

POCONO MOUNTAIN CHARTER SCHOOL
MONROE COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

FEBRUARY 2012

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

Ms. Lisa Bansa, Board President
Pocono Mountain Charter School
16 Carriage Square
Tobyhanna, Pennsylvania 18466

Dear Governor Corbett and Ms. Bansa:

We conducted a performance audit of the Pocono Mountain Charter School (PMCS) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures falling within the scope of our audit. Our audit covered the period July 1, 2006 through August 20, 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 six audit findings within this report. A summary of these results is presented in the Executive Summary section of the audit report. These findings include eighteen recommendations aimed at the Charter School and ten recommendations aimed at a number of different government entities, including the Pennsylvania Department of Education, the State Ethics Commission, and the Monroe County District Attorney.

Summary of Overall Conclusions

Improper Entanglement with a Religious Entity:

The PMCS was so closely affiliated with a related entity, which was a Church, that it was difficult to make a distinction between the **public** charter school and the **private** religious entity. This entanglement occurred largely because the Church's founders, a Pastor and Reverend (also husband and wife), also founded the Charter School and served as Chief Executive Officer (CEO) and Assistant Chief Executive Officer (ACEO). Both entities continued to be managed by these same individuals, giving the appearance that the Church created the Charter School in violation of the Charter School Law.

Possible Conflicts of Interest and Related Party Financial Transactions:

Moreover, the Charter School and the Church entered into a landlord/tenant agreement for building space that is co-occupied by both parties, but that the Charter School largely pays for with taxpayer dollars it receives in the form of tuition payments. Due to the close connection between these parties, we identified possible conflicts of interest surrounding the landlord/tenant agreement and related-party financial transactions in violation of the Ethics Act.

Questionable Leasing Arrangements and Potential Ineligibility to Receive State Funds:

PMCS received \$87,101 in state lease reimbursement and was expecting an additional \$416,044 in state funds that had not yet been received at the close of our audit. However, the Charter School may not have been eligible to receive this state funding due to its ownership interest in the property it was leasing from the Church/Landlord, a related entity, based on lease reimbursement provisions in the Public School Code.

Risk of Potential Abuse:

One individual, the Church Pastor/former Charter School CEO, simultaneously held positions of leadership and influence with both the Charter School and the Church/Landlord. In addition, there was no documentation to support that both parties had taken steps to ensure that required public disclosures took place and that transactions were negotiated at “arm’s length.” As a result, we found that there was a greater risk for potential abuse and an increased likelihood that leasing agreements and financial transactions involving public education money occurred for reasons that were not in the best interest of the PMCS and its students.

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

Sincerely,

JACK WAGNER
Auditor General

February 8, 2012

cc: **POCONO MOUNTAIN CHARTER SCHOOL** Board of Trustees

Table of Contents

	Page
Executive Summary	1
Background Information on Pennsylvania Charter Schools	5
Audit Scope, Objectives, and Methodology	8
Findings and Observations	12
Finding No. 1 – Charter School Engaged in Improper Entanglements with a Religious Entity in Violation of the Charter School Law	12
Finding No. 2 – Charter School May Have Engaged in Related-Party Financial Transactions and Conflicts of Interest in Violation of the Ethics Act	17
Finding No. 3 – Charter School Violated the Sunshine Act by Failing to Maintain Complete Board Meeting Minutes	23
Finding No. 4 – Charter School Violated the State Ethics Act by Failing to Ensure that Board Members and Administrators Filed Statements of Financial Interests	26
Finding No. 5 – Charter School May Have Improperly Received \$87,101 in State Lease Reimbursements in Violation of the Public School Code	30
Finding No.6 – Charter School Lacked a Memorandum of Understanding in Violation of the Public School Code	34
Status of Prior Audit Findings and Observations	36
Distribution List	37



Executive Summary

Audit Work

The Pennsylvania Department of the Auditor General conducted a performance audit of the Pocono Mountain Charter School (hereinafter referred to as “PMCS” or “Charter School”). Our audit sought to answer certain questions regarding the PMCS’s compliance with applicable state laws, contracts, grant requirements, and administrative procedures.

Our audit scope covered the period July 1, 2006 through August 20, 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.

PMCS School Background

The PMCS, located in Monroe County, Pennsylvania, opened in September, 2003. It was originally chartered on February 19, 2003, for a period of three years by the Pocono Mountain School District. PMCS’s mission states, “[I]t seeks to prepare students to meet the academic and social networking challenges of the twenty-first century.” During the 2009-10 school year, the PMCS provided educational services to 334 pupils from five sending school districts through the employment of 36 teachers, 29 full-time and part-time support personnel, and 5 administrators. The PMCS received approximately \$3.8 million in tuition payments from school districts required to pay for its students attending the PMCS in school year 2009-10.

Adequate Yearly Progress

The Charter School made Adequate Yearly Progress (AYP) status for the 2010-11 school year. 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 significant noncompliance with state laws and administrative procedures, as detailed in the six audit findings within this report. These findings include eighteen recommendations aimed at the Charter School and ten recommendations aimed at a number of different government entities, including the Pennsylvania Department of Education, the State Ethics Commission, and the Monroe County District Attorney.

Finding No. 1: Charter School Engaged in Improper Entanglements with a Religious Entity in Violation of the Charter School Law. Our audit found that the Pocono Mountain Charter School (Charter School) was so closely affiliated with a Church that it was difficult to make a distinction between the **public** school and the **private** religious entity for which it shared common founders, officers/employees, and building space (see page 12).

Finding No. 2: Charter School May Have Engaged in Related-Party Financial Transactions and Conflicts of Interest in Violation of the Ethics Act. Our review of lease agreements, property deeds, board meeting minutes, and information gleaned from interviews with PMCS personnel found possible conflicts of interest surrounding landlord/tenant agreements and related financial transactions between the PMCS and its Landlord, a related entity (see page 17).

Finding No. 3: Charter School Violated the Sunshine Act by Failing to Maintain Complete Board Meeting Minutes. Our review of PMCS's contracts and board meeting minutes found that the PMCS failed to record official board action and individual board votes as required by the Charter School Law and the Sunshine Act (see page 23).

Finding No. 4: Charter School Violated the State Ethics Act by Failing to Ensure that Board Members and Administrators Filed Statements of Financial Interests. The PMCS's records for the calendar years ended December 31, 2009, 2008, and 2007 found that the chief executive officer, assistant chief executive officer, and the director of operations, as well as several of its board of trustees' members, failed to file

or filed incomplete annual Statements of Financial Interests with the State Ethics Commission (see page 26).

Finding No. 5: Charter School May Have Improperly Received \$87,101 in State Lease Reimbursements in Violation of the Public School Code. Our audit of the PMCS found that, between July 1, 2006 and August 20, 2010, the PMCS may have improperly received \$87,101 in state lease reimbursements resulting from related party landlord/tenant agreements between the PMCS and a non-profit entity that the PMCS's chief executive officer and assistant chief executive officer, who are also husband and wife, founded and at which they were simultaneously holding positions as officers and/or employees. Moreover, the PMCS filed for and was expecting an additional \$73,340 in state lease reimbursements for the 2007-08 school year and \$342,704 for the 2009-10 school year, but these reimbursements had not yet been received by the PMCS as of the end of our fieldwork (see page 30).

Finding No. 6: Charter School Lacked a Memorandum of Understanding in Violation of the Public School Code. Our audit of the PMCS's records found that the PMCS failed to enter into a Memorandum of Understanding between the PMCS and the police department(s) having jurisdiction over school property setting forth agreed upon procedures to be followed should an incident involving an act of violence or possession of a weapon occur on school property as required by school safety provisions in the Public School Code (see page 34).

Status of Prior Audit Findings and Observations. This is our first audit of the PMCS. Therefore, there are no prior audit findings or observations (see page 36).

Appendix A

The PMCS provided a lengthy response to the findings included in the audit report. We have attached the PMCS's response in its entirety (see Appendix A at the end of this report). We have also included our comments on the PMCS's response in this section.



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 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 Ibid.

³ 24 P.S. § 17-1717-A (a).

⁴ 24 P.S. § 17-1717-A (c).

⁵ 24 P.S. § 17-1717-A (d).

⁶ 24 P.S. § 17-1717-A (f).

⁷ 24 P.S. § 17-1721-A (a).

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.

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.

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 Department of Education (DE), which determines whether the application for a charter should be granted or denied.¹¹ However, if DE denies the application, the applicant can still appeal the decision to the State Charter School Appeal Board.¹² In addition, DE 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 DE.¹⁴

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

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 24 P.S. § 17-1745-A(f)(4).

¹³ 24 P.S. § 17-1741-A(a)(3).

¹⁴ 24 P.S. § 17-1750-A(e).

based on its own budgeted costs, minus specified 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 24 P.S. §§ 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 July 1, 2006 through August 20, 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 Department of Education (DE), 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 DE 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 PMCS'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 1949, as amended²⁰ (Code) and the Charter School Law²¹ (Law)?

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 Public School Code, 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?

²² 65 Pa.C.S. § 1101 *et seq.*

- ✓ Did the charter school accurately report its membership numbers to DE and were its average daily membership and tuition billings accurate?
- ✓ 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 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?

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.

PMCS 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, 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 PMCS operations.

Findings and Observations

Finding No. 1

Charter School Engaged in Improper Entanglements with a Religious Entity in Violation of the Charter School Law

Relevant Constitutional and Public School Code Provisions and Related Criteria

Article 3, Section 15 of the Pennsylvania Constitution provides:

“§ 15. Public school money not available to sectarian schools. No money raised for the support of the public schools of the Commonwealth shall be appropriated to or **used for** the support of any sectarian school.”

Section 1717-A(a) of the Charter School Law (CSL), 24 P.S. § 17-1717-A(a), states the following, in part: “(a) A charter school may be established . . . by any **nonsectarian** corporation not-for-profit, as defined in 15 Pa.C.S. (relating to corporations and unincorporated associations) . . . No charter school shall be established or **funded by** and no charter shall be granted to any **sectarian school, institution or other entity.**”

In 1997, the General Assembly took the important step of enacting the CSL to provide teachers, parents, pupils, and community members with an avenue to establish independent public schools to offer parents and students expanded educational choices and provide the school with a method to establish accountability systems.²⁴ In accordance with long established constitutional mandates to avoid intermingling of the public sector with religion,²⁵ the General Assembly also included certain significant safeguards in the CSL against entanglements of public charter schools and sectarian (i.e., religious) entities, including that a charter school must not be founded or funded by any sectarian entity and it must be nonsectarian in all of its operations.²⁶

During our audit, we found that the Pocono Mountain Charter School (Charter School) was so closely affiliated with a Church that it was difficult to make a distinction between the **public** school entity and the **private** religious entity. First, the Church’s Pastor and Reverend (husband and wife, respectively) founded the Charter School in 2003²⁷ and appointed the initial members of its board of trustees. Second, the Church’s Pastor and Reverend were also the Charter School’s chief executive officer (CEO) and assistant chief executive officer (ACEO), respectively, during our audit period. Moreover, the Church’s Founder/Pastor and the Charter School’s Founder/CEO, who is the same individual, signed the deed for the

²⁴ 24 P.S. § 17-1702-A.

²⁵ See, e.g., *Lemon v. Kurtzman et al.*, 403 U.S. 602, 91 S.Ct. 2105 (1971); *Springfield School District v. Pennsylvania Department of Education et al.*, 483 Pa. 539, 397 A.2d 1154 (1979).

²⁶ See 24 P.S. §§ 17-1715-A(4), 17-1717-A(a).

²⁷ The Pastor is also the headmaster of Tobyhanna Christian Academy established around 1995. The home page of the Christian school, whose address, 16 Carriage Square, Rt. 196, Tobyhanna, PA, 18466, is the exact same as that of the charter school, indicates that it is “[c]ommitted to leadership development and quality Christian education.” www.rsts.net/christianschool/shawneetabernacle/index.html (Last accessed on November 21, 2011.)

Section 1714-A(4) of the CSL, 24 P.S. § 17-1714-A(4), provides: “(a) A charter school established under this act . . . shall . . . (4) Receive and disburse funds for the charter school.”

Section 1715-A(5) of the CSL, 24 P.S. § 17-1715-A(5), prohibits a charter school from “display[ing] religious objects and **symbols** on the premises of the charter school.”

The U.S. Department of Education’s April 2011 *Nonregulatory Guidance* document, addressing questions about grant requirements under its Charter Schools Program (CSP) authorizing statute as amended by The Charter School Expansion Act of 1998, as amended, and by the No Child Left Behind Act of 2001, as amended, provides as follows:

- In a public charter school’s “creation, development, and operation, a charter school must not have any affiliation ‘with a **sectarian** school or religious institution’.”
- “[C]harter schools must be non-religious in their programs, admissions policies, **governance**, employment practices and all other **operations**, and the charter school’s curriculum must be completely secular.”
- “Public funds may not be used for religious purposes or to encourage religious activity.” (See 20 U.S.C. §§ 7221-7225(g)).

Church’s property on September 5, 2002, which includes the building that is rented to the Charter School that he founded and where he remains the CEO.

These factors call into serious question whether the Charter School avoided improper entanglements with the Church as prohibited by the CSL and cautioned against by the U.S. Department of Education’s April 2011 *Nonregulatory Guidance* document reflecting the provisions of The Charter School Expansion Act of 1998, as amended, and the No Child Left Behind Act of 2001, as amended. The Charter School appears to have been established by a sectarian institution in violation of Sections 1715(a)(4) and 1717(a) of the CSL because the Church’s Pastor and Reverend were founders of the Charter School, which has occupied the same space as the Church since its establishment and these same individuals held positions with both the Church and the Charter School.

Furthermore, as detailed in Finding No. 5, the Commonwealth reimbursed the Charter School a portion of its reported lease costs even though the Church also benefited from the shared office and building space being leased by the Charter School. Under the original lease terms dated June 5, 2003, the Charter School was to pay the Church an annual base rent payment of \$259,000 for the initial building. However, on August 1, 2006, the two parties entered into a lease amendment, increasing the annual base rent payment to \$396,000 in 2006-07, which the Charter School’s Board President signed.

The current lease agreement signed on July 9, 2007,²⁸ increased the annual base rent to a total annual rent of \$929,000 in the 2007-08 school year and thereafter. This increase was a result of the Church’s construction of a new building, which is co-occupied by the Charter School and the Church, and the Charter School’s use of athletic fields on the property. The lease agreement limits the Charter School’s use of the premises to between 7:00 a.m. and 5:00 p.m., Monday through Friday on school days throughout the calendar year, with any additional usage for school-related activities, such as parent-teacher meetings and athletic events, as agreed upon by the two parties. At

²⁸ Scheduled to terminate on June 30, 2017.

all other times and dates, the Church has full use of the leased premises.

Further, though the Church is using the building for Sunday school, office space, and other like purposes, the lease agreement provides that the Charter School is fully responsible for obtaining and paying for 100 percent of gas, water, electric, and sewer utilities except 10 percent reimbursement by the Church for these utility costs. Further, the premises' parking lot, entirely funded by the Charter School, is jointly used by the Church and school.

Therefore, during our audit period and as shown in the table below, more than \$3 million in taxpayer funded public education dollars flowed to the private religious entity through the rental payments from the Charter School.

**Rental Payments Charged by the Church
to the Charter School During the Audit Period**

School Years	Rental Payments
2006-07	\$396,000
2007-08	\$775,333
2008-09	\$929,000
2009-10	\$964,996
Total	\$3,065,329

Finally, the Church is also utilizing and benefitting fully from the following items purchased for \$765,763 with public funds in violation of Section 1714-A(4) of the CSL, which requires a charter school to “receive and disburse funds for charter school purposes **only**”:

- | |
|---|
| 1. Gym fitness equipment originally purchased by the Church then sold to the Charter School in the same amount of \$39,579. |
| 2. Gym equipment, such as basketball backstops, divider curtain, volleyball and tennis equipment, scoreboards and bleachers in the amount of \$157,100. |

3. Gym floor, which contains the Church's religious logo in violation of Section 1715-A(5) of the CSL, in the amount of \$134,820.
4. Motor operated gym concession door in the amount of \$3,435.
5. Parking lot expansion jointly used by the Church and the school in the amount of \$348,679.
6. LED sign (with the Church's name written on it, in violation of Section 1715-A(5) of the CSL) in the amount of \$39,250.
7. Installation of an elevator in the amount of \$42,900.

In conclusion, the Charter School engaged in improper entanglements with a private religious entity and received the benefit of public funds for rents, utilities, and other items, such as the gym floor with the Church's religious logo, LED sign with the Church's name written on it, and a jointly used elevator in violation of the CSL. This was also in violation of long established constitutional mandates to avoid intermingling of the public sector with religion. In summary, these violations include:

- The Charter School was established by a sectarian institution in violation of Section 1717(a) of the CSL because the Church's Pastor and Reverend were founders of the Charter School, which has occupied the same space as the Church since its establishment.
- The same individuals (Pastor and Reverend; CEO and ACEO, respectively) held positions with both the Church and the Charter School in violation of Section 1715-A(4) of the CSL, which provides that a charter school must "be nonsectarian in all operations."
- More than \$3 million in rents and utilities, as well as an additional \$765,763 for additional items, in taxpayer funds went to the Church in violation of Section 1714-A(4) of the CSL, which provides that a charter school must "[r]eceive and disburse funds for charter school purposes only."

- The Charter School funded and displayed a religious logo/religious entity's name on the gym floor and on a LED sign in violation of Section 1715-A(5) of the CSL.

Recommendations

The *Pocono Mountain Charter School* (PMCS) should:

1. Request that its solicitor provide PMCS a detailed summary of all the school's legal requirements under the Charter School Law and the U.S. and Pennsylvania Constitutions applicable to **nonsectarian institutions**, such as charter schools.
2. The school should take all action to entirely separate itself from the Church, its facilities, officers, and staff.

The *Department of Education* should:

3. Take any action deemed necessary regarding violations of the CSL pertaining to provisions applicable to sectarian institutions, as well as provisions limiting the receipt and disbursement of funds for charter school purposes only.

Management Response begins on page A-2.

Auditor Conclusion begins on page A-5.

Finding No. 2 →

Charter School May Have Engaged in Related-Party Financial Transactions and Conflicts of Interest in Violation of the Ethics Act

Relevant Statutory Provisions and Related Criteria

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 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.”

The General Assembly declared the following when enacting the Public Official 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 65 Pa.C.S. § 1101.1(a)).

Our audit of the Charter School found possible conflicts of interest surrounding landlord/tenant agreements and related-party financial transactions. These transactions and potential conflicts arose between the Charter School and a non-profit entity that the Charter School’s chief executive officer (CEO) and assistant chief executive officer (ACEO), also husband and wife, respectively, founded and were simultaneously holding positions as officers and/or employees. Moreover, the Charter School’s CEO and ACEO were founders of the Charter School and appointed the initial members of its board of trustees.

Background

On June 5, 2003, the Charter School entered into a contract to lease a building from a non-profit entity (hereinafter referred to as “Landlord”) that the CEO and ACEO also founded and in which they held positions. Under the original lease terms, the Charter School was to pay the Landlord an annual base rent payment of \$259,000.

On August 1, 2006, the Charter School and Landlord entered into an amendment to the original lease, increasing the annual base rent payment from \$259,000 to \$396,000 in 2006-07.

On July 9, 2007, the Charter School and Landlord entered into the current lease scheduled to conclude on June 30, 2017, which further increased the annual base rent from \$396,000 to a total annual rent of \$929,000 in the 2007-08 school year and thereafter.

Furthermore, as detailed in Finding No. 1, financial transactions in the amount of \$765,763 involved the Charter School making permanent improvements to the Landlord’s property, at the Charter School’s expense. This included a parking lot expansion jointly used by the Landlord and the school in the amount of \$348,679 and installation of an elevator in the amount of \$42,900.

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.

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 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. § 1303(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. § 1303(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 or public employee shall not have any supervisory or overall responsibility for the implementation or administration of the contract.

Ethics Act Violations

Under the CSL, the Charter School’s CEO and ACEO are considered “public officials,” and, therefore, are subject to all of the state Ethics Act’s provisions and financial disclosure requirements. Furthermore, Section 1102 of the Ethics Act defines a “conflict of interest” as the use by a public official of his/her position for the private benefit of himself, an immediate family member, or a *business* (which includes non-profit entities) for which he or an immediate family member is associated. Section 1103(a) of the Ethics Act prohibits a public official from engaging in conduct that constitutes a “conflict of interest.”

We found that pursuant to Sections 1102 and 1103 of the Ethics Act, potential conflicts of interest exist between the Charter School and its Landlord because the Charter School entered into the aforementioned lease agreements when its CEO and ACEO, also husband and wife, were founders and officers and/or employees in the non-profit entity acting as the Landlord.

Additionally, Section 1103(f) of the Ethics Act requires that if public officials enter into contracts valued at \$500, or more, with businesses, which includes non-profit entities, that they are associated with, these contracts must be awarded through an open and public process. The provisions for such a process include prior public notice and subsequent public disclosure of all proposals considered and contracts awarded. Should these requirements be met, Section 1103(f) also prohibits public officials from having any supervisory or overall responsibility for the implementation or administration of contracts with businesses or non-profit entities that they are associated with.

Our audit found that the Charter School’s lease agreements constituted contracts in excess of \$500, and that the Charter School failed to document that these leases were awarded in a public approval process that considered other potential lease proposals. Such documentation was necessary, given that these leases were awarded to a Landlord, that was a non-profit entity that the Charter School’s CEO and ACEO were associated with. Moreover, the Charter School’s CEO and ACEO, by virtue of their positions, were individuals

Any contract or subcontract made in violation of this subsection shall be voidable by a court of competent jurisdiction if the suit is commenced within 90 days of the making of the contract or subcontract.

Other Relevant Criteria:

All public schools, including charters schools, must file annual financial reports with the Pennsylvania Department of Education (PDE) Comptroller's Office in accordance with minimum standards of and guidelines for financial accounting and reporting, which are based on generally accepted accounting principles (GAAP) for governmental entities.

Source: *Manual of Accounting and Financial Reporting for Pennsylvania Public Schools.*

GAAP requires that related party relationships and transactions be identified on financial statements.

Related parties are defined by accounting principles to include:

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

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

having responsibilities related to the administration of these lease contracts as prohibited by the Ethics Act.

In addition to the potential conflicts surrounding these lease agreements, our audit also found further possible conflicts of interest resulting from the financial transactions as discussed in Finding No. 1 between the Charter School and the Landlord, totaling \$765,763. All of these transactions were used to make permanent improvements to the Landlord's property, at the Charter School's expense.

The transactions may have constituted violations of the CSL and the Ethics Act because the Charter School paid for permanent building improvements to a non-profit entity with which the Charter School's CEO and ACEO were associated, and because this relationship was not disclosed to the public as required by law. As further discussed in Finding No. 3, we found that the Charter School failed to maintain complete board meeting minutes as required by the CSL and Sunshine Act to support board actions, including the approval of the lease contracts and the financial transactions involving potential conflicts of interests. Consequently, the Charter School was unable to provide documentation that its CEO and ACEO had publicly disclosed the fact that they simultaneously served as officers and/or employees at a non-profit entity with which the Charter School had entered into contracts and financial transactions. Similarly, the lack of complete board meeting minutes also meant that the Charter School could not demonstrate that these individuals had abstained from discussing these matters during the public meeting.

Furthermore, the Charter School's CEO and ACEO may have violated the CSL and the Ethics Act by awarding the lease agreements, and allowing the payments for permanent improvements to the Landlord's property, when they had a reasonable expectation that they would receive a direct or indirect financial benefit from these transactions, given that they simultaneously held positions with both the Charter School and the Landlord. Moreover, their failure to publicly disclose these associations, including failing to indicate their business relationship with the Landlord on their Statements of Financial Interests, also represents a potential violation. (*See* Finding No. 4).

Related-Party Transactions

As public schools, charter schools must maintain financial statements, to be filed with the Department of Education (DE), that provide for a fair presentation of the financial condition of the school in accordance with generally accepted accounting principles (GAAP). This includes a responsibility to disclose financial transactions between related individuals and/or businesses in financial statements. A “related party” is generally defined as any party with which the charter school deals where one of the parties can influence the management or operating policies of the other party.

Based on our audit work, the lease agreements and the financial transactions constituted “related party” transactions that were not properly disclosed in the Charter School’s financial statements in accordance with GAAP. Specifically, the Charter School’s Local Auditor’s Reports for fiscal years ending June 30, 2007, 2008 and 2009 did not contain financial notes disclosing the relationship between the Charter School and its Landlord, two entities who shared common founders and officers/employees and that co-occupied building space that the Charter School was leasing from the Landlord. Furthermore, we have also determined that the Charter School failed to maintain documentation, such as board meeting minutes, to substantiate that these related party transactions were negotiated at “arm’s length”

Absent documentation disclosing these close relationships and the failure to identify related party transactions on financial statements, there is no accountability for the actions of the Charter School and its board of trustees, and the public cannot be assured that these transactions occurred in compliance with the CSL, the Ethics Law, the Sunshine Act, and required financial accounting disclosure practices for public schools. Consequently, there is greater risk for potential abuse and an increased likelihood that these agreements and financial transactions occurred for reasons other than the best interest of the Charter School and its students.

Although the ACEO resigned her position with the Charter School in December of 2009, all of these transactions occurred while she was ACEO.

A copy of the finding will be forwarded to the State Ethics Commission for additional review and action.

Recommendations

The *Pocono Mountain Charter School's* Board of Trustees 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. 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.
3. 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.
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 deed of the property that the Charter School occupies.
6. Reviewing the Charter School CEO's influence over contracts for lease agreements and rental payments between the Charter School and the Landlord.
7. Reviewing the Charter School CEO's influence over items purchased by the Charter School, including those items that were originally purchased by the Landlord and then resold to the Charter School.

The *Department of Education* should:

8. Review any possible related-party financial transactions for the Charter School.

This finding and the rest of this report will also be referred to the district attorney of the county in which the Charter School is situated to take any necessary actions pertaining to other possible violations of law.

Management Response begins on page A-9.

Auditor Conclusion begins on page A-10.

Finding No. 3

Charter School Violated the Sunshine Act by Failing to Maintain Complete Board Meeting Minutes

Relevant Statutory Provisions and Related Criteria

Section 1716-A(c) of the Charter School Law (CSL), 24 P.S. § 17-17-1716-A(c) of the Charter School Law requires:

The board of trustees shall comply with the Sunshine Act, 65 P.S. § 701 *et seq.*

Section 705 of the Sunshine Act, 65 P.S. § 705, requires:

In all meetings of agencies, the vote of each member who actually votes on any resolution, rule, order, regulation, ordinance or the setting of official policy must be **publicly cast** and, in the case of roll call votes, **recorded**.

Section 706 of the Sunshine Act, 65 P.S. § 706, requires that:

Written minutes be kept of all public meetings, including the names of members present, the substance of all official actions and a record by individual member of the roll call votes taken.

The General Assembly stated the following when enacting the Sunshine Act in 1998: “secrecy in public affairs undermines the faith of the public in government and the public’s effectiveness in fulfilling its role in a democratic society.” (65 P.S. § 702)

Section 1103(a) of the Public Official and Employee Ethics Act (Ethics Act), 65 Pa.C.S. § 1303(a), provides that no public official shall engage in conduct that constitutes a conflict of interest.

Our review of the Charter School’s contracts and board meeting minutes found that the Charter School failed to record official board action and individual board votes as required by the CSL and the Sunshine Act. The Charter School’s failure to maintain complete board meeting minutes resulted in a lack of documentation to support board actions, and a lack of accountability to the public and the authorizing school district for actions taken by the Charter School and its board of trustees.

The CSL requires charter schools to comply with the Sunshine Act. In an effort to hold public officials accountable for the spending of taxpayer money, the Sunshine Act requires that public agencies conduct their business transparently. Specifically, the Sunshine Act requires written minutes of all public meetings, including an account of the nature of the official actions and the individual board votes. While the Charter School did maintain limited board meeting minutes indicating the date, location, and members present or not present, we found that these minutes lacked the required details outlined by the Sunshine Act, including a record of all official actions and roll call votes taken. Consequently, the Charter School was unable to produce sufficient documentation surrounding board actions, including the approval of contracts.

Moreover, the Charter School’s failure to maintain complete board meeting minutes contributed to our overall conclusion that the Charter School entered into contracts and financial transactions involving potential conflicts of interest without meeting the Ethics Act’s requirements that public officials engage in such arrangements in an open and public process that achieves full disclosure of the potential conflicts.

Specifically, the Charter School was unable to provide complete board meeting minutes to document that its chief executive officer (CEO) and assistant chief executive officer (ACEO) had publicly disclosed the fact that they founded and simultaneously served as officers and/or employees at a non-profit entity with which the Charter School had entered into contracts (*See Finding No. 1*).

Section 1103(j) of the Ethics Act, 65 Pa.C.S. § 1303(j), provides, in pertinent part: “Any public official or public employee who in the discharge of his official duties would be required to vote on a matter that would result in a conflict of interest shall abstain from voting and, prior to the vote being taken, publicly announce and disclose the nature of his interest as a public record in a written memorandum filed with the person responsible for recording the minutes of the meeting at which the vote is taken.”

The limited board meeting minutes do show that the CEO and/or ACEO attended and participated in board meetings where the approval of leases and related building improvements was discussed. Moreover, the Charter School’s CEO and ACEO were founders of the Charter School and appointed the initial members of its board of trustees. Furthermore, the governance structure in the school’s original charter designated the Charter School’s CEO as “a standing member of the Board with no voting rights.” Consequently, the same individual was a founder, board member, and CEO of the Charter School, all positions of leadership and influence.

The lack of detail in the board meeting minutes prevented the auditors from determining if the Charter School’s CEO and ACEO participated in the board discussion related to the awarding of lease contracts. Under the requirements of the state Ethics Act, the Charter School’s CEO and ACEO should have recused themselves²⁹ from the lease discussion because of their relationship with the Landlord. With no such recusal documented in the board meeting minutes, potential conflicts of interests could not be ruled out.

The Charter School’s failure to maintain complete board meeting minutes that document board votes limits the Charter School and its board of trustees’ transparency and accountability to the public, and also violated the CSL and the Sunshine Act. Furthermore, the Charter School’s lack of recorded board minutes detailing discussions, actions, and roll call votes required under the Sunshine Act restricted our ability to verify that its business was conducted without possible conflicts of interest.

Recommendations

The *Pocono Mountain Charter School’s* Board of Trustees should:

1. Review requirements and implement procedures to ensure that the Board complies with the Sunshine Act.
2. Review the list of items that should be included in official minutes provided by the School Board Secretary's Handbook as guidance to ensure that

²⁹ See 65 Pa.C.S. § 1303(a), (j).

adequate documentation of board meetings is maintained pursuant to the Sunshine Act.

3. Seek the advice of its solicitor regarding the board of trustees' responsibility for ensuring it has an appropriate voting conflict policy and process for recording potential board conflicts.

The State Ethics Commission should:

4. Review whether the Pocono Mountain Charter School's CEO and ACEO should have recused themselves from the lease agreement discussions during the board of trustees' meeting under subsections (a) and (j) of Section 1103 of the Public Official and Employee Ethics Act because of their possible conflict of interest and take whatever action it deems necessary.

Management Response begins on page A-13.

Auditor Conclusion begins on page A-13.

Finding No. 4 →

Charter School Violated the State Ethics Act by Failing to Ensure that Board Members and Administrators Filed Statements of Financial Interests

Relevant Statutory Provisions and Related Criteria

When enacting the Public Official and Employee Ethics Act (Ethics Act), 65 Pa.C.S. §1101 *et seq.*, our General Assembly stated the following: “Because public confidence in government can best be sustained by assuring the people of the impartiality and honesty of public officials, this chapter shall be liberally construed to promote **complete** financial disclosure as specified in this chapter.” (See 65 Pa.C.S. § 1101.1(a)).

The Ethics Act requires all candidates for public office, public officials, and certain public employees to complete a Statement of Financial Interests for the preceding calendar year annually, no later than May 1st of each year they hold their positions and of the year after leaving such positions. (See 65 Pa.C.S. § 1104(a)).

Section 1104(d) of the Ethics Act, 65 Pa.C.S. §1104(d), which pertains to the failure to file the required Statement of Financial Interests, provides in pertinent part, as follows:

“No public official shall be allowed to take the oath of office or enter or continue upon his duties, nor shall he receive compensation from public funds, unless he has filed a statement of financial interests. . . .”

Our audit of the Charter School’s records for the calendar years ended December 31, 2009, 2008, and 2007, found that the chief executive officer (CEO), the assistant chief executive officer (ACEO), and the Director of Operations, as well as several of its board of trustees’ members failed to file or filed incomplete annual Statements of Financial Interests with the State Ethics Commission. Board members and administrators, including the CEO and all other employees of a charter school who by virtue of their positions exercise management or operational oversight responsibilities, are considered “public officials” under the Charter School Law³⁰ and are, therefore, subject to the Public Official and Employee Ethics Act (Ethics Act).

Statements of Financial Interests are intended to provide those charged with governance with information about the existence or nonexistence of relationships between public officials and parties with whom the charter school transacts business.

As such, we found the following potential violations of Sections 1103, 1104(d), 1105(a), and/or 1005(b) of the Ethics Act pertaining to Statements of Financial Interests by calendar year:

2009 – The ACEO, Director of Operations, and three board members failed to file their required Statements of Financial Interests. The CEO filed an incomplete Statement of Financial Interest that did not disclose his relationship and/or compensation with the business (i.e., non-profit entity) that was also the Landlord in a lease contract entered into by the Charter School.

2008 – Two board members failed to file their required Statements of Financial Interests. The Director of Operations and one board member filed incomplete statements. The CEO and ACEO also filed incomplete statements that did not disclose their relationship and/or compensation with the non-profit entity that was also the

³⁰ See 24 P.S. § 17-1715-A(11), (12).

Section 1104(e) of the Ethics Act, 65 Pa.C.S. §1104(e), states, in pertinent part:

“All statements of financial interests . . . shall be made available for public inspection. . . .”

Section 1105(a) of the Ethics Act, 65 Pa.C.S. §1105(a), which requires the filing of a statement of financial interest, states, in part:

“ All information requested on the statement shall be provided to the best of the knowledge, information and belief of the person required to file and shall be signed under oath or equivalent affirmation.”

Relevant Statutory Provisions and Related Criteria

Section 1105(b) of the Ethics Act, 65 Pa.C.S. §1105(b), which specifies required information on a statement of financial interest form, includes requirements to list any office, directorship or employment of any nature whatsoever in any business entity and any financial interest in any legal entity engaged in business for profit.

Section 1109(b) of the Ethics Act, 65 Pa.C.S. §1109(b), provides that any person who is required to file a Statement of Financial Interests but fails to do so may be found guilty of a misdemeanor and may be fined not more than \$1,000 or imprisoned for not more than one year, or both.

Landlord in a lease contract entered into by the Charter School.

2007 – The ACEO and two board members failed to file their required Statements of Financial Interests. The CEO filed an incomplete Statement of Financial Interest that did not disclose his relationship and/or compensation with the non-profit entity that was also the Landlord in a lease contract entered into by the Charter School. Two board members also filed incomplete Statements of Financial Interests.

In addition to violating the Ethics Act, the aforementioned filing deficiencies prevented the Charter School from producing the required financial disclosure information for all administrators and board members during the audit period. This lack of proper documentation then restricted our ability to review this information for potential conflicts of interests between the Charter School’s administrators and/or board members and the entities with which the Charter School is doing business.

Furthermore, the Charter School’s failure to maintain the required Statements of Financial Interests for all administrators and board members means that this information is not available for public inspection and copying as required under Section 1104(e) of the Ethics Act. Consequently, members of the general public and others, such as the chartering school district, would not be provided with complete and accurate information regarding financial disclosures and potential conflicts of interest involving the Charter School’s administrators and board members.

Public office is a public trust sustained by assuring the taxpayers of the impartiality and honesty of public officials and public employees. Accordingly, the Ethics Act requires all candidates for public office, public officials, and certain public employees to annually complete a Statement of Financial Interests for the preceding calendar year, by no later than May 1st of each year they hold their positions and the year after leaving such positions.

The Ethics Act specifically requires public officials and certain public employees to disclose matters on the Statement of Financial Interests that currently or potentially

Criteria relevant to the finding:

Section 1109(f), 65 Pa.C.S. §1109(f), provides, in pertinent part that any person who is required to file a Statement of Financial Interests but fails to do so in a timely manner or who files a deficient Statement of Financial Interests may be subject to a civil penalty at a rate of not more than \$25 for each day such statement remains delinquent or deficient, with a maximum penalty under this chapter or \$250.

create conflicts of interest with their public duties. When a public official does not properly file a required disclosure, the public and others cannot examine the disclosure in order to determine whether conflicts of interest exist. This in turn erodes the public's trust. In addition, an individual's failure to file and/or failure to file complete and accurate Statements of Financial Interests may constitute violations of the Ethics Act that are subject to fines and penalties, or both.

For example, Section 1104(d) of the Ethics Act, which pertains to the failure to file the required Statement of Financial Interests, provides, in pertinent part, as follows:

“No public official shall be allowed to take the oath of office or enter or continue upon his duties, nor shall he receive compensation from public funds, unless he has filed a statement of financial interests as required. . . .”³¹

Likewise, Section 1109(b) of the Ethics Act provides, in pertinent part, that any person who is required to file a Statement of Financial Interests, but fails to do so may be found guilty of a misdemeanor and may be fined not more than \$1,000 or imprisoned for not more than one year.³²

Finally, Section 1109(f) of the Ethics Act provides, in pertinent part, that any person who is required to file a Statement of Financial Interests but fails to do so in a timely manner or who files a deficient Statement of Financial Interests may be subject to a civil penalty, at a rate of not more than \$25 for each day such statement remains delinquent or deficient, with a maximum penalty under this chapter of \$250.³³

A copy of this finding will be forwarded to the State Ethics Commission for additional review and whatever action it deems necessary.

³¹ 65 Pa.C.S. § 1104(d).

³² 65 Pa.C.S. § 1109(b).

³³ 65 Pa.C.S. § 1109(f).

Recommendations

The *Pocono Mountain Charter School's* Board of Trustees should:

1. Seek the advice of its solicitor regarding the board of trustees' responsibility when administrators and board members fail to file or file incomplete Statements of Financial Interests.
2. Develop procedures to ensure that all individuals required to file Statements of Financial Interests do so in compliance with the Ethics Act.
3. Strengthen controls regarding the review process of the State Ethics Commission financial disclosure statements to help ensure detection of any potential conflicts of interest, including a requirement that its solicitor review the statements before submission.

Management Response begins on page A-14.

Auditor Conclusion begins on page A-14.

Finding No. 5

Charter School May Have Improperly Received \$87,101 in State Lease Reimbursements in Violation of the Public School Code

Relevant Public School Code 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 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 1717-A(a) of the Charter School Law (CSL), 24 P.S. § 17-1717-A(a), states the following, in part: “No charter school shall be **established** or funded by and no charter shall be granted to any **sectarian school, institution or other entity.**”

Our audit of the Charter School found that between July 1, 2006 and August 20, 2010, the Charter School may have improperly received \$87,101 in state lease reimbursements resulting from related party landlord/tenant agreements between the Charter School and a non-profit entity that the Charter School’s chief executive officer (CEO) and assistant chief executive officer (ACEO) (also husband and wife, respectively) founded and were simultaneously holding positions as officers and/or employees (hereinafter referred to as “Landlord”). Moreover, the Charter School filed for and was expecting to receive an additional \$416,044, but the Commonwealth’s payments had not been received as of the end of our fieldwork on August 20, 2010. Because the same people were founders and officers/employees 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. 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, a lack of required public disclosure concerning these 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 CEO and ACEO individually, as well as the Landlord, a business/non-profit entity with which they were associated.

Under the CSL and lease reimbursement guidelines established by DE, which also administers the 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.

While the Charter School participated in the Commonwealth’s lease reimbursement program for at least

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.”

four fiscal years, 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 and a lack of public disclosure surrounding the Charter School’s process for approving and awarding its lease agreements, (2) the possibility of a direct and/or indirect financial gain and/or ownership interest by the Charter School’s CEO and ACEO, and (3) their ownership interest in the Landlord’s property due to the positions they held with both the Charter School and the Landlord.

Our review revealed the following relevant facts:

- The CEO and ACEO, also husband and wife, were two of the four original founders of the Charter School and they appointed the initial members of its board of trustees.
- Per the approved charter dated March 2003, the Charter School’s CEO is a standing board member with no voting rights. Consequently, the same individual was the Charter School’s founder, CEO, and lifetime board member, all positions of leadership and influence.
- The Charter School’s CEO and ACEO, also husband and wife, simultaneously held positions with the Charter School that they founded and the Landlord, a business/non-profit entity that they founded and with which they continued to be associated.
- The Charter School’s CEO signed the deed for the Landlord’s property on September 5, 2002, which includes the building that is rented to the Charter School that he founded.
- The Charter School’s CEO signed the original landlord/tenant lease agreement on behalf of the Charter School on June 5, 2003.
- The Charter School’s CEO signed the applications for the Commonwealth’s charter school lease reimbursements filed with PDE verifying the lease costs paid by the Charter School to the Landlord, a business/non-profit entity with which the CEO was

associated, for the 2009-10, 2008-09, 2007-08 and 2006-07 school years.

- The Charter School received a total of \$87,101 in state lease reimbursements for its rental costs for the 2006-07 and 2008-09 school years.
- The Charter School filed for and was expecting an additional \$73,340 in state lease reimbursements for the 2007-08 school year, but the Commonwealth's payment had not been received as of the end of our fieldwork on August 20, 2010, because the reimbursement forms were resubmitted by the Charter School in 2009 and not yet processed by DE.
- The Charter School filed for and was expecting an additional \$342,704 in state lease reimbursements for the 2009-10 school year, but the Commonwealth's payment had not been received as of the end of our fieldwork on August 20, 2010.
- According to the landlord/tenant agreement, both the Charter School and the Landlord shared and utilized the building space that was being leased by the Charter School and subsequently reimbursed by the Commonwealth.

Under DE's eligibility requirements, which are based on Section 2574.3(a) of the Public School Code, buildings owned by a charter school do not qualify for compensation under the Reimbursement for Charter School Lease Program. Because two of the Charter School's four founders were also the CEO and ACEO and were simultaneously holding positions with the Landlord from which the Charter School was leasing educational space during the audit period, we concluded that these potential ownership interests may have made the Charter School ineligible to receive state lease reimbursements. As such, the Charter School may have improperly received state rental reimbursements resulting from its related party landlord/tenant lease agreements.

According to the Charter School's administration, they were unaware that charter school-owned buildings were ineligible for compensation from the Reimbursement for Charter School Lease Program. In addition, they noted

that, because DE had never questioned their application, they had no reason to believe that there was a problem.

Recommendations

The *Pocono Mountain Charter School* should:

1. End the practice of leasing its permanent education building to itself, and cease applying for payment from the Reimbursement for Charter School Lease Program for the permanent building.
2. Ensure that its solicitor and business manager 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 school's legal requirements under the Public School Code and the Charter School Law.

The Department of Education should:

4. Take immediate steps to require the Charter School to repay the \$87,101 owed to the Commonwealth for the improper reimbursement it received from the Reimbursement for Charter Schools Lease Program.
5. Take immediate steps to require the Charter School to repay the \$73,340 state reimbursement for which it applied for the 2007-08 school year if payment has been made by DE after our fieldwork was completed.
6. Take immediate steps to require the Charter School to repay the \$342,704 state reimbursement for which it applied for the 2009-10 school year if payment has been made by DE after our fieldwork was completed.
7. 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 co-occupies building space.

Management Response begins on page A-16.

Auditor Conclusion begins on page A-16.

Finding No. 6 →

Charter School Lacked a Memorandum of Understanding in Violation of the Public School Code

Relevant Statutory Provisions and Related Criteria

Section 1303-A(c) of the *Public School Code (PSC)*, 24 P.S. § 13-1303-A(c), amended November 17, 2010 with an effective date of February 15, 2011, provides, in part:

“ . . . each chief school administrator **shall enter** into a memorandum of understanding with police departments having jurisdiction over school property of the school entity. Each chief school administrator shall submit a copy of the memorandum of understanding to the office by June 30, 2011, and biennially update and re-execute a memorandum of understanding with local law enforcement and file such memorandum with the office on a biennial basis. The memorandum of understanding shall be signed by the chief school administrator, the chief of police of the police department with jurisdiction over the relevant school property and principals of each school building of the school entity. . . .”

The “office” refers to the Office for Safe Schools established within the Department of Education through Section 1302-A(a) of the *PSC*, 24 P.S. § 13-1302-A(a). The term “biennially” means “an event that occurs every two years.”

Prior to the effective date of the above referenced enactment of the MOU requirements, all public schools were required to **develop** a memorandum of understanding with local law enforcement.

Our audit of the Charter School’s records found that the Charter School failed to enter into a Memorandum of Understanding (MOU) between the Charter School and the police department(s) having jurisdiction over school property setting forth agreed upon procedures to be followed should an incident involving an act of violence or possession of a weapon occur on school property as required by school safety provisions in the Public School Code.

The failure to enter into a MOU with all pertinent police departments could result in a lack of cooperation, direction, and guidance between the Charter School’s employees and the police departments if an incident occurs on school grounds, at any school-sponsored activity, or on any public conveyance providing transportation to or from a school or school-sponsored activity. Non-compliance with the statutory requirement to have a MOU could have an impact on police department notification and response, and ultimately, the resolution of a problem situation.

This documentation was requested in the beginning of the audit and the Charter School’s personnel made repeated attempts to acquire a signed MOU from local police. As of our fieldwork completion date of August 20, 2010, the Charter School was informed by local police that the MOU was being reviewed by the police’s attorney and was not yet available.

Recommendations

The *Pocono Mountain Charter School* should:

1. Develop a MOU between the Charter School and all the police departments having jurisdiction over school property pursuant to the terms prescribed by the Public School Code.
2. In consultation with the Charter School's solicitor, review new requirements for MOUs and other school safety areas under the PSC to ensure compliance with amended Safe Schools provisions enacted November 17, 2010 effective February 15, 2011.
3. Adopt a board policy requiring the Charter School's administration to develop a MOU with all the police departments having jurisdiction over school property and biennially update and re-execute each MOU and file a copy with the DE's Office of Safe Schools on a biennial basis.

Management Response begins on page A-18.

Auditor Conclusion begins on page A-18.

Status of Prior Audit Findings and Observations

This is our first audit of the Pocono Mountain Charter School. Therefore, there are no prior audit findings or observations.

APPENDIX A

Responses from the Pocono Mountain Charter School to each finding with Corresponding Comments by the Department of the Auditor General

REGULAR AUDIT FINDINGS AND OBSERVATIONS

Finding No. 1: Charter School Engaged in Improper Entanglements with a Religious Entity in Violation of the Charter School Law

Charter School's response:³⁴

The draft audit contains a number of findings based simply on an assumption that leasing from a religious institution is inherently wrong and automatically constitutes improper entanglement. The fact that [the Pastor]³⁵ was the CEO of the Pocono Mountain Charter School (Charter School) while the religious leader of the [Church] justifies an inquiry whether transactions were appropriate. That fact does not establish a *per se* violation of any laws to which the Charter School is subject. The draft audit expresses this correctly in Finding No. 2 where it says:

Absent documentation, there is no accountability for the actions of the Charter School and its board of trustees, and the public cannot be assured that these transactions occurred in compliance with the CSL, the Ethics Law, the Sunshine Act, and required financial accounting practices (i.e., GAAP) for public schools. Consequently, there is greater risk for potential abuse and an increased likelihood that these agreements and financial transactions occurred for reasons other than the best interest of the Charter School and its students.

In general, management's response in this area is that some transactions could have been documented more effectively, but the fact that there is "an increased risk of improper conduct" does not mean that improper conduct occurred. Management will respond to each specific allegation in the order they were listed in the draft audit.

Draft Audit report: . . . "First, the Church's Pastor and Reverend (husband and wife) founded the Charter School in 2003 and appointed the initial members of its board of trustees. Second, the Church's Pastor and Reverend were also the Charter School's chief executive officer (CEO) and assistant chief executive officer (ACEO) during our audit period . . .

The Charter School appears to have been established by a sectarian institution in violation of Sections 1715(a)(4) and 1717(a) of the CSL because the Church's Pastor and Reverend were founders of the Charter School, which has occupied the same space as the Church since its establishment and these same individuals held positions "

³⁴ Auditor's note: Given that the Charter School's response is organized with a general management response and multiple specific management responses, the Department of the Auditor General's comments refer to management's specific responses by bracketed number (e.g., [1], [2],) for ease of comprehension.

³⁵ 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.

[1] Management response: The charter was formed by an independent non-profit Pennsylvania Corporation as required by the Charter Law. The Charter School had counsel who advised it exactly how the corporation should be established under the law. The fact that [the Pastor and his wife] played a significant role in the formation of the new corporation does not establish any violations of any laws.

Draft Audit report: “Moreover, the Church’s Pastor and one of the Charter School’s founders signed the deed for the Church’s property on September 5, 2002, which includes the building that is rented to the Charter School that he founded and where he remains the CEO.”

[2] Management response: The Church owned property. [The Pastor] signed a deed as a Church official authorized to sign deeds. The identity of the signer is of absolutely no significance. The only issue is whether the underlying transactions between the Church and PMCS were inappropriate, not the identity of the person who executed instruments related to a transaction. The specific transactions will be addressed below.

Draft Audit report: . . . “The lease agreement limits the Charter School’s use of the premises to between 7:00 a.m. and 5:00 p.m., Monday through Friday on school days throughout the calendar year, with any additional usage for school-related activities, such as parent-teacher meetings and athletic events, as agreed upon by the two parties. At all other times and dates, the Church has full use of the leased premises.”

[3] Management response: This lease language is troubling and should not have been included in the lease. The inclusion was an oversight by the Charter School’s attorney. The parties never intended that the Charter School would be denied 24/7 use of the leased premises, and, in fact, have always had 24/7 use of the leased premises. The school can provide sworn testimony from the revocation hearings that the school has always had unrestricted access. The Church has never attempted to restrict that access.

The parties executed an amendment to the lease in the fall of 2010 correcting this language, and a new lease is being negotiated which contains language guaranteeing full use of the leased premises to the Charter School.

Draft Audit report: . . . Further, though the Church is using the building for Sunday school, office space, and other like purposes, the lease agreement provides that the Charter School is fully responsible for obtaining and paying for 100 percent of gas, water, electric, and sewer utilities except 10 percent reimbursement by the Church for these utility costs.

[4] Management response: The actual use of the building by the Church is minimal. The ten percent figure was actually suggested by the solicitor for the Pocono Mountain School District during discussions in 2005. The suggestion was found acceptable by the Charter School and the Church. It was included in the lease. The school believes that this number fairly represents the utility use by the Church.

Draft Audit report . . . “Further, the premises’ parking lot, entirely funded by the Charter School, is jointly used by the Church and school.”

[5] Management response: It is true the school paid for the paving of the lot as the lot was needed for the school, not for the Church. With very minor exceptions, the lot is not used by the Church and would never have been constructed by the Church as it was not necessary for Church operations.

Draft Audit report . . . “during our audit period and as shown in the table below, more than \$3 million in taxpayer funded public education dollars flowed to the private religious entity through the rental payments from the Charter School.”

[6] Management response: This is true. It is not significant. The significance placed on the payment of rent includes the same assumption mentioned above: that there is something inherently wrong with a public entity renting space from a religious institution. Such an assumption is discriminatory against religious institutions as it restricts their rights to lease property in violation of the 5th and 14th Amendments to the U.S. Constitution. The only legitimate question is whether the lease amount was too high as the result of *improper* influence by Church officials, and management contends that it was not.

Draft Audit report . . . “the Church is also utilizing and benefitting fully from the following items purchased for \$765,763 with public funds in violation of Section 1714-A(4) of the CSL Gym fitness equipment originally purchased by the Church then sold to the Charter School in the same amount of \$39,579 . . . Gym equipment, such as basketball backstops, divider curtain, volleyball and tennis equipment, scoreboards and bleachers in the amount of \$157,100.”

[7] Management response: The audit assumes something is improper about a religious institution selling assets to a public entity. There is none. This transaction would only be improper if PMCS overpaid for the items as the result of improper influence by Church members. In fact, PMCS solicited prices for the purchase of gym equipment. The bid submitted by the [Church] was the lowest bid. The purchase was made at the lowest price submitted. Further, a school official checked prices for the equipment and determined that the price was reasonable.

Draft Audit report . . . [The school paid for the] Gym floor, which contains the Church’s religious logo in violation of Section 1715-A(5) of the CSL, in the amount of \$134,820 . . . [The school also paid for the] Motor operated gym concession door in the amount of \$3,435.

[8] Management response: The school paid for the gym floor. The school needs a gym. The Church’s logo should not have been placed on the gym floor and it has been removed at the Church’s expense. The school also paid for the concession stand door, a necessary part of the gym. Management agrees that outside institutions, including the Church should be charged an appropriate amount for use of the gymnasium and the school is

adopting a policy for rental amounts to be paid by outside nonprofit organizations. PMCS plans to adopt the same sliding scale used by the Pocono Mountain School District for the rental of its facilities.

Draft Audit Report . . . : [The school also paid for the] Parking lot expansion jointly used by the Church and the school in the amount of \$348,679.

[9] Management response: As stated above, this lot was necessary for the school. The Church did not need it. Any use by Church members is incidental.

Draft Audit Report . . . : [The school also paid for the] LED sign (with [the Church's name]), written on it, in violation of Section 1715-A (5) of the CSL in the amount of \$39,250.

[10] Management response: The school and the Church had an informal agreement whereby the Church allowed the school to place the sign on its property at no cost to the school. In exchange the Church name was also placed on the sign and the Church was allowed to run announcements on the sign during weekends. This agreement should have been reduced to writing at the time it was made. This arrangement has ended. The school and the Church now have separate signs.

Draft Audit Report . . . : [The school also paid for the] Installation of an elevator in the amount of \$42,900.

[11] Management response: The elevator is necessary for the school to comply with the Americans with Disabilities Act the Rehabilitation Act of 1974. The Church did not need the elevator, would never have installed the elevator, and does not use the elevator.

Management Response to recommendations of the draft audit: Management agrees to implement both recommendations. Disassociating itself completely from the facilities is problematic as suitable facilities are not easy to find. The school is in the process of obtaining a commercial appraisal of the school building with the goal of purchasing the facility from the Church at fair market value. Management does not know if the price will be affordable or if the Church will be willing to sell the facility.

Department of the Auditor General response:³⁶

Before we offer specific comments on management's response, we must make several preliminary points. First, the basis of this finding does not in any manner relate to an "assumption" that leasing from a religious entity "is inherently wrong and automatically constitutes improper entanglement." In fact, the finding makes absolutely **no** judgment on the type or identity of the entity from which PMCS leased its building; does not in any way pertain to a determination of whether leasing from a religious entity violates any laws; and does not

³⁶ As noted earlier, our comments refer back to each of management's specific responses by bracketed number for ease of comprehension.

suggest, as discussed later in management’s response, that there is anything “improper about a religious institution selling assets to a public entity.” To the contrary, the finding **solely** pertains to the Charter School’s violations of: (1) long established constitutional mandates to avoid intermingling of a public entity with a private sectarian entity and (2) certain related significant safeguards in the Charter School Law (CSL) concerning a charter school’s establishment, governance, and operations, including the following:

A charter school must not be established or funded by any sectarian school, institution, or other entity.	24 P.S. § 17-1717-A(a).
A charter school shall receive and disburse funds for charter school purposes only.	24 P.S. § 17-1714-A(4).
A charter school must be nonsectarian in all of its operations.	24 P.S. § 17-1715-A(4).
A charter school shall not provide any religious instruction, nor shall it display religious objects and symbols on the premises of the charter school.	24 P.S. § 17-1715-A(5).

Second, this finding does not discuss any “transactions” that PMCS may have undertaken.³⁷ However, any “inquiry” was purely related to whether the Charter School properly received and disbursed public funds for charter school purposes only and whether the Charter School was not in any way funding a sectarian institution as prohibited by the CSL.

Third, we agree it is not “a *per se* violation” of the law for the Charter School’s former CEO to have simultaneously served as the pastor of the Church, the entity from which the Charter School leased its building. However, it is one of many factors that weighed heavily into our concerns about the intermingling of a public entity with a private sectarian entity as prohibited by the CSL.

Our comments on each of management’s specific responses are as follows:

[1] We agree that the fact that the Church’s Pastor and Reverend might have “played a significant role” in the establishment of the public charter school does not violate any laws. However, as explicitly prohibited by the CSL, a charter school **must not** be established by any sectarian school, institution, or other entity. The fact that these two individuals were high-level Church employees provides ample circumstantial evidence that the Charter School was actually established by the Church in violation of the CSL.

[2] We disagree that in this specific instance, the identity of a signer of a public charter school’s deed is not relevant to the audit. In leasing situations where state reimbursement is requested and received, obtaining a copy of the deed to the building is relevant and necessary to determine the Charter School’s eligibility to receive this state subsidy. The facts that the Church official signing the deed, executed on September 5, 2002, also began simultaneously serving as the CEO of the Charter School and that the school

³⁷ See Finding No. 2 for such a discussion.

signed a lease with the Church approximately eight months later, June 5, 2003, produced valid questions about possible intermingling of a public entity with a private sectarian entity and raised concerns about potential conflicts of interests between the Charter School and the Church as addressed later in the report.

[3] The Charter School's management agrees that the premises restrictions imposed on the Charter School in the current lease are "troubling." Whether or not the landlord meant for the Charter School to be "denied 24/7" access to the leased facility is immaterial because the written and executed lease provisions as they existed during our audit period are operative here. The lease agreement limited the school's use of the premises to the hours between 7:00 a.m. and 5:00 p.m., Monday through Friday on school days throughout the calendar year and provided for other school uses only as agreed to by the parties. Although we have been provided with documentation to support management's reference to a fall 2010 lease amendment, we wish to acknowledge the Landlord's steps to amend the lease to allow for unfettered access to its leased property after our audit ended.

[4] Absent documentation of the Church's actual usage (including copies of utility bills) of the building and parking lot during the week, on weekday evenings, and on the weekends, as well as the actual square footage of the office space used, we must stand by our conclusion that the \$2.6 million in rents and utilities in taxpayer funds went to the Landlord in violation of the CSL, which provides that a charter school must "disburse funds for charter school purposes only."

[5] Based on ample audit evidence developed from auditor observations and well documented staff interviews, we stand by our statement that the Church regularly utilized the building for Sunday school, office space, Church events, and other like purposes. The building's parking lot, entirely funded by the Charter School, was also used for the Church's operations.

[6] The Charter School's management also agrees that more than \$3 million in taxpayer funded public education dollars flowed to the Church through the Charter School's rental payments. However, we disagree with the Charter School's management that taxpayer money totaling \$3 million is "not significant."

[7] As discussed at the beginning of our response, we made **no** judgment on the type or identity of the seller of the fitness and other gym equipment and our audit report mostly focuses, among other issues, on the Charter School's violations of long established state-Church constitutional mandates, certain related CSL safeguards, possible Ethics Act violations, Sunshine Act violations, and possible failure to follow financial accounting practices (i.e., GAAP) for public schools.

[8] The Charter School's management agrees that the Church's logo should not have been placed on the gym floor in violation of the CSL. Although management's response states that the logo was "removed at the Church's expense," we only have

verification³⁸ that the Church agreed not to seek a refund for the removal of the gym floor lettering. Moreover, this documentation was not provided by the Charter School during our fieldwork, but rather was presented in response to this finding. Furthermore, it is unclear how management can state that the lettering was removed at the “Church’s expense” when the Church’s board only agreed that it would not be “seeking a refund for our purchase.”

[9] While we acknowledge the Charter School’s explanation that the expanded parking lot was necessary for the Charter School, we question why the Charter School was responsible for all of the parking lot costs, which totaled \$348,679, while it was also responsible for increased rent payments specific to the parking lot expansion. Furthermore, we stand by our statement on that “the premises’ parking lot . . . is jointly used by the Church and school” based on Article 4.3 of the lease agreement, dated July 9, 2008, stating, in part, “the Landlord shall have full use of the Leased Premises.”

[10] At the beginning of management’s response to this finding, it stated that “the draft audit **expresses this correctly** in Finding No. 2” that “[a]bsent documentation, there is no accountability for the actions of the Charter School and its board of trustees. . . .” Therefore, we believe that management **now** has some understanding that the “informal agreement” regarding the LED sign does not provide proper accountability to the taxpayers of Pennsylvania that the Charter School and its Board of Trustees did not engage in improper entanglements by placing a \$39,250 LED sign on its premises (with [the Church’s name], written on it) in violation of the CSL.

[11] While we acknowledge the Charter School’s explanation that its installation of an elevator totaling \$42,900 was intended for the Charter School’s compliance with the Americans with Disabilities Act, we disagree based on well documented staff interviews that the elevator is not ever utilized for purposes associated with the Church and its members. Moreover, Article 4.3 of the current lease agreement dated July 9, 2008, states that the Landlord shall have full use of the Leased Premises, which would include use of the elevator.

Overall Auditor’s Conclusion:

We wish to emphasize that our auditors made absolutely **no** judgment about the type or identity of the entity from which the Charter School leased its building. The audit evidence speaks for itself that the Charter School violated long established constitutional provisions to avoid intermingling of a public entity with a private sectarian entity and certain important significant safeguards in the CSL concerning a Charter School’s establishment, governance, and operations. We note that, despite some of its comments on the finding, the Charter School’s has agreed to implement our recommendations.

³⁸ See November 3, 2010, response letter from Church to charter school’s board of trustees’ November 4, 2010, letter requesting release of agreements for LED signage, entrance signage, and gym lettering. Please note that both of these letters were sent after our audit period.

Finding No. 2 Charter School May Have Engaged in Related-Party Financial Transactions and Conflicts of Interest in Violation of the Ethics Act

Charter School's response:

Management provided the following response:

1. Management agrees that certain transactions require scrutiny because of the connection between [the Charter School's CEO] and the Church. However, the fact that these transactions took place does not establish that they were disadvantageous to the school. The ultimate question is if the rent paid was reasonable. The Charter School believes it was as an appraisal was obtained of the fair market rental value before the leases were executed. The school can provide sworn testimony from the revocation hearing establishing this.
2. [The Church's Pastor] resigned as CEO in late 2010.
3. Need for public bidding: Management disagrees with the auditor's conclusion that the school needed to engage in public bidding over the lease cost. That conclusion assumes that there were a number of equivalent, suitable properties available for rent. There were not. This is not analogous to the purchase of goods where many entities can supply identical goods. Further, financing and long term lease options are extremely limited for charter schools because the current charter law only provides for 5 year charters. Many commercial landlords and financial institutions are unwilling to enter into long term agreements with charter schools.
4. Need for disclosure:
 - a. Management agrees that the minutes should have reflected whether individuals on the board disclosed potential conflicts of interest and refrained from speaking on transactions that might have indirectly benefitted them. Management has worked to improve its minutes and is looking for additional training for board members (detailed more fully below).
 - b. Management does not agree with the audit's conclusion that because the disclosure is not reflected in the minutes, the disclosure did not take place. This was an issue of improper recording, not improper conduct.
 - c. Management does not agree with the audit's conclusion that because the minutes do not reflect that [the Charter School's CEO] did not disqualify himself from speaking, he must therefore have spoken in favor of the transactions. This was an issue of improper recording, not improper conduct.

Management cannot comment on the possible individual benefit to [the Church's Pastor and his wife]. That conclusion assumes certain facts about the relationship between [the

Charter School’s CEO] and the [Church]. The school is not privy to the details of those relationships.

Draft Audit . . . : Absent documentation, there is no accountability for the actions of the Charter School and its board of trustees, and the public cannot be assured that these transactions occurred in compliance with the CSL, the Ethics Law, the Sunshine Act, and required financial accounting practices (i.e., GAAP) for public schools. Consequently, there is greater risk for potential abuse and an increased likelihood that these agreements and financial transactions occurred for reasons other than the best interest of the Charter School and its students.

Management Response: Management agrees with this conclusion. Management has already disagreed above, and will disagree below with the conclusion that the “risk of abuse” means that abuse occurred. Management agrees that its failure to properly document certain actions, disclosures and transactions gives the appearance of possible impropriety. Management does not agree that the improprieties took place.

Draft Audit Recommendations: Management agrees with recommendations 1, 2 and 4. Recommendation 3 is problematic with regard to leases or purchases of unique property. Soliciting of bids may not be possible under those circumstances. However, should management’s position on Section 1103(f) of the Ethics Act be determined to be legally incorrect, management will certainly follow the law.

Department of the Auditor General response:

1. We are pleased that the Charter School’s management agrees that certain transactions require scrutiny because of “the connection” between the Charter School’s Founder/CEO and the Church’s Landlord/Founder/Pastor, who is the same individual. However, we are concerned that management avoids directly responding to the potential conflicts of interest and related party transactions identified in this finding by diverting its reply to a discussion about fair market rent, which is not in any way relevant to this finding.

However, even if the Charter School could have provided documentation demonstrating that public disclosure of potential conflicts occurred, we obtained evidence that the Charter School’s CEO performed responsibilities involving the lease, which is expressly prohibited by the Ethics Act, due to his association with the Landlord. Specifically, the Charter School’s CEO signed the following documents directly related to oversight of the lease with the Landlord, an entity which he founded and simultaneously held a position at:

- The original landlord/tenant lease agreement dated June 5, 2003.
- The applications for the Commonwealth’s charter school lease reimbursements filed with PDE verifying the lease costs paid by the Charter School to the Landlord, for the 2009-10, 2008-09, 2007-08 and 2006-07 school years.

Thus, based on these findings, there is ample evidence that a violation took place.

2. Although management states that the Charter School's CEO resigned from the Charter School in late 2010, this individual was serving as the Charter School's CEO during the audit period and when these transactions took place. Moreover, these transactions occurred while this individual's wife was serving as the Charter School's ACEO, although she resigned in December, 2009.
3. Based on management's reply, it appears that the Charter School **misinterpreted** our conclusion. We stated that the Charter School failed to document that it complied with the Ethics Act by awarding its leases through a "public approval process" that considered other potential lease proposals.³⁹ However, management has mistakenly taken this to mean that the lease was subject to the Public School Code's competitive "bidding requirements," for contracts in excess of \$10,000,⁴⁰ which we do not address. Consequently, management's reply focuses on public bidding requirements, which are not relevant to this finding.

Our primary concern, based on the evidence we found, was not whether the Charter School was paying a reasonable rent. Instead our finding focused on whether the Charter School awarded its lease contracts in an "open and public process," allowing the public to scrutinize whether the Charter School's CEO and ACEO had a relationship with its Landlord that might lead to an improper influence of power and/or personal gain. As previously stated, the Charter School could not provide documentation to demonstrate that such a process had taken place.

4. We are pleased that the Charter School's management has agreed to work to improve the completeness of its board meeting minutes in an effort to meet the necessary disclosure requirements and that it is seeking additional training for its board members. However, management is incorrect in its assertion that we are equating a lack of disclosure in the Charter School's board meeting minutes to improper conduct. Our finding does not conclude that there was improper conduct relating to the Charter School's board meeting minutes, but rather that, absent documentation, the public cannot be assured that the Charter School's CEO and ACEO did not have any potential conflicts of interest and that they properly refrained from speaking on transactions that might have benefitted them. We wholeheartedly agree with management's statement that the Charter School's "failure to properly document certain actions, disclosures and transactions gives the appearance of possible impropriety," although management denies that any improprieties took place. Once again, we can neither validate nor dispute this claim.

Finally, we find management's reply that the Charter School "is not privy to the details of those relationships" between the Charter School's CEO and the Landlord to be highly disingenuous. The Charter School is fully aware of this relationship because the Charter School's CEO created both the Charter School and the entity serving as its Landlord

³⁹ See 65 Pa.C.S. § 1303(f).

⁴⁰ See 24 P.S. § 8-807.1.

(Church), and both these entities share the same building. Furthermore, the Charter School's CEO simultaneously held positions with both the Charter School and the Landlord/Church. In fact, while they were at the Charter School, our auditors observed that the CEO utilized one large office within the shared building to perform his duties for both the Charter School and the Landlord/Church.

We will follow-up on the completeness of board meeting minutes and the Charter School's compliance with public disclosure requirements, including the identification of potential conflicts of interests, in our next regularly scheduled audit.

Finding No. 3 Charter School Violated the Sunshine Act by Failing to Maintain Complete Board Meeting Minutes

Charter School's response:

Management stated the following:

Management agrees that minutes have not historically been as thorough as required. Since the audit, PMCS has put a number of corrections into action regarding board minutes. The current minutes have full disclosure regarding vote and motions. All topics discussed are outlined in the minutes along with supporting documentation. PMCS has purchased the "PSBA Handbook for School Board Secretaries" and has applied for membership of PSBA. . . .

Management and the board have a much better understanding of the degree of detail required in the minutes and management anticipates that future minutes will be more comprehensive. PMCS and the Board of Trustees will incorporate the Auditors Generals' recommendations into future minutes.

Draft Audit Recommendations: Management agrees with recommendations in the draft audit.

Department of the Auditor General response:

We are pleased that the Charter School's management has indicated that it has taken action to implement our recommendations. Any changes that the Charter School made to its board meeting minutes were subsequent to our audit field work. Therefore, we will follow-up on the Charter School's implementation of our recommendations during our next regularly scheduled audit.

Finding No. 4 Charter School Violated the State Ethics Act by Failing to Ensure that Board Members and Administrators Filed Statements of Financial Interests

Charter School's response:

Management stated the following:

Management agrees that not all statements were submitted as required by the Ethics Act. However, many of these statements were not obtained because board members were not members of the board at the time these statements were solicited by management. For example, the statements were requested in April in order to comply with the May 1 deadline. There were board members who joined the board in July of the previous year and resigned the following March. Those board members were not asked to complete the statements.

Management also points out that the obligation to file the statements is an individual obligation of board members. It is not an obligation of the school. The school can encourage board members and other officials to fill out the statements but cannot require it. Nevertheless, the school has been much more aggressive about requesting that all board members fill out the Statements of Financial Interest and will continue to make serious efforts to insure board members fulfill their responsibility in this area. PMCS has conducted a complete audit of the forms and obtained completed forms for all current Administrative staff and boards members.

Draft Audit Recommendations: Management agrees with recommendations in the draft audit. However, while the solicitor can review the statements to insure that they are facially correct, the solicitor cannot be responsible for the truthfulness or completeness of the information contained in the statements.

Department of the Auditor General response:

We are pleased that the Charter School's management agrees with this finding and our recommendations. However, we must correct the Charter School's misinterpretation of the filing requirements for Statements of Financial Interests.

As presented in the finding, Section 1104(a) of the Ethics Act requires "public officials" and "public employees" to file Statements of Financial Interests **for the preceding calendar year** no later than May 1st of each year in which a position is held and of **the year after leaving such a position**.⁴¹

⁴¹ 65 Pa.C.S. § 1104(a).

Therefore, the Charter School's interpretation that these board members were not required to file Statements of Financial Interests is inaccurate. The Charter School should have requested Statements of Financial Interests from these individuals for each calendar year or part of a calendar year that they held a position and for one calendar year after they left their position.

Finally, we agree that the specific requirements of the Ethics Act apply to the individual and not to the entity. However, we disagree with management's assertion that filing the Statements of Financial Interests forms is not an obligation shared by both the individual and the entity for which he or she is/was a public official or employee. The filing instructions accompanying the Statements of Financial Interests form require that they be filed with the public entity for which the individual is employed or appointed. Therefore, the public entity/employer has an obligation to ensure that this activity takes place, so that the overall requirements of the Ethics Act may be fulfilled.

Finding No. 5 Charter School May Have Improperly Received \$87,101 in State Lease Reimbursements in Violation of the Public School Code

Charter School's response:

Management stated the following:

Management disagrees with this finding. This finding assumes that the school is “leasing its permanent education building to itself” and is therefore ineligible for reimbursement. Part of this conclusion is understandable because of the lease language that gave the Charter School limited access to the leased premises. However, the facts are that the Charter School had full access to the leased premises.

PMCS believes the real issue is whether the rent paid was in excess of fair market value rent. At the time the lease was signed, the PMCS board had obtained appraisals from independent experts suggesting the rent amount was appropriate. It also followed the advice of its counsel, . . . regarding what steps it needed to take to make sure it was acting in accordance with the Charter School Law and Ethics Act. The fact that [the] Pastor . . . was the CEO of the Charter School and Pastor of the [Church] suggests that the transaction be subject to close scrutiny. However, if the rent paid was appropriate, there is nothing wrong with leasing from the Church and requesting lease reimbursement payments. PMCS can provide excerpts from testimony taken during the charter revocation hearings regarding the steps we took to make sure the rent agreed to fair market value rent and to show the school had full 24/7 access to the leased premises.

Draft Audit Recommendations: Management agrees with recommendations 2 and 3 in the draft audit. Management does not agree with recommendation 1 because the school is not “leasing the property to itself” and the school has been and remains eligible for reimbursement.

Department of the Auditor General response:

Our conclusion that the Charter School is leasing its educational building back to itself, and therefore is ineligible to receive state lease reimbursements, is based on the facts presented and the evidence we found, not, as management asserts, on “assumption.” Specifically, this finding includes **ten relevant facts** supporting our conclusion (*see* page 31), none of which were refuted by management. Instead, management only disagreed with our conclusion, and once again tried to re-frame the argument by refocusing its response on the idea of fair market value rent.

As previously stated, our finding focuses on the appropriateness of having the same individual, the Charter School's CEO, function as a key decision-maker for both the Charter School and the

Landlord; consequently, lease costs submitted to the Department of Education (DE) for state reimbursement were certified by an individual associated with both entities. It is important to note that DE relies upon the signatures of the officials submitting these forms as its only means of verifying that the information tendered is accurate. DE's state reimbursement application does not require proof that the rental amounts are accurate or that rental payments were actually paid to the Landlord. However, we were unable to confirm that the Charter School actually made the agreed upon rental payments to the Landlord. Therefore, we cannot verify that the Charter School paid rent to the Landlord/Church directly, and not to someone else, such as the bank holding the Landlord's/Church's mortgage, nor can we confirm that the amounts submitted to DE were accurate. As a result, the Department encourages DE to request the necessary supporting documentation from the Charter School to verify that the rent payments were made from the Charter School to the Landlord.

In addition, it is important to note that Findings No. 1 and No. 2 of this audit report also include evidence that supported our conclusion that the Charter School has an ownership interest in the building it is renting from and co-occupying with the Landlord, and for which it is receiving state lease reimbursement. In fact, management's replies to these findings reaffirmed some of the facts presented.

For example, management's reply to Finding No. 1 acknowledges that founders and officers for the Landlord/Church played significant roles in establishing the Charter School and explains that the permanent building improvements paid for by the Charter School were necessary for and used by the Charter School, and not the Landlord. Regardless of which entity benefited most from these building improvements, the Charter School's decision to use its public taxpayer dollars to pay for permanent improvements to a building that it has no ownership interest in is contrary to Section 1714-A(4), which provides that a charter school shall receive and disburse funds for charter school purposes only,⁴² and sound business practice.

Moreover, management's reply to Finding No. 2 states: "Further, financing and long term lease options are extremely limited for charter schools because the current charter law only provides for 5 year charters. Many commercial landlords and financial institutions are unwilling to enter into long term agreements with charter schools." We agree that a landlord might find entering into an agreement with a charter school risky for the reasons management describes above. Consequently, it is curious that the Landlord/Church did not have these same concerns. Instead, it financed the costs of a new building on behalf of a Charter School, as well as entered into a ten-year lease. It would have been useful if the Charter School was able to explain why it believed it was able to win over its current landlord and achieve such a beneficial arrangement.

Based on the facts presented, we continue to question the Charter School's eligibility to receive state funding resulting from this lease arrangement, which was created among related parties sharing ownership interest in the property.

⁴² 24 P.S. § 17-1714-A(4).

Finding No. 6 Charter School Lacked a Memorandum of Understanding in Violation of the Public School Code

Charter School's response:

Management stated the following:

The Charter School has made every effort to obtain MOU. For over 60 days we have been awaiting a signed copy of our MOU. We were told that the Police Chief had the MOU. Then we were told that the attorney for the Police Department was now in possession of our MOU. We have recently written a letter to [our] Congressman in the efforts that this may expedite or clarify the delay in obtaining our MOU.

On December 9, 2011, management supplemented its original response with the following:

The lack of a Memorandum of Understanding was an oversight on the part of the PMCS. PMCS was not fully aware of the need for the document or the consequence of not having this document. The MOU has been obtained. [Note: This documentation was provided but is not included in the audit report.] Management response has already been provided.

Department of the Auditor General response:

The Charter School's personnel made documented efforts to obtain an MOU with the Charter School's local police department. Moreover, this persistence appears to have been effective, given that the Charter School eventually obtained a signed MOU as of June 30, 2011. We commend the Charter School for its efforts to obtain the signed MOU and encourage the Charter School to continue to biennially update and re-execute each MOU and file a copy with DE's Office of Safe Schools on a biennial basis as required by the Public School Code.

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:

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

The Honorable Ronald J. Tomalis
Secretary of Education
1010 Harristown Building #2
333 Market Street
Harrisburg, PA 17126

The Honorable Robert M. McCord
State Treasurer
Room 129 - Finance Building
Harrisburg, PA 17120

Ms. Nichole Duffy
Director, Bureau of Budget and
Fiscal Management
Department of Education
4th Floor, 333 Market Street
Harrisburg, PA 17126

Dr. David Wazeter
Research Manager
Pennsylvania State Education Association
400 North Third Street - Box 1724
Harrisburg, PA 17105

Dr. David Davare
Director of Research Services
Pennsylvania School Boards Association
P.O. Box 2042
Mechanicsburg, PA 17055

Ms. Marlene Kanuck
Department of Education
Attn: Charter and Cyber Charter Schools
333 Market Street, 8th Floor
Harrisburg, PA 17126

Dr. Elizabeth M. Robison, Superintendent
Pocono Mountain School District
P.O. Box 200
Swiftwater, PA 18370

Mrs. Meg Dilger, Board President
Pocono Mountain School District
P.O. Box 200
Swiftwater, PA 18370

Mr. John J. Contino, Executive Director
State Ethics Commission
309 Finance Building
P.O. Box 11470
Harrisburg, PA 17108

Department of Education
Chief, Division of School Facilities
4th Floor, 333 Market Street
Harrisburg, PA 17126

E. David Christine, Jr.,
Monroe County District Attorney
610 Monroe Street
Suite 126
East Stroudsburg, PA 18360

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.

