



KEYSTONE EDUCATION CENTER
CHARTER SCHOOL

MERCER, 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. Todd Hedderick, Board President
Keystone Education Center Charter School
270 Sharon Road
Greenville, Pennsylvania 16125

Dear Governor Corbett and Mr. Hedderick:

We conducted a performance audit of the Keystone Education Center Charter School (Charter School) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period April 23, 2009 through December 9, 2011, except as otherwise indicated in the report. Additionally, compliance specific to state subsidy and reimbursements was determined for the school years ended June 30, 2009 and June 30, 2010. 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 noncompliance with state laws and administrative procedures, as detailed in the three audit findings and two observations within this report. A summary of these results is presented in the Executive Summary section of the audit report.

Our audit findings, observations, 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,

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

EUGENE A. DEPASQUALE
Auditor General

March 7, 2013

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



Table of Contents

	Page
Executive Summary	1
Background Information on Pennsylvania Charter Schools	3
Audit Scope, Objectives, and Methodology	6
Findings and Observations	10
Finding No. 1 – Charter School May Have Improperly Received \$85,375 in State Lease Reimbursements in Violation of the Public School Code	10
Finding No. 2 – Failure to Report Special Education Student Information in the Annual Report	15
Finding No. 3 – Failure to Approve Professional Salaries by Board of Trustees	18
Observation No. 1 – Possible Conflict of Interest Violations of the Ethics Act	20
Observation No. 2 – Keystone Education Center Charter School Lacks Sufficient Internal Controls Over Its Student Record Data	23
Status of Prior Audit Findings and Observations	25
Distribution List	29



Executive Summary

Audit Work

The Pennsylvania Department of the Auditor General conducted a performance audit of the Keystone Education Center 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 April 23, 2009 through December 9, 2011, 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 2008-09 and 2009-10.

Charter School Background

The Keystone Education Center Charter School, located in Mercer County, Pennsylvania, opened in August 1997. It was originally chartered on July 9, 1997, for a period of five years by the Greenville Area and Reynolds Area School Districts. The Charter School's mission states: "The Keystone Education Center was established to provide educational alternatives that address the needs of a variety of students who have difficulty functioning in the traditional public school environment. The intent of the Keystone Education Center Charter School is to afford students the opportunity to gain positive educational experiences, to earn a high school diploma, develop marketable skills, and to develop

the necessary work ethic needed for post high school success. The school will also address the behavioral and emotional needs of each child." During the 2009-10 school year, the Charter School provided educational services to 601 pupils from 35 sending school districts through the employment of 26 teachers, 7 full-time and part-time support personnel, and 7 administrators. Lastly, the Charter School received more than \$234 thousand in state funding in school year 2009-10.

Adequate Yearly Progress

The Charter School did not make Adequate Yearly Progress (AYP) for the 2010-11 school year and is in a Corrective Action II status level. A school that misses only one measure will not meet AYP. This is the fourth year that the Charter School did not meet all AYP measures. The Charter School will need to meet AYP for two years in a row to be considered on track to meet the goal of all students attaining proficiency in Reading and Math by the year 2014.

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% 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 three compliance-related matters reported as findings and two observations.

Finding No. 1: Charter School May Have Improperly Received \$85,375 in State Lease Reimbursements in Violation of the Public School Code. Our audit of the Charter School found that between July 1, 2008 and June 30, 2010, the Charter School may have improperly received \$85,375 in state lease reimbursements resulting from related party landlord/tenant agreements between the Charter School and a for profit entity that the Charter School's executive director founded and is simultaneously holding the position of president (see page 10).

Finding No. 2: Failure to Report Special Education Student Information in the Annual Report. Our audit of the Charter School's annual report for the 2010-11, 2009-10, and 2008-09 school years revealed that the Charter School failed to include the required special education student information as prescribed by the Pennsylvania School Code (see page 15).

Finding No. 3: Failure to Approve Professional Salaries by Board of Trustees. Our audit of professional salaries for the 2009-10 school year disclosed that the compensation for professional employees was not approved by the board of trustees (see page 18).

Observation No. 1: Possible Conflict of Interest Violation of the Ethics Act. Our audit of the 2009-10 and 2008-09 school years revealed several possible related party transactions (see page 20).

Observation No. 2: Keystone Education Center Charter School Lacks Sufficient Internal Controls Over Its Student Record Data. Our audit of the Charter School's controls over data integrity found that internal controls need to be improved (see page 23).

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 2007-08, 2006-07 and 2005-06 school years, we found the Charter School had taken appropriate corrective action in implementing our recommendations pertaining to child accounting, certification, fiscal precautions necessary, and failure to develop a Memorandum of Understanding. We found that the Charter School had not taken appropriate corrective action in regards to possible related party transactions (see page 25).

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 the 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 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 Charter School 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

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).

expenditures, 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 Charter School 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 April 23, 2009 through December 9, 2011, except for the verification of professional employee certification which was performed for the period February 2009 through August 2011.

Regarding state subsidy and reimbursements, our audit covered school years 2008-09 and 2009-10.

For the purposes of our audit work and to be consistent with Pennsylvania Department of Education 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 Law²¹ (Law)?
- ✓ 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

²⁰ 24 P.S. § 1-101 *et seq.*

²¹ 24 P.S. § 17-1701-A *et seq.*

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?
- ✓ Does the Charter School have sufficient internal controls to ensure that the membership data it reported

²² 65 Pa.C.S. § 1101 *et seq.*

to the Pennsylvania Information Management System (PIMS) is complete, accurate, valid, and reliable?

- ✓ 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.

The Charter School management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Charter School is in

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.

compliance with applicable laws, contracts, grant requirements, and administrative procedures. Within the context of our audit objectives, we obtained an 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 and deposited state funds.

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 December 9, 2010, we reviewed the Charter School's response and then performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1

Charter School May Have Improperly Received \$85,375 in State Lease Reimbursements in Violation of the Public School Code

Public School Code and criteria relevant to the finding:

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

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

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

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

Our audit of the Keystone Education Center Charter School (Charter School) found that between July 1, 2008 and June 30, 2010, the Charter School may have improperly received \$83,670 in state lease reimbursements resulting from related party landlord/tenant agreements between the Charter School and a for-profit entity that the Charter School’s executive director founded and is simultaneously holding the position of president (hereinafter referred to as “Landlord”). Because the same person was founder and officer of both the Charter School leasing building space and the Landlord owning the premises being rented, we concluded that these lease arrangements were created among related parties sharing ownership interest in the property. In addition, the Charter School’s director of finance simultaneously holds the position of secretary for the Landlord. Properties owned by a charter school are not eligible to receive state lease reimbursement. Furthermore, we found that these landlord/tenant agreements may have been improperly awarded by the Charter School because of potential conflicts of interest and the reasonable likelihood that these transactions could result in direct or indirect financial benefits received by the Charter School’s executive director and secretary individually, as well as the Landlord, a business entity with which they were associated.

Under the PSC and lease reimbursement guidelines established by Pennsylvania Department of Education (PDE), the state agency responsible for administering the Reimbursement for Charter School Lease Program, a charter school may receive reimbursement from the Commonwealth for a portion of its costs associated with leasing building space for educational purposes. However, certain criteria must be met in order to be eligible to receive state lease reimbursements.

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

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

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

Our review revealed the following relevant facts:

- The Charter School’s executive director founded and simultaneously serves as president of the entity serving as the Charter School’s Landlord.
- The Charter School’s director of finance simultaneously holds the position of secretary for the Landlord.
- The Charter School’s director of finance signed the 2010 and 2011 landlord/tenant agreements on behalf of the Landlord, and the Charter School’s executive director signed on behalf of the Charter School. Both of these individuals have dual roles with the Charter School and the Landlord, and both individuals are signing and certifying information required on the application for state lease reimbursement.
- The Charter School’s executive director signed the applications for the Commonwealth’s charter school reimbursement filed with PDE verifying the lease costs paid by the Charter School to the Landlord, as the lessor (Landlord). The director of finance is the Charter School contact person for these applications.
- The Charter School received a total of \$85,375 in state lease reimbursement agreements for its rental costs for the 2008-08 and 2009-10 school years.

Based on the aforementioned facts, it appears that the entity acting as the Charter School's Landlord was created by the Charter School's executive director to create a circular leasing arrangement for the Charter School to file for state lease reimbursement. However, we maintain that this circular leasing arrangement was created among related parties with which there is continued association, and that the Charter School was essentially leasing to itself. Consequently, there is circumstantial evidence that the Charter School maintains ownership interest in the building that it is leasing from a related party. Moreover, we question the fact that the Charter School's executive director and director of finance are signing off and certifying lease amounts and payments made when both individuals are serving in key roles for both the Charter School and the Landlord.

Under PDE's eligibility requirements, which are based on Section 2574.3(a) of the PSC, buildings owned by a charter school do not qualify for compensation under the Reimbursement for Charter School Lease Program. Because the Charter School's executive director and director of finance were simultaneously holding positions with the Landlord from which the Charter School was leasing educational space during the audit period, we concluded that the landlord/tenant agreements between related parties resulted in the Charter School having ownership interest in the building, which would make the Charter School ineligible to receive state lease reimbursements. As such, the Charter School may have improperly received state rental reimbursements totaling \$85,375 for the 2008-08 and 2009-10 school years.

Recommendations

The Keystone Education Charter School should:

1. End the practice of leasing its permanent education buildings to itself and cease applying for payment from the Reimbursement for Charter School Lease Program for these buildings.
2. Ensure that its solicitor review and approve the terms of all and any reimbursement prior to submitting an application.

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

The *Pennsylvania Department of Education* should:

4. Take immediate steps to require the Charter School to repay the \$83,670 owed to the Commonwealth for the improper reimbursement it received from the Reimbursement for Charter School Lease Program.
5. Cease from making future payments to the Charter School under the Reimbursement for Charter School Lease Program if the Charter School continues to lease space from a related-party entity for which it shares ownership interest and common officers.

Management Response

Management stated the following:

Section 2574.3 of the Public School Code of 1949, as amended, provides that rent payment on leases of buildings or portions of buildings for a charter school use, which have been approved by the Secretary of Education, shall have the annual rent payable pursuant to the lease, reimbursed. For a charter school to qualify for the reimbursement under the legislation, the school must be a Pennsylvania approved charter school and have a signed lease agreement for rent of a building and the building is being used for educational purposes.

In accord with the requirements of the Department of Education's lease reimbursement program, Keystone completed forms PDE 418 and PDE 419 for years 2008-09 and 2009-10, to obtain reimbursement for rent paid. The Auditor General was provided copies of Keystone's PDE 418 and PDE 419 for both years. Consequently, the Auditor General is fully aware that the lease agreements were submitted to the Department of Education along with a copy of the deed for the leased premises and the names of every Keystone School Board Members. Based upon all of the information provided by Keystone to the Department of Education and the Department of Education's review of the information, the rent reimbursement was approved. The parties to the lease agreement were at all times extensively disclosed in the documents submitted to the Department of Education as well as in Keystone's records including those

provided to the Auditor General and numerous other state and federal government agencies since our inception. At no time in the history of Keystone did the Charter School “improperly receive” any funds including lease reimbursements.

Auditor Conclusion

As previously stated, our finding focuses on the appropriateness of having the same individuals, the Charters School’s executive director and director of finance, function as key decision-makers for both the Charter School and the Landlord. Moreover, lease amounts and payments submitted to PDE for state reimbursement were certified by an individual associated with both parties.

It is important to note that PDE relies upon signatures of officials submitting the forms PDE 418 and PDE 419 as the only means of verifying that the information tendered is accurate. Based on the facts presented, we continue to question the Charter School’s eligibility to receive state funding from these lease arrangements, which were created among related parties sharing ownership interest in the property.

As the state agency responsible for administering the lease program and reimbursements, our department will refer this matter to PDE for final determination regarding the Charter School’s eligibility to receive state lease reimbursement under its lease agreement with a related party Landlord and lease oversight by common officers of the two parties.

The Charter School should review the program’s eligibility requirements and discuss any issues with PDE.

Finding No. 2

Failure to Report Special Education Student Information in the Annual Report

Charter School Law and Pennsylvania regulations relevant to the finding:

Section 17-1728-A(b) of the Charter School Law (CSL), 24 P.S. § 17-1728-A(b), requires each charter school to submit an annual report no later than August 1st of each year to the local board of school directors of the authorizing school district(s) and the secretary of the Pennsylvania Department of Education in the form prescribed by the secretary.

Section 22 of the Pennsylvania Code, 22 Pa. Code § 711.6 (c), states:

“The annual report must include the age and type of exceptionality for each enrolled child with a disability; the level of intervention provided to each child with a disability; certification of staff providing services to each child with a disability; and programs and services available to children with a disability.”

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

Charter schools are required to file an annual report on a form prescribed by PDE by August 1st of each year with the authorizing school district(s) and PDE. The purpose of the annual report is to facilitate the chartering school district’s required annual review of whether a charter school is meeting the goals of and is in compliance with its approved charter. Chapter 711 Special Education Regulations pertain to the delivery of special education services and programs in charter and cyber charter schools.

Specifically, Chapter 711 Special Education Regulations require that the annual report include information relating to the age and type of exceptionality for each enrolled child and the level of intervention provided. This information is considered public data because it is to be presented by student age or grade level and not by individual student identifying data.

It is important that all of the required information be reported as it represents very limited special education data available to the authorizing school districts (Greenville Area and Reynolds Area), PDE, and the public regarding the special education population served by the Charter School since special education information is largely protected by confidentiality laws. Moreover, the Charter School’s annual report includes an assurance statement for the operation of the charter school services and programs, signed by the board president and chief executive officer (CEO) of the Charter School stating it is in compliance with specific regulations, including the requirements of 22 Pa. Code Section 711.

While we acknowledge that PDE's eStrategic Planner Template Annual Report directions did not specify the inclusion of this information, the Charter School remains responsible for ensuring the implementation of special education services or programs and meeting reporting requirements of the Pennsylvania Special Education Regulations.

Recommendations

The *Keystone Education Center Charter School* should:

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

The *Pennsylvania Department of Education* should:

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

Management Response

Management stated the following:

1. Pennsylvania Department of Education does not request this information in the annual report;
2. Keystone Education Center Charter School provides all information pertaining to Special Education students when requested by the Department's Bureau of Special Education;
3. An audit was completed by the Bureau of Special Education in May 2011 and found Keystone Education Center Charter School to be in compliance with all reporting relating to the Special Education student information.

Auditor Conclusion

Again, we acknowledge that PDE's eStrategic Planner Template Annual Report directions did not specify the inclusion of this information. However, the Charter School still remains responsible for all information required to be included in the Charter School's annual report. Specifically, Chapter 711 Special Education Regulations in Section 22 of the Pennsylvania Code require that the annual report include information relating to the age and type of exceptionality for each enrolled child and the level of intervention provided. Moreover, PDE's eStrat Planner Tool is an open format that allows charter schools to freely

enter information without predefined choices, including the ability to submit required information and accompanying attachments.

Moreover, this finding is specific to the special education information that state statute mandates be included in the annual report required to be filed by all charter schools. Consequently, the fact that the Charter School may have provided special education student information to PDE's Bureau of Special Education does not address its absence in the annual report. Similarly, PDE's review, not audit, may have indeed found the Charter School in compliance with special education reporting requirements, but again, this information is irrelevant to the finding. If this information was supplied elsewhere, it does not dismiss the fact that it must be contained in the Charter School's annual report, which must also be filed with the Charter School's authorizing school district(s) and is made available to the public.

Therefore, the audit finding stands as presented.

Finding No. 3 →

Failure to Approve Professional Salaries by Board of Trustees

Charter School Law relevant to the finding:

Section 1716-A of the Charter School Law (CSL), 24 P.S. § 17-1716-A, requires the board of trustees of a charter school to exercise control over the operation of the school.

Section 1716-A(a) of the CSL, 24 P.S. § 17-1716-A(a), states:

“The board of trustees of a charter school shall have the authority to decide matters related to the operation of the school, including, but not limited to, budgeting, curriculum and operating procedures, subject to the school's charter. The board shall have the authority to employ, discharge and contract with necessary professional and nonprofessional employees subject to the school's charter and the provisions of this article.”

Section 1724-A(a) of the CSL, 24 P.S. § 17-1724-A(a), states, in a pertinent part:

“The board of trustees shall determine the level of compensation and all terms and conditions of employment of the staff . . .”

Our audit of professional salaries for the 2009-10 school year disclosed that the compensation for professional employees was not approved by the Keystone Education Center Charter School’s (Charter School) board of trustees as required by the CSL. Specifically, the CSL requires that the board of trustees control the Charter School’s operations, including determining the level of compensation and conditions of employment of the staff.

Officials stated that they don’t have board approved salaries because they are unable to determine salaries until October of the school year when they know how many students will be enrolled. Top administrators then set the professional salaries.

Charter schools operate with taxpayer monies, and because of this, should act in the most transparent way possible. One way to do this is to adopt top administrators salaries at an open meeting and have that information documented in board meeting minutes.

Additionally, our review of the Charter School’s approved charter disclosed under the responsibilities of the board of trustees and charter by-laws, approval of professional employees’ salaries was not included.

The *Keystone Education Center Charter School* should:

Ensure that the board of trustees approves individual professional salaries at an open board meeting.

Management Response

Management stated the following:

1. All salaries including professional/administrative salaries are approved by the board on an annual basis when the board approves the Charter School budget;
2. The Charter School also reports all professional/administrative salaries annually through PIMS to Pennsylvania Department of Education’s Data

Collection Team in the Professional Staff Department Report.

Auditor Conclusion

Although the board of trustees did approve the professional/administrative salaries in the aggregate when the budget was approved, the board did not specifically approve the individual salaries at an open board meeting.

Therefore, the audit finding stands as presented.

Observation No. 1

Charter School Law and statutory provisions relevant to the observation:

Section 1715-A of the Charter School Law (CSL), 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 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.”

The General Assembly declared the following when enacting the Public Officials and Employee Ethics Act (Ethics Act): “[P]ublic office is a public trust and that any effort to realize personal financial gain through public office other than compensation provided by law is a violation of that trust. . . .” (see Pa. C.S. § 1101.(a)).

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

Possible Conflict of Interest Violations of the Ethics Act

Our audit of the Keystone Education Center Charter School (Charter School) for the 2009-10 and 2008-09 school years found several possible “conflict of interest” violations of the Ethics Act.

The executive director of the Charter School was a member of the board of trustees during the 2008-09 school year and through January 13, 2010. He was also involved in the formation of the Charter School through an Adolescent Center (Center), for which he was president. The Charter School and the Center share building space.

In addition, the executive director is also the president of a company which rents classroom space to the Charter School. Rent is determined by using the lower of two appraisals provided by independent appraisers. During the 2009-10 and 2008-09 school years, the Charter School paid \$129,840 in rent each year according to financial statements.

Moreover, the Charter School employs various members of the executive director’s family in different capacities, including positions such as the chief administrative officer, director of personnel, and director of finance. Payments to family members for wages and benefits totaled approximately \$317,750 for the 2008-09 school year and \$324,995 for the 2009-10 school year.

Additionally, the Charter School purchased meals from a local school district, which are used in the food service program. Purchases totaled \$130,946 during the 2008-09 school year and \$126,853 during the 2009-10 school year. It should be noted that one of the Charter School’s board of trustees is the superintendent of the local school district for which the Charter School was purchasing meals.

As previously stated, our audit found that the Charter School’s executive director’s immediate family members are employed by the Charter School in key administrative roles, and they have financially benefited either directly or indirectly, from the assorted transactions made by the executive director or other family members on behalf of the Charter School.

Section 1102 of the Ethics Act (Ethics Act), 65 Pa.C.S. § 1102, defines a “business” as any corporation, partnership, sole proprietorship, firm, enterprise, franchise, association, organization, self-employed individual, holding company, joint stock company, receivership, trust or any legal entity organized for profit.

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 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.

Section 1103(a) of the Ethics Act, 65 Pa.C.S. § 1103(a), provides that no public official shall engage in conduct that constitutes a conflict of interest.

Section 1103(f) of the Ethics Act, 65 Pa.C.S. § 1103(f), provides 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 shall not have any supervisory or overall responsibility for the implementation or administration of the contract.

We recommend that the State Ethics Commission review this matter for potential conflicts of interest and related party transactions. Furthermore, it should be noted that a copy of our prior audit finding pertaining to this same issue was forwarded to the Ethics Commission.

Recommendations

The *Keystone Education Center Charter School* should:

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

The *State Ethics Commission* should determine if the Public Official and Employee Ethics Act has been violated by:

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

Management Response

Management stated the following:

We are waiving the opportunity to respond at this time due to the on-going ethics investigation. We will be happy to respond to the appropriate government agency at the appropriate time.

Auditor Conclusion

During our audit, the State Ethics Commission was investigating the potential conflicts of interest and related party transactions noted. As of April 18, 2012, our department had not received any correspondence from the State Ethics Commission regarding its determination. As of January 18, 2013, the State Ethics Commission had completed its review and was awaiting a final decision of the Commissioner. The final decision will be held "confidential" for 30 days and then will be released to the public.

Observation No. 2

Keystone Education Center Charter School Lacks Sufficient Internal Controls Over Its Student Record Data

Criteria relevant to the observation:

According to PDE's 2009-10 *PIMS User Manual*, all Pennsylvania LEAs must submit data templates as part of the 2009-10 child accounting data collection. PIMS data templates define fields that must be reported. Four important data elements from the Child Accounting perspective are: District Code of Residence; Funding District Code; Residence Status Code; and Sending Charter School Code. In addition, other important fields used in calculating state education subsidies are: Student Status; Gender Code; Ethnic Code Short; Poverty Code; Special Education; LEP Participation; Migrant Status; and Location Code of Residence. Therefore, PDE requires that student records are complete with these data fields.

Additionally, according to the *Federal Information Systems Control Manual (FISCAM)*, a business entity should implement procedures to reasonably assure that (1) all data input is done in a controlled manner; (2) data input into the application is complete, accurate, and valid; (3) incorrect information is identified, rejected, and corrected for subsequent processing; and (4) the confidentiality of data is adequately protected.

Beginning with the 2009-10 school year, the Pennsylvania Department of Education (PDE) now bases all local education agencies' (LEA) state subsidy calculations, such as the basic education subsidy, on the student record data it receives in the Pennsylvania Information Management System (PIMS). PIMS is a statewide longitudinal data system or "data warehouse", designed to manage and analyze individual student data for each student served by Pennsylvania's Pre-K through Grade 12 public education systems. PIMS replaces PDE's previous reporting system, the Child Accounting Database (CAD), which PDE ran concurrently until it brought PIMS completely online. PDE no longer accepts child accounting data through the CAD system.

Because PDE now uses the data in PIMS to determine each LEA's state subsidy, it is vitally important that the student information entered into the system is accurate, complete, and valid. Moreover, anytime an entity implements a computer system of this magnitude, there is an increased risk that significant reporting errors could be made. LEAs must ensure that they have strong internal controls to mitigate these risks to their data's integrity. Without such controls, errors could go undetected and subsequently cause the LEA to receive the improper amount of state reimbursement.

Our review of the Keystone Education Center Charter School's (Charter School) controls over data integrity found that internal controls need to be improved. Specifically, our review found that charter school personnel exported student membership information to PIMS by school, instead of a blanket (all school) membership export to PIMS via the PIMS Export Utility. As a result, student membership days for a specific program were unintentionally excluded from this export to PIMS and school districts whose students are enrolled in this program were not given proper credit for membership days while they were in the program.

While charter schools do not receive most of the state subsidies, like the basic education subsidy, that school districts receive, charter schools must still file student record data with PDE. This student record data is used to generate charter school billings to sending school districts, and to credit sending school districts with students attending a charter school for purposes of the sending school district's state subsidy calculations. Since school districts are required to pay tuition for its students attending a charter school, student membership reported by a charter school gets credited by PDE back to the home school district, so students attending a charter school are still counted in the home school district's total student membership count for purposes of calculating state subsidies. For example, after a charter school files its student record data, PDE prepares a child accounting summary for the sending school district crediting student membership days back to the sending school district for inclusion in the school district's total student membership used to calculate the school district's state subsidies. Moreover, PDE's child accounting summary should be utilized by the charter school and the sending school district to verify the days students attended a charter school and resulting charter school tuition billings.

Recommendations

The Keystone Education Center Charter School should perform an internal audit of its subsequent years PIMS data submissions to ensure adequate procedures are in place to verify all student membership days are reported to PIMS and to make adjustments as needed.

Management Response

Management stated the following:

This observation stems from our 1st year of using the PA Information Management System (PIMS). We will continue to work with PIMS help desk staff and our software staff (IU IV) to rectify this issue and ensure all student data is properly uploaded.

Status of Prior Audit Findings and Observations

Our prior audit of the Keystone Education Center Charter School (Charter School) for the school years 2007-08, 2006-07, and 2005-06 resulted in five reported findings. The findings pertained to child accounting internal control weaknesses, certification deficiency, fiscal precautions necessary, the failure to develop a Memorandum of Understanding, and possible related party transactions. 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 charter school personnel regarding the prior findings. As shown below, we found that the Charter School did implement recommendations related to child accounting, certification deficiency, fiscal precautions necessary, and the failure to develop a Memorandum of Understanding. We found that the Charter School did not take appropriate corrective action in regards to possible related party transactions.

School Years 2007-08, 2006-07, and 2005-06 Auditor General Performance Audit Report

Finding No. 1: Child Accounting Internal Control Weaknesses

Finding Summary: Our audit of the Charter School found violations of the Public School Code (PSC) and charter school board policy and internal control weaknesses.

Recommendations: Our audit finding recommended that the board of trustees require the administration of the Charter School to comply with board policy and the PSC by:

1. Reviewing and complying with the October 1, 2004 Basic Educational Circular (BEC) regarding charter schools, and specifically;
2. Strengthening the enrollment requirements to include the collection of the parental statement regarding suspended or expelled students;
3. Turning over the compulsory attendance enforcement to the district of residence;
4. Developing tuition invoices that comply with the requirements established by the October 1, 2004 BEC;
5. Completing the enrollment notification forms entirely by requiring evidence of residency for the district of residence as stated on the enrollment form application; and
6. Performing an internal audit of all subsequent unaudited membership, and change the reports, if necessary.

Current Status: During our current audit, we found that the Charter School did implement our recommendations during the course of our prior audit, and no current deficiencies were noted.

Finding No. 2: Certification Deficiency

Finding Summary: One individual was assigned as the curriculum director/special education director without proper certification for the 2008-09, 2007-08, and 2006-07 school years.

Recommendations: Our audit finding recommended that the Charter School:

Establish review procedures to ensure that all employees are properly certified and assigned.

Current Status: During our current audit, we found that the Charter School did implement our recommendation from the prior audit, and we found no current certification deficiencies. After receiving the Final Audit Review Citation dated March 26, 2009, from the Bureau of School Leadership and Teacher Quality, the Charter School assigned another appropriately certified employee to the position of special education supervisor.

Finding No. 3: Fiscal Precautions Necessary

Finding Summary: The board secretary, board treasurer, and activity fund custodians were not properly bonded.

Recommendations: Our audit finding recommended that the Charter School:

1. Implement procedures to review staff assignments on a regular basis to ensure that all staff members are properly bonded.
2. Review the coverage with the carrier, and ask the carrier to add an endorsement to the policy by which the determination of the word "Employee" would be amended to specifically include the board secretary, board treasurer and student activity fund custodians under coverage.
3. Request guidance from Pennsylvania Department of Education in this area, if necessary.

Current Status: During our current audit, we found that the Charter School now has the proper bonds in place on the board secretary, board treasurer, and activity fund custodian. Copies of the bonds were dated August 29, 2011.

Finding No. 4: Failure to Develop a Memorandum of Understanding

Finding Summary: The Charter School did not have a Memorandum of Understanding (MOU) with local law enforcement. During the audit, the Charter School did obtain a MOU with the local law enforcement agency.

Recommendations: Our audit finding recommended that the Charter School:

1. Should continue to review, update, and re-execute the current MOU every two years; and
2. Should adopt a policy requiring the administration to review and re-execute the MOU every two years.

Current Status: The school has in force a MOU with local law enforcement, which was updated on September 20, 2011.

Finding No. 5: Related Party Transactions

Finding Summary: During our audit of the 2007-08, 2006-07, and 2005-06 school years of operations, we noted that the Charter School entered into a number of possible “related party” transactions.

Recommendations: Our audit finding recommended that the Charter School:

Should request legal counsel to review with the Commonwealth of Pennsylvania State Ethics Commission the “related party” concerns noted to ensure no improper related party transactions are occurring.

Current Status: During our current audit, we found that the Charter School did consult with its legal counsel. Although the Charter School’s administrators do disclose their various relationships, we continue to note possible conflicts of interest, as further discussed in Observation No. 1 of our current audit report. After the prior audit, we sent a copy of our finding to the State Ethics Commissions. As of December 9, 2011, the Ethics Commission was still reviewing the Charter School’s structure to determine if any violations of the Ethics Act occurred.



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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