by May 1st of each year.[22] In all three years of the review period, Aspira, Inc. was responsible for maintaining the SFI records for all of the Charter Schools. Aspira, Inc. was unable to provide copies of SFIs for any parent members of the Boards; nor could it provide SFIs for any senior administrators of the Charter Schools, including principals and vice-principals. Therefore, we could not determine whether any of these public officials had conflicts of interest.

Additionally, in fiscal year 2014, only two of five non-parent board members' SFIs were provided; in 2015, only one of five were provided; and in 2016, only three of six were provided. (During 2016, one

[21] *See* 15 Pa.C.S. § 5712.
[22] 65 Pa.C.S. § 1104.

non-parent board member resigned and another was appointed, so there were a total of six non-parent board members who should have filed.) Again, for those board members whose SFIs were unavailable, we could not rule out potential conflicts of interest.

Further, the two SFIs that were provided for fiscal year 2014 and the three filed for fiscal year 2016 were filed late. Aspira, Inc. officials said that all of the Charter Schools' board members filed SFIs, but they were unable to locate those SFIs that were not provided to us; therefore, we were unable to verify whether or not the respective public officials and employees actually did complete the SFIs.

Consistent with the Ethics Act, the Pennsylvania State Ethics Commission has stated that "public office is a public trust and that any effort to realize personal financial gain through one's public office other than compensation provided by law is a violation of that trust."[23] Senior administrators and board members of charter schools are public officials. As a result of Aspira, Inc.'s inability to provide the requisite documentation, the Aspira-managed Charter Schools were not compliant with the Ethics Act and not transparent about their own officials' potential or actual conflicts of interest.

Lack of Transparency on the Schools' Shared Website

The schools shared a website with Aspira, Inc., and each Charter School, except Cyber, had its own webpage. We visited the website on numerous occasions, including several dates in April, May, August, and October 2017 and found that the website's lack of financial and Board information seriously reduced public transparency. For example, we found that:

- Board meeting minutes were not posted timely. As of October 2017—well into the 2017-18 school year—the most recent minutes posted were dated November 21, 2016. We found that at least

[23] http://www.ethics.pa.gov/The-Commission/Pages/About-the-Commission.aspx. Pennsylvania State Ethics Commission, About the Commission. Last accessed on March 27, 2018.

five more meetings were held during fiscal year 2017.[24]

- Board-approved budgets were not posted.
- Except for Olney's and Stetson's audited annual financial statements for 2015, the Charter Schools' audited annual financial statements were not posted. In other words, only 2 of a possible 15 annual financial statements issued for the schools in the three-year period were posted.

We also found that the Right-To-Know (RTK) officer listed on the Charter Schools' website was actually an employee of Aspira, Inc. and not the schools. The address and phone number provided were those of Aspira, Inc., as well. We believe that this is another indicator of reduced transparency, and we are concerned about an individual employed by Aspira, Inc., a private company, acting as a *public organization's* RTK officer. We brought this to the attention of management company officials, and they said that they would address this problem and make sure that, going forward, all RTK requests go directly to the Charter Schools.[25]

Conclusion

Our review of board meeting minutes, extensive written responses to our questions, and other documentation, as well as information obtained from numerous interviews with Charter School and Aspira, Inc. officials, led us to conclude that the Boards clearly did not provide sufficient governance to their schools in accordance with the CSL, and consequently, diluted their independence from Aspira, Inc. and each other. In addition, the Boards' lack of good governance likely contributed not only to Aspira, Inc.'s failure to provide sufficient accountability, but also to the Charter Schools' overall declining financial position, as demonstrated in other findings in this report. If the Boards had appropriately governed the schools, they may have

[24] In August 2017, after our requests from several months earlier, Aspira, Inc. finally provided us with board meeting minutes from November 29, 2017, January 30, 2017, February 21, 2017, March 20, 2017, and April 24, 2017.

[25] RTK information was last accessed on October 17, 2017, and the information had not yet been updated. http://www.aspirapa.org/home/ourstory/right-to-know-information/.

instead provided timely monitoring of financial matters, such as budgeting and budget adjustments, and other financial transactions, including soliciting bids and proposals and negotiating and monitoring vendor contracts with the schools.

Aspira, Inc. officials claimed that the Boards had begun to recruit board members to improve oversight of Aspira, Inc. and that the new Treasurer, appointed in May 2016, had an appropriate financial background. In fiscal year 2017, Aspira, Inc. officials replaced the prior financial team with a new team, and they stated that over the course of fiscal years 2017 and 2018, the Aspira, Inc. financial team began to implement a new software system that would help improve accountability and provide greater authority to the schools with regard to financial transactions. We were unable to confirm the effectiveness of all of these claims, since they were largely not in place during the review period. In particular, according to business office officials, the new accounting software system was still in the process of being implemented during our review.

<u>Recommendations</u>

The *Aspira Charter Schools* should do the following:

1. Create separate, independent Boards or some other board composition for each school so that each Board is composed of members who are independent of both the members of the other Charter Schools' Boards and of Aspira, Inc.

2. Increase each school's administrative supervision and Board oversight of Aspira, Inc. by implementing policies and procedures that require each school's officials to review and approve all their financial transactions. These procedures should include the following:

    a. School officials and employees should routinely—meaning on a daily or weekly basis—review and approve all deposits, disbursements, bank statements, and bank reconciliations. This might require each school to have its own fiscal officer or business manager.

b. Only authorized school officials should sign checks or otherwise authorize disbursements from school bank accounts *prior* to payment, with a minimum of two signatures on checks/disbursements.

c. Bids and proposals for goods and services should be *publicly* advertised.

d. The majority of the Board should then publicly review and approve all contracts and agreements awarded for goods and services *before* the President of the Board and/or any other board members or school officials sign contracts.

e. Conduct a routine (daily, weekly, or monthly), separate, and detailed accounting of all intercompany payments to and from Aspira, Inc.—and any other related Charter Schools or companies. This accounting record should be routinely reviewed and approved by each school's Board. Aspira, Inc. should be able to *timely* substantiate all charges to the schools, providing documentation to support the accuracy and appropriateness of all charges to the schools and compliance with respective contract terms, if applicable.

f. Establish a Board-approved policy addressing related parties and conflicts of interest. This policy should require all Board members to publicly disclose conflicts of interest and abstain from corresponding votes in accordance with the Ethics Act.

Management Response

The Preliminary Statement referred to below is included in Appendix B.

As described in the Preliminary Statement, there is no legal infirmity in the structure of ASPIRA and the Schools' relationship. Nonetheless, we agree that the Schools Boards can do a better job of documenting transactions with ASPIRA to address any concerns about transparency. However, given ASPIRA's role as founder of 3 of the Schools and then as the charter management organization ("CMO"), the Schools Boards understand that they must ensure independence and transparency about the relationship with ASPIRA.

It is important to understand that from their inception the governance structure of the Schools was made on the advice of counsel and was approved by the School Reform Commission ("SRC") in granting the Schools' charters. While the governance structure does not violate the Charter School Law ("CSL") or any other law, ASPIRA and the Schools appreciate that the structure is less than ideal and the Schools' Boards have changed their bylaws and adopted resolutions to improve board governance.

- The report identifies overlapping board members as a weakness; however, it does not and cannot provide authority that suggests such a structure is prohibited by law or otherwise inappropriate.

- Likewise, the report cites the Schools' business being handled in single meetings as evidence of lack of independence. Again, such meetings are neither violations of the CSL nor contrary to the Schools' charters or otherwise prohibited.

- ASPIRA and the Schools concur that oversight by the Schools over budgets, contracts and some other charter school matters must continue to improve. In 2016, the following changes were undertaken:

    - The prior Treasurer for each of the Boards did not have a financial background. That Treasurer was replaced by one who holds an MBA and works as an analyst in a major financial services firm;

    - The Chief Financial Officer was terminated and replaced with a new finance and accounting team. A new interim financial consultant was hired in May 2016, a new controller with charter school experience was hired in August 2016 and additional accounts payable staff, a new senior accountant, staff accountant, and finance specialists have also been hired since the end of FY16;

    - Each School Board established a Finance Committee and established monthly meetings of the Finance Committee with the ASPIRA finance and accounting team in advance of the Board of Trustees meetings;

    - This new team has implemented new processes for budgeting and controls, as well as a new cloud-based accounting system - Intacct. Intacct implements system-controlled workflows to ensure that all transactions requiring school approval are sent to the Schools for approval prior to any payment processing on behalf of the Schools by ASPIRA (per the Master Service Level Agreements);

    - ASPIRA and the Schools agree that major contracts should be publicly approved at a Board meeting. In Fiscal Year 2017, the Schools began issuing RFPs and other solicitations from multiple vendors in FY17 for various services for high value contracts:

        - Brokerage services for medical & ancillary benefits

    - Brokerage services for general liability and business insurance
    - Olney accelerated and transitional programs
    - Stetson transitional program
    - Professional services (various services related to students with IEPs)
    - New accounting software package
    - Snow removal

  - ASPIRA and the Schools agree that the Schools Boards should have authorized the relocation to the Campus building of two educational services programs—an accelerated services program and an emotional support program—at a public meeting and have undertaken steps to ensure that occurs in the future;

  - The Boards of Trustees have each adopted a conflict of interest policy. The Boards agree signing the policy is appropriate. In addition, the Boards have each implemented a procedure to ensure Board members, senior administrators, and charter school employees annually file *Statements of Financial Interest* by May 1st of each year;

  - The Schools Boards will undertake to appoint a new Right-to-Know officer employed by the Schools. The Schools Boards agree that the website needed to be updated to reflect this.

Management's Response to the Conclusion: As noted above, the conclusion is premised on an inaccurate assumption that overlapping boards by their very nature violate the Charter School Law. In addition, the vast majority of governance findings and recommendations in the report are no longer valid. As the report acknowledges, many of the recommendations made by the report are moot as many recommended changes have already been implemented.

Management Response to the Recommendations:

1. The School Boards disagree with this recommendation. See above. In addition, in order to enhance independence, there are no current Board members appointed by ASPIRA. ASPIRA has not appointed a Board member since 2013. Both ASPIRA and the School Boards amended their respective bylaws to prohibit ASPIRA appointees.

2. The School Boards and ASPIRA agree and
   a. Have already acquired Intacct accounting cloud-based software which came online on July 1, 2017. Workflow inside the Intacct system requires school officials' approval of school expenditures (ASPIRA's role is to confirm accuracy of invoices, match invoices to school approved POs, and process payment of invoices or contracts approved by school officials).
   b. This practice has been put in place. Disbursements require authorization from school officials prior to disbursement and two signatures.
   c. The Board of Trustees is preparing and will consider a policy change to adopt a requirement that all bids and contracts with expenditures over $10,000 be approved at public meetings.
   d. See c. above.
   e. The School Boards will each implement a monthly review and approval of invoices by the

Schools' Finance Committees.

f. The Boards have each adopted a conflict of interest policy that meets this recommendation.

Auditor Conclusion

We are pleased that the Charter Schools have agreed to the five points made in the second recommendation and are taking multiple corrective actions to improve the Charter School's oversight of its management company. Further, we appreciate the Charter Schools' acknowledgment that their "structure is less than ideal" and are glad that the Boards have taken proactive steps to amend their bylaws and have adopted resolutions to enhance their governance.

We reiterate and continue to stand firm on the important fact that the CSL and each school's charter **clearly require independent governance** of each school's operations. We strenuously maintain that the Boards' chronic lack of oversight, coupled with the nearly identical board composition, resulted in the Charter Schools' failure to comply with the CSL and their own charters. Furthermore, this lack of good governance may have been detrimental to one or more of the schools as evidenced by their weakened financial positions. We reinforce our recommendation that each Charter School should create a separate, independent board or some other composition allowing for each school to operate independently, as required by law.

Finding No. 2	**Reduced Revenues, Persistent Operating Deficits, Poor Cash Flow, & Overspent Budgets Caused the Charter Schools' Combined General Fund Balance to Plummet from $7.7 Million in 2014 to $(419,000) in 2016**

Criteria relevant to the finding:

The benchmarks used as criteria for this objective were based on best business practices established by several agencies, including the Pennsylvania Association of School Business Officials (PASBO), the Government Finance Officers Association, the Colorado State Auditor, and the National Forum on Education Statistics. The following are some of the benchmarks used in our evaluation:

- A school should maintain a trend of stable or increasing fund balances.
- Financial industry guidelines recommend that a fund balance should range between 5 and 10 percent of annual expenditures.
- The trend of current ratios should be at least 2 to 1 or increasing. Anything less calls into question the school's ability to meet its current obligations with existing resources.

During the three-year review period ending June 30, 2016, the Charter Schools' financial standing eroded. Overall revenues decreased, General Fund balances declined, operating expenditures exceeded revenues, expenditures exceeded budgets, and liquidity was poor. To make matters worse, Aspira, Inc.'s financial position was also weak, and the schools' resources were at risk of having to be used to prop up the financial standing of Aspira, Inc. rather than for the education of the Charter Schools' students.

Declining Revenues and Deficit General Fund Balances

During the three-year period from fiscal years 2014 through 2016, four of the five charter schools' General Fund balances declined sharply. In terms of enrollment and revenues, only the smallest of the five schools, the Cyber school, realized an increased General Fund balance. Collectively, the schools' $7.7 million General Fund balance as of June 30, 2014 substantially decreased to a negative $419,000 by June 30, 2016. Figure 1 shows each Charter School's General Fund balance at the end of each fiscal year in the three-year period. By the end of June 30, 2016, Hostos, Olney, and Pantoja had negative General Fund balances.

Figure 1

Aspira-Managed Charter Schools General Fund Balances[26]					
Charter School	**FY 2014**	**FY 2015**	**FY 2016**	**$ Change 2014 to 2016**	**% Change 2014 to 2016**
Cyber	$ 499,483	$ 781,514	$ 679,302	$ 179,819	36.0%
Hostos	(392,949)	(1,663,247)	(857,855)	(464,906)	-118.3%
Olney	4,183,566	2,907,358	(76,808)	(4,260,374)	-101.8%
Pantoja	1,162,679	1,056,238	(223,329)	(1,386,008)	-119.2%
Stetson	2,197,476	1,644,545	59,609[27]	(2,137,867)	-97.3%
Total	**$7,650,255**	**$4,726,408**	**$ (419,081)**	**$(8,069,336)**	**-105.5%**

[26] Source: Data was obtained from the independently audited financial statements for fiscal years 2014, 2015, and 2016 for Aspira Bilingual Cyber Charter School, Antonia Pantoja Charter School, Eugenio Maria de Hostos Charter School, John B. Stetson Charter School, and Olney Charter High School.
[27] Stetson's reported fund balance in its FY 2016 audited financial statements was $612,540. However, we found that the fund balance was overstated due to an error that is described in Finding No. 8. We show the corrected fund balance of $59,609 to more accurately reflect the declining financial position.

Criteria relevant to the finding (continued):

- To ensure timeliness and accountability, budgets should be submitted timely, monitored routinely, and adjusted as necessary to achieve educational and financial goals.

From the charter schools' bylaws: *Article XVII-A*, § 1729-A(3), *Causes for Nonrenewal or Termination*, states:

"Failure to meet general accepted standards of fiscal management or audit requirements."

According to enrollment data from PDE, the five Charter Schools' enrollment increased slightly by about 5 percent from 3,847 students in 2014 to 4,069 in 2016. However, during the same period, overall revenues decreased by 4.3 percent from $55.7 million in fiscal year 2014 to 53.3 million in fiscal year 2016.[28]

When we asked about the declining revenues, Aspira, Inc. officials explained that in both fiscal years 2015 and 2016—late in the school year and months after the schools' budgets had already been approved—the School District of Philadelphia (SDP) had notified the charter schools that it had reduced the per-student tuition rate for that school year. This belated reduction in the tuition rate paid to the charter schools was a significant cause, though not the only one, of the schools' operating deficits, discussed in the next section.

Operating Deficits

Figure 2 below highlights each charter school's General Fund revenues and expenditures and results of operations in fiscal year 2016, the last year in our review period. During that one fiscal year, on behalf of the schools, altogether Aspira, Inc. handled more than $53 million in revenues and nearly $58 million in expenditures. As illustrated below, four of the five schools—Cyber, Olney, Pantoja, and Stetson—spent more than they received and, therefore, realized operating deficits.

Figure 2

Aspira-Managed Charter Schools
Results of General Fund Operating Revenues & Expenditures[29]
Fiscal Year 2016

	Cyber	Hostos	Olney	Pantoja	Stetson	Total
Revenues	$3,825,781	$8,497,493	$21,926,204	$9,048,088	$9,971,233	$53,268,799
Expenditures	$3,940,896	$7,404,400	$24,717,506	$10,092,029	$11,815,694	$57,970,525
Operating Surplus/Deficit	**$(115,115)**	**$1,093,093**	**$(2,791,302)**	**$(1,043,941)**	**$(1,844,461)**	**$(4,701,726)**

[28] According to the independently audited financial statements for fiscal year 2017, total General Fund revenues for the Charter Schools increased approximately 11% in fiscal year 2017 to $59.3 million, and total enrollment increased by approximately 2% to 4,169 students.

[29] Source: *The Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds*, for the General Fund, of the independently audited financial statements for fiscal year 2016 for Aspira Bilingual Cyber Charter School, Eugenio Maria de Hostos Charter School, Olney Charter High School, Antonia Pantoja Charter School, and John B. Stetson Charter School.

Criteria relevant to the finding (continued):

From the charter schools' bylaws (using Olney's as an example): *Article III, Board of Trustees*, §3.1(h), *Powers*, states:

Adopt the annual budget and conduct an annual independent audit of the School's finances; all expenditures in excess of $5,000 and not in the budget must be approved by two board members, one of which must be an officer of the board. All expenditures in excess of $10,000 and not in the budget must be approved by the Board at a duly constituted meeting."

Also from the charter schools' bylaws: *Article IV, Officers and Agents*, § 4.7, *Treasurer*, states, in part:

"The Treasurer shall oversee the receipt and disbursement of all funds including local, state and federal funds and privately donated funds and shall periodically report to the Board on the financial condition of the school. The Treasurer shall monitor payments out of these funds on proper orders approved by the Board. The Treasurer may pay out such funds on orders which have been properly signed without the approval of the Board first having been secured for the payment of amounts owing under any contracts which shall previously have been approved by the Board and by which prompt payment the School will receive a discount or other advantage. The Treasurer shall oversee the deposit of the funds belonging to the corporation in a depository approved by the Board."

Fiscal year 2016 was not the only year that the schools ran operating deficits. As shown in Figure 3 below, in both fiscal years 2015 and 2016, the Aspira-managed charter schools collectively realized net operating deficits of $2.3 million and $4.7 million, respectively. Other than the external pressures of reduced funding common to most Commonwealth public schools, the next section addresses other significant reasons for the steadily declining financial position of the schools.

Figure 3

Aspira-Managed Charter Schools
Operating Surplus/Deficits Fiscal Years 2014 Through 2016[30]

	FY 2014	FY 2015	FY 2016	TOTAL
Cyber	$456,588	$156,730	($115,115)	$498,203
Hostos	($286,634)	($825,884)	$1,093,093	($19,425)
Olney	$2,692,111	($787,543)	($2,791,302)	($886,734)
Pantoja	$967,278	($49,105)	($1,043,941)	($125,768)
Stetson	$871,906	($764,511)	($1,844,461)	($1,737,066)
TOTAL	**$4,701,249**	**($2,270,313)**	**($4,701,726)**	**($2,270,790)**

Increased Payments to Aspira, Inc.

In addition to the declining revenues previously discussed, another factor affecting the negative operating position overall was the spike in management fees, including direct service costs, in fiscal year 2016.[31] In just one year, total fees, costs, and expenses paid by the schools to Aspira, Inc. for management services increased from $7.2 million in fiscal year 2015 to $12.9 million in fiscal year 2016, or 79.6 percent. Aspira, Inc. officials attributed the increase in fees to the costs associated with their hiring of a Superintendent and the creation of a new central office.

While Aspira, Inc. officials maintained that the creation of the new central office would ultimately achieve cost savings for the schools and improve the quality of services, we believe that the persistently weak accounting records and ineffective Board governance rendered such an

[30] Source: the independently audited financial statements provided by Aspira, Inc. for fiscal years 2014 through 2016.

[31] According to the "Definitions" section of each school's management agreement, Section 1.5: " '**Management Fee**' means the percentage of local school funds plus reimbursement for any Direct Service Costs payable by [Charter School] to ASPIRA for the Services." According to Section 1.4 " '**Direct Service Costs**' means, collectively, the fees, costs and expenses payable by [Charter School] to ASPIRA for the Services."

Criteria relevant to the finding (continued):

Also from the charter schools' bylaws: *Article VII*, *Miscellaneous*, § 7.6, *Debts*, states:

"The School shall be prohibited from (i) co-mingling any funds of the School with the funds of ASPIRA of Pennsylvania, Inc. or the funds of any other charter school; (ii) guaranteeing any debts of, or pledging any of the School's revenue to secure any debts of, ASPIRA of Pennsylvania, Inc. or of any other charter school; and (iii) having any direct liability for the debts of ASPIRA of Pennsylvania, Inc. or of any other charter school. No member of the Board or officer of the School shall cause the School to enter into any transaction in violation of this Section 7.6. Nothing in this Section 7.6 shall prohibit the School from paying or guaranteeing the debts of the School or for paying for services rendered to or on behalf of the School."

Best practice criteria from Article VI, School Finances, Section 609 (relating to Budgeted Funds not to be Used for Other Purposes or Exceeded) of the PSC states, in part:

"The amount of funds in any annual estimate by any school district, at or before the times of levying the school taxes, which is set apart or appropriated to any particular item of expenditure, shall not be used for any other purpose, or transferred, except by resolution of the board of school directors receiving the affirmative vote of two-thirds of the members thereof.

No work shall be hired to be done, no materials purchased, and no contracts made by any board of school directors which will cause the sums appropriated to specific purposes in the budget to be exceeded. . . ." *See* 24 P.S. § 6-609.

assertion questionable. (Finding No. 3 addresses the weak management services agreements, and Finding No. 1 addresses the Boards' failure to provide good governance.)

<u>Overspending Budgeted Expenditures</u>

One more reason for the Charter Schools' declining financial positions was the frequent overspending of budgeted expenditures, as shown in Figure 4 below. Three of the five charter schools overspent their budgeted expenditures in all three years of the review period. In two of the three years, the Charter Schools collectively overspent their budgets.

<u>Figure 4</u>

Aspira-Managed Charter Schools Overspending of Budgeted Expenditures[32]			
	2014	**2015**	**2016**
	(Over)/Underspent Budgeted Expenditures		
Cyber	($208,177)	($78,141)	($711,105)
Hostos	($1,062,991)	($203,667)	($307,231)
Olney	($2,916,492)	($172,345)	($3,241,383)
Pantoja	($340,721)	$476,384	$119,425
Stetson	$95,597	$90,452	($1,138,624)
Total	**($4,432,784)**	**$112,683**	**($5,276,918)**

In fiscal years 2014 and 2016, the Charter Schools overspent their budgeted expenditures by 8.9 percent and 9.4 percent, respectively. Management officials attributed the excess spending in 2016 to the costs associated with the creation of its new central office headed by their Superintendent. Section 609 of the PSC prohibits school districts from exceeding budgeted expenditures, and although the Charter School Law does not specifically require charter schools to abide by this section of the PSC, it is certainly a best practice for managing finances with the goal of achieving financial stability.[33]

We also acknowledge that, in fiscal years 2015 and 2016, the belated tuition reductions levied by SDP would have

[32] Ibid.
[33] Section 609 (relating to Budgeted Funds Not to Be Used for Other Purposes or Exceeded) of the PSC. *See* 24 P.S. § 6-609.

negatively impacted budget versus actual variances. However, the Boards should have been monitoring budgets throughout the year and considered possible budget adjustments to reflect the revenue reductions. They did not do this.

But the excess of actual spending over budgeted expenditures was not the only concern we noted in the charter schools' budgets. We also found that in fiscal years 2015 and 2016, the Charter Schools' budgeted expenditures exceeded budgeted revenues by $550,000 and $400,000, respectively. Budgeting for deficits is not a best practice for achieving financial stability.

Cash Flow Problems

The current ratio compares current assets to current liabilities. It is a measure of an organization's liquidity or, in other words, its ability to pay its bills. Generally, a ratio below 2.0 is considered weak, and a ratio below 1.0 indicates that the organization has current liabilities exceeding its current assets and may be having trouble paying its bills.

Figure 5 below provides the current ratios as of June 30, 2016 for each of the five schools, as well as the total Charter Schools' current ratio. None of the schools had a strong current ratio, and Olney, Pantoja, and Hostos were below 1.0.

Figure 5

Aspira-Managed Charter Schools
Fiscal Year 2016 Current Ratio Analysis[34]

Charter School	Current Assets	Current Liabilities	Current Ratio
Cyber	$1,725,745	$1,046,443	1.6
Hostos	$278,326	$1,136,181	0.2
Olney	$3,482,877	$3,764,899	0.9
Pantoja	$1,306,984	$1,478,013	0.9
Stetson	$1,924,550	$1,313,215	1.5
Total	$8,718,482	$8,738,751	1.0

[34] Source: Data was obtained from the fiscal year 2016 independently audited financial statements—*Statement of Net Assets*, for Aspira Bilingual Cyber Charter School, Antonia Pantoja Charter School, Eugenio Maria de Hostos Charter School, John B. Stetson Charter School, and Olney Charter High School.

Our review revealed a significant interconnection between the Charter Schools and Aspira, Inc.[35] Because we found that the liquidity of the individual schools was not strong, we also reviewed the current ratio of Aspira, Inc., using data from its June 30, 2016 audited financial statements, the most recent year available. As of June 30, 2016, Aspira, Inc. had a current ratio of 0.2, which was extremely poor.

Part of the reason for Aspira, Inc.'s lopsided current ratio was that over $13 million in long-term debt was in forbearance, meaning that it was past due and not yet collected through foreclosure or other means. That past due liability was reflected as a current liability since the debt had not been refinanced. However, *even after factoring out the past due, long-term debt of more than $13 million*, the remaining $7.6 million in current liabilities were still more than twice the amount of Aspira, Inc.'s cash, prepaid expenses, and short-term receivables of $3.3 million.

<u>The Schools' Ties to Their Management Company</u>

We found further evidence of Aspira, Inc.'s weakened financial position. In fiscal year 2016, the management company's expenditures exceeded its revenues by nearly $3 million, and the consolidated change in net assets of Aspira, Inc. and its related companies was more than negative $2.2 million. Aspira, Inc.'s poor financial condition was relevant to the Charter Schools not only because it managed all of their revenues and expenditures, but also because its long-term debt was guaranteed and collateralized by the Charter Schools' revenues and net assets.

As of June 30, 2016, this debt was in forbearance, meaning that it was unpaid and past due, and the bank had provided the management company additional time to obtain refinancing. However, as of December 2017, the forbearance deadline of October 31, 2017 had expired, and the loans were still past due, unpaid, and had not been refinanced. Then in February 2018, Aspira, Inc. officials informed us that the bank had extended the forbearance through December 31, 2018. This new extension provides

[35] Aspira, Inc.'s independently audited financial statements for June 30, 2016, included a supplementary section that included the consolidated financial statements for Aspira, Inc. and its subsidiaries, along with each of the five charter schools. Other findings in this report further demonstrate the schools' lack of independence and the interconnectedness of the schools with Aspira, Inc.

additional time for Aspira, Inc. to obtain refinancing for its debt. (Finding No. 4 further addresses debt and the Charter Schools' security agreements.)

Conclusion

The charter schools and their management company, Aspira, Inc., were clearly in declining financial positions, in part from external factors such as tuition reductions from SDP. However, the Charter Schools' declining financial position may have been exacerbated by their relationship with the management company. While the schools' fund balances plummeted, their ties to the management company increased. This scenario put public education resources—which should be used for the education of the charter schools' students—at risk of having to be used to shore up the finances of the management company. The risk is further increased by the inadequate checks and balances on the control the management company had over the Charter Schools' resources. We are concerned about the schools paying more money to Aspira, Inc. when it was not held accountable for the charges that it levied upon the schools for the services it was already providing. The negative effects of the weak internal control environment will become more evident in the rest of the findings in this report.

The Charter Schools should take control of their own fiscal affairs, which would be more consistent with both the intent and spirit of the CSL. In doing so, the Charter Schools would not only be implementing common best business practices in managing their public resources, but also they would become compliant with their own amended bylaws, which require more specific accountability by the Board and its Treasurer.

Each school should consider the implementation of a financial accounting and oversight system that allows its own fiscal management officials and Board to *proactively* monitor financial activities. The schools should establish formal policies and procedures that address all aspects of financial operations, including the receipt and disbursement of all public funds and the accounting for such transactions. These policies and procedures should establish a system of internal controls limiting the authority of Aspira, Inc. in its handling of the schools' funds.[36]

Recommendations

Each *Aspira Charter School* should do the following:

3. Formally and publicly review its actual financial standing in light of its ties to Aspira, Inc., including its debt collateralization arrangements. This review should ensure that school officials take responsibility for management of the school's resources and that they do not surrender control to Aspira, Inc.

4. Establish formal policies and corresponding procedures at the school level that foster regular monitoring and authorization of all financial activities, including receipts, disbursements, payrolls, bank account reconciliations, contracts with vendors, and hiring. These policies and procedures should designate clear lines of responsibilities so that the school can practically and routinely check the power of its management company and hold it accountable.

5. Consider implementing strategies for improving its cash flow to achieve and then maintain a current ratio of 2:1 or more so that it will be able to pay its bills. These strategies should include closer governance of all financial activities, including regular monitoring of all receipts, disbursements, contracts, payrolls, and hiring.

6. Implement formal policies and procedures for monitoring its budgets throughout the year to ensure that it accounts for all significant budget variances and seeks Board authorization for any budget adjustments required during the school year.

[36] The CSL requires a charter school to be an "independent public school" and the schools' Boards to operate "independently." *See* 24 P.S. § 17-1703-A and 24 P.S. § 17-1716-A. Subsection (a) of Section 1921 (relating to Legislative intent controls) of the Statutory Construction Act provides: "The object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly. Every statute shall be construed, if possible, to give effect to all its provisions." *See* 1 Pa.C.S. § 1921(a).

Management Response

We appreciate that the Auditor General recognizes that a “significant cause” impacting financial performance during the audit period was profoundly impacted [sic] by revenue reductions which impacted all Philadelphia schools and over which ASPIRA and the Schools had no control. Although the overall revenue reduction was 4.3 percent from FY14, because of increased enrollment, the per-student reduction was actually 9.5 percent in that year alone.

As the report recognizes, The School District of Philadelphia, other charter schools in Philadelphia and many districts throughout the Commonwealth, the financial performance of the ASPIRA Schools deteriorated between FY12 and FY16 primarily due to the decline in funding levels for public education. ASPIRA recognized issues with the financial position of Schools early in 2016 (after the schools experienced a $1.6 million mid-year reduction in the per pupil payment from The School District of Philadelphia), reassigned management oversight of its own finance and accounting function, and recruited an interim financial consultant.

In April and May of 2016, ASPIRA apprised its Board and the School Boards of the significant challenges the prior financial performance posed, and recommended a corrective action plan. As part of this plan, at the start of FY17, ASPIRA implemented significant cost reductions (over $1.6 million) including a reduction in force and reorganized how ASPIRA delivered its services. ASPIRA also assisted the Schools in their own cost reduction efforts by providing administrative support and issuing RFPs to lower health care and other costs (we can enumerate if needed).

For the FY18 budgeting process (after another $2.1 million mid-year reduction in the per pupil payment from The School District of Philadelphia), ASPIRA informed the Schools of the significant risks to their budgets, and again assisted the Schools in a review of their financial position. ASPIRA and each School made significant budget cuts for FY18 (totaling over $5 million). Redesign of the medical benefits plan (which continued at no charge to employees), reductions in force, and reductions of expenses at both the Schools and ASPIRA have resulted in significantly improved financial performance at the Schools. The Boards also recruited a new Treasurer with a financial background, and each formed a Finance Committee that meets monthly to review the financial results of each School. The result is that in FY18, the combined Schools are projected to end the year with operating surplus of $650,000 versus a projected loss of $544,000 (an improvement of $1.193 million).

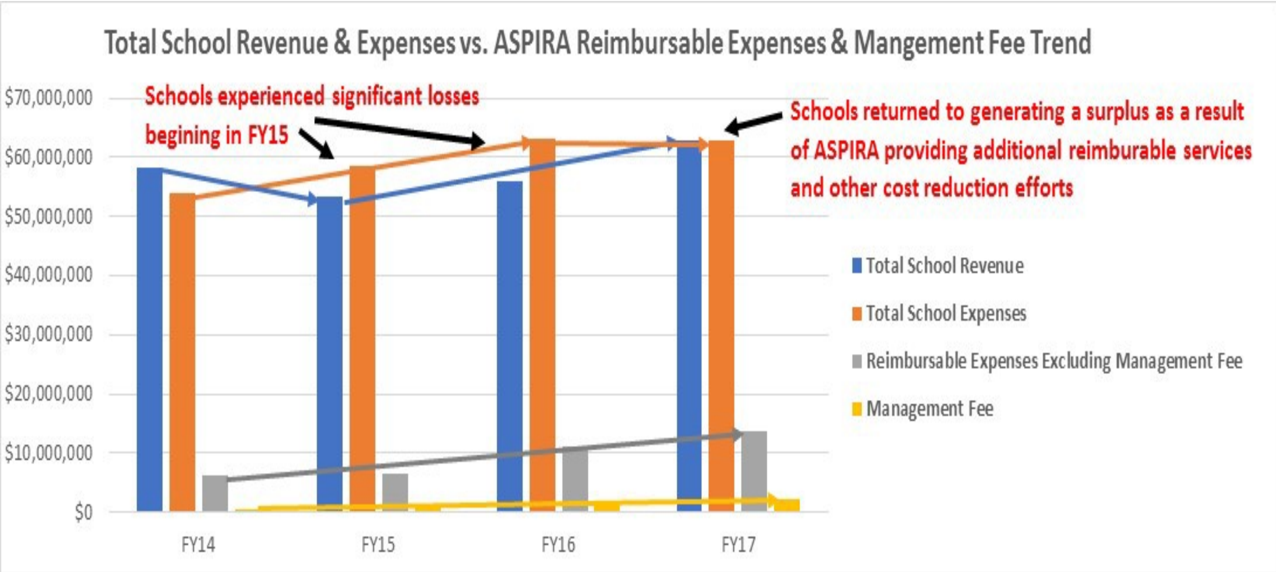
Increased Payments to Aspira Inc.

A fee is a fee. An expense is not a fee. The report claims that management fees “spiked” in FY16 and that they rose from $7.2 million to $12.9 million. While dramatic, that simply is not accurate. Payments to ASPIRA from the Schools absolutely increased during that timeframe and fee payments increased modestly. However, as demonstrated below, most of the increases in payments to ASPIRA from the Schools were for direct reimbursable expenses and for functions that the Schools no longer paid, in which cases the Schools had expense reductions that mirrored or exceeded those increases. In short, increased payments from the Schools to

ASPIRA during FY13-16 were primarily for ASPIRA providing services previously paid for by the Schools.

Overall school revenue declined 4% between FY14-FY16, though the number of students grew 6.1% from 3,755 to 3,984. That growth and other cost increases, of course, caused expenses to rise by 17.4% between FY14 and FY16. Revenue declined in FY14 from $58.2 million to $55.9 million in FY16 because of the reduction in per pupil payments and other federal and grant revenue reductions. In order to manage those cuts, ASPIRA worked with the Schools to centralize many of the administrative and instructional support functions ("Support Functions")[1]. Notably, ASPIRA's reimbursable expenses remained flat in FY14 and FY15 (at 11% and 12% of total School revenues respectively), and only increased in FY16 as a result of ASPIRA assuming responsibility for the Support Functions. Thus, the Total Payment to ASPIRA grew from $5.7 million in FY14 to $12.9 million in FY16. However the vast majority (86.1% or $11.1 million in FY16) of that payment to ASPIRA was for reimbursable expenses. The actual reimbursable expenses paid to ASPIRA grew on a gross basis given the additional services provided, and the management fee increased on a gross basis as a result of increased enrollment (at an average of 3.4%) but is still much lower than management fees received by other CMOs.

The following chart explains what has actually occurred at the Schools and ASPIRA over the past 4 years.



The end result is that the Schools, which were faced with lower revenue, increased enrollment and increased costs, project a combined operating surplus of $650,000 in FY18. Each of the Schools operating alone would never have been able to accomplish this result.

Management Response to the Recommendations:

[1] The Support Functions include Educational Program Management Services, Administrative & Contracting Services, Facilities (including security & maintenance), Nutrition Services, IT, Human Resources & Payroll, and Financial Management Services.

3. The School Boards will formally and publicly review their actual financial standing in light of its ties to ASPIRA, including its debt collateralization arrangements. This review should ensure that school officials take responsibility for management of the school's resources and that they do not surrender authorization for transactions and accountability solely to ASPIRA.

4. The School Boards will establish formal policies and corresponding procedures at the school level that support the regular monitoring and authorization of all financial activities, including receipts, disbursements, payrolls, bank account reconciliations, contracts with vendors, and hiring. These policies and procedures will designate clear lines of responsibilities so that each school can practically and routinely evaluate the services of its management company and hold it accountable.

5. The School Boards will consider implementing strategies for improving their cash flow to achieve and then maintain a current ratio of 2:1 or more so that they will be able to pay their bills. These strategies should include closer governance of all financial activities, including regular monitoring of all receipts, disbursements, contracts, payrolls, and hiring.

6. The School Boards will consider implementing formal policies and procedures to monitor their budgets throughout the year to ensure that they account for all significant budget variances and seek Board authorization for any budget adjustment required during the school year. The School Boards have already established Finance Committees for FY18, which meet monthly, but will consider formalizing their process and reporting out to the full Boards.

Auditor Conclusion

While Aspira, Inc. and its Charter Schools assert that "[a]n expense is not a fee," they failed to acknowledge that expenses were plainly spelled out as part of the fee structure in the management services agreements. We are concerned that they may be missing the important point made in both this and the next finding that **Aspira, Inc.'s poor accountability to the Charter Schools impeded auditors from determining the validity and accuracy of fees, costs, and expenses for management services, as charged by the management company to the schools**.

However, we are encouraged that the Charter Schools have agreed to our recommendation to formally and publicly review their financial standing and the status of the management company's debt. We appreciate their willingness to adopt formal policies and procedures that will provide meaningful oversight of all of their financial activities and the management company. We are also encouraged that they will consider the adoption of a formalized budget monitoring policy as well as strategies for improving their cash flow. During our next audit, we will review and evaluate the implementation of each of our recommendations, as well as the new Finance Committees' accountability to the Board and their schools.

Finding No. 3 — A Poor Organizational Structure, Weak Management Agreements, and Lack of Board Oversight Allowed Aspira, Inc. to Control All School Revenues and Expenditures—Including Payments to Itself—with Little Documentation to Support Charges to the Schools

Criteria relevant to the finding:

1. Section 1716-A(a) of the CSL places the responsibility of governance and decision-making on a charter school's Board of Trustees. *See* 24 P.S. § 17-1716-A(a). Board responsibilities were further clarified by a 2002 Pennsylvania Supreme Court decision observing that a charter school is to be governed by an independent board of trustees who retains "ultimate authority over the general operation of the school." It is our interpretation of the court's observation that once the Board is in place, it has the authority and responsibility for the control of school, rather than the applicant, founder, or contracted management company. *See West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).

2. Section 1714-A(a)(4) of the CSL states: "(a) A charter school established under this act is a body corporate and shall have all powers necessary or desirable for carrying out its charter, including, but not limited to, the power to: . . . (4) Receive and disburse funds for charter school purposes **only**." [Emphasis added.] *See* 24 P.S. § 17-1714-A (a) (4).

The five Charter Schools allowed Aspira, Inc., the management company, to manage a wide-range of educational and financial services. Over the course of the three-year period ending June 30, 2016, the Charter Schools collectively received General Fund revenues of $160 million. The same business office at Aspira, Inc.'s headquarters managed all of those funds along with its own revenues and expenditures and those of its related property-holding companies. As a result, **Aspira, Inc. paid itself** millions of dollars from the schools' public funds for the wide range of services it provided to the schools, and it did so without a sufficient check on its own control.

More importantly, the five Charter Schools and their Boards failed to demand accurate and appropriate accountability from Aspira, Inc. for the costs associated with the broad range of services provided by its primary vendor. Insufficiently documented intercompany transactions persisted throughout the review period, meaning that numerous payments between the schools and the management company lacked support and documentation.

During the same three-year period, the total amount of fees, costs, and expenses paid by the schools to Aspira, Inc. for management services, increased by more than 92 percent, from $6.7 million in fiscal year 2014 to $12.9 million in 2016.[37] Other charter school costs paid to Aspira, Inc., such as lease payments and educational program costs, also increased and are discussed later in Findings No. 4 and No. 6.[38]

[37] Source: the independently audited financial statements for fiscal years 2014 through 2016 for Aspira Bilingual Cyber Charter School, Eugenio Maria de Hostos Charter School, Olney Charter High School, Antonia Pantoja Charter School, and John B. Stetson Charter School. The Cyber, Hostos, Olney, and Pantoja management fee payments were adjusted to include a portion of the management fee that school officials agreed had been mistakenly omitted in the fiscal year 2016 related party note.

[38] According to the "Definitions" section of each school's management agreement, Section 1.5: " '**Management Fee**' means the percentage of local school funds plus reimbursement for any Direct Service Costs payable by [Charter School] to ASPIRA for the Services." According to Section 1.4 " '**Direct Service Costs**' means, collectively, the fees, costs and expenses payable by [Charter School] to ASPIRA for the Services."

Criteria relevant to the finding (criteria):

3. Section 1715-A(12) of the CSL states, in part:

   "…The term 'administrator' shall include the chief executive officer of a charter school and all other employees of a charter school who by virtue of their positions exercise management or operational oversight responsibilities. A person who serves as an administrator for a Charter School shall be a public official under 65 Pa.C.S. Ch. 11 (relating to ethics standards and financial disclosure). A violation of this clause shall constitute a violation of 65 Pa.C.S § 1103(a) (relating to restricted activities), and the violator shall be subject to the penalties imposed under the jurisdiction of the State Ethics Commission." *See* 24 P.S. § 17-1715-A(12).

4. Excerpts of the Management Services Agreements:

   (a) Eugenio Maria De Hostos Charter Contract, Article XI. *Books Records, Audits and Access*, states, in part:

   (b) "The Charter School shall keep accurate and complete books and records of all funds received hereunder in accordance with generally accepted accounting principles. . . for a period of six (6) years from the end of the Term."

The CSL requires each Charter school, with the support of its Board, to use its own money—public funds—for charter school purposes only and to be managed by an independent board of trustees.[39] The Boards were also mandated by the CSL to retain control over the operation of the schools.[40] Therefore, even though Aspira, Inc. was contracted by the schools to manage many aspects of their operations, the Boards were required to maintain control. However, we found that charter school officials—especially the Boards of Trustees—were not actively involved in the fiscal operations of their respective schools. Without regular and timely oversight of the management company and how it used the Charter Schools' resources, public funds were at risk of fraud, waste, and abuse. Finding No. 1 addresses specific failures of the Boards to be independent and fulfill their governance duties.[41]

Increased Payments for Management Services

In fiscal year 2016, while the Charter Schools' collective financial position had declined, fees, costs, and expenses charged by the management company to the schools spiked. In just one year, payments by the schools to Aspira, Inc. for management services increased from $7.2 million in fiscal year 2015 to $12.9 million in fiscal year 2016, or 79.6 percent. According to the management services agreements and the schools' accounting records, the schools paid a two-part management fee, the first of which was a revenue-based management fee. This meant that each school paid an established percentage of local revenues to the management company. The second part of the management fees was vaguely-defined as *direct services*, which included "fees, costs, and expenses" according to the schools' management agreements.

[39] The CSL requires a charter school to be an "independent public school" and the schools' Boards to operate "independently". *See* 24 P.S. § 17-1703-A and 24 P.S. § 17-1716-A.
[40] 24 P.S. § 17-1716-A(a), states the board must "retain ultimate authority of the general operation of the school."
[41] Section 1716-A(a) of the CSL, 24 P.S. § 17-1716-A(a), places the responsibility of governance and decision-making on the Board of Trustees. *See also West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002), which further held that a Charter School is to be governed by an independent Board of trustees who retains "ultimate authority over the general operation of the school." Further, Section 1716-A(a)(4) of the CSL, 24 P.S. § 17-1716-A(a)(4), states: "(a) A charter school established under this act is a body corporate and

Criteria relevant to the finding (criteria):

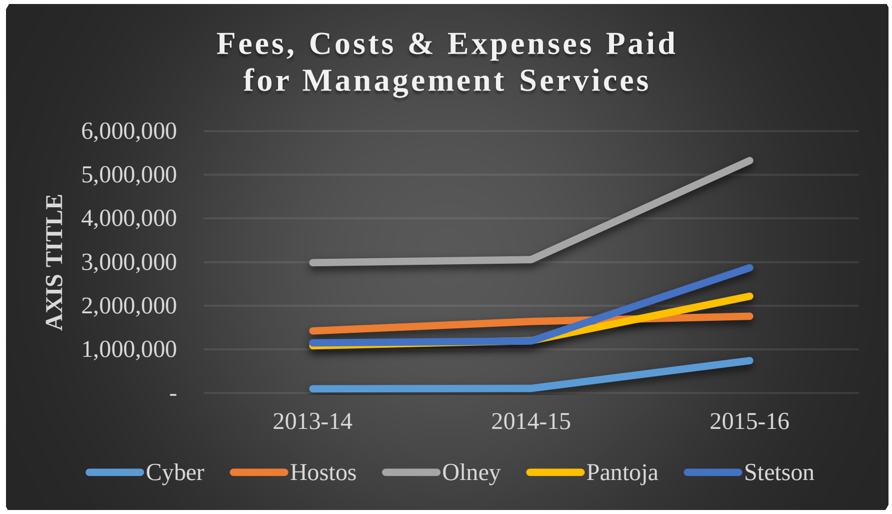
5. Government Accountability Office Green Book, Section 10.03 states, in part:

   a. *Appropriate documentation of transactions and internal control:* "Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination . . . Documentation and records are properly managed and maintained."

   b. *Segregation of duties:* "Management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event."

Figure 1 below shows the significant increase in payments for management services.

Figure 1[42]



Management company officials attributed the spike in payments for management services during fiscal year 2016 to the creation of a central office led by a Superintendent hired by Aspira, Inc. who had three support services directors and other staff. They said this centralization was part of a strategy employed to address the revenue reductions from SDP. This organizational structure is addressed in the next two sections.

Based on our review of Board minutes and testimony from Aspira, Inc. officials, we concluded that payments to the management company were expected to increase even more in the future because, in fiscal year 2017, Aspira, Inc. increased the number of services it was providing to the schools. The management company also started providing a self-funded health insurance program, additional transportation services for after school and other activities, and additional educational support services at the high school that had been previously provided by an outside vendor. The Charter Schools must implement strong internal accounting controls to check the authority of

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shall have all powers necessary or desirable for carrying out its charter, including, but not limited to, the power to: . . . (4) Receive and disburse funds for charter school purposes only."

[42] Source: the data was obtained from the related party notes to the independently audited financial statements for the respective years for Cyber, Hostos, Olney, Pantoja, and Stetson. Also, the Cyber, Hostos, Olney, and Pantoja payments were adjusted to include a portion of the management fee that school officials agreed had been mistakenly omitted in the fiscal year 2016 related party note.

Aspira, Inc., and reduce the risk of fraud, waste, and abuse of public education funds.

Flawed Agreements and Organizational Structure

The agreements between the Charter Schools and Aspira, Inc. established the foundation for many of the issues we found throughout the audit. The agreements provided for a broad range of services to be provided to the Charter Schools by the management company with little required accountability and transparency. The services included the following:[43]

- Educational Program Management
- Administrative and Contracting
- Financial
- Facilities (including maintenance and security)
- Human Resources and Payroll
- Transportation
- Nutrition
- Information Technology And Support

The agreements did not contain specific cost assignments for the different types of services, and therefore provided for little or no transparency or accountability. They also contained automatic renewal clauses that discouraged competitiveness in pricing and quality of services. But perhaps most importantly, while the agreements stipulated that the management company would submit invoices for services rendered, we found that 1) the invoices lacked sufficient details to provide verification of services for any potential reviewer *and* 2) no school officials reviewed these invoices anyway.

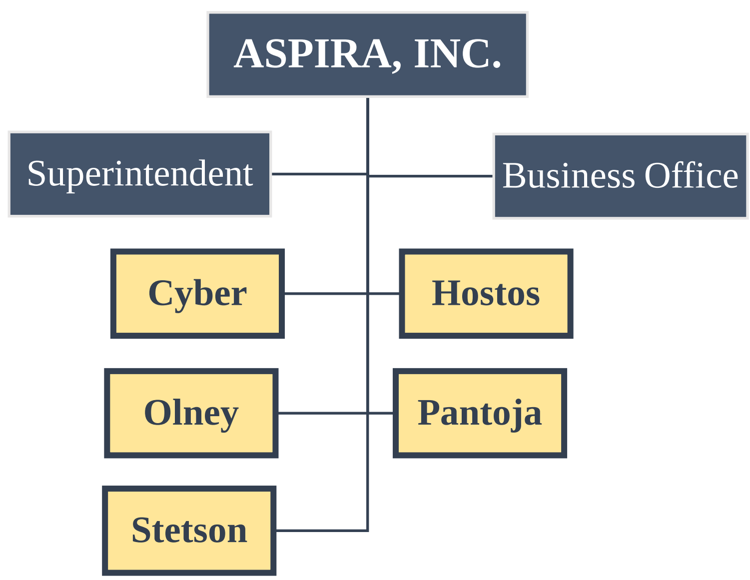
The Charter Schools did not have their own business offices or business managers. The highest level administrators at the Charter Schools were the principals, who managed the day-to-day operations of the schools but not the schools' fiscal affairs. Instead, the business office staff at Aspira, Inc.'s headquarters managed the Charter Schools' revenues, expenditures, and record-keeping with little actual oversight by school officials and the schools' respective Boards. The same business office staff also managed revenues, expenditures, and record-keeping for

[43] Source: the list of services per the Olney Charter High School management services agreement for fiscal year 2016. The other schools' agreements listed the same types of services to be provided by the management company.

Aspira, Inc. and its related companies, along with other programs, including an Aspira pre-school. Therefore, as shown in Figure 2 below, the chief financial officer and the controller for the schools were the same financial officers for Aspira, Inc. and its related companies. The same staffing scenario applied for other administrative offices, such as human resources and payroll.

The centralization of all these fiscal functions for numerous organizations allowed the schools' resources to be managed with less transparency than what would normally be required of a traditional school district or a charter school without a management company. Therefore, it was more incumbent upon the Boards and/or a fiscal officer employed by the schools, if they had employed one, to provide a check and balance on Aspira, Inc. to ensure accountability over the use of public funds.

Figure 2 – The Administration of the Aspira-Managed Charter Schools



The lack of segregation of duties between who controlled the public Charter Schools' resources and who controlled Aspira, Inc.'s private resources represented a structural internal control weakness, especially in light of the Boards' failure to govern the schools. The same Aspira, Inc. staff managed both the payers' and the payees' bank accounts and flow of funds. With regard to the previously mentioned invoices from Aspira, Inc., this organizational structure allowed Aspira, Inc. personnel to process their own invoices, and therefore, **Aspira, Inc. paid itself millions of dollars without sufficient and timely oversight**.

Although the Superintendent oversaw the schools, the Superintendent and the central office directors were actually employees of Aspira, Inc. Also, according to the Boards' meeting minutes, the Superintendent reported to the Chief Executive Officer (CEO) of the management company.[44] In addition, during audit work in the spring and summer of 2017, we observed that the Superintendent's offices were located at the Aspira, Inc. headquarters on the same floor and down the hall from the CEO.[45] This organizational structure further impaired the independence of the Charter Schools and contributed to the schools' apparent noncompliance with their own charters and the CSL.

Possible Circumvention of CSL and Ethics Act

The CSL and the Pennsylvania Supreme Court have made clear that charter schools are to be governed by independent Boards of Trustees who "retain ultimate authority over the general operation of the school."[46] Also, the CSL regulates administrators of charter schools and designates them as public officials. But, in the case of the Aspira-managed schools, all senior administrators (aside from principals) were employees of the management company and were, therefore, **not** bound by the CSL, the Ethics Act, and other rules and regulations governing charter schools.

A charter school is also a non-profit corporation and independent public school. And, it should not be an operating division or a subsidiary of another corporation. In short, a charter school must operate separately and wholly independently of any other corporation with which it is associated.[47]

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[44] Per the Charter Schools' February 2, 2015 board meeting minutes.

[45] Aspira Inc.'s headquarters were located at 4322 N. Fifth Street in Philadelphia. The offices of the CEO, the Controller, the Superintendent, and the other support services directors were all located on the third floor.

[46] Section 1715-A of the CLS, 24 P.S. § 17-1715-A, addresses the role of administrators of charter schools as public officials. *See also West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).

[47] The state Supreme Court observed in 2002 that, "[a] prerequisite to the grant of a charter is the organization of the school as a nonprofit corporation governed by a board of trustees that possesses authority to decide matters relating

However, the organization of the Aspira-managed Charter Schools and weak management services agreements allowed the *private* management company, without properly established checks and balances, to be in charge of virtually every aspect of the *public* charter schools' operations. This structure also may have permitted Aspira, Inc. to circumvent our General Assembly's legislative intent of the CSL and the Ethics Act by allowing the Superintendent to avoid being subject to the Ethics Act as a "public official."[48]

The next sections address some of the effects of the lack of transparency—mainly significant instances of a lack of accountability for the costs that were charged by Aspira, Inc. to the Charter Schools.

Significant Payments to Management Company

The schools' agreements with Aspira, Inc. resulted in payments of potentially unnecessarily high management fees. Each school had a two-pronged management fee structure for paying Aspira, Inc. One part of the fee was based upon a *percentage of each school's local revenues*. The second part of the management fee was called *direct services*, and according to the contracts with Aspira, Inc. it included "fees, costs and expenses" payable by the schools to Aspira, Inc. for each type of service that was provided.

Management company officials claimed that the range of revenue-based fees for the schools, which varied from 1.5 percent for Hostos to 5 percent for Stetson, was lower than most fees charged to other Philadelphia area charter schools by other management companies. Other than stating that Hostos could not afford more than a 1.5 percent fee, Aspira, Inc. officials could not explain the rationale for the varying rates charged to the Charter Schools. Commonly accepted best business practices discourage revenue-based fees because they disregard costs as a factor for charging for services.

More importantly, when combined with the *direct services* charges for fees, costs, and expenses, as shown in Figure 3

to the operation of the school, subject to the school's charter." See *Mosaica Acad. Charter Sch. v. Dep't of Educ.*, 572 Pa. 191, 200, 813 A.2d 813, 818 (2002).

[48] Subsection (a) of Section 1921 (relating to Legislative intent controls) of the Statutory Construction Act. *See* 1 Pa.C.S. § 1921(a).

below for fiscal year 2016, we found that the total management fees as a percentage of revenues for each school ranged from 19.3 percent to 28.8 percent. The next two sections address an array of problems with Aspira, Inc.'s accounting for the cost of direct services that it charged to the schools.

Figure 3

Aspira-Managed Charter Schools Comparison of Management Fees to Revenues and Expenditures – Fiscal Year 2016[49]						
	Cyber	Hostos	Olney	Pantoja	Stetson	Total
Total Management Fees	$739,895	$1,757,783	$5,325,616	$2,216,582	$2,869,437	$12,909,313
As a % of Revenues	19.3%	20.7%	24.3%	24.5%	28.8%	24.2%
As a % of Expenditures	18.7%	23.7%	21.5%	21.9%	24.2%	22.2%

Direct Services Charges: Allocated Costs of Aspira's Senior Administrators & Other Employees

The direct services charges included, but were not limited to, allocations of over 90 percent of the salaries and benefits of senior administrators employed by Aspira, Inc. This included the Chief Executive Officer (CEO), the Chief Operating Officer (COO), the Superintendent, and other department directors. In addition, other Aspira, Inc. employees' salaries were allocated to the Charter Schools, including support services employees, financial office employees, human resources and payroll staff, maintenance, security, kitchen staff, and others. We found that more than 100 management company employees' salaries and benefits were allocated to the Charter Schools.

While the Boards received monthly financial reports, these reports lacked details and did not provide specific information about the direct services charges to each school or the allocations of specific Aspira, Inc. employees' salaries and benefits. Thus, a meaningful review of financial activities and a comparison to approved budgets was impossible. Since Aspira, Inc. itself had other operations and programs, including the operation of a separate pre-school, the Charter Schools and their Boards

[49] Source: the independently audited financial statements for fiscal year 2016 for Aspira Bilingual Cyber Charter School, Eugenio Maria de Hostos Charter School, Olney Charter High School, Antonia Pantoja Charter School, and John B. Stetson Charter School. Note that the management fee payments are from the related party note to the financial statements. Also, the Cyber, Hostos, Olney, and Pantoja payments were adjusted to include a portion of the management fee that school officials agreed had been mistakenly omitted in the fiscal year 2016 related party note.

should have carefully monitored the allocations charged to each school.

Additionally, other than a perfunctory board vote approving the hiring of the Superintendent, the Charter Schools and their Boards had no authority to hire, contract with, or determine contract terms, such as buyout clauses, with the senior administrators of Aspira, Inc. who operated the schools. They also did not manage the payrolls of the numerous Aspira, Inc. employees whose salaries and benefits were charged to the Charter Schools.

Although we believe this is not a valid comparison, Aspira, Inc. officials repeatedly claimed that they operated the Charter Schools similarly to how a school district operates—as if each charter school was one school in a district and the management company acted as a school district's administration. However, the transparency related to the cost of senior administrators and other employees of Aspira, Inc. was markedly less than that of similar administrations in typical school districts. It was also markedly less than that of charter schools that aren't operated by a separate management company.

For instance, in school districts, the senior administrators are employed by the district and are directly accountable to taxpayers and subject to the requirements of the PSC, the Ethics Act, and other Pennsylvania statutes. So, too, the hiring, firing, and salary adjustments of a school district's senior administrators and other employees are reviewed and approved in a public forum, i.e. at a school board meeting. Finally, school districts and charter schools are subject to audits by the Department of the Auditor General while private management companies are not, which allows for a significant reduction in the transparency of the use of public funds.

Figure 4 below lists Aspira, Inc.'s top administrators and their salaries for fiscal year 2016, which were allocated almost entirely, along with benefits (not included in this table), to the Charter Schools.

Figure 4

Aspira-Managed Charter Schools Aspira, Inc.'s Senior Administrators FY 2016 Salaries (Excludes Benefits)	
Position	**Salary[50]**
CEO	$200,000
COO	$160,577
CFO	$170,000
Superintendent	$180,000
Controller[51]	$110,770
Total	**$821,347**

In an audit of a regular school district or a charter school that is not run by a separate management company, we would have been able to review senior administrators' employment contracts and payroll records. We would have been able to verify whether the contracts were board-approved, whether compensation actually paid to the administrator complied with the terms of the contract, and whether any other payments were made outside of the contract terms, such as contract buyouts.

However, since Aspira, Inc. is neither a charter school nor a school district, we could not review senior administrator and other Aspira employee contracts or related employment costs. As a result, among other possible issues, we could not determine whether senior administrator contracts were appropriate and whether there were any contract buyouts, the costs of which may have been borne by the Charter Schools. This is one more example of the reduced transparency in the way that public funds were used in this organization.

Furthermore, the allocation of Aspira employees' salaries to the charter schools was not limited to the senior administrators. For instance, schools were allocated the cost of salaries and benefits for food service, maintenance, and security workers. However, those allocations did not

[50] Salaries are from each individual's respective 2016 IRS Form W-2, with the exception of the CFO, whose salary was taken from the 2015 IRS Form 990, since that individual terminated employment with the management company sometime during fiscal year 2016. According to officials, the current interim CFO is a paid contractor rather than an employee of the management company. Therefore, the CFO's and any other financial consultant's compensation may be more or less than the amount reported in the 2015 IRS Form 990.

[51] This amount is estimated. The Controller was hired in August of 2016, and therefore, we annualized his salary based on his 2016 IRS Form W-2, estimating that it was for approximately 5 months' wages.

necessarily correspond with their work performed at the respective schools. And again, because all of these employees who actually worked at the Charter Schools were employed by Aspira, Inc., their hiring, firing, and payrolls were not public; therefore we could not review their employment contracts, etc.

Business office officials from Aspira, Inc. acknowledged that portions of the compensation costs of some employees who may not have actually worked at certain schools could still have been charged to those schools. They claimed, however, that they have rectified this accounting problem by implementing a new allocation process and accounting software system for fiscal year 2017-18.

<u>Other Direct Services Charges & Record-Keeping Problems</u>

Salaries and benefits of Aspira, Inc. employees were not the only costs to the schools that made up what were classified as direct services charges. For instance, travel costs and intercompany transactions were also included in these management costs. Due to incomplete records, we could not adequately reconcile the direct services charged to the schools' respective accounting records. For example, we found that in the three-year review period ending June 30, 2016, nearly $400,000 in travel charges among the five schools contained inconsistent levels of information describing the purpose of the travel. Aspira, Inc. officials acknowledged the documentation for many of those transactions was likely missing.[52]

During our review of accounting records, we also found vague and/or unsubstantiated journal entries and other *intercompany* transactions between the management company and the schools with notations such as "payroll help," "realignment of operations," "to net intercompany receivables and payables," and "research." These entries did not contain further information or documentation to support what was charged to the schools. The lack of information explaining these intercompany transactions is troubling and further demonstrates the lack of

[52] The approximate $400,000 in travel charges was tallied from the schools' intercompany transaction records, which contained profit/loss pages that reconciled to the independently audited financial statements. We did not audit the accuracy or completeness of the intercompany transaction records because management had already acknowledged errors, incompleteness, and lack of documentation for many of the transactions.

independence among the Charter Schools and their management company, Aspira, Inc.

Aspira, Inc. officials admitted that they lacked supporting documentation for many related-party transactions and said that the accounting records were not complete. According to Aspira, Inc. officials, the previous financial team, in place during the three-year review period ending June 30, 2016, did not sufficiently maintain accounting records. Thus, the accuracy, validity, and appropriateness of the related party transactions between the schools and Aspira, Inc. could not be determined.

Conclusion

Because of vague and overly broad language and a failure to include accountability requirements in the management agreements, the five Charter Schools and their Boards surrendered too much authority to Aspira, Inc., their primary vendor. Numerous unsupported intercompany transactions and insufficient record-keeping weakened any semblance of independence of the Charter Schools and their Boards. As a result, public funds designated for the education of individual students at each of the five Charter Schools may not have been appropriately used by those institutions responsible for the education of their respective students.

Again, Aspira, Inc. and its senior administrators who managed the schools were not bound by the CSL, the Ethics Act, and other regulations governing charter schools and school districts. Because of this, the Charter Schools, their students, parents, and the community were deprived of the opportunity to be timely informed of the schools' financial activities and to consider options for managing costs and/or obtaining goods and services from other vendors.

Further, given the fact that the management company began providing even more services in fiscal year 2017, the Charter Schools and their Boards should immediately take control of their fiscal operations to ensure that public funds are used properly and in accordance with the CSL.

Recommendations

The *Aspira Charter Schools* should do the following:

7. Immediately conduct a formal, detailed review of the documentation supporting the payments made to the management company and other related parties for the three-year period ending June 30, 2016. They should determine whether sufficient documentation exists to support the payments, and if not, consider whether to seek reimbursement from Aspira, Inc. for charges not sufficiently substantiated. In addition, they should require full documentation for any and all invoices submitted by the management company **before** making payment.

8. Consider the appropriateness of the cost allocation of the salary and benefits of each employee of Aspira, Inc. whose compensation is charged to each of the schools. The schools should include in their consideration:

    a. The question of what the revenue-based portion of the management fee is supposed to pay for.

    b. The question of whether the salary and benefits allocation ratios are appropriate in light of the actual services provided by specific Aspira employees to the respective schools.

    The Charter Schools should then routinely monitor these charges throughout the school year to verify that they comply with the agreed upon allocations authorized as part of the budgeting process.

9. Review and modify both the organizational structure and the management services agreements so that the schools and their Boards have greater authority governing the use of their public funds and so that Aspira, Inc. is required to be accountable to the schools and their Boards. Each school should insist that it employs at least one senior administrator to monitor the services provided by Aspira, Inc., to scrutinize all financial activities, and to monitor and pre-authorize the use of the school's public funds. This employee of each Charter School will automatically be designated as a public official, and as such, will be subject to the CSL,

the Ethics Act, and any other regulations and rules that govern Chief Executive Officers/administrators of charter schools.

10. The schools should consider the adoption of board-approved policies governing internal accounting controls, invoicing, payment of bills, and budgets and budget monitoring. These policies should require a segregation of duties, including a separation between the fiscal offices of the schools from those of Aspira, Inc. and its subsidiaries and programs.

Management Response

The findings here again suffer from an inaccurate view of controlling law and ignore that each charter school was audited under actual GAAP standards with no findings supporting this report's views. This section continues by admitting that ASPIRA staff "were employees of the management company and were therefore **not** bound by the CSL, the Ethics Act, and other rules and regulations governing charter schools." This section concludes that "this structure also may have permitted ASPIRA, Inc. to impede our General Assembly's legislative intent of the CSL and the Ethics Act and even allowed the Superintendent to avoid being subject to the Ethics Act as a 'public official'."

While the Auditor General may object to private management of charters and may wish the law were different, the report does not and cannot conclude that there was anything improper or inappropriate in the management of the schools. The report complains that if ASPIRA were a public school or a school district the Auditor General would have authority to audit its records. The report goes on to suggest that ASPIRA is somehow to blame for that. That complaint, however, belongs in the legislature, not in this report.

Charter management organizations do just that. They manage. And they manage many of the administrative functions of a charter school so that educators can teach. Once again, ASPIRA's management of the schools was entirely lawful, appropriate and consistent with how numerous other management companies operate. The report's complaints about the law simply reflect that ASPIRA and the Schools operated within the law.

We agree with the report's conclusion that "[t]he CSL requires each Charter school, with the support of its Board, to use its own money—public funds—for charter school purposes only and to be managed by an independent board of trustees." Nothing in this independent report concludes anything to the contrary. The report's observation that "public funds were at risk of fraud, waste, and abuse" is a statement that can be made of any recipient of public funds and does not equate to a finding that there was, in fact, a single instance of waste fraud or abuse.

Management Response to the Recommendations:

7. The Schools will consider a formal, detailed review of the documentation supporting the payments made to the Management Company and other potentially related parties for the three-year period ending June 30, 2016. They will determine whether sufficient documentation exists to support the payments, and if not, consider whether to seek reimbursement for charges not sufficiently substantiated. In addition, they will require appropriate documentation for any and all invoices submitted by the Management Company **before** making payment.

8. The Schools decline to investigate the salary allocations of senior officials at ASPIRA. ASPIRA is a separate company and the Schools have no authority or basis to change such salaries. However, the Schools will inquire of ASPIRA:

   a. What the revenue-based portion of the management fee pays for; and
   b. Whether the management fee and other fees and expenses paid to ASPIRA are appropriate and prudent.

9. The Schools' Boards will review and, if appropriate, modify both the organizational structure and the management services agreements so that the Schools and their Boards have greater authority governing the use of their public funds to ensure ASPIRA continues to be accountable to the Schools and their Boards. The Schools will consider the recommendation that each School should employ at least one senior administrator to monitor the services provided by ASPIRA, to scrutinize all financial activities, and to monitor and provide input to support the Boards' preauthorization of the use of the Schools' public funds.

10. The Schools will consider the adoption of Board-approved policies governing internal accounting controls, invoicing, payment of bills, and budgets and budget monitoring. This review will consider requiring a segregation of duties, including a separation between the fiscal offices of the Schools from those of ASPIRA and its subsidiaries and programs.

Auditor Conclusion

We emphasize that the weak organizational structure and poor governance by the Charter Schools' Boards, which allowed Aspira, Inc. to control over $150 million in public school funds without appropriate accountability which **heightened the risk of fraud, waste, and abuse of public school funds.** A management company having one business office responsible for managing five charter schools' public funds plus its own money, as well as that of other related companies, is simply not a best practice and is not in accordance with the intent of the CSL.[53]

[53] The Commonwealth Court in *Insight PA Cyber Charter School v. Department of Education,* 162 A.3d 591, 602 (Pa. Cmwlth, 2017), in recently rejecting the Charter Appeal Board's decision to deny Insight's charter application observed that the Insight Chief Executive Officer (CEO) was "a direct employee" of the Insight board and had "day-to-day supervisory authority" of Insight itself. This helped to support that Insight's management agreement had met the "Real and Substantial Authority" Test which also was the legal test utilized in *West Chester Area Sch. Dist*. Moreover, the Insight's Chief Financial Officer (CFO) was also an employee of Insight and not the management company.

It remains our position that a charter school should have a well-engaged board of trustees and at least one public administrator, such as a business manager, overseeing the school's operations and the support services of the management company. The Charter Schools we audited have neither. Instead, the Superintendent and all business office employees worked for Aspira, Inc. and approved and accounted for the transactions charged to the schools by Aspira, Inc. itself.

While this report did not conclude that there was no evidence of fraud, waste, and abuse, it is important to note that this was a limited procedures engagement of the Charter Schools that did not encompass a forensic examination of Aspira, Inc. However, we did clearly conclude that the management company's recordkeeping of the charter schools' financial activities was so poor that we would not have been able to sufficiently validate the fees, costs, and expenses charged to the schools by Aspira, Inc. for management services.

We emphasize the duty of each individual Charter School to account for its own expenses, including its own determination of the appropriateness of the allocations charged by the management company. We also emphasize the duty of each school to routinely monitor and verify all expenses it incurs, including all cost allocations charged by the management company. As previously stated, each school must accomplish these important duties through the employment of at least one administrator or business manager.

However, we are pleased that, despite their earlier assertions, the Charter Schools have agreed to our recommendation to review and consider modifying the organizational structure, as well as the management services agreements. We also appreciate that the Charter Schools will consider the adoption of board-approved policies governing internal accounting controls and an array of financial activities. Further, we are encouraged that the Charter Schools are considering a formal review of the payments they made to Aspira, Inc. during the review period and that they will consider seeking reimbursement for charges not sufficiently substantiated. We are also pleased that, from now on, they will require appropriate documentation *prior* to payment. We will follow up on this during our next audit.

Finally, we express sincere concern about the Charter Schools' resistance to requiring Aspira, Inc. to account for the allocations of salaries and benefits of those Aspira employees whose payroll costs are charged to the schools. This is a critical step in determining the appropriateness of the costs, fees, and expenses paid by the schools for management services. Failing to require accountability for such expenses would represent a gross dereliction of their duty to govern and maintain control over their schools' operations.

Finding No. 4	The Charter Schools Pledged Revenues and Net Assets to Secure Aspira, Inc.'s Debt, and Most of That Debt was Unpaid and Past Due

Criteria relevant to the finding:

The By Laws of the Charter Schools, Article VII, *Miscellaneous*, § 7.6, *Debts*, state:

"The School shall be prohibited from (i) co-mingling any funds of the School with the funds of ASPIRA of Pennsylvania, Inc. or the funds of any other charter school; (ii) guaranteeing any debts of, or pledging any of the School's revenue to secure any debts of, ASPIRA of Pennsylvania, Inc. or of any other charter school; and (iii) having any direct liability for the debts of ASPIRA of Pennsylvania, Inc. or of any other charter school. No member of the Board or officer of the School shall cause the School to enter into any transaction in violation of this Section 7.6. Nothing in this Section 7.6 shall prohibit the School from paying or guaranteeing the debts of the School or for paying for services rendered to or on behalf of the School."

Subsection (f) of Section 1103 (relating to Restricted activities) of the Ethics Act states:

"(f) *Contract*.--No public official or public employee or his spouse or child or any business in which the person or his spouse or child is associated shall enter into any contract valued at $500 or more with the governmental body with which the public official or public employee is associated or any subcontract valued at $500 or more with any person who has been awarded a contract with the

As of June 30, 2016, the Charter Schools' management company, Aspira, Inc., and its property-holding subsidiaries owed more than $17 million in overdue debt. Most of the debt was connected with the Aspira companies' acquisition and/or improvement of school buildings and its own headquarters. More than $14 million, or 81.7 percent of the debt, was secured by the pledged collateral of the Charter Schools, including their revenues and net assets.

By December 2017, most of the debt was still unpaid and past due, and an October 31, 2017 forbearance deadline had expired without Aspira, Inc. securing refinancing. However, in February 2018, management company officials stated that the bank had extended the forbearance deadline to December 31, 2018, providing additional time for the management company to obtain refinancing of its debt. Also, by December 2017, a separate lender of a line of credit (LOC) with an $800,000 past due balance notified Aspira, Inc. of its intent to exercise its right to be repaid in full. In March 2018, Aspira, Inc. officials said that the bank holding the LOC had also granted a forbearance extension through December 31, 2018.

According to Aspira, Inc. officials, the banks extended the forbearance deadlines, in part, because they recognized the difficulty in obtaining refinancing while awaiting a final decision on the SRC's charter nonrenewal vote for two of the schools. If Aspira, Inc. and its subsidiaries failed to secure refinancing and defaulted on this debt, then the schools' collateral in the form of their revenues and net assets—instead of being used to educate their students—could be seized for repayment of the debt. However, Aspira, Inc. officials stated that the school buildings themselves provided security on most of the debt, as well, and the banks could potentially seize the school buildings in the event of foreclosure. Therefore, in the event of foreclosure, the risk to the schools potentially could be mitigated by the value of the school buildings.

Criteria relevant to the finding (continued):

governmental body with which the public official or public employee is associated, unless the contract has been awarded through an open and public process, including prior public notice and subsequent public disclosure of all proposals considered and contracts awarded. In such a case, the public official or public employee shall not have any supervisory or overall responsibility for the implementation or administration of the contract. Any contract or subcontract made in violation of this subsection shall be voidable by a court of competent jurisdiction if the suit is commenced within 90 days of the making of the contract or subcontract." *See* 65 Pa.C.S. § 1103(f).

The Charter Schools' ties to the management company's debt was further complicated by the fact that the cost of their school building leases was based on Aspira, Inc.'s debt service. Debt service is the annual amount of principal plus interest obligated to be paid on a mortgage. Three of the Charter Schools' leases used the management company's debt service as a factor for establishing the rents paid by the schools. Yet, the terms of the leases did not require Aspira, Inc. to then apply the debt-service based rents it received to the reduction of its debt. Therefore the Charter Schools bore significant risk associated with the management company's delinquent, unpaid debt.

We also found no record of the Charter Schools' Boards authorizing the related party lease agreements or the collateralization of the related-party debt.

In addition, a promissory note with a $2.3 million balance as of June 30, 2016, which was owed by Aspira, Inc. to Olney, was not board-authorized. The amount of the promissory note reflected the net amount of the numerous insufficiently documented intercompany transactions between Aspira, Inc. and Olney.

These related-party agreements, including the promissory note, the lease agreements, guarantees, and security agreements, may have been executed in noncompliance with the Ethics Act.

The Schools' Relationship to Aspira, Inc.'s Debt

Figure 1 below shows the breakdown of the debt held by Aspira, Inc. and its subsidiaries. When a school is a **Grantor** as part of a security agreement, it has pledged revenues and assets as collateral if the borrower defaults. When a school is a **Lender**, it has loaned money to an organization. When a school is a **Guarantor**, it promises to pay back a loan if the borrower fails to repay the loan.

Details of each of the five loans are discussed further in the following sections.

Figure 1

Aspira-Managed Charter Schools Analysis of Related Party Loans as of June 30, 2016 and December 2017[54]					
#	Grantor/Lender/ Guarantor	Borrower	Original Loan Amount	Balance as of June 30, 2016	Status as of December 2017
1	All 5 schools **Hostos ($500K)**	ACE/D	$12,750,000 (orig. 2011)	$8,496,247	Past due; forbearance expired, then extended; foreclosure risk
2	Pantoja	ACE	$5,400,000 (orig. 2007)	$4,447,227	Past due; forbearance expired, then extended; foreclosure risk
3	Pantoja	ACE	$1,742,573 (orig. 2013)	$1,239,345	Matures August 2018
4	Olney	Aspira Inc.	$2,371,820 (orig. 2016)	$2,371,820	Balance $433,656 Due by Nov 2018
5	**All 5 schools**	Aspira Inc.	$1,400,000[55] (orig. 2016)	$800,000	Past due; forbearance expired, then extended; foreclosure risk
	TOTAL		**$23,664,392**	**$17,354,639**	

The $12.75 Million Loan and the Security Agreements

Delinquent; In Forbearance. In 2011, Aspira, Inc. and its subsidiaries borrowed $12.75 million as part of a refinancing and consolidation of debt on the Campus building, the Pantoja building, and its own headquarters building. The President of the Boards of Trustees of all five Charter Schools, who was the same person, signed security agreements with a financial institution pledging each of the school's revenues and net assets as collateral, as follows:

> "Collateral" shall include all of Grantor's Gross Revenues, tuition, grants, amounts received from fundraising, net assets released from restriction, registration fees, investment income, subsidies, bequests, rental income, ticket sale income and similar assets . . .

As of June 30, 2016, the balance on this debt was $8.5 million, and it was in forbearance. This loan, dated October 2011, had a starting balance of $12.75 million,

[54] Sources: The respective loan and security agreements and the schools' and Aspira, Inc.'s independently audited financial statements as of June 30, 2016.
[55] This loan was a revolving line of credit.

which was then reduced in large part by $3.25 million in funding received from the Commonwealth's Redevelopment Assistance Capital Program (RACP). This loan matured October 1, 2016. A forbearance agreement with the lender was granted through October 31, 2017, in order to give Aspira, Inc. time to obtain a refinancing arrangement.

As stated previously, in February 2018, management company officials stated that the bank had extended the forbearance deadline to December 31, 2018, providing additional time for the management company to obtain refinancing. We confirmed the forbearance status in Aspira, Inc.'s fiscal year 2017 long-term debt note to its independently audited financial statements, which contained the following statement about the debt:

> …the Organization [Aspira, Inc.] is in violation of certain loan covenants and is in forbearance with these loans as well. The Organization has negotiated terms of these loans with the bank and have been agreed to be extended through December 2018. As a result the loans are considered all currently due….

No Board Authorization. Aspira, Inc. officials could not provide any documentation to verify that these security agreements had been reviewed and approved by a majority of each school's respective Board in an open and public forum. As stated earlier, the agreements may have been entered into in noncompliance with the Ethics Act.

Because the Charter Schools' collateral was pledged to secure the debt, their tuition revenues and net assets could have been seized to repay the debt if the management company defaulted and the lender demanded payment in full.

Flawed lease agreements. Altogether the Charter Schools paid nearly $2 million annually to Aspira, Inc. to lease school buildings. We believe that the related party lease terms were unfair to the schools because three of the four related party leases based the rents paid by the schools on the debt service of the management company. Debt service was an unusual factor for charging rent to the schools compared to a more common factor such as square footage. But also unusual and certainly unfair was the fact that the lease terms contained no corresponding provisions requiring Aspira, Inc. to remit any portion of the rents collected to pay down its debt. Also, none of the debt agreements with the banks required Aspira, Inc. to remit any portion of rents collected to pay down the debt.

Approximately $1.7 million, or 85 percent, of the $2 million of the annual, related party rent payments were based on Aspira, Inc.'s debt service. Yet by December 2017, Aspira, Inc.'s debt, most of which had balloon payments due in October 2016, was still unpaid, past due, and at risk of foreclosure. Since the debt was now at risk of default and foreclosure, the Charter Schools were now at risk of having to use their own revenues and net assets to pay Aspira, Inc.'s debt rather than to fund the education of their own students.

Failure to publicly disclose security agreements on the Campus building. Even though all five schools provided collateral to secure this debt, the only related disclosure made was by Stetson, which incorrectly disclosed that it was a *guarantor* of the debt in its independent audit report. This disclosure was inaccurate because Stetson was actually a *grantor* providing collateral to secure the debt. This lack of disclosure by each of the schools about their actual relationship to the debt owed by Aspira, Inc. constituted a lack of transparency, and may have misled the public about the risk borne by the school. (See Finding No. 8 for more information related to issues with the audited financial statements)

Other poor business practices. Because the debt was a consolidation loan, part of the original debt that was now being secured by the Charter Schools' collateral was connected to the acquisition of Aspira, Inc.'s headquarters building. Although the CSL does not explicitly prohibit it, charter schools should not pledge collateral to secure the debt of a vendor—in this case the debt on the management company's headquarters building.

In addition, Olney and Stetson were *Renaissance Charter Schools* of the SDP, which were managed by Aspira, Inc. The schools occupied buildings owned by the SDP and not Aspira, Inc., yet they provided collateral to secure debt related to the Campus Building, the Pantoja building, and Aspira, Inc.'s headquarters building—all buildings that they did not occupy—demonstrating another instance of a poor business practice. These arrangements further weakened the independence of the Charter Schools.[56]

Finally, in addition to the security agreement, Hostos also separately guaranteed $500,000 of this loan. However, this guarantee was not disclosed in Hostos' financial statements.

1. <u>The First Pantoja Building Loan</u>

Nondisclosure in financial statements. As of June 30, 2016, according to its independently audited financial statements, Pantoja was a guarantor of a mortgage owed by ACE, which had a balance of over $4.4 million. The mortgage was owed on the property occupied by the Charter School. The original loan was issued in September 2007 for $5.4 million; it matured in October 2016. A forbearance agreement with the lender was granted through October 31, 2017, in order to give Aspira, Inc. time to obtain a refinancing arrangement. However, as of December 2017, the forbearance expired, and the loan was still unpaid and had not been refinanced.

Similar to the loan discussed in the previous section, Pantoja and the other four Charter Schools had security agreements on this loan, pledging revenues and net assets as collateral, but they did not disclose this in their own financial statements. In addition, Pantoja's lease factored in this loan's debt service as well as the debt service on the loan addressed in Section 1 above.

2. <u>The Second Pantoja Building Loan</u>

Second mortgage and no board authorization. Although Pantoja had disclosed its *guarantee* of the aforementioned loan in the notes to its financial statements, it did not disclose its potential obligation related to another loan in its June 30, 2016 financial statements. According to Aspira, Inc.'s audited financial statements, Pantoja also guaranteed another mortgage loan on the same property, which originated in August 2013, and had a balance of

[56] A Renaissance Charter School is a neighborhood school that is operated as a public charter school and can only enroll students from the neighborhood, also known as a catchment zone. Also, in fiscal year 2017, Olney began to rent the third floor of the Campus building for its accelerated program, but the vast majority of its students and operations were located in its own separate school building, which was owned by SDP.

$1.2 million. Further, Pantoja and the other four Charter Schools had security agreements on this loan, as well. None of the schools disclosed this information. A clause in the *Summary of Terms and Conditions* included in the loan documents confirms this arrangement:

> Collateral   Same as existing debt: All Credit Facilities share in the collateral
>
> 1) Gross revenue lien of Aspira, Inc. of PA & Affiliates
> 2) Cross-collateralized Mortgages and assignment of rents of the real estate of ACE (management company subsidiary).[57]

For both of these loans on the Pantoja school building, Aspira, Inc. officials acknowledged that there was no documentation to support whether Pantoja or any of the other Charter Schools and their respective Boards properly and publicly authorized these guarantee and security agreements.

3. The Aspira, Inc. Promissory Note Owed to Olney

Intercompany loans. In December 2016, Aspira, Inc.'s CEO signed a promissory note for $2.3 million owed to Olney, due in November 2018. No officials from Olney signed the note, nor did the Board authorize it in a public vote. When we inquired about this loan, officials stated that the amount represented the intercompany balance that "resulted from a practice used by the former finance and accounting team of 'netting' payables and receivables." They attributed the build-up of this balance owed to Olney "as a result of the lack of visibility into the underlying transactions."

Officials also asserted that proper invoicing and accounting procedures, including a new software system, would be implemented by fiscal year 2018 to prevent the accumulation of an intercompany receivable/payable such as this in the future.[58]

[57] Term Note, PNC, $1,742,573.08, dated August 2013, signed by Andres Perez, CEO of ACE, attached Aspira, Inc. of PA & Affiliates, SUMMARY OF TERMS AND CONDITIONS, July 12, 2013.

[58] According to management officials, the Board voted in May 2016 to adopt a proposal from a financial consulting group that included plans to reduce and eliminate intercompany balances. This is not the same as the Board voting to authorize the terms of a debt arrangement.

According to Olney's independently audited financial statements as of June 30, 2017, the balance of the note was $433,656. However, the accumulation of debt of $2.3 million owed by Aspira, Inc. to one if its Charter Schools was wrong, particularly in light of the fact that the school itself did not authorize it and the public had not been informed.

4. Line of Credit Guaranteed by the Charter Schools

No board authorization. A $1.4 million revolving line of credit, issued in April 2016, was obtained by Aspira, Inc. to pay off the balance of a line of credit with a different lending institution. Like the mortgage debt vehicles discussed above, it was guaranteed by the Charter Schools and was not authorized by their respective Boards. The balance as of June 30, 2016, was $800,000. As of December 2017, the balance was still outstanding, and we were notified that the bank "gave notice of their intent to exercise their right to be repaid . . ." Aspira, Inc. officials said they were "prepared to repay them their full outstanding loan balance of $800,000. We are awaiting their decision on how much, and over what period, they would like to be repaid."

In March 2018, Aspira, Inc. officials informed us they were granted a forbearance extension through December 31, 2018, and said the balance was $800,215.[59]

Noncompliance with charter bylaws. This loan was issued after the Charter Schools adopted bylaws in October 2015 that prohibited the schools from guaranteeing or pledging collateral on any debt of Aspira, Inc. Therefore, this loan guaranteed by the Charter Schools violated their own bylaws. Further the Charter Schools' funds for the 2017 school year, which should have been used for the education of their students, may have been at risk of having to be used to repay this debt.

Conclusion

The Charter Schools paid Aspira, Inc. to lease the school buildings it owned. The schools' lease costs were based on Aspira, Inc.'s debt service, yet the management company

[59] We did not receive any documentation, i.e., from the bank, supporting the forbearance extension through December 31, 2018; therefore, we could not verify this claim by management company officials.

was not required, in turn, to pay down its debt with any portion of the rents collected.[60] The Charter Schools further pledged their own collateral in the form of revenues and net assets to secure the debt owed by Aspira, Inc.

After the expiration of the forbearance deadlines in October 2017, we were informed by Aspira, Inc. that the banks had extended the forbearance deadlines to December 31, 2018. While this debt was also secured by the school buildings, the Charter Schools were still at risk because of the pledged collateral in their security and guarantee agreements.

The decisions about what debt the Charter Schools would guarantee and secure with their own collateral should have been made in an open and public forum. So, too, should the leases have been negotiated and authorized in an open and public forum. The lack of transparency related to this debt and the leases resulted in a situation whereby the Charter Schools potentially could have been forced to repay Aspira, Inc.'s debts. Consequently, their ability to pay their own bills—and to use their resources for the education of their students—could have been and still could be seriously impaired.

<u>Recommendations</u>

The *Aspira Charter Schools* should do the following:

11. Require a full and public accounting from Aspira, Inc. and its subsidiaries of the status of its long-term debt, its ability to pay its loans, and its own financial standing.

12. The schools' Boards should independently review the terms of all debt, security, and guarantee agreements to assess the financial outlook of each school in the event the debt defaults. They should also discuss with the management company and the banks whether the security and guarantee agreements can be dissolved.

13. The schools should comply with their own bylaws which prohibit the schools from entering into any future

[60] Our limited review of the management company's (including its subsidiaries') debt payments indicated that it had made debt payments according to the terms of its loan terms, but that it did not pay the balloon payments that were due in October 2016.

debt security agreements with the management company.

Management Response

Notwithstanding the findings in this section, the real estate transactions described in this section were entered into on the advice of separate, independent, nationally recognized counsel on behalf of the Schools and ASPIRA. Indeed, ASPIRA obtained an opinion letter which specifically states that ASPIRA and the Schools entering into the transaction does not "violate such Loan Party's Articles or Bylaws" or "violate any applicable law or regulation" or "result in a default of any contract, agreement or instrument." The report's conclusions are consistent with that advice. Even though the transactions were legal and appropriate, ASPIRA and the Schools acknowledge that the concerns raised by the Auditor General about the financing. To that end, we have continued to work to refinance the debt to remove any guarantees by the Schools.

The report is correct that the cumulative debt owed by ASPIRA and its affiliated companies was approximately $17 million as of June 30, 2016, and that most of the debt related to acquisition and improvement of school buildings. ASPIRA and its lenders have been in constant communication throughout the forbearance period, and the forbearance agreement with PNC Bank was recently extended for a year until December 31, 2018. This extension could not have been achieved without the ASPIRA-led improvements in a range of systems, processes and financial performance noted elsewhere in this response. **Importantly, the original forbearance did not result from a failure to service the debt. To the contrary, no payments have been missed.** Rather, long before and in anticipation of the PNC debt becoming due and payable, ASPIRA had engaged investment bankers and counsel, and obtained approval from Philadelphia Authority for Industrial Development for a tax-exempt bond financing. That financing would have completely removed all guarantees and obligations from the Schools. **For nearly 3 years, blue chip lenders have expressed interest in refinancing the PNC debt. However, it is the School Reform Commission's 2-year delay in acting on the Olney and Stetson renewals which has made this financing impossible to conclude.** ASPIRA and the Schools are in constant discussions with investment banks and lenders that have indicated that they continue to be very interested in a similar financing upon renewal~~s~~ of the charters.

Lease agreements: Contrary to the report's characterizations, the leases are not in any way "unfair." Given that they use the debt service as the basis for rent, the amounts paid by the Schools are at market rate and result in zero markup by ASPIRA.

Management's Response to the Conclusion: The report's ultimate conclusion is inaccurate. The debt on the buildings was paid down substantially from $23 million down to $17 million by the end of the audit period, and as of December 2017, had been paid down to $14.2 million.

Contrary to the report's suggestion, in 2015-16, ASPIRA took appropriate steps to obtain refinancing on very favorable terms to remove the Schools' collateral obligations and guarantees. Moreover, as a result of significant budget reductions at both ASPIRA and the Schools during FY 17 and FY18, the cash flow performance at each of the Schools has improved substantially. All vendors are current, cash is managed tightly on a daily and weekly basis using a highly accurate and robust 16-week cash flow forecasting process, and budget-to-actual performance is reviewed regularly with the Schools' Boards and their Finance Committees.

Finally, as described above, the anticipated refinancing will only obligate ASPIRA and will be structured to eliminate the intercompany balances, as well as eliminate the need for revenue pledges and guarantees from the Schools.

Management Response to the Recommendations:

11. The Schools and ASPIRA agree that the Schools should require a full and public accounting from ASPIRA and its subsidiaries of the status of its long-term debt, its ability to pay its loans, and its own financial standing.

12. The Schools' Boards will consider an independent review the terms of all debt, security, and guarantee agreements to assess the financial outlook of each School in the event the debt defaults. Moreover, the new ASPIRA finance and accounting team has implemented processes to ensure that the Boards and their Finance Committees are regularly apprised of the cash flow and financial performance of each School. These processes are being improved monthly with ASPIRA.

13. The Schools agree and will comply with their own bylaws prohibiting the Schools from entering into any future debt security agreements with ASPIRA.

Auditor Conclusion

We acknowledge that the SRC's delay in acting on the Charter Schools Office's recommendations for nonrenewal of the charters for two of the five schools may have affected Aspira, Inc.'s ability to obtain refinancing for its delinquent debt. We also emphasize that the recommendations for nonrenewal were made in part because neither of the schools were deemed to have sound financial health or management practices consistent with acceptable standards.[61] Our review found further substantive evidence of weaknesses in the Charter Schools' financial standing and significant flaws in the management of its financial activities.

We must also point out the inaccuracy of management's statement that "given that they use the debt service as the basis for rent, the amounts paid by the Schools are at market rate and result in zero markup by ASPIRA." Equating a portion of a management company's debt service on consolidated debt, which by the way includes debt on the management company's own headquarters, to market value, is simply illogical. Despite repeated assertions that the various leases were at market value, management never provided documentary evidence to support their claims.

[61] Charter Schools Office, The School District of Philadelphia, "2015-16 Charter School Renewal Recommendation Report, John B. Stetson Charter School" and "2015-16 Charter School Renewal Recommendation Report, Olney Charter High School," April 11, 2016.

Finally, management's claim that the debt was substantially reduced is disingenuous and inaccurate. The debt was not significantly reduced during the three-year audit period, and as of the date of this report, it was still delinquent and in forbearance. In addition, a significant portion of the payments on the debt were from Commonwealth Redevelopment Assistance Capital Program (RACP) funds rather than from the management company's operating funds. The debt conditions we found—namely the delinquent debt of the management company and the Charter Schools' financial risk associated with that debt—reinforce how imperative it is that the Charter Schools and Aspira, Inc. ensure full transparency about this debt and all financial transactions involving public school resources.

We are, however, encouraged that the Charter Schools have agreed to require a full, public accounting of the status of Aspira, Inc.'s delinquent debt, which the schools have collateralized. We also appreciate that they will formally consider the possibility of dissolution of the security and guarantee arrangements that they have with Aspira, Inc. and the banks. We are also pleased that they have agreed to refrain from entering into any future debt security arrangements with Aspira, Inc. and to comply with their own bylaws.

Finding No. 5	A Lump Sum of $210,000 Paid by Pantoja Charter School to a Former Administrator was Not Properly Board Authorized, Not Part of an Employment Contract, and May Have Been Part of a Lawsuit Settlement Involving Aspira, Inc.'s CEO

Criteria relevant to the finding:

Employment Contract Best Practices related to school district superintendent employment contracts:

Subsection (e)(2)(v) of Section 1073 of the PSC provides:

"(e) The following shall apply: . . . (2) A contract for the employment of a district superintendent or assistant district superintendent shall do all of the following: (v) Specify the termination, buyout and severance provisions, including all postemployment compensation and the period of time in which the compensation shall be provided. Termination, buyout and severance provisions may not be modified during the course of the contract or in the event a contract is terminated prematurely." *See* 24 P.S. § 10-1073(e)(2)(v).

Note: While this provision is not included in the CSL's list of PSC provisions to which charter schools are subject, we believe that it should be applied by charter schools as a best practice. 24 P.S. § 17-1732-A(a)

In early August 2013, less than two months after the settlement of a sexual harassment lawsuit involving the CEO of Aspira, Inc., Pantoja Charter School paid a lump sum of $210,000 to a former administrator who had separated employment from the Charter School in June 2013. We found that the payment by the Charter School was not properly authorized by Charter School officials or the Board and, therefore, may have violated the Sunshine Act. Furthermore, school officials could not provide any explanation or documentation—such as a contract or separation agreement—to support the reason for the payment.

Our review of publicly available records disclosed that the former administrator had been the plaintiff in the lawsuit and received settlement proceeds of $350,000 from Aspira, Inc.[62] The $350,000 settlement was paid by Aspira, Inc.'s insurance agency. However, we could not determine from publicly available documents if the additional $210,000 lump sum payment from Pantoja Charter School was connected in any way to the lawsuit. School officials eventually provided documentation indicating that insurance proceeds from the Charter School's insurance company may have been used to pay the former administrator.[63]

Former Administrator's Employment Contract

We reviewed the Charter School's former administrator's employment contract for fiscal year 2013, which was the last employment contract for this employee. The contract was signed by the former administrator in September 2012, but the Board chair and Board secretary did not sign it until February 11, 2013, the same month the former

[62] The lawsuit is discussed in *National Union Fire Co. of Pittsburgh v. Aspira, Inc.*, ID 160402319 and the settlement is related to *Nunez v. Aspira et al.* in case number 130201444.
[63] We received documentation that a payment of $325,000 from an insurance company was made to Pantoja and deposited into Pantoja's bank account, but we could not verify whether that payment or any portion of it actually related to the $210,000 lump sum that was paid to the former administrator.

Criteria relevant to the finding (continued):

Section 1716-A(a) of the CSL states:

"(a) The Board of trustees shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school's charter. The Board shall have the authority to employ, discharge and contract with necessary professional and nonprofessional employee's subject to the school's charter and the provisions of this article." *See* 24 P.S. § 17-1716-A(a).

administrator filed a lawsuit against Aspira, Inc. and its CEO.

This last employment contract with the former administrator stipulated wages of $160,000 for the 2013 school year. No bonus or severance clauses were included in the contract terms. We reviewed payroll records and supporting payments that totaled an amount approximately equal to the $160,000 as stipulated in the contract, and therefore, we concluded that the administrator was paid in full. As stated earlier, this contract was the last contract the former administrator had with Pantoja or any other Aspira companies.

According to school records, however, on August 2, 2013, Pantoja then paid the former administrator a lump sum of $210,000 for unknown reasons. Figure 1 below illustrates the timeline of the former administrator's last year of employment in conjunction with the settlement.

Figure 1

Antonio Pantoja Charter School, An Aspira-Managed Charter School Timeline of Payments to the Former Administrator	
September 2012	Administrator signs employment contract for FY 2013 with $160,000 salary.
February 2013	Pantoja Board secretary and Board chair sign the employment contract.
	Administrator files sexual harassment claim against CEO of Mgmt. Co. *et al.*
June 2013	Administrator receives final paycheck on $160,000 contract.
	Management company settles lawsuit with administrator for $350,000.
August 2013	Pantoja Charter School pays former administrator $210,000.

Questionable Payment from Charter School

Management company officials provided documentation of an August 2, 2013 paycheck for zero hours worked in the amount of $210,000 to the former administrator. They also provided documentation of a payment from an insurance company for $325,000 on July 26, 2013. The documentation does not specify what that payment was for. Officials said this payment from the Charter Schools'

Criteria relevant to the finding (continued):

Section 1714-A(a)(4) of the CSL states:

"(a) A charter school established under this act is a body corporate and shall have all powers necessary or desirable for carrying out its charter, including, but not limited to, the power to: . . . (4) Receive and disburse funds for charter school purposes **only**." [Emphasis added.] *See* 24 P.S. § 17-1714-A(a)(4).

5. Board responsibilities were further clarified by a 2002 Pennsylvania Supreme Court decision holding that a charter school is to be governed by an independent board of trustees who retains "ultimate authority over the general operation of the school." It is our interpretation of the court's observation that once the Board is in place, it has the authority and responsibility for the control of the school, rather than the applicant, founder, or contracted management company. *See West Chester Area Sch. Dist. v. Collegium Charter School*, 571 Pa. 503, 524, 812 A.2d 1172, 1185 (2002).

Section 702 (related to Legislative findings and declaration) of the Sunshine Act states:

"(a) Findings. The General Assembly finds that the right of the public to be present at all meetings of agencies and to witness the deliberation, policy formulation and decision making of agencies is vital to the enhancement and proper functioning of the democratic process and that secrecy in public affairs undermines the faith of the public in government and the public's effectiveness in fulfilling its role in a democratic society.

insurance company covered the cost of the lump sum payment to the former administrator.

According to Aspira, Inc. officials, the Charter School's Board of Trustees authorized the payment in an executive session, outside of public view. The Sunshine Act provides specific constraints on what can be addressed in executive sessions and provides that any official action and deliberations must be done a public session. It certainly does not permit Board votes authorizing the use of public funds or even insurance payments, since the cost of that insurance would have been paid for with the public school's funds. Therefore, this vote—in a nonpublic forum—violated the Sunshine Act.

If this $210,000 payment was part of a sexual harassment settlement involving alleged actions by a senior administrator of a vendor—in this case, the related management company—Charter School officials and their legal counsel should determine whether it was appropriate for the Charter School to pay that settlement through its insurance company. The determination should be analyzed in the context of the CSL's provision that requires charter schools to receive and disburse funds for charter school purposes only.[64]

Going forward, the Charter Schools and their respective Boards should determine—independently of Aspira, Inc. and in an open and public forum—whether or not it is appropriate for public school funds to be used for this type of lawsuit and any other potential or future lawsuits involving employees of Aspira, Inc. or any other vendors. The Charter Schools should also consider formally requiring Aspira, Inc. to keep them timely and routinely apprised of the status of any potential or actual lawsuits or settlements that could result in a liability or an obligation of public school resources.

[64] 24 P.S. § 17-1714-A(a)(4).

Criteria relevant to the finding (continued):

(b) Declarations. The General Assembly hereby declares it to be the public policy of this Commonwealth to insure the right of its citizens to have notice of and the right to attend all meetings of agencies at which any agency business is discussed or acted upon as provided in this chapter." *See* 65 Pa.C.S. § 702.

According to Section 708(a) of the Sunshine Act, an executive session may only be held for the following reasons:

- Employment and personnel matters.
- Matters related to negotiation or arbitration of a collective bargaining agreement.
- In consideration of purchasing and leasing of real estate property.
- To consult with an attorney in connection with litigation.
- To review and discuss agency business that if discussed in public would violate lawful privilege or lead to the disclosure of information or confidentiality protected by law.

For duly constituted committees of a board or council of trustees of a State-owned, State-aided or State-related college or university or community college to discuss matters of academic admission or standings. *See* 65 Pa.C.S. § 708(a).

Recommendations

The *Antonio Pantoja Charter School (along with the other Aspira-managed Charter Schools)* should do the following:

14. Require its Board and senior administrators, with the assistance of their own legal counsel, to review the settlement payment and to determine whether it was appropriate for the Charter School to bear the cost within the context of Section 1714-A (a)(4) of the CSL requiring a charter school to receive and disburse funds for charter school purposes only. All of the Aspira-managed Charter Schools should require an accounting of its management company to determine whether any other such payments, using public funds, were made to other current or former employees. They should also consider establishing a formal policy requiring Aspira, Inc. to keep them timely and routinely apprised of the status of all potential or actual lawsuits or settlements that could result in a liability or an obligation of public school resources.

15. Adopt a board-approved policy instituting an absolute ban on payments to employees that are not in accordance with their employment contracts. This will help to ensure that all administrator contracts have termination provisions clearly defined and to prohibit unauthorized payouts to separated employees. This policy should include all school administrators as well as management company administrators whose salaries and benefits are allocated to the schools. This policy should incorporate, as a best practice**,** requirements like those mandated for superintendent and assistant superintendent contracts as set forth in Section 1073 of the PSC, 24 P.S. § 10-1073~~.~~

Management Response

This section relates to the lawsuit that formed the original stated justification for this audit, that is whether public funds were used to settle this lawsuit. The lawsuit described in this section named the board of trustees of the Schools including the Antonia Pantoja Charter School. The audit demonstrates that no public funds were used to settle this lawsuit.

We confirmed and provided the documentation that shows that the insurance carrier funded the $210,000 payment into Pantoja's bank account on July 26, 2013. Pantoja, in turn, made the payment on August 2, 2013. No public funds were used to make this payment.

Management Response to the Recommendations:

14. The Pantoja Board has confirmed that this payment was not funded by public funds and that it was authorized and appropriate. The Schools' Boards have further confirmed that no payment as described above using public funds have been made to other current or former employees.

15. We agree that future administrator contracts should have clearly defined termination provisions and prohibit unauthorized payouts to separated employees. The Schools' Boards will draft and consider such a policy.

Auditor Conclusion

We appreciate the Charter Schools considering the implementation of a formal policy prohibiting unauthorized payouts and will follow up during our next audit. While the Charter School has asserted that public funds were not used to pay such a settlement, we emphasize that the CSL limits the receipt and disbursement of public funds for "charter school purposes only." We believe that even using public funds to pay insurance costs related to such a claim would be prohibited. We continue to recommend that the schools consider establishing a formal policy requiring the management company to keep all of the Charter Schools routinely apprised of all potential or actual lawsuits that could result in a liability or obligation of public school resources.

Finding No. 6	Olney's Board and Administration Failed to Meet Their Fiduciary Duties by Ineffectively Procuring and Monitoring Related Party Contracts for Educational Services

Criteria relevant to the finding:

The CSL designates members of a charter school's board of trustees as public officials along with administrators of the school. It also addresses the governance duties of the board of trustees.

Section 1715-A(11) of the CSL states:

"Trustees of a charter school shall be public officials." *See* 24 P.S. § 1715-A(11).

Section 1715-A(12) of the CSL, states, in part:

"A person who serves as an administrator for a charter school shall be a public official under 65 Pa.C.S. Ch. 11 (relating to ethics standards and financial disclosure) . . ." *See* 24 P.S. § 1715-A(12).

Section 1715-A(12) also provides:

"The term 'administrator' shall include the chief executive officer of a charter school and all other employes of a charter school who by virtue of their positions exercise management or operational oversight responsibilities." Ibid.

During the three-year review period ending June 30, 2016, Aspira, Inc. contracted with an outside vendor to operate two educational support programs at Olney High School. One was an accelerated program serving students who were considered over-age and needed more credits to catch up with their peers. The other one was a transition program, which was a behavioral support program.[65]

We found an array of issues related to the authorization and oversight of these two educational support program contracts, including the following:

- When the accelerated program was moved from Olney High School to the Campus building beginning in the 2014-15 school year, the charter schools' Boards, including Olney's and the other two charter schools already located in that building, were not involved in reviewing and approving this relocation to the Campus building.

- In fiscal year 2016, Olney started paying rent for its space at the Campus building. Its charter expired as of June 30, 2016, and yet the lease for the Campus space extended until at least 2021. Therefore, the school itself might still have been obligated to pay the related Aspira company, even if its charter wasn't renewed.[66]

- The contracts governing the two educational support programs were not board-authorized and contained flawed terms, resulting in a lack of transparency about the costs borne by Olney.

[65] Our scope did not include a review of all educational services contracts that the Charter Schools had with Aspira, Inc. or any other vendors; therefore, the problems found with these contracts may or may not have existed with other similar types of contracts that Olney or the other Charter Schools may or may not have had in place during the review period.
[66] In April 2016, the SDP's Charter School Office recommended that Olney's charter not be renewed. As of the date of this report, a final decision by the SDP had not yet been made.

Criteria relevant to the finding (continued):

Section 1716-A(a) of the CSL addresses the duties of the Board of Trustees by providing:

"The board of trustees of a charter school shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school's charter. The board shall have the authority to employ, discharge and contract with necessary professional and nonprofessional employes subject to the school's charter and the provisions of this article." *See* 24 P.S. § 1716-A(a).

The Nonprofit Corporation Law of 1988 addresses fiduciary duties of nonprofit corporations:

Subsection (a) of Section 5712 (relating to Standard of care and justifiable reliance) of the Nonprofit Corporation Law of 1988, to which the charter schools are subject, provides for the fiduciary duties of board members as follows:

> "(a) Directors.--A director of a nonprofit corporation shall stand in a fiduciary relation to the corporation and shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, **in good faith**, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including **reasonable inquiry, skill and diligence**, as a person of ordinary prudence would use under similar circumstances. In performing his duties, a director shall be entitled to rely in good faith on information, opinions, reports or statements, including financial statements and other financial data . . ." (Emphases added.) *See* 15 Pa.C.S. § 5712(a).

- The procurement of the contracts related to the accelerated and transition programs, which cost $5.2 million in the three-year review period, was not open and public, and gave Aspira, Inc. an advantage in its submission of price quotes. Also, because of related-party issues, the contracts may have violated the Ethics Act.

<u>The Campus Building</u>

For the three-year review period, Olney, the Aspira-managed high school, received educational support services for its accelerated and transition programs from an outside vendor. Prior to the 2014-15 school year, both the transitional and accelerated programs were operated in the lower level of the Olney high school building. According to the 2014-15 contract with the outside vendor, the accelerated program was moved to the Campus building, which already housed two other Aspira-managed Charter Schools—Hostos (grades K-8) and Cyber (grades K-12). In addition to those schools, an Aspira preschool was also housed in the Campus building. The building was owned by ACE/Dougherty, a related property-holding company.[67] The accelerated program occupied part of the third floor, and the Cyber Charter School occupied another part of it.

Beginning in the 2015-16 school year, Olney signed a lease agreement with the related Aspira, Inc. to pay rent on its share of space on the third floor of the Campus building. We found no evidence in Olney's board meeting minutes that it had reviewed and approved this related-party lease, even though the lease itself was signed by the president of the Board. Further, the Hostos and Cyber Charter School Boards did not authorize the location of this Olney educational support program for older students at the Campus building. This lack of transparency about operations at the Campus building deprived the public, including parents and students, of information that should have been provided timely.

[67] Aspira, Inc. of PA had a property holding subsidiary, Aspira Community Enterprises (ACE), which owned the building occupied by Pantoja. ACE had a subsidiary, ACE/Dougherty, LLC., which owned the Campus building.

Criteria relevant to the finding (continued):

The Ethics Act defines the following terms:

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

In addition, as noted previously, the lease term extended to at least fiscal year 2021, well beyond Olney's charter expiration date of June 30, 2016. (The charter had been recommended for nonrenewal in December 2017.) This excessively long lease term may have put public funds at risk in the event that the school was closed or its administration or management company changed.

The Accelerated and Transition Program Contracts

Figure 1 below highlights the costs of Olney's accelerated and transition programs, which fluctuated significantly from year to year.

It's important to note that the Charter School did not pay per student rates based on actual enrollment. It paid the total cost per the contract. We obtained contradicting enrollment numbers from different Aspira, Inc. officials at different times during our review, and we were unable to verify the accuracy of the different sets of data. Therefore, we were unable to determine whether cost variances were appropriate or not in comparison with program capacity limits and actual enrollment in the programs. Olney's administration and Board should have regularly monitored enrollment in conjunction with the costs related to these programs.

Figure 1

Aspira-Managed Olney High School
Olney's Accelerated and Transition Program Costs[68]

Fiscal Year	Vendor/Program	Program Capacity Accelerated/Transition	Paid Per Contract	Paid Per Contract	Variance % from Prior Year
2014	Outside Vendor / both	110/150		$1,350,000	
2015	Outside Vendor / both	110/150		$2,192,000	62% increase
2016	Outside Vendor / both	105/70		$1,635,000	25% decrease
2017	Aspira, Inc. - accelerated Outside Vendor - transition	250 115	$1,397,250 $1,107,668	$2,504,918	53% increase
			Total Accelerated & Transition Program Costs	**$7,681,918**	

[68] Amounts provided by Aspira, Inc., per accounting records and the respective contracts.

Criteria relevant to the finding (continued):

Business with which he is associated is defined as "any business in which the person or a member of the person's immediate family is a director, officer, owner, employee or has a financial interest." A *public official* is defined as: "Any person elected by the public or elected or appointed by a governmental body or an appointed official in the executive, legislative or judicial branch of this Commonwealth or any political subdivision thereof, provided that it shall not include members of advisory boards that have no authority to expend public funds other than reimbursement for personal expense or to otherwise exercise the power of the State or any political subdivision thereof." *See* 65 Pa.C.S. § 1102.

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

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

In fiscal years 2014 through 2016, Olney paid an outside vendor to provide both the accelerated program and transition program services. In fiscal year 2017, however, the contract for accelerated program services was separated from the contract for transition program services. The same outside vendor continued providing the transition program services, but now Aspira, Inc. was awarded the contract for providing the accelerated program services. While Aspira, Inc. officials claimed it would help Olney to save costs by providing the accelerated services itself, we found that total costs actually increased from the prior year by 53 percent, as shown above.

We found other significant flaws in these contracts:

- In each of the fiscal years 2014 through 2016, the accelerated and transition program services were provided as part of a single contract with no delineation between the cost of each program, which reduced accountability.

- The fiscal year 2014 contract with the outside vendor was signed by the Olney Board President and Treasurer; however, we found no evidence in the minutes that the contract was ever reviewed and approved by a majority of the school's Board, therefore reducing transparency.

- In fiscal year 2015, the cost of the contract with the outside vendor jumped to $2.2 million, a 62 percent increase in costs from the prior year. Management could not provide an explanation for this spike in cost. (The subsequent lower cost in fiscal year 2016 was due to the lower program capacity limits established in that year's contract.)

- The fiscal year 2016 contract with the same outside vendor was only signed by the CEO of Aspira, Inc. and the CEO of the vendor, **not by any representative of the school or board member**, again hindering transparency and accountability in the use of public funds for education.

Criteria relevant to the finding (continued):

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

The **United States Department of Education** in a guidanace letter to State Education Agengies (SEAs) dated September 28, 2015, stated:

"Suggested areas where States may play a helpful role are listed below: . . . review[ing] . . . charter school governing boards for **conflicts of interest, related party transcations, and appropriate segregation of duties**, to ensure that CMO [i.e. charter mangement organizations] and EMO [i.e. educational managemewnt organizations] provide effective and efficient management services to charter schools at a reasonable cost." [Emphasis added.] *See* p. 2.

Examples of segregation of duties control categories are: Authorizes/Reviews Transactions, Executes Transactions, Records Transactions, and Reconciles Ledgers/Accounts.

Related parties are defined by accounting principles to include:

"Other parties that can significantly influence **the management of operating policies of the transacting parties or that have an ownership interest** in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursing its own separate interests." [Emphasis added.]

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

- For the 2017 school year, Aspira, Inc. took over operation of the accelerated program, and the same outside vendor still operated the transition program.
- Although Aspira, Inc. officials claimed the new accelerated program agreement would save costs, the combined cost of these two contracts was $2.5 million, a 53 percent increase in total costs from the prior year to operate these two programs.
- The educations services contracts with the outside vendor in fiscal years 2016 and 2017 and the contract with Aspira, Inc. in 2017 may have violated the Ethics Act because of conflicts of interest discussed further below.

Potential Conflict of Interest with Outside Vendor

The Superintendent hired by Aspira, Inc., whose appointment was announced at the February 2015 board meeting, was an immediate family member of a senior executive of the outside vendor that provided education support services throughout the three-year review period and continuing through 2017.[69] Consequently, this relationship should have been disclosed in an open and public forum, and public bids should have been solicited to encourage arms-length transactions, and to comply with the Ethics Act. When we asked Aspira, Inc. about the vendor selection process and the Superintendent's relationship, we were told the Superintendent was not involved in any matters relating to this vendor. However, Aspira, Inc. officials should have, as a matter of best business practice, conducted the business related to this vendor openly and in a manner that would have mitigated any appearance of bias or impropriety.

Also, the signatures on the 2016 related party vendor contract were undated with no witness signatures. We found no evidence in Board meeting minutes that Olney's Board approved *any* of the contracts related to its accelerated and transition programs. Even the 2017 contract with Aspira, Inc. was not board approved. This contract is further discussed in the next section.

[69] The Ethics Act defines "immediate family" as a parent, spouse, child, brother, or sister. *See* 65 Pa.C.S. § 1102 (Definitions).

Potential Conflict of Interest with Aspira, Inc.

Prior to awarding the 2017 accelerated program contract to the related Aspira, Inc., the Olney principal solicited quotes from four outside vendors. However, the principal and the Board did not solicit bids in an open and public forum, which they should have done to comply with the Ethics Act.

Aspira, Inc. was awarded the contract by Olney's principal. However, our review of emails related to the outside vendor proposals revealed that the lowest bidder of the four outside vendors courtesy-copied the COO of Aspira, Inc. on the email containing its bid information. The email was sent to the Olney principal and Aspira, Inc. *before* Aspira, Inc. submitted its own bid. The management company, therefore, had an unfair advantage when it submitted its own bid and subsequently was awarded the contract.

Also, the related management company clearly had an advantage over the other possible providers because Aspira, Inc. wrote the request for quotes on behalf of Olney and provided Olney with the list of other possible vendors. The way this contract was procured was certainly not a best business practice and appears to have potentially violated the Ethics Act.

Further, we found that **soon after the contract was awarded and before the school year began**, **Aspira. Inc. increased the cost** beyond the original agreed-upon terms to pay "for all computer equipment associated with the program, as well as upgrades to our Campus facility." Upgrades to a facility should not have been included as an educational services cost, particularly since, as previously stated, Olney also had to pay for a lease with an Aspira, Inc. affiliate to rent part of the third floor at the Campus building.

Aspira, Inc. officials stated that Olney's Board did not review and approve the contract because the amount allocated to cover this educational program was included in the approved budget. Budget approval for the cost of education services in no way suffices as a substitute for the Board's duty to govern the operations of the school, including oversight of a contract for educational services. The only two signatures on the contract included the principal for Olney and the Aspira, Inc.'s COO, the same two individuals involved in soliciting quotes.

Conclusion

Clearly, Aspira, Inc. had too much control over the procurement and administration of Olney's accelerated and transition program contracts. Further, Olney's Board failed to provide proper oversight of its program contracts as required by the CSL. Again, because of the lack of independence and transparency, decisions made by Aspira, Inc. may not have been in the best interest of Olney High School.

Recommendations

Olney High School and the other Aspira-managed Charter Schools should do the following:

16. Review all contracts in place for the provision of accelerated, transition, and other educational support services. School officials for all of the Aspira-managed Charter Schools should determine whether these contracts are in the best interest of their students and their schools.

17. Consult with their respective legal counsel to ensure that their contracts are in compliance with the PSC, the CSL, and the Ethics Act. The schools' officials should also seek to implement best business practices in contracting for goods and services to ensure optimal pricing and quality of service for the schools and their students.

18. Establish Board-approved policies prohibiting Aspira, Inc. from entering into any contracts involving the use of the schools' public funds without the prior approval, in an open and public forum, of the schools' Boards.

19. Establish Board-approved policies governing related party transactions and potential conflicts of interests. These policies should foster the schools' compliance with the Ethics Act and require public transparency and accountability.

Management Response

The Schools and ASPIRA disagree that the Boards failed to meet their fiduciary duties in monitoring these support program contracts. The data cited by this finding demonstrates that during FY14-FY16 the costs to Olney for these services were increasing significantly on a per pupil basis. Olney identified more students in need of Accelerated services and sought to lower per pupil costs for FY17. Olney issued an RFP and solicited bids. While ASPIRA provided input into the proposed RFP, the school issued the RFP, oversaw the selection process and ultimately selected ASPIRA. The selection of ASPIRA led to a cost reduction for Olney in its FY17 budget of $692,250. The next lowest bidder charged a per pupil cost of $9,631 as compared to $6,862 by ASPIRA.

The report's criticism that the costs for the Transitional Accelerated Services increased by 53% from FY16 to FY17 is disingenuous, as on a weighted average per pupil basis the cost to Olney actually decreased by 16.8% to $7,771 per student, allowing Olney to serve more students and improve graduation rates. The overall cost increased solely because of the higher total enrollment in FY17 vs. FY16 (365 vs. 175 students respectively).

Likewise, the report's finding that the single contract reduced accountability is misplaced. The contracts require that staff be hired and available to serve the requested enrollments so students that need these services can be immediately placed. There are detailed accountability metrics delineated in Exhibit C of these contracts, and the contracts also require monthly meetings to review student-level performance information against these accountability metrics.

While the Schools and ASPIRA believe that the contracts served the school and students well, we also appreciate the concern that the contracting process needs to be transparent. Because of those concerns, the process for selecting contractors and who oversees contract implementation was changed prior to the start of FY17. Since that time, school principals who manage the day-to-day contracts have led the contracting process, as well as led selection of and negotiation with the service providers (including ASPIRA).

Management Response to Recommendations No. 16 Through No. 19

The Schools and ASPIRA agree with the recommendations, many of which have already been put into place.

Auditor Conclusion

Management's response related to the Transitional Accelerated Services is misleading. The fact is that the Charter School **did not pay per student rates** based on actual enrollment. In every single year reviewed, it paid the total cost per the contract. We reiterate that management could not provide verifiable enrollment data. Their per student enrollment analysis, is therefore, unreliable.

Management states, “Olney issued an RFP and solicited bids.” This statement is inaccurate. Olney’s principal solicited bids from vendors provided by Aspira, Inc. Aspira, Inc. officials had insider information on those bids when it provided its own bid and won the contract. It then promptly raised its price. This process was not transparent—it did not involve the Board—and it was a procurement process that was unfair to other potential bidders and was not executed to obtain the highest quality service at the best price on behalf of the school and its students.

Despite several flawed assertions by management, we are, however, pleased that the Charter Schools have agreed to implement all four recommendations to improve procurement procedures and address related party issues. We are hopeful that they will improve transparency surrounding all procurement and contract monitoring activities. During our next audit, we will follow up on the specific corrective actions taken.

Finding No. 7 — The Charter Schools' Boards May Have Repeatedly Failed to Comply with the Sunshine Act When Conducting Their Executive Sessions

Criteria relevant to the finding:

Section 1716-A(c) of the Charter School Law states in part:

"(c) The board of trustees shall comply with the act . . . known as the "Sunshine Act." *See* 24 P.S. § 17-1716-A(c).

Section 702 (related to Legislative findings and declaration) of the Sunshine Act states:

"(a) Findings. The General Assembly finds that the right of the public to be present at all meetings of agencies and to witness the deliberation, policy formulation and decision making of agencies is vital to the enhancement and proper functioning of the democratic process and that secrecy in public affairs undermines the faith of the public in government and the public's effectiveness in fulfilling its role in a democratic society.

(b) Declarations. The General Assembly hereby declares it to be the public policy of this Commonwealth to insure the right of its citizens to have notice of and the right to attend all meetings of agencies at which any agency business is discussed or acted upon as provided in this chapter." *See* 65 Pa.C.S. § 702.

In the three-year review period ending June 30, 2016, we found that the majority of the executive sessions of the Charter Schools' Boards were held without the required public announcement. This failure to announce the topics discussed in executive sessions deprived the public of its right to know the reasons for those sessions that excluded the public. We also found that, for several of those executive sessions that were announced, the stated reasons for those sessions may not have been allowable under the Sunshine Act, and therefore, may have improperly deprived the public of its right to witness the Boards' governing processes.

The Sunshine Act provides for the right of the general public to participate in meetings held by the governing boards of public entities, such as charter schools. The public has the right to witness the democratic process, including the management of public funds. The Sunshine Act also states that "secrecy in public affairs undermines the faith of the public in government and the public's effectiveness in fulfilling its role in a democratic society." However, the Sunshine Act also allows for executive sessions, which are meetings "from which the public is excluded," although it specifically proscribes requirements for announcing such sessions, *and* it restricts the allowable topics for holding such meetings.[70]

Officials from Aspira, Inc. could not provide a reason for the Boards' apparent non-compliance with the Sunshine Act, but they did say that they had received guidance on executive sessions from the Charter Schools' solicitor. However, they also did not dispute what we found and provided us with a *Board of Trustees Professional Development Agenda*, dated May 2, 2017, with a topics list, including, "Becoming familiar with the Sunshine Act."[71]

[70] The Sunshine Act, 65 Pa.C.S. § 701 *et seq.*
[71] Aspira of PA Schools. Board of Trustees, Professional Development Agenda. May 2, 2017. The letterhead groups the schools together and refers to them collectively and also lists them independently by name; this document also refers to the board as a singular body, not as a separate board for each school.

Criteria relevant to the finding (continued):

Section 703 (related to Definitions) of the Sunshine Act states:

"Executive session is a meeting from which the public is excluded, although the agency may admit those persons necessary to carry out the purpose of the meeting." *See* 65 Pa.C.S. § 703.

Section 708 (related to Executive Sessions) of the Sunshine Act states, in part:

"(b) . . . the reason for holding the executive session must be announced at the open meeting occurring immediately prior or subsequent to the executive session." *See* 65 Pa.C.S. § 708(b).

According to Section 708(a) of the Sunshine Act, an executive session may only be held for the following reasons:

- Employment and personnel matters.
- Matters related to negotiation or arbitration of a collective bargaining agreement.
- In consideration of purchasing and leasing of real estate property.
- To consult with an attorney in connection with litigation.
- To review and discuss agency business that if discussed in public would violate lawful privilege or lead to the disclosure of information or confidentiality protected by law.
- For duly constituted committees of a board or council of trustees of a State-owned, State-aided or State-related college or university or community college to discuss matters of academic admission or standings.

See 65 Pa.C.S. § 708(a).

Numerous Executive Sessions Held Without Announcements

The Charter Schools held board meetings and executive sessions, as shown in Figure 1 below. In the three-year review period ending June 30, 2016, the Charter Schools' Boards held 29 board meetings. In 19 of those meetings, or 66 percent, they also held executive sessions.

Figure 1

Aspira-Managed Charter Schools Board Meetings & Executive Sessions			
Fiscal Year	Board Meetings	Executive Sessions (ES)	ES-Purpose Not Announced
2014	6	1	1
2015	12	11	8
2016	11	7	3
Total	29	19	12

We found that the Boards failed to announce the purpose for 12 of 19, or 63 percent, of the executive sessions held during the three-year audit period. Further, votes were taken immediately following 3 of the 12 unannounced executive sessions in noncompliance with the Sunshine Act. The description of the votes did not disclose to the public sufficient information about what was being voted upon. For example, the meeting minutes described one Board vote as approving "Contract 001." Without the vendor name and a description of the goods or services being purchased, the public had no way of knowing how and why the Board was approving the expenditure of public funds. This failure to specifically describe what is being voted on reduced transparency and resulted in the Boards' apparent violation of Section 708(b) of the Sunshine Act.[72]

[72] Section 708(b) of the Act provides the following, in part: "(b) . . . the reason for holding the executive session must be announced at the open meeting occurring immediately prior or subsequent to the executive session." *See* 65 Pa.C.S. § 708(b).

Some Announced Sessions May Have Been Held for Reasons Not Allowed

In fiscal year 2016, the Boards held seven executive sessions. As shown in the table above, the topics for three executive sessions were never announced as required. Additionally, three of four of the announced topics may have been inappropriate reasons for meeting outside of a public forum and, therefore, possibly not permitted under the Sunshine Act. Specifically, the stated reasons for the executive session were so vague that we couldn't determine if the discussions were permissible. Sometimes more than one topic was announced for each session, but all terms were vague (e.g. contracts, governance, financials, board matters, and academic conditions). Officials were unable to verify whether or not the specific topics discussed in those executive sessions were in compliance with the Sunshine Act. Not adhering to the requirements for executive sessions can also result in unnecessarily blocking the public from participation in matters that should have been addressed in public.

Conclusion

In all, we found that 12 of 19, or 63 percent, of the executive sessions held by the Charter Schools' Boards were not in compliance with the Sunshine Act and that an additional 3 more may not have been. As a result, the public may have been deprived of its basic right "to witness the deliberation, policy formulation, and decision making" of those public officials charged with governance of the Charter Schools. At all times, a public agency, such as the Charter Schools' Boards, should acknowledge the importance of full transparency in their public meetings.

Recommendations

The Charter Schools should:

Require their respective Boards to adopt a policy requiring compliance with the Sunshine Act, including requirements to:

20. Announce the purpose of each executive session in a public meeting.

21. Restrict the purpose of executive sessions to only those reasons which are specifically allowed in the Sunshine Act.

22. Record subsequent board votes with sufficient information for the public to know the purpose of the votes.

Management Response

ASPIRA and the Schools began Board of Trustees trainings on the Sunshine Act, Board Responsibilities of Charter School Trustees and similar regular trainings, as well as an onboarding process for new Board members. In addition, the Schools' Boards have recruited new members with deep knowledge and experience in non-profit governance. Since 2016, executive sessions held by the Charter Schools' Boards have been in compliance with the Sunshine Act.

Management Response to Recommendations No. 20 Through No. 22

The Schools agree with the recommendations and have implemented all of them.

Auditor Conclusion

We are pleased that the Charter Schools have agreed to all three recommendation to improve compliance with the Sunshine Act.

Finding No. 8 — The Charter Schools' Audited Annual Financial Statements Contained Errors, Omissions, and Inconsistencies

Criteria relevant to the finding:

Subsection (a) of Section 218 (relating to *Reports to Department of Education*) of the PSC, states:

"An annual financial report shall be submitted to the Secretary of Education by each school district, charter school, cyber charter school and area vocational-technical school not later than the 31st day of October. All financial accounting and reporting by school districts, charter schools, cyber charter schools and area vocational-technical schools to the Department of Education shall be in accordance with generally accepted accounting and reporting standards . . ." *See* 24 P.S. § 2-218.

The following provisions are relevant excerpts from the charter schools' bylaws (using Olney's as an example):

Article III, Board of Trustees, §3.1(h), *Powers*:

"Adopt the annual budget and conduct an annual independent audit of the School's finances; all expenditures in excess of $5,000 and not in the budget must be approved by two board members, one of which must be an officer of the board. All expenditures in excess of $10,000 and not in the budget must be approved by the Board at a duly constituted meeting."

Also from the CSL: *Article XVII-A*, §1729-A(3), *Causes for Nonrenewal or Termination*, states: "Failure to meet generally accepted standards of fiscal management or audit requirements."

As part of our performance audit, we referred to and reviewed certain financial items that were reported in the Charter Schools' annual financial statements. Although these financial statements were independently audited by an accounting firm, we found numerous errors, omissions, and inconsistencies. The issues discussed in this finding represent only highlights of what we discovered as part of our performance audit. They also do not necessarily represent *all* of the actual or potential errors, omissions, and inconsistencies in the charter schools' financial statements for the three-year review period.

Nearly all of the errors we discovered presented each charter school's financial standing in a more favorable light. As a result, these financial statements may have misled the public about the actual financial standing of each of the schools.

<u>Errors, Omissions, and Inconsistencies</u>

We found the following errors, omissions, and inconsistencies:

<u>*Error in Stetson's 2016 Beginning General Fund Balance*</u>. Stetson's 2016 *Statement of Revenues, Expenditures and Changes in Fund Balance* erroneously reported the 2016 beginning General Fund balance because, instead of using 2015's **ending fund balance** of $1,644,545, it used 2015's **beginning fund balance** of $2,194,476, resulting in a $549,931 *overstatement* of its beginning General Fund balance for 2016. In effect, the erroneous beginning fund balance reported in this statement disregarded the net effect of financial operations in 2015 on the General Fund balance.

Management company officials acknowledged the error, attributing it to an "oversight" due to an error in an Excel formula. Aspira, Inc. officials also acknowledged, however, that there was also a "bad GASB 68 adjustment under the instruction expense…" and that the net effect of the two errors did not affect the ending General Fund balance for fiscal year 2016. Since we did not audit the financial statements or the Charter School's pension obligation, we could not verify this second error. The management company said the errors would be corrected in the 2017 independently audited financial statements. [73]

<u>*Failure to Disclose Management Fee Payments*</u>. Amounts paid to Aspira, Inc. for management fees were not accurately and consistently disclosed in the related party notes to the annual financial statements for fiscal years 2015 and 2016. As discussed in Finding No. 3, the Charter Schools paid a two-part management fee that consisted of a revenue-based fee plus *direct services* charges.

For fiscal year 2016, only Stetson, in its related party note to the financial statements, disclosed its total management fee, including the total of both fee components. The other four schools—Cyber, Hostos, Olney, and Pantoja—all underreported their management fees in the notes because they *excluded* payments on the revenue-based component of the management fee. As a result, these Charter Schools *failed to fully disclose* what they paid for management services by more than $1.3 million, or 10 percent of the total reported management fees of $12.9 million paid by all five schools in that year.

For fiscal year 2015, none of the Charter Schools included in their management fees the payments they made on the revenue-based portion of the management fee. The total underreported amount in the notes for that year was $633,356. Therefore, the total management fees disclosed for all schools was $6,423,624 rather than the $8,706,980 that should have been reported. (The spike in total management fees paid for 2015 to 2016 is discussed in Finding No. 3, which addresses the flawed management services agreements.)

<u>*Olney's Failure to Disclose a Related Party Lease Payment.*</u> In fiscal year 2016, Olney rented third floor space at the Campus building to operate its accelerated program for under-credited, over-age students. It paid $320,000 in rent to one of Aspira, Inc.'s property-holding subsidiaries, and it failed to disclose this payment in its related party note in that year's financial statements. This omission,

[73] Email from Aspira, Inc. officials, dated July 21, 2017 contained an attachment, entitled "Information Request-9.docx", from which the quoted acknowledgement is cited.

therefore, resulted in the Charter School's failure to fully disclose the cost of its financial ties to Aspira, Inc.

Failure to Disclose Loan Collateralization & Guarantees. In all three years' annual financial statements, four of the five Charter Schools—Cyber, Hostos, Olney, and Pantoja—failed to disclose that they had pledged revenues and assets to secure a significant $12.75 million related party mortgage loan held by a subsidiary of Aspira, Inc. The loan balance as of June 30, 2016 was $8.5 million, and was in forbearance, meaning that it was unpaid and past due, and that the bank had provided the borrower a specific timeframe to obtain refinancing. Failure to disclose the schools' financial ties to debt held by a subsidiary of Aspira, Inc. reduced the transparency about the schools' financial ties to the management company. Finding No. 4 further addresses debt and loan guarantees.

Pantoja's Failure to Disclose a Second Loan Guarantee. One of Aspira, Inc.'s subsidiaries had two mortgages on the property occupied by Pantoja, and Pantoja guaranteed both loans. However, in its audited financial statements, Pantoja disclosed its guarantee on only one of the loans. It disclosed its guarantee of the loan that had a balance of $4.4 million as of June 30, 2016, but not its guarantee on the second mortgage that had a balance of $1.2 million as of June 30, 2016. Therefore, the Charter School failed to fully disclose the cost of its financial ties to Aspira, Inc.

Math Errors in Stetson's 2016 Budget Schedule. We found two separate math errors in Stetson's supplemental *Budgetary Comparison Schedule*, a schedule required by GASB Statement No. 34, as amended. The cumulative effect of these errors resulted in Stetson reporting an ending total fund balance budgetary variance of $139,083 rather than the significant negative variance of nearly $2.8 million. In addition to the math errors, the amount included in the budget schedule erroneously included two minor funds in addition to the General Fund. Only major funds, such as the General Fund, should be included in this schedule, according to GASB Statement No. 34, as amended. The erroneous inclusion of the minor funds mitigated the more significant budget variances in the General Fund.

Charter Schools' Lack of Involvement in Their Financial Reporting

Aspira, Inc.'s financial team included a Chief Financial Officer, a Controller, a Chief Operating Officer, and others. The financial team was responsible for preparing the financial statements for each of the schools. It also maintained the accounting records for the Charter Schools, paid their bills, selected vendors, etc. This same financial team also prepared the financial statements for Aspira, Inc.

Further, the Charter Schools did not independently procure their own accountants to perform financial audits. The accounting firm that audited the financial statements of the Charter Schools was hired by Aspira, Inc. This accounting firm was the same firm that audited Aspira, Inc.'s financial statements in fiscal years 2014, 2015, and 2016. The use of the same firm to conduct audits of both the schools and the management company—when the management company maintained the accounting records for all the involved entities—weakened the independence of the schools by failing to provide a check on the power of Aspira, Inc. and resulted in the issuance of potentially inaccurate financial statements.

Management company officials attributed the errors and other issues with the audited financial statements to failures by the previous financial team, which was replaced during the fiscal year 2017. However, the independently audited financial statements were the responsibility of the Charter Schools and their Boards, not their management company. Thus, the errors and other issues discussed in this finding are ultimately the responsibility of the schools. Without a restructuring of the accounting and other financial systems, the financial statement errors and other problems will likely persist.

Conclusion

Aspira, Inc. officials acknowledged the errors, omissions, and inconsistencies and said they would be corrected in the 2017 financial statements of each of the Charter Schools. These statements were issued on October 25, 2017. We reviewed the 2017 statements to determine whether the corrections were made to the previously issued 2016 financial statements. We found that the correction to

Stetson's financial statements was disclosed in the notes. However, the *Budgetary Comparison Schedule* was still being reported using *Total Governmental Funds*, which is not in compliance with GASB 34, as amended, as discussed previously.

The numerous errors, omissions, and inconsistencies in the 2016 financial statements were significant because all of them collectively presented a better financial picture of each of the charter schools. The financial statements were, therefore, not merely lacking in transparency, they also misled the general public about the financial standing of Stetson and the other Charter Schools, and they failed to fully disclose the financial ties the schools had with Aspira, Inc.

<u>Recommendations</u>

The *Aspira Charter Schools* should do the following:

23. Review all of their financial statements for the last three years to determine whether there were additional errors, omissions, and inconsistencies. They should also consider whether the net effect of these errors, omissions, and inconsistencies are significant enough to require them to revise and reissue their financial statements.

24. Implement a policy requiring the schools to have separate auditors from the auditors of Aspira, Inc. and its subsidiaries. This policy should also address procurement of these services so that only school officials are involved in that process.

Management Response

This finding is inaccurate. Per Stetson's auditor, the FY16 audit report did not overstate the 2016 ending fund balance. The $550,000 discrepancy was due to the misclassification of the GASB 68 pension adjustment. (We will confirm whether we need to restate to correct the misclassification.)

The report's finding that the management fees paid to ASPIRA in FY15 and FY16 were "Underreported" is inaccurate. The audited statements included all management fees, but did not fully disclose the amounts in the audit notes. The audit notes were corrected for the FY17 audit to fully disclose the management fees.

The report's finding that there was inadequate corrective action is inaccurate. The reclassification section at the end of footnote 2 in the 2017 audit report disclosed the misclassification reported in the 2016 audit report.

Management Response to Recommendations No. 23 and No. 24:

23. Management did not respond to Recommendation No. 23.

24. The Schools' Finance Committees are issuing a solicitation for a new auditor and expect that the new auditor will be in place for FY18. ASPIRA will also be engaging a new auditor. The Schools and ASPIRA agree that the Schools and ASPIRA should have separate auditors. Both ASPIRA's Board and the School Boards will adopt such a policy.

Auditor Conclusion

With regard to management's response to the condition of Stetson's erroneous 2016 **beginning** General Fund balance, management mistakenly addressed the **ending** fund balance. In fact, the 2016 beginning fund balance, as reported by the school, is the same as 2015's beginning fund balance, which means that the 2016 beginning fund balance failed to account for the effect of operations and other transactions in 2015 on the General Fund balance.

Management is also disingenuous in denying that the Charter Schools underreported payments made for management services. We reiterate that they underreported these payments by more than $1.3 million, or 10 percent of the total reported management fees of $12.9 million paid by all five schools in that year.

We must emphasize the fact that the **numerous errors, omissions, and inconsistencies** in the 2016 financial statements were significant because altogether they presented a better financial picture of each of the Charter Schools. Therefore, **they misled the general public about the financial standing of the Charter Schools, and they failed to fully disclose the financial ties the schools had with Aspira, Inc.**

Further it is very concerning to us that management has not acknowledged that it failed to fully correct the errors, omissions, and inconsistencies found in the 2016 financial statements. Overall, the lack of a commitment to accurate reporting points to a resistance to transparency about financial activities and financial standing.

Since it did not respond to Recommendation No. 23, we must reiterate the importance of accountability and again recommend that the schools review the financial statements for all three years in the audit period to address the conditions we found and to determine whether additional errors, inconsistencies, and omissions existed. It should then consider issuance of revised statements.

Despite their numerous inaccurate assertions, we are somewhat encouraged by the Charter Schools' willingness to adopt a practice of more stringent oversight of its financial reporting and to procure auditing services independently of the management company. These efforts, if implemented properly, should help to improve the accuracy of their financial reporting, and we look forward to following up on the results of these efforts in our next audit of the schools.

Appendix A: Audit Scope, Objectives, and Methodology

In order to properly plan our limited procedures engagement and to guide us in selecting objectives, we reviewed the Charter Schools' by-laws and charters, pertinent laws and regulations, board meeting minutes, financial reports, annual budgets, new or amended policies and procedures, news articles, accounting records, and each of the schools' independently audited financial statements for the three fiscal years ending June 30, 2014, through June 30, 2016. This limited procedures engagement was the first review of the Charter Schools by the Department of the Auditor General; no previous engagements or audits of the Charter Schools had been conducted by this Department.

Limited procedures engagements 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 review focused on the Charter Schools' efficiency and effectiveness in the following areas:

- Governance
- Contracting, including management company services
- Financial stability and operations
- Payments to senior administrators and PSERS
- Leases

As we conducted our review procedures, we sought answers to the following questions, which served as our review objectives:

- *Were the Charter Schools operating independently of the management company, Aspira, Inc., and other related organizations, and were they operating with appropriate accountability related to governance in compliance with the Charter School Law, the Public Official and Employee Ethics Act, the Nonprofit Law, and the Sunshine Act?*

    - We obtained and reviewed the board meeting minutes for all five Charter Schools for the review period. We conducted multiple interviews with Aspira, Inc. officials and the school principals, who are the highest level administrative employees of the schools. We also reviewed the charters, by-laws, and major contracts. Finding No. 1 contains the results of our review.

    - We reviewed and analyzed the frequency of and reasons for executive sessions in the meeting minutes. We reviewed the Aspira-managed Charter Schools' website on various dates and documented our results. Finding No. 7 contains the results of our review.

- *Were the Charter Schools' significant contracts—including agreements with the related Aspira, Inc. and its subsidiaries—properly procured, approved, executed and monitored in accordance with the Charter School Law, the Public School Code, the PA Public*

Official and Employee Ethics Act, and best practices? Were the Charter Schools' resources sufficiently and appropriately accounted for by the management company?

- We reviewed all of the management services agreements in place during the review period for all five Charter Schools. These contracts are the Charter Schools' largest contracts.

- We reviewed these agreements to determine whether the terms fostered management company accountability, arms-length transacting, and optimal pricing and quality of service for the charter schools. To determine how the schools monitored these services and compliance with the agreements, we conducted interviews with school and management company personnel; we reviewed contracts, board minutes, source documents, such as invoices, bank records, and accounting records, as well as independently audited financial statements. We considered the following questions:

    - Did Charter School officials authorize the agreements?
    - Were the contract terms reasonable in terms of length of time and in relation to the schools' charters?
    - Did the contracts have automatic renewal clauses?
    - What were the compensation terms? Were terms based on cost-plus formulas?
    - What accountability standards were established in the contracts?
    - How did the schools actually oversee the management company and its accounting for the different types of services it provided?

- We also reviewed a selection of education services agreements with the management company and another related vendor. Similar to the objectives and review procedures conducted for the management services agreements, we also reviewed these agreements, related costs, and the Charter Schools' involvement in governance over these agreements.

As a result of our review procedures, we issued Findings No. 3 and No. 6.

- *Were the Charter Schools' in a stable or a declining financial position? Were the funds allotted to each Charter School being used for that school? Were the Charter Schools encumbered in any way by the management company and its obligations?*

    - We obtained the Independent Audit Reports, Annual Financial Reports and General Fund Budgets for all five schools for the review period. We also obtained debt and security agreements. We then performed an assessment using fiscal benchmarks to determine whether the Charter Schools are stable or in a declining financial position. We completed a General Fund balance analysis, revenue/expenditures/net operations analyses, current ratio analysis, budget to actual analysis, and a debt analysis. These benchmarks and analyses helped to determine whether the Charter Schools General Fund balances have declined over a five-year period, and to determine:

- Operating surpluses/deficits
- Liquidity
- Debt
- Management company costs as a percentage of total expenditures

Findings No. 2, 4, and 8 address the results of our review.

- *Were Charter School administrators enrolled in PSERS eligible for enrollment, and were management company and other contracted employees not enrolled in PSERS? Were non-wage payments to separated senior administrators appropriately authorized and excluded from PSERS contribution eligibility in accordance with PSERS guidelines?*

  - We obtained payroll records and IRS Forms W2 for management company employees and compiled a list of employees, which we shared with PSERS officials. PSERS officials confirmed that no employees of the management company were participating in PSERS.

  - We also reviewed final payments to senior administrators of the Charter Schools' who separated during the three-year review period. We compiled that list from a combined review of IRS 990s, payroll records, and board minutes. We reviewed payroll summaries, employment contracts, IRS Form 990s, and other records to determine whether or not payments were authorized. Finding No. 5 contains the results of our review.

- *Were the Charter Schools' lease agreements current, properly authorized, executed, and monitored, and not in violation of §§ 1103(a) or 1103(f) of the Public Official and Employee Ethics Act? Did the Charter Schools receive and qualify for state reimbursement for leasing a building under the Charter School Lease Reimbursement Program?*

  - We obtained the lease agreements for all five Charter Schools along with the deeds for the two properties the related management company owns. We also obtained the charter agreements for all five Charter Schools. We reviewed the terms of each of the lease agreements and compared the terms of the lease agreements to the charter agreements and other criteria. We then obtained the PDE 418s for all five Charter Schools to determine whether the Charter Schools were receiving reimbursements for properties leased by related parties. We also reviewed the IRS Forms 990 to determine whether any Board of Trustee members were owners of the leased property. Finding No. 4 contains the results of our review related to weaknesses in the lease agreements.

Appendix B: Management Response – Preliminary Statement

ASPIRA Management's Preliminary Statement:

ASPIRA and the Schools appreciate the opportunity to review and respond to the findings for the limited procedures engagement of the ASPIRA Charter Schools that were provided to ASPIRA and the Schools. We trust you will agree we have been open and responsive over the past year to requests made for this engagement. We are also grateful for the opportunity to discuss our concerns with what we believe are inaccurate views of the legal principles applicable to charter schools and what in many instances are inaccurate characterizations and unsupported speculation.

Given the circumstances that precipitate this audit, the report is perhaps more meaningful in what it did not find. After an exhaustive yearlong investigation, there is no finding of waste, fraud or abuse. There are no findings of excessive salaries or the like. There is no finding that public funds were used inappropriately. In short, while the report has many useful suggestions, it concludes what all previous audits of the Schools have concluded. The Aspira Schools have operated in accordance with the law.

ASPIRA Charter Schools (the "Schools") educate over 4,500 students in one of the poorest neighborhoods in America. Before ASPIRA, Inc. of Pennsylvania ("ASPIRA") assumed its management role, two of these schools were consistently on the list of persistently dangerous schools in Pennsylvania. Many children were in profoundly underperforming District-run schools. The Schools have among the highest percentage of English Language Learners and Special Needs students in Pennsylvania. Moreover, the recent hurricane in Puerto Rico has resulted in more students enrolling in ASPIRA Schools. Notwithstanding those challenges, ASPIRA Schools have overseen dramatic improvement in climate and have raised student academic outcomes. One powerful testament to the desirability of ASPIRA Schools is enrollment growth from 3,543 to 4,542 over the past four years.

<u>Inaccurate Legal Principles</u>

<u>Overlapping Boards.</u> While we have had productive discussions, the report is premised on an assumption that overlapping boards by their very nature violate the Charter School Law ("CSL"). That assumption has been laid to rest by the legislature. Indeed, Act 55 of 2017 amended the Public School Code to add Section 1729.2-A to the Charter School Law, 24 P.S. § 17-1729.2-A, and it permits the consolidation of existing charter schools into a Multiple Charter School Organization ("MCSO"). Thus, state law now specifically anticipates and authorizes the consolidation of two or more charter schools into a MCSO.

The findings repeatedly conclude the Schools' relationship with ASPIRA as a negative and as *per se* evidence of a lack of independence. In support, the report cites the overlapping School Boards, joint School Board meetings, ASPIRA finance professionals managing financial operations, and centralized administrative functions.

Those assumptions permeate the report and are incorrect and undermine many of the report's conclusions. Put simply, there is no legal or other prohibition against charter schools having such "connections" to their founder or Charter Management Organization ("CMO"). Indeed, many of the highest performing charter schools in Pennsylvania have virtually identical governance structures in which there is an overlapping board of trustees with a single, separate CMO or other schools. CMO staff members are intimately involved in the management of various school functions and attend board meetings, and finance and administrative functions for multiple schools are centralized. See, for example, (a) the KIPP Philadelphia board minutes that reflect no fewer than 14 management company staff and board members attending the overlapping, joint school boards meeting which manages at least 6 Philadelphia charter schools. http://kippphiladelphia.org/wp-content/uploads/2017/12/KPCSBOTMarch2.pdf; and (b) the Mastery Schools board which manages 14 Philadelphia charter schools with no separate independent member per school. http://www.masterycharter.org/about/board-of-trustees/. Indeed, ASPIRA's structure is arguable more independent than Mastery's, as each School has a director that is independently appointed by the Schools' parent organization. Moreover, the idea that charter school boards would be well served by not having an actively engaged and participating CMO is patently absurd.

Governance Issues. In addition, without stating the basis, the report repeatedly suggests that the ASPIRA somehow controls the School Boards and accordingly makes findings on that basis. While ASPIRA originally had appointment authority for Board members, it has never had control of the Schools' Boards. There are no ASPIRA appointees on the School Boards, and ASPIRA's Board voted to discontinue the practice of appointing members to the School Boards on June 15, 2013. Accordingly, ASPIRA and the Schools disagree with the Auditor General's conclusions that are based on that assumption. Nevertheless, we wish to address any concerns the Auditor General may have in that regard.

Given those erroneous assumptions, ASPIRA and the Schools understand why the report reaches the erroneous conclusion that during 2013-2016 the Schools' Boards were not sufficiently independent. While we disagree that the Boards were improperly constituted, we think it is important to understand that the governance structure of the Schools from their inception was implemented on the advice of counsel and was approved by the School Reform Commission ("SRC") in granting the Schools' charters. While the governance structure does not violate the CSL or any other law, when ASPIRA and the Schools were informed by the SRC that they viewed the structure as a concern, the response of the Schools' Boards was to change their bylaws to address those concerns and commence orderly transition off the Boards of the sole remaining ASPIRA appointee.

External Financial Forces

Like The School District of Philadelphia, other charter schools in Philadelphia and many districts throughout the Commonwealth, the financial performance of the ASPIRA Schools deteriorated primarily due to the decline in funding levels for public education. Notwithstanding those obstacles, the ASPIRA Schools have never missed payroll or a PSERS payment or otherwise failed to perform their obligations, and today the Schools are in much improved financial health.

Similarly, the report criticizes the Schools and ASPIRA for the cross-collaterization of certain PNC Bank debt. However, the report ignores that the transaction was required by PNC and was approved by outside counsel at Fox Rothschild in an opinion letter. Large, nationally recognized law firms independently represented ASPIRA and the Schools. ASPIRA and the Schools had worked to secure financing that would have removed the cross-collateralization in early 2016. However, the 20-month delay in SRC action on charter renewals was the principal reason the financing has not been completed.

Like The School District of Philadelphia, other charter schools in Philadelphia and many districts throughout the Commonwealth, the financial performance of the ASPIRA Schools deteriorated between FY12 and FY16 primarily due to the decline in funding levels for public education. In 2016, a mid-year reduction in the per-pupil payment from The School District of Philadelphia resulted in a $1,057,450 reduction to the Schools. In response, ASPIRA reassigned management oversight of its own finance and accounting function, and recruited an interim financial consultant. In April and May of 2016, ASPIRA apprised its Board and the School Boards of the significant challenges the prior financial performance posed and recommended a corrective action plan. As part of this plan, at the start of FY17, ASPIRA implemented significant cost reductions (over $1.6 million) that included a reduction in force and reorganized how it delivered its services. ASPIRA also assisted the Schools in their own cost reduction efforts by providing administrative support and issuing RFPs to lower health care and other costs (e.g. ASPIRA designed and put in place a self-insurance plan, created and implemented a 403(b) plan, reduced professional fees and implemented reductions in force).

In 2017, the Schools suffered another $2,187,780 mid-year reduction from The School District of Philadelphia. ASPIRA informed the Schools of the significant risks to their budgets, and again assisted the Schools in a review of their financial position.

During FY13 to FY16, the Schools were also faced with increased PSERS employer contributions that went from 12.36% to 25.84%. For FY18, that figure is 32.57%.

In short, the Schools have faced daunting revenue reductions and increased costs from external forces. ASPIRA and each School made significant budget cuts for FY18 (totaling over $5 million), which have resulted in significantly improved performance at the Schools. The Boards also recruited a new Treasurer with a financial background, and each formed a Finance Committee that meets monthly to review the financial results of each School. The result is that, notwithstanding these issues, the combined Schools are projected to end this fiscal year with an operating surplus of $650,000.

Scope of Review

Finally, the Auditor General's original engagement letter of January 30, 2017 stated:

> "Our focused areas of review for this LPE include:
>
> - Board governance
> - Budgeting and financial position

- Leasing arrangements
- PSERS payments
- Contracting and grant oversight
- Other area(s) identified as significant during the course of the LPE.

> Our responsibilities as auditors are limited to the period(s) and area covered by our LPE and do not extend to matters that might arise during any later periods for which we are not engaged as auditors."

Although the engagement by its own terms does "not extend to matters that might arise during any later periods during which we are not engaged as auditors," the report repeatedly and selectively uses post-audit period facts to support its findings. However, although there have been dramatic improvements in finance and governance since the end of the audit period, not once does the report credit those improvements. Thus, in several instances the responses necessarily refer to post-audit period actions.

Auditor Conclusion to Management's Preliminary Statement

The Charter Schools agreed to implement 22 of 24 of our recommendations, and we commend them for their overall willingness to improve their operations on behalf of the students and their school community. However, certain assertions made by the schools in the management response appeared to contradict their willingness to implement so many of our recommendations, which are based upon the conditions we found, and therefore, we must address some of their claims.

The scope of this limited procedures engagement (LPE) of the Charter Schools did not encompass a forensic examination of Aspira, Inc. **As a result, this report could not and did not conclude that there was no evidence of fraud, waste, and abuse.** We do emphasize that the weak organizational structure and poor governance by the Charter Schools' Boards, which allowed Aspira, Inc. to control over $150 million in public school funds without appropriate accountability, **heightened the risk of fraud, waste, and abuse of public school funds.**

In particular, a management company having one business office responsible for managing five charter schools' public funds plus its own money, as well as that of other related companies, is simply not a best practice and is not in accordance with the intent of the CSL. The schools themselves should each have their own fiscal officer or senior administrator designated as a public official, subject to the Charter School Law, the Public Official and Employee Ethics Act, and any other laws and regulations governing public charter schools. That fiscal officer or senior administrator should work with the respective school's Board to ensure meaningful oversight of the management company.

Unfortunately, Aspira, Inc. and the Charter Schools resisted our work to follow through on the status, beyond June 30, 2016, of certain conditions identified in the findings. When such conditions exist and claims are made that corrective actions were taken, auditors have every right to verify whether or not those corrective actions were implemented. In addition, while auditors are conducting the audit and information is provided to auditors about the existence of certain conditions, they also have a right to review them. This was clearly stated in the engagement letter, as follows: "Our LPE will cover July 1, 2013, through June 30, 2016, with updates, where applicable, through the end of fieldwork."

Finally, Management has clearly mischaracterized what it refers to as our underlying "legal principles." The Department of the Auditor General is confident in its interpretation of the Charter School Law and the Public School Code, as well as the good government laws—namely, the Ethics Act and the Sunshine Act—which guide our audits. The Department has been auditing charter/cyber charter schools for more than ten years. Our fundamental legal conclusions about charter schools have been consistent with those of PDE and the U.S. Department of Education's Inspector General, and we know our legal conclusions are sound. We, therefore, believe that Management's perspective has more to do with its private nature than any actual perceived "inaccuracies."

We also note that Act 55 of 2017, which amended the PSC to add Section 1729.2-A to the CSL (24 P.S. § 17-1729.2-A) to provide for the merger of two or more charter schools into "Multiple Charter School Organizations" solely applies to high performing charter schools. In fact, none of the Aspira-Managed Charter Schools are on PDE's list of eligible charter schools. Further, the addition of Section 1729 to the CSL is actually an acknowledgement by the General Assembly that these mergers are expressly reserved for charter schools that can meet vigorous conditions set forth by PDE and that the status of the needed independence of the other charter schools remains unchanged.

Distribution List

This letter was initially distributed to the Superintendent of the Charter Schools, the Board of Trustees, and the following stakeholders:

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