



**BEAR CREEK COMMUNITY CHARTER SCHOOL
LUZERNE COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT**

MARCH 2013

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE AUDITOR GENERAL





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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania 17120

Mr. David Blazejewski, Board President
Bear Creek Community Charter School
2000 Bear Creek Boulevard
Wilkes-Barre, Pennsylvania 18702

Dear Governor Corbett and Mr. Blazejewski:

We conducted a performance audit of the Bear Creek Community Charter School (Charter School) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period October 5, 2007 through October 12, 2010, except as otherwise indicated in the report. Additionally, compliance specific to state subsidy and reimbursements was determined for the school years ended June 30, 2008 and June 30, 2007. Our audit was conducted pursuant to 72 P.S. § 403 and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found significant noncompliance with state laws and administrative procedures, as detailed in the four audit findings and one observation within this report. A summary of these results is presented in the Executive Summary section of the audit report. These findings and observation include recommendations aimed at the Charter School and a number of different government entities, including the Pennsylvania Department of Education, the State Ethics Commission, the Pennsylvania Department of State, and the authorizing school district.

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

Sincerely,

EUGENE A. DEPASQUALE
Auditor General

March 7, 2013

cc: **BEAR CREEK COMMUNITY CHARTER SCHOOL** Board of Trustees



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Executive Summary

Audit Work

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

Our audit scope covered the period October 5, 2007 through October 12, 2010, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidy and reimbursements was determined for school years 2007-08 and 2006-07.

Charter School Background

Bear Creek Community Charter School, located in Luzerne County, Pennsylvania, opened in September 2004. It was originally chartered on September 6, 2004, for a period of five years by the Wilkes-Barre Area School District. The Charter School's mission states: "Our mission is to embrace a diverse student body and inspire student success through an innovative curriculum, the cultivation of environmental stewardship, and by holding students, parents, and staff accountable for results." During the 2009-10 school year, the Charter School provided educational services to 419 pupils from 11 sending school districts through the employment of 26 teachers, 36 full-time and part-time support personnel, and 3 administrators.

The Charter School received approximately \$3.4 million in tuition payments from school districts required to pay for their students attending the Charter School in school year 2007-08.

Adequate Yearly Progress

The Charter School made Adequate Yearly Progress (AYP) for the 2009-10 school year by meeting all AYP measures.

AYP is a key measure of school performance established by the federal No Child Left Behind Act (NCLB) of 2001 requiring that all students reach proficiency in Reading and Math by 2014. For a school to meet AYP measures, students in the school must meet goals or targets in three areas: (1) Attendance (for schools that do not have a graduating class) or Graduation (for schools that have a high school graduating class), (2) Academic Performance, which is based on tested students' performance on the Pennsylvania System of School Assessment (PSSA), and (3) Test Participation, which is based on the number of students that participate in the PSSA. Schools are evaluated for test performance and test participation for all students in the tested grades (3-8 and 11) in the school. AYP measures determine whether a school is making sufficient annual progress towards the goal of 100 percent proficiency by 2014.

Audit Conclusion and Results

Our audit found that the Charter School complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures; however, as noted below, we identified four compliance-related matters reported as findings and one matter unrelated to compliance that is reported as an observation.

Finding No. 1: Bear Creek Community Charter School Improperly Received \$106,332 in State Lease Reimbursement.

Our audit found that between May 2008 and June 30, 2010, the Charter School improperly received \$106,332 in state lease reimbursements for two buildings that were ineligible for those payments because they were previously owned by the Charter School and now owned by a related party, and one of the two buildings includes three attached modular classrooms (see page 10).

Finding No. 2: Bear Creek Community Charter School Had Possible Related Party Transactions and Ethics Violations.

At the April 21, 2008 board meeting, the board approved a resolution to transfer properties owned by the Charter School to the Bear Creek Foundation (Foundation). In May 2008, the Charter School and the Foundation entered into a lease agreement for these same properties (see page 22).

Finding No. 3: Bear Creek Community Charter School Failed to File Their IRS Form 990 Return of Organization Exempt From Income Tax.

Our audit of the Charter School records found that the Charter School failed to file their Return of Organization Exempt from Income Tax, IRS Form 990, for calendar years ending December 31, 2009, 2008, and 2007 (see page 34).

Finding No. 4: Bear Creek Community Charter School Had a Possible Certification Violation.

Our audit found a special education coordinator was employed during the 2008-09 school year without the proper professional certification required by the State Board of Education (see page 40).

Observation: Bear Creek Community Charter School Had Unmonitored Vendor System Access and Logical Access Control Weaknesses.

We noted that the Charter School personnel should improve controls over remote access to its computers. In particular, controls should be strengthened over outside vendor access to their student accounting applications (see page 44).

Status of Prior Audit Findings and Observations.

With regard to the status of our prior audit recommendations to the Charter School from an audit we conducted of the 2005-06 and 2004-05 school years, we found the Charter School had taken appropriate corrective action in implementing our recommendations pertaining to their Statement of Financial Interests forms (see page 49).

Background Information on Pennsylvania Charter Schools

Description of Pennsylvania Charter Schools:

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

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

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

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

Pennsylvania Charter School Law

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

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

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

¹ 24 P.S. § 17-1702-A.

² *Id.*

³ 24 P.S. § 17-1717-A (a).

⁴ *Id.* § 17-1717-A (c).

⁵ *Id.* § 17-1717-A (d).

⁶ *Id.* § 17-1717-A (f).

⁷ 24 P.S. § 17-1721-A (a).

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

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

Funding of Pennsylvania Charter Schools:

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

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

Pennsylvania Charter School Funding

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

⁸ 24 P.S. § 17-1720-A.

⁹ Pennsylvania Department of Education, Basic Education Circular, "Charter Schools," Issued 10/1/2004.

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

¹¹ 24 P.S. § 17-1745-A(d).

¹² *Id.* § 17-1745-A(f)(4).

¹³ 24 P.S. § 17-1741-A(a)(3).

¹⁴ 24 P.S. § 17-1750-A(e).

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

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

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

¹⁵ See 24 P.S. § 17-1725-A(a)(2).

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

¹⁷ See 24 P.S. § 17-1725-A(a)(5).

¹⁸ See 24 P.S. § 25-2591.1. Please note that this provision is contained in the general funding provisions of the Public School Code and not in the Charter School Law.

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

Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

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

Our audit, conducted under the authority of 72 P.S. § 403, is not a substitute for the local annual audit required by the Public School Code of 1949, as amended. We conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit covered the period October 5, 2007 through October 12, 2010, except for the verification of professional employee certification which was performed for the period August 21, 2007 through June 30, 2010.

Regarding state subsidy and reimbursements, our audit covered school years 2007-08 and 2006-07 because the audit evidence necessary to determine compliance, including payment verification from the Commonwealth's Comptroller Operations and other supporting documentation from the Pennsylvania Department of Education (PDE), is not available for audit until 16 months, or more, after the close of a school year.

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

Objectives

What is the difference between a finding and an observation?

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

Performance audits draw conclusions based on an evaluation of sufficient, appropriate evidence. Evidence is measured against criteria, such as laws and defined business practices. Our audit focused on assessing the Charter School's compliance with applicable state laws, contracts, grant requirements, and administrative procedures. However, as we conducted our audit procedures, we sought to determine answers to the following questions, which serve as our audit objectives:

- ✓ Was the Charter School in overall compliance with the Public School Code of 1949²⁰ (PSC) and the Charter School Law (Law)?²¹

²⁰ 24 P.S. § 1-101 *et seq.*

²¹ 24 P.S. § 17-1701-A *et seq.*

- ✓ Did the Charter School have policies and procedures regarding the requirements to maintain student health records and perform required health services, and keep accurate documentation supporting its annual health services report filed with the Department of Health to receive state reimbursement?
- ✓ Did the Charter School receive state reimbursement for its building lease under the Charter School Lease Reimbursement Program, was its lease agreement approved by its board of trustees, and did its lease process comply with the provisions of the Public Official and Employee Ethics Act?²²
- ✓ Did the Charter School comply with the open enrollment and lottery provisions of the Law?
- ✓ Does the Charter School provide the services required for its special education students through outside agencies and/or through properly certified professional staff with the required instructional hours and/or training?
- ✓ Did the Charter School board of trustees and administrators, and the chartering school board members comply with the PSC, the Public Official and Employee Ethics Act, and the Sunshine Act?
- ✓ Were at least 75 percent of the Charter School’s teachers properly certified and did all of its noncertified teachers meet the “highly qualified teacher” requirements?
- ✓ Did the Charter School require its noncertified professional employees to provide evidence that they are at least 18 years of age, a U.S. citizen, and certified by a licensed Pennsylvania physician to be neither mentally nor physically disqualified from successful performance of the duties of a professional employee of the Charter School?
- ✓ Did the Charter School accurately report its membership numbers to PDE and were its average daily membership and tuition billings accurate?

²² 65 Pa.C.S. § 1101 *et seq.*

- ✓ Did the Charter School comply with the Law’s compulsory attendance provisions and, if not, did the charter school remove days in excess of ten consecutive unexcused absences from the Charter School’s reported membership totals pursuant to the regulations?²³
- ✓ Did the Charter School take appropriate steps to ensure school safety?
- ✓ Did the Charter School require that all of its employees enroll in the Public School Employees’ Retirement System at the time of filing its charter school application as required by the Law, unless the board of trustees had a retirement plan that covered the employees or the employees were already enrolled in another retirement program?
- ✓ Did the Charter School use an outside vendor to maintain its membership data, and if so, are internal controls in place related to vendor access?
- ✓ Were there any other areas of concern reported by local auditors, citizens, or other interested parties which warrant further attention during our audit?
- ✓ Did the Charter School take appropriate corrective action to address recommendations made in our prior audits?

Methodology

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

Charter School management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Charter School is in compliance with applicable laws, contracts, grant requirements, and administrative procedures. Within the context of our audit objectives, we obtained an

²³ 22 Pa. Code § 11.24.

What are internal controls?

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

- Effectiveness and efficiency of operations;
- Relevance and reliability of operational and financial information;
- Compliance with applicable laws, contracts, grant requirements, and administrative procedures.

understanding of internal controls and assessed whether those controls were properly designed and implemented.

Any significant deficiencies found during the audit are included in this report.

Our audit examined the following:

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

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

Lastly, to determine the status of our audit recommendations made in a prior audit report released on November 14, 2008, we reviewed the Charter School's response and then performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1

Bear Creek Community Charter School Improperly Received \$106,332 in State Lease Reimbursement

Relevant Public School Code (PSC) provisions and related criteria:

The Pennsylvania Supreme Court has held that the term “business,” as defined in the Public Official and Employee Ethics Act, includes “non-profit entities.” See *Rendell v. Pennsylvania State Ethics Commission* 603 Pa. 292, 983 A.2d 708 (2009).

Related parties are defined by accounting principles to include:

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

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

Section 2574 of the PSC, 24 P.S. § 25-2574(a), provides reimbursement for “approved permanent improvements to the school plant including . . . the cost of providing needed additions or alterations to existing buildings . . .” However, some relocatables can meet this requirement and be considered the same as traditional permanent construction.

The Commonwealth provides a state reimbursement subsidy to charter schools for approved annual rental of leases of school buildings used for educational purposes. Our audit found that between May 2008 and June 30, 2010, the Bear Creek Community Charter School (Charter School) improperly received \$106,332 in state lease reimbursements for two buildings that were ineligible for those payments because they were previously owned by the Charter School but transferred to a related party foundation for only \$1 each to create a circular lease arrangement between the related parties, and one of the two buildings includes three attached modular classrooms, which are ineligible for state lease reimbursement.

Property Owned by the Charter School

The Charter School has a two building campus located on land that it formerly owned. The first of the two buildings is a permanent education space that serves the Charter School’s students in grades Kindergarten through Eighth Grade. This permanent structure was donated to the Charter School on April 25, 2003, and includes three attached modular units. The Charter School has been located in this building since it was first chartered in 2004. The second building is a permanent structure, which is adjacent to the main building, and houses the administrative offices and is also used to provide music and language instruction to students. This building has been used since it was purchased by the Charter School for \$145,000 in December 2007. According to the Realty Transfer Tax Statement of Value recorded May 2008, the properties had a fair market value of \$363,200 and \$126,200, respectively.

Transfer of Property to Related Entity

On April 21, 2008, the Charter School sold its properties for only \$1 to the Bear Creek Foundation (Foundation), a related party to the Charter School, created in November 2006 for the purpose of renting real estate to the Charter School. The chief executive officer (CEO) of the Charter

Charter School Lease
Reimbursement Program Directives
from Bureau of Budget and Fiscal
Management, Pennsylvania
Department of Education (PDE),
state, in part:

“Lease rental costs for land and
relocatable structures/trailers are not
eligible for reimbursement under
this program; and

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

School created the Foundation and serves as president of the Foundation. The Charter School’s CEO also signed as the Pennsylvania notary public on both deeds to transfer the property from the Charter School to the Foundation.

Since the Charter School is a public school funded largely by taxpayer dollars, the Charter School’s transfer of real estate valued at over \$1 million to a related non-profit foundation for only \$1 included property paid for with taxpayer dollars and state funds and resulted in assets intended for public education being transferred to and controlled by a nonprofit entity, the Foundation, with no accountability to the Charter School, the authorizing school district, or taxpayers.

Circular Lease Agreement

On April 21, 2008, the same day that the Charter School conveyed its properties to the Foundation for only \$1, the Charter School’s board of trustees approved a lease agreement for the Charter School to pay rent to the Foundation through April 2038. The Charter School’s CEO signed the lease as “Attestor” (i.e. witness) to the board president’s signature for the Charter School.

According to the lease agreement that was effective immediately beginning on April 21, 2008, the Charter School was required to pay the Foundation \$23,227 per month, which totaled \$278,724 annually. Beginning on the first day of the second year of the term and on the first day of each year of the term thereafter, the monthly rent increases annually at a rate of three percent, plus utilities, insurance, and all maintenance costs for use of the property.

This circular lease arrangement between related parties resulted in the Charter School applying for and receiving a total state reimbursement of \$31,973, \$44,524, and \$29,835 for these buildings for school years 2009-10, 2008-09, and 2007-08, respectively, under the Commonwealth’s Reimbursement for Charter School Lease Program. Also, the Charter School applied for, but has not received, \$10,871 in state lease reimbursement for the final payment of the 2009-10 school year.

Applications for Lease Reimbursements

PDE's process for reimbursement of lease costs involves submission of the leasing arrangements and a request for reimbursement of lease costs. PDE's Application for Reimbursement for Charter School Lease form requires the signatures of the Charter School's CEO and the building lessor as certification of lease costs and payments. As further explained in Finding No. 2 of this report, the Foundation is governed by a three member board, for which the Charter School's CEO is the president. Since the same individual is a key decision-maker for both the Charter School and the Foundation, lease costs submitted to PDE for reimbursement were certified by related parties.

Eligibility for Lease Reimbursement

Under PDE's eligibility requirements, which are based on Section 2574.3(a) of the PSC,²⁴ buildings owned by a charter school do not qualify for state compensation under the Reimbursement for Charter School Lease Program. Furthermore, PDE's eligibility requirements for the Reimbursement for Charter School Lease Program state that trailers and modular classrooms are not eligible for reimbursement. Therefore, the Charter School has improperly received rental reimbursements resulting from questionable leasing arrangements of buildings originally owned by the Charter School and for three modular units attached to one of the buildings, when trailers and modular classrooms are not eligible for state reimbursement for the past three school years.

Background Information Relevant to Property Ownership

The following background information was provided by the Charter School's CEO in July 2010 to further explain the circumstances surrounding the property donated to the Charter School in 2003.

The individual who last purchased and owned the property (Purchaser) that was eventually donated to the Charter School in 2003 had left the property to the former Bear Creek School District to be used solely for education or community purposes. The Bear Creek School District later transferred the

²⁴ 24 P.S. § 25-2574.3(a).

property to the State School Authority, who gave the property to the Wilkes-Barre Area School District. When the Wilkes-Barre Area School District closed the building, the property reverted to the estate of the Purchaser as stipulated in the deed. The Purchaser's family in charge of estate matters then gave the property to the Charter School. The Purchaser's estate had to pay \$16,000 in real estate transfer tax on this property worth over \$800,000, which was a substantial expense to the family. The Purchaser's daughter-in-law serves on the Charter School's board and the Purchaser's son serves on the Foundation's board.

The Foundation's by-laws state that the board of the Foundation cannot sell the properties sold by the Charter School to the Foundation without consent of the Charter School's board because the Charter School is the sole member of the Foundation.

Furthermore, the Charter School's CEO represented that he recently testified in court concerning a related pending court action due to buying land adjacent to the Charter School through eminent domain. This eminent domain case is between the Charter School and the Bear Creek Township, where the Charter School's CEO also serves as a township supervisor.

Since property originally owned by the Charter School was transferred for only \$1 to the Foundation, a related party entity controlled by the same individuals as the Charter School, and then leased back to the Charter School under a related party landlord/tenant agreement, we conclude that the Charter School maintains an ownership interest in the property and that property owned by a charter school is ineligible for lease reimbursement. Therefore, the Charter School has improperly received state rental reimbursements for three school years for related party leasing costs for properties for which the Charter School indirectly maintains ownership interest.

Moreover, the Charter School improperly received state lease reimbursements for three modular units attached to one of its buildings for the past three school years, and modular classrooms are not eligible for reimbursement.

Furthermore, the Charter School's transfer of property purchased, in part, with state and/or taxpayer dollars were transferred to the Foundation, a related party entity with no accountability to the authorizing school district, the taxpayers or the Commonwealth.

Recommendations

The *Bear Creek Community Charter School* should:

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

The *Pennsylvania Department of Education* should require the Charter School to pay back the \$106,332 owed to the Commonwealth for the improper reimbursement it received from the Reimbursement for Charter Schools Lease Program.

Management Response

Auditor's note: The Charter School's responses identified individuals and entities by their specific names, which the Department of the Auditor General has replaced with position titles and entity type as they were identified throughout the report.

Management stated the following:

On October 6, 2010, Bear Creek Community Charter School received an audit finding that the School improperly received \$106,33[2] in state lease reimbursement. When presented with this finding, Bear Creek Community Charter School requested clarification as to the basis of the Auditor General's assertion. [The audit supervisor] responded that the lease reimbursement was improper for two reasons:

1. There is a conflict of interest due to related parties in the landlord/tenant agreement, and provided Section 2574.3 of the Public School Code²⁵, as a statutory reference in support of the Auditor General's position; and

²⁵ 24 P.S. § 25-2574.3.

2. Modular units were improperly included in lease reimbursement.

Bear Creek Community Charter School respectfully **disagrees** with the audit finding.

Issue #1 – There is a conflict of interest due to related parties in the landlord/tenant agreement.

As to the Auditor General’s position that there is a conflict of interest due to related parties in the landlord/tenant agreement, 24 P.S. § 2574.3 does not address issues related to conflicts of interest, related parties, or charter school landlord/tenant agreements. Furthermore, Bear Creek Community Charter School could not locate any statutory basis to substantiate the Auditor General’s assertion.

The Public School Code (24 P.S. § 2574.3) provides reimbursement for leases of buildings or portions of buildings for charter school use, which have been approved by the Secretary of Education on or after July 1, 2001.

Each year, the Pennsylvania Department of Education forwarded Bear Creek Community Charter School a program information booklet outlining the criteria and application instructions for the charter school facility lease reimbursement program, and the Bear Creek Community Charter School responded by submitting a completed Application for Approval of Charter School Lease (PDE-418). Following each year’s submitted Application, Bear Creek Community Charter School received a letter from the Pennsylvania Department of Education stating the School’s Application for Approval of Charter School Lease was reviewed and approved.

As late as September 21, 2009, the Pennsylvania Department of Education forwarded Bear Creek Community Charter School a program information booklet outlining the criteria and application instructions for the charter school facility lease reimbursement program. Included in the program material provided by the Department for the 2009-2010 school year was a listing of *“Additional Information Required with Submission of PDE-418, 2009-2010 Application for Approval of Charter*

School Lease”, which stated:

To ensure that the Charter School Lease Reimbursement Program is being administered properly, the following information must be submitted with PDE-418 2009-2010 Application for Approval of Charter School Lease form:

- 1. A copy of the signed lease agreement for the leased building;*
- 2. A copy of the deed for the leased building;*
- 3. Names of the board of directors and administrators of the charter school. If the owner of the leased building is a foundation/non-profit organization, the names of the board members for the foundation/non-profit organization are also required.*

On October 5, 2009, Bear Creek Community Charter School submitted a completed PDE-418 2009-2010 Application for Approval of Charter School Lease, and provided PDE the following additional documentation as requested.

1. A copy of the signed lease agreement between Bear Creek Foundation and Bear Creek Community Charter School dated April 21, 2008;
2. A copy of the deed dated April 21, 2008 between Bear Creek Community Charter School and Bear Creek Foundation recorded May 21, 2008 with the Luzerne County Recorder of Deeds;
3. A listing of the names of the administrators and Board of Trustees of the Bear Creek Community Charter School;
4. A listing of the names of the Board of Directors of the Bear Creek Foundation.

On May 1, 2010, Bear Creek Community Charter School received written notice from [the Chief of the Division of School Facilities], stating that “*the 2009-2010 Application for Charter School Lease, Form PDE-418, for your school has been reviewed and approved.*”

After submitting all the documentation requested by the Department and in compliance with the provisions of the Application for Approval of Charter School Lease (PDE-418), the Pennsylvania Department of Education

approved the Bear Creek Foundation's lease to Bear Creek Community Charter School on three separate occasions. The department never requested additional information, never questioned the information submitted, or never raised any concern to the Bear Creek Community Charter School that the Application for Approval of Charter School Lease was inappropriate – even after being provided all the requested documentation surrounding the real estate lease.

The Board of Trustees of the Bear Creek Community Charter School is dismayed as to how the Pennsylvania Auditor General can assert that the Bear Creek Community Charter School received improper lease reimbursement after Pennsylvania Department of Education specifically approved the lease on three separate occasions.

Issue #2 – Modular units were improperly included in lease reimbursement.

On October 6, 2010, Bear Creek Community Charter School was also told that modular classrooms were improperly included in lease reimbursement. When asked for clarification as to the basis of the Auditor General's assertion that modular units were improperly included in the lease reimbursement, we engaged in a discussion as to what constitutes a modular unit. On October 6, 2010, [the audit supervisor] provided the school with a one-page document with a title "Reimbursement for Permanent Modularized Construction" with a footer that reads "Plancon-A, July 1, 2007, Instructions Expire 06-30-09, Page 32". It appears there are more pages and more information in this document that was not provided. It also appears that this document is completely unrelated to the Charter School Lease Reimbursement Program. The School requested that a complete copy of this document be provided, a request that was reiterated on two separate occasions. To date, this document has not been provided to the school by the Auditor General's office. The School attempted to locate the document in question on the Pennsylvania Department of Education web site, but we were unable to locate the document.

The program material received from Pennsylvania Department of Education on August 26, 2008 and again on September 21, 2009 outlining the criteria for charter lease reimbursement states that "*lease rental costs for land and relocatable structures/trailers are not eligible for lease*

reimbursement under this program.” The program material does not define “relocatable structures/trailers,” nor does it reference the information contained on the single page document provided by [the audit supervisor] with a title “*Reimbursement for Permanent Modularized Construction*” with a footer that reads “*Plancon-A, July 1, 2007, Instructions Expire 06-30-09, Page 32*”.

Three modular classrooms are permanently attached to the original school building and have existed at this site for at least ten years. These classrooms are permanently attached to the school building through interior corridors, are integrated into the school’s electrical and data network, and one even sits on a concrete block foundation. These classrooms are not mobile and cannot be detached from the school without being destroyed. These are separate and distinct from the modular classrooms which the school had been leasing from [a modular building system company.]

The Public School Code (24 P.S. § 2574.3) provides reimbursement for leases of buildings or portions of buildings for charter school use, which have been approved by the Secretary of Education on or after July 1, 2001. The approved reimbursable annual rental for approved leases of buildings or portions of buildings for charter school use is the lesser of (i) the annual rental payable under the provisions of the approved lease agreement, or (ii) the product of the charter school facility’s enrollment times a legislated dollar amount based on the type of school. The subsidy paid equals the approved reimbursable annual rental multiplied by the aid ratio for the charter school.

The lease agreement executed on April 21, 2008 between Bear Creek Community Charter School and the BCF makes no reference to modular classrooms or relocatable structures/trailers. The lease explicitly references three parcels of land, along with an improved two-story building commonly known as 1900 Bear Creek Boulevard and a two-story building commonly known as 2000 Bear Creek Boulevard.

The Board of Trustees of the Bear Creek Community Charter School believes that the Pennsylvania Auditor General’s assertion that the School improperly received \$106,33[2] in state lease reimbursement because modular classrooms were improperly included in the charter school lease reimbursement to be unsubstantiated.

Auditor Conclusion

In response to management's reply that there is no legal provision explicitly prohibiting the related party landlord/tenant agreement, we are in agreement. However, under PDE's eligibility requirements, which are based on Section 2574.3 of the PSC, buildings owned by a charter school do not qualify for state funds under the Reimbursement for Charter School Lease Program. Given that properties owned by the Charter School and currently worth over \$1 million were sold in 2008 for only \$1 to the Foundation, a related entity that the Charter School's CEO created and is the president, we concluded that the Charter School continues to maintain an ownership interest in the properties despite the landlord/tenant agreement contriving a rent situation with no accountability to the Charter School, the authorizing school district, or taxpayers.

Moreover, the Charter School's CEO, who is also the Foundation's president, informed us during the audit that the Foundation's by-laws state that the board of the Foundation cannot sell the properties sold by the Charter School to the Foundation without consent of the Charter School's board because the Charter School is the sole member of the Foundation. This information further supports our position that the Charter School maintains an ownership interest in the properties.

The May 1, 2010 letter received by the Charter School from the chief of PDE's Division of School Facilities, which is referenced in management's response as approving the 2009-2010 Application for Charter School Lease, further states that the approval is based on a limited review of the information submitted and that if information reviewed subsequent to approval violates law, policy, or procedure, PDE reserves the right to rescind the approval. Given that our audit evidence substantiates a circular lease arrangement in which the Charter School continues to maintain an ownership interest in the real estate valued at over \$1 million, we are certain that PDE will closely review and act upon our finding.

Furthermore, while PSC § 2574.3 allows for the reimbursement of rental payments, the auditors provided the Charter School's administration with the criteria noted in this finding including Charter School Lease Reimbursement Program Directives provided by PDE's Bureau of Budget and Fiscal Management (*see* criteria

box), which state, in part:

Lease rental costs for land and relocatable structures/trailers are not eligible for reimbursement under this program; and

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

According to the CEO of the Charter School, the modular units that are attached to the main building at 2000 Bear Creek Boulevard are resting on posts that sit on concrete slabs. However, we observed wheels for the modular units, which were detached and maintained at 1900 Bear Creek Boulevard.

Moreover, the PDE-418 asks if the leased building is a relocatable structure/trailer. The Charter School answered “no” on the form submitted to PDE. While the main building is not a trailer, there is no reference that the attached buildings are relocatable trailers.

Also, the separate and distinct modular classrooms which the Charter School had been leasing from a modular building system company are not included for reimbursement, and therefore, are not disputed in this finding.

Furthermore, according to tax returns filed with the Internal Revenue Service, the Foundation is an organization created specifically to provide economic support to the Charter School, and mostly all of the Foundation’s reported revenue is from the rent payments made by the Charter School as a result of the related party landlord/tenant agreement. The fact that the Charter School owned the buildings until the sale of the property for only \$1 in April 2008 to the Foundation, which resulted in a questionable lease situation, coincides with the Charter School’s first filing for rental reimbursement from the state.

Finally, the “Reimbursement for Permanent Modularized Construction” with a footer that reads “Plancon-A July 1, 2007” referenced in management’s reply was a document provided by the auditor subsequent to this finding as part of a separate discussion that would only be

relevant at the time the building, with the attached modular units, was constructed. This document was not used as criteria to support this finding.

Based on the facts presented, we maintain our position that the Charter School improperly applied for \$117,203 in lease reimbursements and received \$106,332 as of the end of our fieldwork.

Subsequent to our fieldwork completion date, on October 12, 2010, a letter posted on the Charter School's website dated August 14, 2012, stated:

“Despite the best efforts of all parties, we were unable to acquire the land necessary to move forward with the development plans near the existing site, and all efforts to acquire this adjoining land have now been concluded.”

Therefore, the eminent domain case has been dropped.

Finding No. 2

Bear Creek Community Charter School Had Possible Related Party Transactions and Ethics Violations

Public School Code and criteria relevant to the finding:

Section 1715-A of the Charter School Law, 24 P.S. § 17-1715-A, states that:

“Charter schools shall be required to comply with the following provisions:

(11) Trustees of a charter school shall be **public officials**.

(12) A person who serves as an administrator for a charter school shall not receive compensation from another charter school or from a company that provides management or other services to another charter school. 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.”

Section 1102 of the Ethics, Act, 65 Pa.C.S. 1102, defines “conflict” or “conflict of interest” as use by a public official or public employee of the authority of his office or employment or any confidential information received through his holding public office or employment for the private pecuniary benefit of himself, a member of his immediate family or a business with which he or a member of his immediate family is associated.

Our review of lease agreements, property deeds, minutes of the meetings of the board of trustees, and an interview with the Bear Creek Community Charter School’s (Charter School) personnel found possible conflicts of interest resulting from transactions between the Charter School and the Bear Creek Foundation (Foundation).

As presented in Finding No. 1, the Charter School and the Foundation are related party entities by way of sharing common officers. The Charter School’s chief executive officer (CEO) created the Foundation in November 2006 and simultaneously serves as president of the Foundation and CEO and board secretary (non-voting member) of the Charter School.

On April 25, 2003, a citizen donated property to the Charter School, which opened in September 2004. This property was used to educate students in grades Kindergarten through Eighth Grade. In December 2007, the Charter School purchased adjoining property for the sum of \$145,000. This property was used to provide music classes to students, as well as house the Charter School’s administrative offices. According to the Realty Transfer Tax Statement of Value recorded May 2008, the properties had a fair market value of \$363,200 and \$126,200, respectively. The Foundation’s Internal Revenue Service (IRS) Form 990 filed in the 2010 calendar year valued these properties at over \$1 million.

On April 21, 2008, the Charter School’s board of trustees approved a resolution to transfer both properties to the Foundation. Consequently, the Charter School conveyed these properties valued at over \$1 million to the Foundation for \$1 each. At the same board meeting, the board approved a lease agreement between the Charter School and the Foundation, along with an application for lease reimbursement to Pennsylvania Department of Education (PDE) for the Charter School to receive state funds resulting from the lease agreement.

Furthermore, the Charter School’s CEO signed the lease attesting to the signatures obtained from the Director of the Foundation and the board president of the Charter School.

Section 1103(a) of the Ethics Act states that no public official shall engage in conduct that constitutes a conflict of interest.

Section 1103(f) states that no public official or public employee or his spouse or child of 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 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.

Section 1103(a) of the Ethics Act states that no public official shall engage in conduct that constitutes a conflict of interest.

Section 1103(f) states that no public official or public employee or his spouse or child of 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 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.

The Charter School's CEO also signed as the notary public on both deeds to transfer the property from the Charter School to the Foundation, which may constitute a violation of the Notary Public Law.²⁶ According to the Foundation's web page, the Foundation's mission is as follows:

"Bear Creek Foundation was incorporated as a non-profit corporation in the Commonwealth of Pennsylvania, organized exclusively for educational and charitable purposes. Bear Creek Foundation shall own and maintain real estate in support of the Bear Creek Community Charter School, raise funds in support of school activities and expansion, implement an educational scholarship program, and facilitate educational activities for the community."

According to the Charter School's CEO, this transaction was performed so the property will remain with the community if the Charter School fails.

As addressed in Finding No. 3 of this report, the Charter School failed to submit an IRS Form 990, a tax form specific to nonprofit organizations and subject to public inspection, for the 2009, 2008, and 2007 calendar years. An IRS Form 990 is a tax document required of most tax-exempt organizations that must be made available for public inspection. This resource may provide additional information about board members, salaries, contracts, expenditures, assets, and related party transactions. However, the Foundation did file IRS Form 990s for calendar years 2006 and 2010, which we reviewed for further information about the relationship and transactions between the Charter School and the Foundation. We found that the Foundation's IRS Form 990s identified the Charter School as a related party. The properties acquired by the Foundation from the Charter School were identified as "noncash contributions" totaling over \$1.2 million from a "related organization" on the Foundation's IRS Form 990 for the calendar year 2008. For calendar years 2008, 2009, and 2010, the Foundation's IRS Form 990s show that the rent paid by the Charter School's accounts for almost all of the revenue received by the Foundation, which is listed

²⁶ 57 P.S. § 165(e).

below.

	Program Service Revenue	Rent from Charter School
2008	\$185,871 ²⁷	\$185,816
2009	\$296,745	\$284,300
2010	\$329,712	\$292,832

For all calendar years, the Foundation’s IRS Form 990s were signed by the Foundation’s president, who is also the CEO of the Charter School. Moreover, for calendar years 2009 and 2010, the Foundation’s IRS 990s included Schedule O - Supplemental Information to Form 990, which stated that the 990 was prepared by the CPA employed at the Bear Creek Community Charter School, and that the 990 is reviewed by the president and then distributed to the remaining members. Since the Foundation’s president is also the Charter School’s CEO and board secretary, a non-voting member of the board of trustees, we found that this potential conflict of interest could result in inaccuracies in financial reports filed by the Charter School pertaining to rental payments between the Charter School and the Foundation since there is not a clear separation of duties by the individual serving as the Charter School’s CEO and the Foundation’s president. Furthermore, since the Charter School’s CPA allegedly prepared, but did not sign off as “Preparer,” the IRS 990s filed by the Foundation creates another potential conflict and lack of a separation of duties between the Charter School and the Foundation.

Recommendations

The *Bear Creek Community Charter School* should ask its solicitor to review the terms of any contract, as well as possible related party agreements, prior to approval.

The *State Ethics Commission* should review actions taken by the Charter School’s CEO and determine if ethical violations occurred.

The *Pennsylvania Department of Education* should review the findings and observations in this audit report in comparison to the Charter School’s lease reimbursement filings to determine whether inaccuracies or omissions of information existed in the Charter School’s filings provided for reimbursement.

²⁷ This amount excludes the properties received by the Foundation from the Charter School deemed as “contributions and grants” totaling \$1,226,762 in revenue for 2008.

The *Pennsylvania Department of State* should review the deed transactions between the Charter School and the Foundation to determine whether the documentation was properly notarized or whether a violation of the Notary Public Law occurred.

Management Response

Management provided the following:

Bear Creek Community Charter School (“Charter School”) vehemently disagrees with the draft audit finding that Bear Creek Community Charter School had possible related party transactions and ethics violations as a result of transactions between the Charter School and the Bear Creek Foundation (“Foundation”). The fact that the Charter School Board of Trustees transferred the property it uses to educate students in grades kindergarten through eighth grade and the adjoining property which was used to provide music classes to students and house some of the Charter School’s administrative offices to the Foundation for \$1.00 each does not violate the Ethics Act. Likewise, the fact that the Board of Trustees at the same time on April 21, 2008 approved the Lease Agreement between the Charter School and the Foundation whereby the Charter School paid rent under said Lease to the Foundation for the use of the aforesaid properties does not violate the Ethics Act.

A “conflict” or “conflict of interest” is defined in the Ethics Act at 65 Pa. C.S.A. §1102 as use by a public official or public employee of the authority of his office or employment or any confidential information received through holding a public office or employment for the private pecuniary benefit of himself, a member of his immediate family or a business with which he or a member of his immediate family is associated. [The Chief Executive Officer of the Charter School who serves] as a member of and President of the Board of the Foundation never received any private pecuniary benefit for himself or for a member of his immediate family. He receives no compensation whatsoever from the Foundation for serving as the President of the Board of the Foundation, as a member of the Board of the Foundation, or for any other reason.

Moreover, at the time the aforesaid property transfers were made and the Lease was entered into, the Pennsylvania

Supreme Court in the case of *In Re: Nomination Petition of Carroll*, 586 Pa. 624, 896 A.2d 566 (2006), had stated that a non-profit organization is not a business as defined by the Ethics Act. Therefore, the property transfers and the Lease arrangement with the Foundation, a Pennsylvania non-profit entity, did not violate the Ethics Act since there was no private pecuniary benefit to a “business” with which [the Charter School CEO] or a member of his immediate family was associated. The fact the he simultaneously was the CEO of the School and President of the Foundation did not result in a conflict of interest. While the Pennsylvania Supreme Court in *Rendell v. Pennsylvania State Ethics Commission*, 603 Pa. 292, 983 A.2d 708 (2009), changed its mind and in that case concluded that the term “business” as defined in Section 1102 of the Ethics Act should be interpreted to include non-profit entities, that decision came after the property transfers took place and the Lease was executed in April 2008 and hence that decision is not applicable to those transactions. Indeed, any attempt to apply *Rendell* retroactively to those transactions would violate due process under both the Federal and Pennsylvania Constitutions.

There is a second reason why the property and lease transactions do not violate the Ethics Act. There is no private pecuniary benefit to the Foundation as a result of those transactions. The Bear Creek Community Charter School, acting through its Board of Trustees, is the sole member of the Foundation as set forth in the Amended and Restated By-Laws of the Foundation. The Board of Trustees of the Charter School appoints the Board of Directors of the Foundation and can suspend them or remove them from office without cause at any time. Thus, the Foundation is controlled by the Board of Trustees. The Foundation cannot sell, lease, mortgage, exchange, pledge, assign, renovate, transfer, create a security interest in, and/or otherwise dispose of or encumber any assets of the Foundation, including, without limitation, any real estate and/or personal property owned by the Foundation or any interest in real estate and/or personal property owned by the Foundation, without the approval of the Board of Trustees of the Charter School, as set forth again in the Amended and Restated By-Laws of the Foundation. Therefore, since control over ownership of the real property transferred to the Foundation still remains with the Board of Trustees, there has been no private pecuniary gain to the Foundation.

As noted in the Articles of Incorporation of the Foundation, the Foundation exists “to own and maintain real estate in support of the Bear Creek Community Charter School; fundraising in support of school activities and expansion; implementation of an educational scholarship program; and facilitate educational activities for the community.” Thus, the Foundation exists solely for the purpose of supporting the Charter School, by whom it is controlled. In addition, the Articles of Incorporation of the Foundation provide that upon the dissolution of the Foundation, “assets shall be distributed for one or more exempt purposes within the meaning of Section 501 (c) 3 of the Code (or the corresponding provision of any future United States Internal Revenue Law) or shall be distributed to the federal government, or to a state or local government, for a public purpose.” Thus, the Foundation could not at any time use the assets or monies transferred to it for private pecuniary gain as required in order for there to be a violation of the Ethics Act.

Third, the Pennsylvania Supreme Court in *Kistler v. State Ethics Commission*, 610 Pa. 516, 22 AJd 223 (2011) held that to violate the conflict of interest provision of Section 1103(a) of the Ethics Act, “a public official must be consciously aware of a private pecuniary benefit for himself, his family or his business, and then must take action in the form of one or more specific steps to obtain that benefit.” 610 Pa. at 528. There is no evidence to support a finding that [the Charter School’s CEO] was consciously aware of any such private pecuniary benefit or that such a private pecuniary benefit even existed.

Therefore, for each of the foregoing reasons, any proposed finding that there are conflicts of interest resulting from the transactions between the Charter School and the Foundation is without any merit. Section 1103(a) of the Ethics Act, which prohibits public officials from engaging in conduct that constitutes a conflict of interest, clearly has not been violated.

Section 1103(f) of the Ethics Act provides in pertinent part as follows:

“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 \$500.00 or more with a governmental body with which the public official or public employee is associated or any subcontract valued at \$500.00 or more with any person who has been awarded a contract with a 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.” 65 Pa. C.S.A. § 1103(f).

For the same reasons stated above, there is no violation of Section 1103(f). In addition, the property transfers and the execution of the Lease were approved by the Board of Trustees of the Charter School at the Charter School’s public board meetings. Therefore, those transactions took place through an open and public process as contemplated by Section 1103(f). In *Kistler v. State Ethics Commission*, 610 Pa. 516, 22 A.3d 223 (2011), the Pennsylvania Supreme Court held that the Section 1103(f) requirement “that a contract be awarded through an open and public process does not require competitive bidding with respect to the contract.” Thus the property and Lease transactions between the Charter School and the Foundation do not violate Section 1103(f) of the Ethics Act.

You also cite in your draft finding Section 1715-A(I2) of the Charter School Law, 24 P.S. § 17-1715-A(I2), which prohibits a person who serves as an administrator for a charter school from receiving compensation from another charter school or from a company that provides management or other services to another charter school. As you are aware, [the Charter School’s CEO] receives absolutely no compensation of any kind from the Foundation for his service on the Board or as the President of the Board or for any other services he renders to the Foundation. Thus, there has been no violation of this provision of the Charter School Law.

The draft of your audit finding also references the Notary Public Law, 57 P.S. § 165(e), which is erroneously cited as 65 P.S. § 165 (e) in your draft audit finding, suggesting that the fact that the Charter School’s CEO attested to the signatures on the Lease of both the Director of the Foundation and the Board President of the Charter School and that he also signed as the Notary Public on both deeds

to transfer the properties from the Charter School to the Foundation, might constitute violations of the Notary Public Law. This contention is wholly without merit. Section 165(e) of the Notary Public Law provides as follows.

“(e) No Notary Public may act as such in any transaction in which he is a party directly or pecuniarily interested. For the purpose of this section, none of the following shall constitute a direct or pecuniary interest:

(2) Being an officer, director or employee of a company that is a party to the notarized transaction unless the director, officer or employee personally benefits from the transaction other than provided in clause (3); or (3) Receiving a fee that is not contingent upon the completion of the notarized transaction.” 57 P.S. §165(e).

Since [the Charter School’s CEO] in no way personally benefited from the transfer of the properties from the Charter School to the Foundation or from the execution of the Charter School’s Lease with the Foundation, there clearly is no violation of the Notary Public Law.

Your draft audit finding also calls into question the preparation of the Foundation’s IRS Form 990, Return of Organization Exempt from Income Tax and implies that there is a potential for intentional inaccuracies in financial reports due to an alleged conflict of interest. This is nothing more than conjecture, and there is no evidence that inaccuracies exist. Both Bear Creek Community Charter School and the Bear Creek Foundation are audited annually by an independent third-party certified public accountant, and no such concerns have ever been raised. Furthermore, your draft audit finding takes exception that the Charter School’s CPA “allegedly prepared, but did not sign off as Preparer.” IRS Form 990 as well as the corresponding instructions state “Paid Preparer” and include the definition of “anyone who is paid to prepare the return must sign the return.” Since the School’s CPA was not paid to prepare the return, she complied with the IRS instructions and did not sign the return.

In response to your recommendations, be advised that Bear Creek Community Charter School’s solicitor does review the terms of contracts, as well as related party agreements,

prior to approval. Furthermore, Bear Creek Community Charter School provided the Pennsylvania Department of Education with a complete copy of the School's lease, deeds to the property involved in the charter school lease, a listing of both the Board of Trustees of the School and the Board of Directors of the Foundation, along with other documentation, as part of the 2010-2011 Application for Reimbursement for Charter School Lease. The Department approved the Application for that program year, as well as the subsequent year.

As a point of clarification, the draft audit finding inaccurately contains information that the School was provided the audit finding "Bear Creek Community Charter School Had Possible Related Party Transactions and Ethics Violations," and that the Auditor General's Office did not receive a management response as of January 5, 2011. It is important to note that the Charter School's CEO learned of "possible ethics violations" when the field representative of the Auditor General's Office made reference to these allegations to a School employee, and that employee brought the allegations to the attention of [the CEO], who then questioned the Auditor General's field representative as to the merit of the allegations. The last communication relating to this matter was a telephone call from the Auditor General's Office on October 4, 2010 advising [the CEO] that the audit review conference was postponed. The substance supporting the Auditor General's finding related to ethics violations was not presented to the School until August 24, 2012. The Charter School was unable to respond to the audit prior to August 2012 since it was unaware of the basis of the finding.

The draft finding with respect to the Bear Creek Community Charter School having possible related party transactions and ethics violations should be withdrawn in its entirety. It is not only wholly without merit, but defamatory of the Charter School, the foundation and [the CEO].

State officials and state employees making such baseless allegations, which appear to be motivated by the Auditor General Office's opposition to charter schools, violates the Federal and State constitutional rights of the Charter School, the Foundation and [the CEO].

Auditor Conclusion

In response to management's objections to this finding, which we continue to stand by in its entirety, our rebuttal is as follows:

First, our audit conclusions about potential conflicts of interest under the Ethics Act, as well as the possible related party transactions, pertaining to the questionable circular lease arrangement resulted from the totality of the circumstances. Based on management's reply, it appears that the Charter School may have **misinterpreted** our concerns as relating solely to the Charter School transferring the properties owned by the Charter School to the Foundation; the Board of Trustees' approving the Lease Agreement in a open and public process; and that we were somehow arguing that the Foundation may have received private pecuniary benefit from these transactions. Under the Ethics Act, the questions of private pecuniary gain only apply to public officials or employees, not private entities such as the Foundation. Moreover, our conclusions about possible Ethics Act violations relate to: 1) the fact that the same individual was a key decision-maker for both the Charter School and the Foundation; 2) the public charter school's assets (i.e., properties with an estimated value of \$1 million) were wholly transferred to a private foundation; and 3) the Charter School paid public tax dollars for rental fees of \$278,724 in 2008, with monthly rent increases annually at a rate of three percent in subsequent years, with **absolutely no** accountability and transparency to the Charter School, the authorizing school district, or taxpayers. Given that we do not have any authority to audit the Foundation and the Foundation's financial information on the IRS Form 990 is entirely self-reported, it is unknown whether the Charter School's CEO/president of the Foundation received the private pecuniary benefit for the questionable lease arrangement. Only the State Ethics Commission can determine if ethical violations by the Charter School's CEO occurred, as well as whether the 2009 and 2011 Pennsylvania Supreme Court decisions in *Rendell* and *Kistler* retroactively apply to these transactions. Therefore, we will appropriately be referring this finding to the Commission.

Second, our audit evidence about a possible violation of the Notary Public Law is well founded. While the draft finding originally provided to management contained a typo to the citation reference, management was clearly informed that

we were referring to the Notary Public Law. As indicated in management's reply, we were specifically referring to Section 165(e) of the Notary Public Law, 57 P.S. § 165(e), which is the provision regarding the duty of a notary to guard against notarizing documents in which he/she may have an interest. Section 165(e) states as follows:

(e) No notary public may act as such in any transaction in which he is a party **directly or** pecuniarily interested. For the purpose of this section, none of the following shall constitute a direct or pecuniary interest:

(1) being a shareholder in a publicly traded company that is a party to the notarized transaction;

(2) being an officer, director or employe of a company that is a party to the notarized transaction, unless the director, officer or employe personally benefits from the transaction other than as provided in clause (3); or

(3) receiving a fee that is not contingent upon the completion of the notarized transaction. (Emphasis added.)

The Pennsylvania Department of State's website states, "[a]s public officials who are appointed and commissioned by the Secretary of the Commonwealth, notaries public are held to the highest standards of integrity, honesty and trust." Further, "[n]o notary public may act as such in **any** transaction in which he is a party **directly or** pecuniarily interested." (Emphases added.) Moreover, as recently stated in dicta by the Pennsylvania Commonwealth in *In re Berg*, 973 A.2d 447, 449 (Pa.Cmwlt. 2009), citing *Citizens Committee to Recall Rizzo v. Board of Elections of the City and County of Philadelphia*, 470 Pa. 1, 22, 367 A.2d 232, 242 (1976), "The purpose of such a statute is to ensure impartiality on the part of a notary with regard to the matter before him."

As provided for in subsection (e) of the Notary Public Law, even if the CEO did not have a pecuniary interest in the deeds that he attested to, as a notary public, he should not have acted in that capacity if he had any direct or "general" interest in the deed transactions. (See *In re Nomination Petitions of McIntyre*, 778 A.2d 746 (Pa.Cmwlt. 2001), in the Commonwealth Court again stated in dicta that "A notary is prohibited from having more than a general interest in a document he or she notarizes." Therefore, we

are referring this finding to the Pennsylvania Department of State to ask that they review the deed transactions to determine whether a violation of the Notary Public Law occurred.

Third, with regard to your objections to our conclusion about the preparation of the Foundation's IRS Form 990, we note that our concerns are again well founded and may have been misinterpreted. Because the Foundation's president is also the Charter School's CEO and board secretary, a non-voting member of the board of trustees, we believe that the highly conflicted roles of this individual could possibly lead to inaccuracies in the financial reports filed by the Charter School pertaining to rental payments between the Charter School and the Foundation. Therefore, we are referring the finding to the Pennsylvania Department of Education to determine if the Charter School's filings for lease reimbursement contain any inaccuracies or omissions of information and comport with the Charter School's financial reports.

Finally, during our audit process, documentation associated with related party transactions and ethics violations were requested from the Charter School's personnel. Our review found questionable procedures and possible conflicts of interest among related parties, namely resulting from transactions between the Charter School and the Foundation. The audit staff communicated the questionable transactions and possible violations to the Charter School's CEO throughout the audit. However, the final draft version of this finding was not presented to the Charter School until August 2012, which was the Charter School's first opportunity to provide a management response.

Finding No. 3

Bear Creek Community Charter School Failed to File Their IRS Form 990 Return of Organization Exempt From Income Tax

Public School Code (PSC) and criteria relevant to the finding:

Section 17-1720-A(a) of the Charter School Law, 24 P.S. § 17-1720-A(a), states, in part:

“A charter will be granted only for a school organized as a public, **nonprofit** corporation.”

Nonprofits are eligible to apply for tax-exempt status with the Internal Revenue Service (IRS) under the Internal Revenue Code (IRC).

The IRC requires tax-exempt entities, including charter schools, to file an annual information return, such as an IRS Form 990, “Return of Organization Exempt from Income Tax,” or IRS Form 990EZ, “Short Form Return of Organization,” unless a filing exception is met.

Nonprofits, including charter schools, granted tax-exempt status by the IRS are required to file an IRS Form 990, “Return of Organization Exempt from Income Tax,” or IRS Form 990EZ, “Short Form Return of Organization Exempt from Income Tax” unless they meet one of the exceptions.

Our audit of the Bear Creek Community Charter School’s (Charter School) records found that the Charter School failed to file their Return of Organization Exempt from Income Tax, IRS Form 990, for calendar years ending December 31, 2009, 2008, and 2007.

The Charter School Law requires charter schools to incorporate as a nonprofit corporation in Pennsylvania before a charter may be granted. By organizing as a Pennsylvania nonprofit, charter schools are eligible for certain benefits, such as state sales, property, and income tax exemptions.

Nonprofits, including charter schools, are also eligible to apply for a federal tax-exempt status with the IRS. The benefits of a tax-exempt status include exemption from federal income tax and eligibility to receive tax-deductible charitable contributions. To receive these benefits, most organizations must file an application for recognition of exemption with the IRS. Educational organizations, such as charter schools, generally apply for a 501(c)(3) tax-exempt status.

For a charter school to establish a 501(c)(3) tax-exempt status under the IRC, whether it purchases some or all of the services required to operate, it must establish that it is organized and operated for the benefit of the public and not for the benefit of any private person, such as a service provider (i.e., management company). The Charter School applied for and received tax-exempt status from the IRS in 2002 and filed its initial IRS Form 990 “Return of Organization Exempt from Income Tax,” for the 2002 calendar year. This annual tax return was filed before the Charter School opened in September of 2004 and was the only return filed by the Charter School.

Tax-exempt organizations with \$25,000 or more in gross receipts, or \$50,000 or more for tax years ending on or after December 31, 2010, are required to file an IRS Form 990, “Return of Organization Exempt from Income Tax,” or IRS Form 990EZ, “Short Form Return of Organization.” The

Charter School received total revenue of \$4,193,929 for the school year ending June 30, 2009, and therefore, an IRS Form 990 was required to be filed.

The IRS Form 990 is a public document open to public inspection. The IRS Form 990 provides the public and interested parties with information about the organization's mission, programs, and finances. Specifically, the IRS Form 990 contains information about the organization's governance structure, board members, salaries, contracts, financial transactions, management policies, and disclosure practices. The Charter School's failure to file an annual return with the IRS lessens the transparency and accountability needs of the state, the authorizing school district, Pennsylvania Department of Education (PDE), and local community members served by the organization, such as teachers, parents, and students.

According to the Charter School, they thought they were not required to file an IRS Form 990 because they were a government entity. Government entities are not required to file an IRS Form 990. However, ordinarily, charter schools are not treated as governmental units or affiliates of governmental units because they are not "operated, supervised, or controlled by a governmental unit." In Pennsylvania, charter schools operate under a contract (i.e. a charter) with a governmental unit (i.e. a local school district, or PDE if a cyber charter school), but the governmental unit does not elect or appoint the charter school's board of trustees or control the operations or finances of the charter school. In fact, the Charter School Law defines a charter school as "an independent public school." As such, the Charter School is an independent public charter school organized as a Pennsylvania nonprofit corporation and is not a governmental unit or affiliate of a governmental unit under state law.

Recommendations

The *Bear Creek Community Charter School* should:

1. File an IRS Form 990 for calendar years ending 2009, 2008, and 2007, and each subsequent year.
2. Request its solicitor to provide a summary of all the Charter School's legal requirements under the Charter School Law, the Nonprofit Corporations Law of 1988, and the IRC.

The *Pennsylvania Department of Education* should take any action deemed necessary.

Management Response

Management provided the following:

In response to your audit finding of August 16, 2010 entitled “Bear Creek Community Charter School Failed to File Their IRS Form 990 Return of Organization Exempt from Income Tax,” Bear Creek Community Charter School respectfully disagrees with the audit finding.

Bear Creek Community Charter School did file the IRS Form 990 as an initial return, covering the period August 15, 2002 through June 30, 2003. The School acknowledges not filing IRS Form 990 for subsequent years, and disagrees with the Auditor General’s assertion that the School was required to file IRS Form 990 for years subsequent to the School obtaining a charter to operate a public school under 24 P.S. § 17-1717A.

Pursuant to the instructions for IRS Form 990, a “governmental unit” or affiliate of a “governmental unit” is exempt from filing Form 990. The glossary to the instructions for Form 990 states that a “governmental unit” is, “a state or possession of the United States or a political subdivision of a State or U.S. possession.”

Pennsylvania Code §32.1 provides that Pennsylvania public schools, which are governed by the Public School Code of 1949, are political subdivisions rather than nonprofit educational institutions. In Pennsylvania, a public charter school (i.e. Bear Creek Community Charter School), is subject to the Pennsylvania Charter School Law. § 17-1715A (1) of the Pennsylvania Charter School Law incorporates the rules of the Public School Code of 1949 and applies them to public charter schools.

Since Bear Creek Community Charter School is governed by the Pennsylvania Charter School Law and in turn the Public School Code of 1949, it is a political subdivision of the Commonwealth of Pennsylvania under Pennsylvania Code § 32.1. As a political subdivision of the state, the Bear Creek Community Charter School is deemed to be a “governmental unit” for IRS purposes and thereby exempt from annually filing a Form 990.

As we discussed previously, Bear Creek Community Charter School received correspondence from the Internal Revenue Service in December 2007 regarding the filing status of Bear Creek Community Charter School's IRS Form 990, and received a site visit by [an IRS Revenue Officer]. [The IRS Revenue Officer] and I discussed Bear Creek Community Charter School's history, and how it progressed from a non-profit organization to a public charter school, when its charter was approved by the Wilkes-Barre Area School District. [The IRS Revenue Officer] agreed with our position, and no further follow-up with the internal revenue service was requested or required.

Following the presentation of your audit finding, I attempted to contact [the IRS Revenue Officer], but the Wilkes-Barre Office of the Internal Revenue Service informed me that [the officer] was "no longer assigned to our case" and was unavailable to speak to me. I explained the situation, and I requested to speak with the IRS representative who was assigned to the case. I was then told "there is no open case." I tried to get an explanation, but with no success.

For these reasons, we assert our disagreement with the finding of the Auditor General's office.

[We provided] a copy of the letter received from IRS Revenue Officer dated December 5, 2007, along with a copy of the legal opinion letter on this matter drafted by [our law firm dated October 8, 2010, which states in part:

This letter is in response to your inquiry regarding Bear Creek Community Charter School and whether it is required to file Internal Revenue Service ("IRS") Form 990, Return of Organization Exempt from Income Tax, with the IRS. After conducting research into the matter, it is my opinion that Bear Creek is not required to file Form 990. . .

Since Bear Creek is not required to file Form 990 with the IRS under federal law, it is the opinion of this firm that there is no authority permitting the Commonwealth of Pennsylvania and/or any of its agencies to require Bear Creek to file a federal form, including Form 990. Therefore, since the IRS has not mandated that Bear Creek

file Form 990, any filing requested by an entity other than the IRS would not be enforceable.]

Auditor Conclusion

Although the Charter School stated that they are exempt from the IRS Form 990 filing requirement as a “governmental unit” by citing to a section of the Pennsylvania Code, we disagree. First, management’s assertion that “Pennsylvania Code § 32.1 provides that Pennsylvania public schools, which are governed by the Public School Code of 1949, are political subdivisions rather than nonprofit educational institutions,” is entirely erroneous given that this section, 22 Pa.Code § 32.1, solely relates to “general authority and purpose” of Equal Education Opportunity in Higher Education, which has nothing to do with charter schools. Moreover, the U.S. Court of Appeals, Third Circuit, recently held that Pennsylvania charter schools are **not** political subdivisions under Pennsylvania law.²⁸ Second, as stated in the finding, the Charter School Law requires Pennsylvania charter schools to organize as a public **nonprofit corporation** before a charter may be granted by a local school district or the Pennsylvania Department of Education in the case of cyber charter schools. Although charter schools are public schools, this incorporation status provides a distinct difference between charter schools and local school districts in Pennsylvania. Charter schools must be formed as nonprofits, whereas local school districts are formed as corporate bodies (24 P.S. § 2-211) that are considered “governmental entities” and further defined as “political subdivisions” (1 Pa.C.S. § 1991). Since the Charter School is not “operated, supervised, or controlled by the district” and consistent with the Charter School Law’s definition of a charter school is “an independent public school,” the Charter School is not a governmental unit or an affiliate of a governmental unit under state law. Therefore, the Charter School does not qualify for exception from filing an IRS Form 990 as a governmental unit.

²⁸ The court observed that for purposes of a charter school bringing suit, the Charter School Law “merely states that a charter school can sue and be *sued to the same extent* that a political subdivision *can be sued*. The inclusion of ‘to the same extent and upon the same condition makes it clear that the statute does not, as the District Court asserts, *equate* a charter school with a political subdivision. Rather, the statute states that, for the limited purpose of determining a charter school's ability to be sued, the same circumstances under which political subdivisions and local agencies can be sued shall apply to charter schools.” *Pocono Mountain Charter School v. Pocono Mountain School Dist.*, 442 Fed.Appx. 681, 686, C.A.3 (Pa. 2011).

Further, our analysis of IRS records revealed that more than 90 percent of Pennsylvania charter and cyber charter schools, operating during the 2009-10 school year, filed for and received a tax-exempt status with the IRS, and over 85 percent have filed IRS Form 990 Returns. As such, this finding will be forwarded to the IRS for further review and determination.

Finding No. 4 →

Bear Creek Community Charter School Had a Possible Certification Violation

Charter School Law and Pennsylvania regulations relevant to the finding:

Section 17-1732-A of the CSL, 24 § 17-1732-A, requires charter schools to comply with Chapter 711 of the Pennsylvania Code, 22 Pa. Code § 711 *et seq.*, specific to special education services and programs at charter and cyber charter schools.

Chapter 711 regulations require:

“Persons who provide special education or related services to children with disabilities in charter schools and cyber charter schools shall have appropriate certification. . .” (22 Pa. Code § 711.5(a))

Pennsylvania Department of Education’s certification guidelines, CSPG 91 states, in part:

An educator holding a valid Pennsylvania certificate as a Supervisor of Special Education is qualified to function as a liaison between the school administration and the certified professional special education staff of a public school for the purpose of:

1. Enhancing the attainment of the district’s expectations and goals by authorizing activities using judgment not equally shared by all professionally special education certified staff.
2. Directing other certified special education persons.

Our audit of Bear Creek Community Charter School’s (Charter School) professional employees’ certification and assignments for the period August 21, 2007 through June 30, 2010, was performed in order to determine compliance with the Charter School Law (CSL), the Public School Code (PSC), Chapter 711 of the Pennsylvania Code (Chapter 711), the federal No Child Left Behind Act, and Certification and Staffing Policies and Guidelines (CSPG) issued by the Pennsylvania Department of Education’s (PDE) Bureau of School Leadership and Teacher Quality (BSLTQ).

Our audit found a special education coordinator was employed during the 2008-09 school year without the proper professional certification required by the State Board of Education. The following duties were included in the special education coordinator’s job description: making recommendations relative to personnel placements; transfers and discipline; delegating proper staff assignments; monitoring special education staff for completing individualized education programs (IEP); and monitoring staff performance and providing input to the chief administrative officer on special education staff evaluations.

All special education professional staff must hold appropriate state certification and cannot be part of the 25 percent noncertified professional staff allowable at charter schools and cyber charter schools.

Lack of properly certified teachers could result in the Charter School’s students not receiving a quality education or special services to which they are entitled. In addition, certification deficiencies may force a chartering school district to not renew or revoke a charter because the charter school has not fulfilled its contractual obligations to provide required certified instructors, such as employing properly certified special education staff.

Certification deficiencies are not determined by this Department. Information pertaining to the questionable assignments was submitted to PDE’s BSLTQ for

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| <p>3. Providing direct input to administrators, which affects the employment, assignment, transfer, promotion, layoff, discharge or other similar personnel actions of other professional-level employees certified in special education.</p> |
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determination. If PDE’s BSLTQ confirms these deficiencies, the Charter School would not be subject to any monetary sanctions as the CSL does not hold charter schools accountable for certification deficiencies in the same manner as traditional schools, which are subject to subsidy forfeitures for certification deficiencies.

Recommendations

The *Bear Creek Community Charter School’s* chief executive officer should ensure that:

1. Individuals are properly certified for their area of administrative responsibility or subject in which they teach.
2. The individual cited in this finding obtain proper certification or be re-assigned to a position for which he/she is properly certified.

The *Bear Creek Community Charter School’s* board of trustees, in order to ensure compliance for all subsequent years, should establish procedures to ensure that:

1. Professional employees are properly certified for their area of administrative responsibility or subject in which they teach, for the entire school year, in compliance with the CSL, Chapter 711, and PDE’s CSPGs.
2. Administrative personnel are provided with sufficient training in order to understand and manage charter school certification requirements as defined by the CSL, Chapter 711, and PDE’s CSPGs.

As the authorizing school district, the *Wilkes-Barre Area School District* should:

1. Follow-up with the Charter School regarding BSLTQ’s certification determination regarding its possibly uncertified special education staff.
2. Review the charter, based upon BSLTQ’s determination, and determine whether the Charter School is violating certification and/or special education terms of its approved charter with the district.

The *Pennsylvania Department of Education* should review the CSL and the Public School Code and make

recommendations to the State Board of Education and the General Assembly to amend existing laws to hold charter schools accountable for certification deficiencies in the same manner as traditional schools, including the imposition of monetary sanctions.

Management Response

Management provided the following:

In response to your audit finding of August 16, 2010, entitled “Possible Certification Irregularity” for the audit period ending June 30, 2007 and June 30, 2008, Bear Creek Community Charter School respectfully disagrees with the audit finding.

The Pennsylvania Auditor General’s office asserts that [the employee] did not hold the proper state certification from the Pennsylvania Department of Education during her period of employment beginning August 11, 2008 and ending August 31, 2009 when she served in the position as Special Education Coordinator.

The Pennsylvania Auditor General’s Office failed to provide any factual or legal basis to support the assertion that the position of Special Education Coordinator requires a specific Pennsylvania certification.

Furthermore, the Pennsylvania Auditor General’s Office failed to provide any legal basis in either the Public School Code or any other statute to support the assertion, despite two requests from Bear Creek Community Charter School.

The Public School Code of 1949, 24 P.S. § 17-1724-A, provides the controlling statutory authority for the certification of charter school staff, which sets forth, in pertinent part:

- (a) The board of trustees shall determine the level of compensation and all terms and conditions of employment of the staff except as may otherwise be provided in this article. At least seventy-five per centum of the professional staff members of a charter school shall hold appropriate State certification.

Bear Creek Community Charter School considers the position of Special Education Coordinator to be a professional staff member. The school is only required to ensure that seventy five percent of the school’s total number

of professional staff holds state certification. Accordingly, only having one professional employee lack state certification for a period of one academic year does not contravene any applicable state statute.

Accordingly, the Act itself contains statutory language which indicates that charter schools are exempt from statutory requirements set forth in the Public School Code of 1949. The statute setting forth charter school requirements states as follows:

P.S. § 17-1715-A(1)

Except as otherwise provided in this article, a charter school is exempt from statutory requirements established in this act, from regulations of the State board and the standards of the secretary not specifically applicable to charter schools. Charter schools are not exempt from statutes applicable to public schools other than this act.

For these reasons, we respectfully disagree with this finding of the Auditor General's office.

Auditor Conclusion

We respectfully disagree with management's contention that the Department "failed to provide any factual or legal basis to support the assertion that the position of Special Education Coordinator requires a specific Pennsylvania certification." The factual evidence outlined in the finding, as well as the criteria box containing the pertinent legal standards at the beginning of this finding provided for all of the necessary elements underlying the foundation for our conclusion, including first and foremost that Section 1732-A(b) of the CSL requires adherence to Chapter 711 of the Pennsylvania Code, which mandates that any persons providing special education or related services to children with disabilities in charter schools must have appropriate certification.

By the very nature of the position of "Special Education Coordinator," which includes the duties of, among other things, "monitoring special education staff for completing IEPs," it is evident that the individual fulfilling these duties must be certified. Therefore, our finding stands as presented.

Observation



What is logical access control?

“Logical access” is the ability to access computers and data via remote outside connections.

“Logical access control” refers to internal control procedures used for identification, authorization, and authentication to access the computer systems.

Bear Creek Community Charter School Had Unmonitored Vendor System Access and Logical Access Control Weaknesses

The Bear Creek Community Charter School (Charter School) uses software purchased from an outside vendor for its critical student accounting applications (membership and attendance). Additionally, the Charter School’s entire computer system, including all its data and the vendor’s software are maintained on the vendor’s servers which are physically located at the vendor’s location. The Charter School has remote access into the vendor’s network servers. The vendor also provides the Charter School with system maintenance and support.

Based on our current year procedures, we determined that a risk exists that unauthorized changes to the Charter School’s data could occur and not be detected because the Charter School was unable to provide supporting evidence that they are adequately monitoring all vendor activity in their system. However, since the Charter School has adequate manual compensating controls in place to verify the integrity of the membership and attendance information in its database, that risk is mitigated.

Reliance on manual compensating controls becomes increasingly problematic if the Charter School would ever experience personnel and/or procedural changes that could reduce the effectiveness of the manual controls.

Unmonitored vendor system access and logical access control weaknesses could lead to unauthorized changes to the Charter School’s membership information and result in the Charter School not receiving the funds to which it was entitled from the state.

During our review, we found that the Charter School had the following weaknesses over vendor access to the Charter School’s system:

1. The Charter School’s Acceptable Use Policy does not include provisions for authentication (password security and syntax requirements).
2. The Charter School does not have current information technology (IT) policies and procedures for controlling

the activities of vendors/consultants, nor does it require the vendor to sign the Charter School's Acceptable Use Policy.

3. The Charter School has certain weaknesses in logical access controls. We noted that the Charter School's system parameter settings do not require all users, including the vendor, to use passwords that are a minimum length of eight characters.
4. The vendor has unlimited access (24 hours a day/7 days a week) into the Charter School's system.
5. The Charter School does not have evidence to support that they are generating or reviewing monitoring reports of user access and activity on the system (including vendor and the Charter School's employees). There is no evidence to support that the Charter School is performing any procedures in order to determine which data the vendor may have altered or which vendor employees accessed their system.

Recommendations

The *Bear Creek Community Charter School* should:

1. Include the Acceptable Use Policy provisions for authentication (password security and syntax requirements).
2. Establish separate IT policies and procedures for controlling the activities of vendors/consultants and have the vendor sign this policy, or the Charter School should require the vendor to sign the Charter School's Acceptable Use Policy.
3. Implement a security policy and system parameter settings to require all users, including the vendor, to use passwords that are a minimum length of eight characters.
4. Only allow access to their system when the vendor needs access to make pre-approved changes/updates or requested assistance. This access should be removed when the vendor has completed its work. This procedure would also enable the monitoring of vendor changes.

5. Generate monitoring reports (including firewall logs) of vendor and employee access and activity on their system. Monitoring reports should include the date, time, and reason for access, change(s) made and who made the change(s). The Charter School should review these reports to determine that the access was appropriate and that data was not improperly altered. The Charter School should also ensure it is maintaining evidence to support this monitoring and review.

Management Response

Management provided the following:

Bear Creek Community Charter School (the “School”) acknowledges its use of software purchased from an outside vendor for student accounting applications, including membership and attendance. Bear Creek Community Charter School utilizes [an outside vendor]. The web-based application and data are maintained on the Vendor’s servers, which are physically located at the Vendor’s location. The School has remote access into the Vendor’s network servers. The Vendor also provides the School with system maintenance and support.

A review by the Pennsylvania Auditor General’s Office (the “Auditor”) determined that a risk exists that unauthorized changes to the School’s data could occur and not be detected because the School was unable to provide supporting evidence that they are adequately monitoring all Vendor activity in their system.

The Auditor also found that since the School has adequate manual compensating controls in place to verify the integrity of the membership and attendance information in its database, that the risk is mitigated. For example, student attendance and enrollment information is reviewed monthly in preparation of invoices to the various school districts of residence from which students originate. Included in this process is the download of student data from [an outside vendor], a review and comparison of this data to the prior billing period, and a review and comparison of the following: new enrollments; withdrawals; change of address; and new, renewed, or expired Individualized Education Programs (IEPs). Hard copy documentation is maintained to support any change in student membership, which is cross-referenced against changes detected during the monthly invoicing process.

During the review, the Auditor found the School had the following weaknesses as of October 12, 2010, over vendor access to the charter school's system.

1. The School will review its Acceptable Use of Technology Policy and will consider making changes to address the concern raised by the Auditor.
2. The School will develop a policy and associated procedures to control the activities of vendors/consultants who have a legitimate business-purpose to access the School's network or data, which will be provided to all vendors/consultants and require their written acknowledgement.
3. All network passwords assigned to employees are randomly generated and include a mix of eight alpha/numeric characters. The School will thoroughly review access credentials for the [outside vendor] application to ensure all users, including the vendor, use passwords that are a minimum of eight characters.
4. The [outside vendor's] application is housed on the vendor's network servers and therefore the vendor does technically have access to the School's data, not the School's systems. The vendor can only access data that is stored within the [outside vendor] application, which the vendor is responsible for managing under the current agreement between the School and the vendor. The vendor does not have access to the School's network or any application or data residing on the School's network. The School will investigate what options are available to restrict vendor access to the School's data within the [outside vendor's] application, including only allowing access to School data when the vendor needs access to make pre-approved changes/updates or requested assistance. The School will also develop a procedure for monitoring vendor changes to School data.
5. The School does monitor user access to the School's network, including firewall logs, through the WatchGuard UTM suite. The School will work with the vendor to implement safeguards allowing the School to generate and review monitoring reports of

vendor access to the School's data within the [outside vendor's] application. Monitoring reports will include the date, time, change(s) made and who made the change(s). The School will review these reports to determine that the access was appropriate and that data was not improperly altered. The School will maintain copies of monitoring reports for a ninety (90) day period as to provide the Auditor [with] evidence that this procedure has been implemented and is ongoing.

Bear Creek Community Charter School's Board of Trustees recently approved the creation of the position of Network and Technology Administrator, who will be responsible for implementing technology-related controls, among other responsibilities. The School is finalizing the interview process for perspective candidates, and the Board expects to fill this position by December 27, 2010.

Auditor Conclusion

The conditions and recommendations stated above represent the information communicated to the auditor during our fieldwork. Any subsequent improvements or changes in management representations will be evaluated in the subsequent audit.

Status of Prior Audit Findings and Observations

Our prior audit of the Bear Creek Community Charter School (Charter School) for the school years 2005-06 and 2004-05 resulted in one reported finding pertaining to Statement of Financial Interests. As part of our current audit, we determined the status of corrective action taken by the Charter School to implement our prior recommendations. We performed audit procedures, and questioned the Charter School's personnel regarding the prior finding. As shown below, we found that the Charter School did implement recommendations related to Statement of Financial Interests.

School Years 2005-06 and 2004-05 Auditor General Performance Audit Report

Finding: **In Violation of the Public Official and Employee Ethics Act, Two Principals Failed to File their Statement of Financial Interests Form at Some Time During the Audit Period**

Finding Summary: Our prior audit of the Charter School's records for the calendar years ended December 31, 2006 and 2005, found that two principals failed to file their Statement of Financial Interests form with the State Ethics Commission for the calendar year December 31, 2005.

Recommendations: Our audit finding recommended that the Charter School:

1. Seek the advice of its solicitor in regard to the board of trustees' responsibility when administrators and/or members fail to file their Statement of Financial Interests forms.
2. Develop procedures to ensure that all individuals required to file a Statement of Financial Interests form do so in compliance with the Ethics Act.

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



Distribution List

This report was initially distributed to the chief executive officer of the charter school, the board of trustees, our website address at www.auditorgen.state.pa.us, and the following:

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