VITALISTIC THERAPEUTIC CHARTER SCHOOL OF THE LEHIGH VALLEY

LEHIGH COUNTY, PENNSYLVANIA

PERFORMANCE AUDIT REPORT

SEPTEMBER 2012

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

Ms. Joyce Thompson, Board President
Vitalistic Therapeutic Charter School
of the Lehigh Valley
111 Dewberry Avenue
Bethlehem, Pennsylvania 18107

Dear Governor Corbett and Ms. Thompson:

We conducted a performance audit of the Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period July 1, 2006 through October 21, 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 seven audit findings and observation within this report. A summary of these results is presented in the Executive Summary section of the audit report. These findings and one observation include forty-three recommendations aimed at the Charter School and twelve recommendations aimed at a number of different government entities, including the Pennsylvania Department of Education, the State Ethics Commission, the Public School Employees' Retirement System and the authorizing school districts. Additionally, due to the seriousness of the findings, we have also sent a copy of this report to the Lehigh County District Attorney.

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

Sincerely,

/s/
JACK WAGNER
Auditor General

September 14, 2012

cc: **VITALISTIC THERAPEUTIC CHARTER SCHOOL OF LEHIGH VALLEY**
Board of Trustees

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JACK WAGNER

AUDITOR GENERAL

Executive Summary

Audit Work

The Pennsylvania Department of the Auditor General conducted a performance audit of the Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School). Our audit sought to answer certain questions regarding the Charter School's compliance with applicable state laws, contracts, grant requirements, and administrative procedures.

Our audit scope covered the period July 1, 2006 through October 21, 2010, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidy and reimbursements was determined for school years 2007-08 and 2006-07.

Charter School Background

The Charter School, located in Lehigh County, Pennsylvania, opened in February, 2001. It was originally chartered on March 1, 2001, for a period of five years by the State Charter Appeal Board, deemed approved by the inaction of the Board of School Directors of the Bethlehem Area School District, and approved by the Allentown City School District. The Charter School's mission states: "Our mission is to provide positive learning experiences for children needing a highly individualized, unique program within a therapeutic setting. VTCSLV aims to support resiliency in children." During the school year 2009-10, the Charter School provided educational services to 116 pupils from 6 sending school districts through the employment of 12 teachers, 18 full-time, and part-time support personnel, and 4 administrators. The Charter School received approximately $1.1 million in tuition payments from school districts required to pay for their students attending the charter school in during the school year 2009-10.

Adequate Yearly Progress

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

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

Audit Conclusion and Results

Our audit found that the Charter School complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures, except for seven compliance-related matters reported as findings and one matter unrelated to compliance that is reported as an observation.

Finding No. 1: Vitalistic Therapeutic Charter School of the Lehigh Valley Improperly Received $43,074 in State Lease Reimbursement. Our audit found that the Charter School improperly received $31,546 in state lease reimbursements for school years 2006-07 through 2008-09 for its main building that was ineligible for those payments because it was owned by the Vitalistic Therapeutic Center which creates a related party landlord and tenant agreement. Furthermore, the Charter School applied for, and will receive, $11,528 in state lease reimbursement for the 2009-10 school year (see page 11).

Finding No. 2: Certification Deficiencies and Failure to Comply with the 75 Percent Certified Staff Requirement of the Charter School Law. Our audit of professional employees' certification and assignments for the period July 1, 2006 through June 30, 2010, found the Charter School did not meet the requirement under the Charter School Law that at least 75 percent of its professional staff hold appropriate state certification.

Additionally, the Charter School educates students in grades kindergarten through third. Each grade contains both regular education and special education students that are instructed in the same classroom and by the same teacher. Our audit found that these teachers are not dually certified in Special Education and either certified or highly qualified in Elementary Education as required (see page 14).

Finding No. 3: Related Party Transactions and Ethics Violations. Our audit of the Charter School records, minutes of the meetings of the Board of Trustees and interviews with Charter School personnel found possible conflict of interest transactions. The Charter School's prior chief executive officer and board of trustees may have engaged in prohibited conduct. These conflicts and possible ethics violations are in the following areas: lease agreement; board of trustees employed by charter school; related party transactions; loans for related party operating expenses; and lack of segregation of duties (see page 18).

Finding No. 4: Internal Control Weaknesses and Lack of Documentation. Our review of the Charter School procedures and records found internal control weaknesses in general and financial operational areas including a lack of documentation of expenses (see page 27).

Finding No. 5: Lack of Adherence to Vitalistic Therapeutic Charter School of the Lehigh Valley's Governance Structure. Our review of the Charter School procedures found a lack of adherence to the Charter School's governance structure and lack of Board oversight (see page 37).

Finding No. 6: Inadequate Transportation Procedures Regarding Bus Drivers' Qualifications. Our review of Act 34 (Criminal History Clearance) found that one driver did not have this clearance on file. Our review of Act 151 (Child Abuse Clearance) found that two drivers did not file for the clearance, and two drivers filed two-three years prior to employment with the Charter School.

Our review of Act 114 (Federal Bureau of Investigation Clearance) found that three drivers did not file for the clearance, and one driver filed for the clearance and only provided the printed receipt indicating the clearance was performed; however, no results were available.

Our review of physical examination certificates found that one driver did not have a current, valid physical examination certificate on file.

Our review of serious crimes beyond five years found that one driver was convicted of a serious crime. This was beyond the five-year look back period, and employment is not barred (see page 42).

Finding No. 7: Failure to Develop Memorandum of Understanding with Local Law Enforcement. Our audit of the Charter School records found that the Charter School did not have signed Memorandums of Understanding with two local police departments (see page 44).

Observation: Vitalistic Therapeutic Charter School of the Lehigh Valley Is Operating with a 48 Percent Unreserved-Undesignated General Fund Balance. According to audited financial statements, Charter School had annual expenditures of $1,221,119 and $1,044,701 for the 2008-09 and 2007-08 school years, respectively. The cumulative unreserved-undesignated general fund balance for the 2008-09 and 2007-08 school years were 48 and 40 percent of its cumulative annual expenditures, respectively. By way of comparison, school districts are prevented under state law from raising taxes if they have a cumulative unreserved-undesignated fund balance of more than 8 to 12 percent of their annual expenditures. These limits help ensure that the Commonwealth spends taxpayer funds responsibly and equitably, and that the school districts return excess payments to the Commonwealth (see page 46).

Status of Prior Audit Findings and Observations. This is our first audit of the Charter School. Therefore, there are no prior findings or observations.

Background Information on Pennsylvania Charter Schools

Description of Pennsylvania Charter Schools:

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

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

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

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

Pennsylvania Charter School Law

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

The Law permits the establishment of charter schools by a variety of persons and entities, including, among others, an individual; a parent or guardian of a student who will attend the school; any nonsectarian corporation not-for-profit; and any nonsectarian college, university or museum.[3] Applications must be submitted to the local school board where the charter school will be located by November 15 of the school year preceding the school year in which the Charter School will be established,[4] and that board must hold at least one public hearing before approving or rejecting the application.[5] If the local school board denies the application, the applicant can appeal the decision to the State Charter School Appeal Board,[6] which is comprised of the Secretary of Education and six members appointed by the Governor with the consent of a majority of all of the members of the Senate.[7]

[1] 24 P.S. § 17-1702-A.
[2] *Id.*
[3] 24 P.S. § 17-1717-A(a).
[4] *Id.* § 17-1717-A(c).
[5] *Id.* § 17-1717-A(d).
[6] *Id.* § 17-1717-A(f).
[7] 24 P.S. § 17-1721-A(a).

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

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

Funding of Pennsylvania Charter Schools:

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

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

Pennsylvania Charter School Funding

The Commonwealth bases the funding for charter schools on the principle that the state's subsidies should follow the students, regardless of whether they choose to attend traditional public schools or charter schools. According to the 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(a).
9 Pennsylvania Department of Education, Basic Education Circular, "Charter Schools," Issued 10/1/2004.
10 24 P.S. §§ 17-1703-A, 17-1741-A *et seq*.
11 24 P.S. § 17-1745-A(d).
12 *Id.* § 17-1745-A(f)(4).
13 24 P.S. § 17-1741-A(a)(3).
14 24 P.S. § 17-1750-A(e).

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 Id.* §§ 17-1725-A(a)(3), 25-2509.5(k).
[17] *See* 24 P.S. § 17-1725-A(a)(5).
[18] *See* 24 P.S. § 25-2591.1. Please note that this provision is contained in the general funding provisions of the Public School Code and not in the Charter School Law.
[19] Please note that the general funding provision referenced above (24 P.S. § 25-2591.1) has not been repealed from the Public School Code and states the following: "For the fiscal year 2003-2004 and each fiscal year thereafter, if insufficient funds are appropriated to make Commonwealth payments pursuant to this section, such payments shall be made on a pro rata basis." Therefore, it appears that state funding could be restored in future years.

Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

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

Our audit, conducted under 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 October 21, 2010.

Regarding state subsidy and reimbursements, our audit covered school years 2007-08 and 2006-07.

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

Objectives

What is the difference between a finding and an observation?

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

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

- ✓ Was the charter school in overall compliance with the Public School Code of 1949[20] (PSC) and the Charter School Law (Law)?[21]

- ✓ Did the charter school have policies and procedures regarding the requirements to maintain student health records and perform required health services, and keep accurate documentation supporting its annual health

[20] 24 P.S. § 1-101 *et seq.*
[21] 24 P.S. § 17-1701-A *et seq.*

services report filed with the Department of Health to receive state reimbursement?

- ✓ Did the charter school receive state reimbursement for its building lease under the Charter School Lease Reimbursement Program, was its lease agreement approved by its board of trustees, and did its lease process comply with the provisions of the Public Official and Employee Ethics Act?[22]

- ✓ Did the charter school comply with the open enrollment and lottery provisions of the Law pertaining to student admissions?

- ✓ 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 of trustees comply with the PSC, the Public Official and Employee Ethics Act, and the Sunshine Act?

- ✓ Were at least 75 percent of the charter school's teachers properly certified and did all of its noncertified teachers meet the "highly qualified teacher" requirements?

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

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

- ✓ Did the charter school comply with the Law's compulsory attendance provisions and, if not, did the

[22] 65 Pa.C.S. § 1101 *et seq.*

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

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.

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

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

[23] 22 Pa. Code § 11.24.

Our audit examined the following:

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

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

Findings and Observations

Finding No. 1

Vitalistic Therapeutic Charter School of the Lehigh Valley Improperly Received $43,074 in State Lease Reimbursement

Public School Code relevant to the finding:

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

"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 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 the Department of Education, 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."

Our audit found that the Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School) improperly received $31,546 in state lease reimbursements for school years 2006-07 through 2008-09 for its main building that was ineligible for those payments because it is owned by the Vitalistic Therapeutic Center (Center), which creates a related party landlord and tenant agreement. Furthermore, the Charter School applied for, and was scheduled to receive, $11,528 in state lease reimbursement for the 2009-10 school year.

Relevant Background Information

The Charter School opened in 2001. The Charter School's founder was also the founder of the Center, which opened in 1972. According to the Center's web site, the Center provided educational and therapeutic services to children from birth to 12 years of age who have developmental delays and/or mental health issues. The Charter School serves students from grades K-3. The Charter School was located in the same building as the Center. Since the Center closed in September 2010, the Charter School was ultimately left without a building in which to operate. While the Charter School is still officially open, the Charter School delayed the start of its 2012-13 school year until September 17, 2012 until it was able to find a new location.

Our audit found that the Charter School's founder and prior chief executive officer (CEO), who was also the founder and CEO of the Center, controlled all aspects of the Charter School and Center operations. The prior CEO made all decisions, both operational and financial for both entities without oversight by the Charter School's board of trustees as required by the Charter School Law (CSL). As such, it was difficult to make a clear distinction between the two operations. Moreover, the Charter School did not have proper documentation of money received or spent as noted in our findings.

> Charter School Lease Reimbursement Program Directives provided by the Bureau of Budget and Fiscal Management and PDE states, in part:
>
> "Buildings owned by the charter school are not eligible for reimbursement under this program. Payments related to the acquisition of a building do not qualify for reimbursement under the program."
>
> **Related parties** are defined by accounting principles to include:
>
> "Other parties that can significantly influence **the management of operating policies of the transacting parties or that have an ownership interest** in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursing its own separate interests."
>
> Source: Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 850-10-50.

Application for State Lease Reimbursement

Under the Commonwealth's Reimbursement for Charter School Lease Program, the Charter School applied for and received $11,493, $9,923, and $10,130 for the main building for school years 2008-09, 2007-08 and 2006-07, respectively. The Charter School has been located in this building since it was first chartered in 2001. The other building is owned by the Center and housed part-time kindergarten students. No state reimbursement has been applied for or received for this building.

According to the deed for the main education building, the Center bought the building on September 26, 2001. The Center then leased the building to the Charter School effective October 2001, and has renewed it annually.

The Charter School's founder and CEO is also the founder and the CEO of the Center and both entities had the same board of trustees, thus creating a related party landlord and tenant agreement. Although the Center and the Charter School are separate entities, the Center supported the Charter School with start-up costs when the charter was approved.

Under the Pennsylvania Department of Education's (PDE) eligibility requirements, which are based on Section 2574.3(a) of the PSC,[24] buildings owned by the charter school do not qualify for compensation under the Reimbursement for Charter School Lease Program. Therefore, the Charter School has improperly received rental reimbursement for this building for the past four years.

According to the Charter School's administration, it was unaware that the relationship of the Center and the Charter School created a related party landlord and tenant agreement.

[24] 24 P.S. § 25-2574.3(a).

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* should:

1. Ask its solicitor to review the terms of any reimbursement and/or grant program prior to submitting an application.

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

The *Pennsylvania Department of Education* should:

3. Require the Charter School to pay back the $43,074 owed to the Commonwealth for the improper reimbursement it received from the Reimbursement for Charter Schools Lease Program.

Management Response

VTCSLV would appreciate guidance on this matter, so as to eliminate any improper behavior. The Board of Trustees will consult with Charter School counsel to review regulations and make any changes that may be necessary.

Auditor Conclusion

The Charter School should review filing requirements with PDE following its resolution of this finding.

Finding No. 2

Certification Deficiencies and Failure to Comply with the 75 Percent Certified Staff Requirement of the Charter School Law

Charter School Law (CSL) and Pennsylvania Regulations relevant to the finding:

Section 17-1724-A(a) of the Charter School Law. 24 P.S. § 17-1724-A(b). requires ". . . [a]t least seventy-five per centum of the professional staff members of a charter school shall hold appropriate State certification."

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

Chapter 711 regulations require:

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

Section 7801(23) of the federal No Child Left Behind Act (NCLB), 20 U.S.C. § 6301 et. seq., requires that all teachers who teach core academic subjects in public schools be "highly qualified"

"Highly qualified" teacher status applies to all charter school teachers of "core content" subjects at all grade levels, including noncertified teachers allowed at charter and cyber charter schools.

Our audit of Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School) professional employees' certification and assignments for the period July 1, 2006 through June 30, 2010 was conducted to determine compliance with the certification requirements of the Charter School Law (CSL), the Public School Code (PSC), Chapter 711 of the Pennsylvania Code (Chapter 711), the federal No Child Left Behind Act (NCLB), and the Pennsylvania Department of Education's (PDE) Bureau of School Leadership and Teacher Quality's (BSLTQ) Certification and Staffing Policies and Guidelines (CSPG).

Non-Compliance with 75 Percent Certified Requirement

Our audit found the Charter School was in violation of the CSL's requirement to have at least 75 percent of its professional staff appropriately certified in their area of administrative responsibility or subject area in which they teach. Instead, the percentage of certified professional personnel to total professional staff was as follows:

School Year	Total Professional Employees	# Not Certified	% of Professional Staff Certified
2009-10	16	7	56%
2008-09	15	8	47%
2007-08	13	8	38%
2006-07	13	8	38%

In Pennsylvania, the NCLB **core content** subjects include English, Reading/Language Arts, Mathematics, Sciences, Foreign Languages, Music and Art, and Social Studies (History, Economics, Geography, and Civics and Government).

PDE is responsible for establishing the methods for Pennsylvania teachers to obtain "highly qualified" status.

Non-Compliance with Special Education Requirements

The Charter School educates students in kindergarten through third grade. Each grade contains both regular education and special education students that are instructed in the same classroom and by the same teacher. Discussions with Charter School staff found that students share some of the same coursework, and additional special education coursework or behavior modification required by a student's Individualized Education Plan is integrated into that student's daily instruction within the regular classroom setting. Under these circumstances, those teachers are providing special education services to students and are also the teacher of record of core content subjects. As such, those teachers must be dually certified in special education and either certified or highly qualified (HQ) in elementary education. All special education teachers must hold appropriate state certification and cannot be part of the 25 percent non-certified staff allowed at charter schools.

We found that the Charter School did not comply with the CSL and Chapter 711 requirements that all special education teachers be properly state certified. Specifically, we found that teachers holding Elementary Education certificates were teaching Special Education students, which is not permissible because all special education teachers must hold appropriate state certification and cannot be part of the 25 percent non-certified staff allowed at charter schools. There were four teachers in this category during each of the 2009-10, 2008-09, 2007-08, and 2006-07 school years.

Non-Compliance with Highly Qualified Teacher Requirements

Similarly, we found teachers that were certified in Special Education, but were not certified or HQ in Elementary Education as required. During the 2008-09 school year, there were two teachers in this category. There were three teachers in this category during each of the 2009-10, 2007-08, and 2006-07 school years. However, not all documentation to determine HQ status was available for audit.

The Charter School's failure to employ at least 75 percent certified professional staff and properly certified teachers

could result in students not receiving a quality education or special education services to which they are entitled.
In addition, non-compliance with the CSL's requirements may force a chartering school district to revoke or not renew a charter because the charter school has not fulfilled its contractual obligations, such as providing the required percentage of certified teachers and employing properly certified teachers and special education staff.

Certification Determination from PDE's BSLTQ

Information pertaining to the certification deficiencies was submitted to PDE's BSLTQ for review. On September 26, 2011, the BSLTQ determined that the following teachers held Elementary K-6 Instructional certificates but were employed by the Charter School to teach Special Education K-3 and they did not hold Special Education certificates or emergency permits: four teachers in 2006-07, three in 2007-08, five in 2008-09, and five in 2009-10. Additionally, BSLTQ concluded that one teacher in 2006-07 and one teacher in 2007-08 was employed by the Charter School to teach Speech Therapy without the proper Speech Language Impaired Instructional certificate or emergency permit. BSLTQ had access to additional certification documentation that was not available at the time of our audit fieldwork.

Unlike traditional school districts, charter schools are not subject to subsidy forfeitures for certification deficiencies. As such, the BSLTQ issued citations for these deficiencies, but no monetary penalties were imposed upon the Charter School.

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* should ensure that:

1. At least 75 percent of the professional employees are properly certified for their assigned positions, for the entire school year, in compliance with the CSL.

2. Special education related duties are assigned to a staff member holding appropriate state certification in accordance with standards of the State Board of Education.

3. Administrative personnel are provided with sufficient training in order to understand and manage certification requirements as defined by the CSL and PDE's CSPGs.

As the authorizing school districts, the *Bethlehem Area School District* and *Allentown City School District* should:

4. Follow-up with the Charter School regarding these individuals' future teaching assignments and certification status.

5. Ensure that the Charter School is meeting the CSL's requirement to employ at least 75 percent certified staff.

6. Verify that all Special Education staff are properly state certified and that special education staff who provide core content instruction to Elementary level special education students are also "highly qualified" in fundamental subjects content knowledge as required.

7. Review the charter of the Charter School and determine whether the Charter School is violating certification terms of its approved charter with the districts.

Response of Management

Management stated the following:

Review of certifications and discussion from Principal regarding certificates and highly qualified teaching staff. Principal will also review certification requirements with PA Dept of Ed.

Finding No. 3

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

Charter School Lease Reimbursement Program Directives provided by the Bureau of Budget and Fiscal Management and PDE states, in part:

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

Related parties are defined by accounting principles to include:

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

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

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.

Related Party Transactions and Ethics Violations

Our audit of the Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School) records, minutes of the meetings of the board of trustees and interviews with Charter School personnel found possible related party transactions. The Charter School's prior chief executive officer (CEO) and board of trustees may have engaged in prohibited conduct.

The following possible conflicts of interest and possible ethics violations will be forwarded to the State Ethics Commission for additional review and investigation, as it deems necessary:

- Lease agreement;
- Board of trustees employed by charter school;
- Related party transactions;
- Loans for related party operating expenses;
- Inaccurate billings for student therapy;
- Lack of segregation of duties; and
- Non-compliance with ethics filing requirements.

Lease Agreement

As noted in Finding No. 1 (see page 11) of this report, the Charter School is located in an education building that serves the Charter School's students in full-time kindergarten and grades 1 through 3. Under the Commonwealth's Reimbursement for Charter School Lease Program, the Charter School applied for and received state funding for the main building for school years ending 2008-09, 2007-08 and 2006-07. The Charter School has been located in this building since it was first chartered in 2001. The other building is owned by Vitalistic Therapeutic Center (Center) and housed part-time kindergarten students. No state reimbursement has been applied for or received for this building.

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

Section 1103(f) of the Ethics Act, 65 Pa. C.S. § 1103(f), states that no public official or public employee or his spouse or child of any business in which the person or his spouse or child is associated shall enter into any contract valued at $500 or more with the governmental body with which the public official or public employee is associated unless the contract has been awarded through an open and public process, including prior public notice and subsequent public disclosure of all proposals considered and contracts awarded.

In such a case, the public official or public employee shall not have any supervisory or overall responsibility for the implementation or administration of the contract. 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.

Section 1104(a) of the Ethics Act provides that each public official/public employee must file a Statement of Finance Interest for the preceding calendar year, each year that he holds the position including the last year of employment and the year following termination of employment.

According to the deed for the main education building, the Center bought the building on September 26, 2001. The Center then leased the building to the Charter School effective October 2001, and then renewed it annually.

The Charter School's founder and prior CEO who resigned May 12, 2010, is also the founder and CEO of the Center, and both entities had the same board of trustees, thus creating a related party landlord and tenant agreement. Although the Center and the Charter School are separate entities, the Center supported the Charter School with start-up costs when the charter was approved.

The Pennsylvania Department of Education's (PDE) eligibility requirements for lease reimbursement require board certification by obtaining the signatures of the Charter School's CEO and board secretary ensuring that the lease costs reported for reimbursement were correct. Because PDE's lease forms were certified by the Charter School's CEO and board secretary, both of whom hold those same titles with the Center for whom Charter School is leasing the building, this created a conflict of interest in reports submitted to PDE for reimbursement.

Related Party Transactions

Our review of the Charter School cash disbursements journal found the husband and son of the current business manager received payments for construction services totaling $14,118 during the 2009-10 school year with no record of board approval. The business manager also served on the board of trustees prior to being employed by the Charter School.

Furthermore, the son of the prior CEO received payments totaling $3,325 during the 2008-09 school year and $500 during the 2007-08 school year with no record of board approval and no documentation to show the purpose of the payments. The prior CEO's son lives out of state and services were to be conducted when he was in town. Also, the daughter-in-law of the prior CEO received a payment of $500 during the 2007-08 school year with no documentation for the purpose of payment. In fact, according to Charter School and Center personnel, the prior CEO's son also received payments from the Center.

Charter School personnel thought he was only to be paid by the Center.

The number of family relationships surrounding these transactions makes it difficult for the public to be assured that their taxpayer dollars were being used in the best interest of the Charter School's students. Moreover, the risk of misuse in this situation is compounded by the fact that the Charter School did not seek approval from the board of trustees, and by the fact that that board of trustees does not appear to have been independent.

Loans for Related Party Operating Expenses

The 2002 Local Auditor's Report (LAR) notes that the Center loaned the Charter School start-up money. The balance on June 30, 2002 was $90,774. The Charter School's 2004 LAR noted the balance was paid in full.

The 2005 LAR noted that the Charter School loaned the Center $82,844 for construction costs to expand the existing building. The amount due to the Charter School from the Center on this loan increased each year, resulting in a total due of $291,979 on June 30, 2008. The reason this loan amount increased was due to the prior CEO arbitrarily transferring money from the Charter School to the Center, thereby increasing the debt owed to the Charter School. For example, our review of the 2006 and 2007 LARs found that at least $90,000 was transferred from Charter School's main account to the Center without any documentation to substantiate these transfers. We also found transfers from the Center to the Charter School's main account totaling $25,000 during this time period. Again, no documentation was available to substantiate the reasons for these transfers.

Then in 2008, the Charter School board president was informed by the prior CEO that she moved money from the Charter School to the Center as needed. The money was transferred over many years. According to the current CEO and financial secretary, the board told the prior CEO to stop this practice. The prior CEO agreed to stop, but according to the financial secretary, she transferred money several more times. The solicitor wanted documentation for the money loaned to the Center and a loan agreement was drawn up to include the $291,979 as a loan to the Center.

Payments and interest were to be collected by the Charter School. It is unknown how the balance was derived. Then the balance decreased to $210,146 on June 30, 2009. The Center was to make $10,000 monthly payments to the Charter School for repayment on the loan. According to the financial secretary, there were only a few payments made on this loan. The financial secretary also indicated that the loan was also to be used to advance the Center’s payroll.

According to a default clause included in the loan agreement, if the borrower fails to make any payment required by the note within 30 days after its due date, or the borrower fails to keep any promise made in the note, the lender may declare that the borrower is in default on the note. Upon default, the borrower must immediately pay the full amount of all unpaid principal, interest, other amounts due on the note and the lenders cost of collection and reasonable attorneys fees.

Based on the numerous transfers the prior CEO made without board approval, the lack of documentation to support these transactions and the prior CEO’s overall autonomy with regard to the operations of both entities, there can be no assurance of the financial transfers or the finality of monthly payments on the loan.

Most importantly, the Charter School is not authorized under the CSL to make loans to the Center. Under the CSL, charter schools are public schools that receive public funds. As such, the Charter School is not allowed to make loans with taxpayer dollars.

Section 1725-A(a)(5) of the PSC [25] states that payments shall be made to the charter school based on average daily membership for the purpose of providing basic education funding and special education funding. Charter schools are part of the Commonwealth’s public school system. Therefore, the money they receive from the state can be characterized as public school funds. Charter schools receive public funding from school districts only for performing legally authorized services. To expend these funds for other than their intended purpose is therefore illegal.

[25] 24 P.S. § 17-1725-A(a)(5).

Also, because the prior CEO was in charge of both entities, the lender and the borrower are the same, making it unlikely that the Charter School would demand restitution during the CEO's term of employment.

Inaccurate Billings for Student Therapy

In July 2010, the Center back-billed the Charter School for three types of therapy for non-partial hospitalization students whose care was not funded by the behavioral services agency that the center worked with. This original billing was retroactive to January 2010 in the amount of $113,000. The new Center executive director, who was also a Charter School board of trustee member employed by the Charter School, stated that the Center had previously billed the Charter School for these therapies, which consisted of conflict resolution/decision making; music/drama; and movement therapy. These therapies were incorporated in the daily instructional activities provided by the classroom teachers. Also, see Finding No. 2 (see page 14) pertaining to certification violations for those with improper certification for special education instruction. The current CEO and new Center director came up with a figure and payments which were transferred from the Charter School to the Center. There was an additional $55,000 added after the original billing. The Charter School was never billed for these therapeutic services in the past. There was an approximate balance of $15,000 due from the Charter School as of September 30, 2010. We asked the current CEO, business manager and financial secretary why this money was not put on the loan from the Charter School. The financial secretary stated the funds are not available and the Center needed the money.

The current CEO stated that the Charter School would deduct future non-partial hospitalization payments from the balance of the Center loan. However, the Center closed in September 2010 so there will be no future payments for non-partial hospitalization. The remaining non-partial hospitalization students were educated at the Charter School until December 2010. The Center never provided a contract for non-partial hospitalization services.

In October 2010, the Center appointed the prior board member, noted above as receiving employment prior to the conclusion of her term, as executive director of the Center. According to the executive director, her job is to conclude financial activities of the Center and ensure all Center activities are finalized properly. According to the Charter School and Center financial secretary, there are very little funds left in the Center's account. The Center's financial secretary also noted that because the Center and Charter School were essentially the same entity the Charter School will be responsible to cover costs, including the director's salary, if they are not met by the non-partial hospitalization funds. The director is also the daughter of the current Charter School principal, and has been involved with the Center for over 20 years.

Since the Center billed the Charter School for prior year student services, these payments essentially constituted from the Charter School to the Center. Again, making loans to the Center was not within the powers granted to the Charter School by the legislature. Moreover, the Charter School did not have the power to divert money for this purpose from its state-subsidized funds.

Section 1725-A(a)(5) of the PSC [26] states that payments shall be made to the charter school based on average daily membership for the purpose of providing basic education funding and special education funding. Charter schools are part of the Commonwealth's public school system. Therefore, the money they receive from the state can be characterized as public school funds. Charter schools receive public funding from school districts only for performing legally authorized services. To expend these funds for other than their intended purpose is therefore illegal.

Lack of Segregation of Duties

As noted throughout this report, the prior CEO controlled all aspects of the Charter School and Center operations. The prior CEO made all decisions, both operational and financial for both entities without oversight. Our review also found that financial transfers were made between the two entities without board approval or oversight. Furthermore, according to a current Charter School official and administrator, the prior CEO received approximately

[26] 24 P.S. § 17-1725-A(a)(5).

$100,000 in payments, in addition to her salary, between the Charter School and the Center. These payments were reportedly identified by a Charter School official through paid checks written by the prior CEO to herself from the Charter School's account without board approval or documentation supporting the reason for payment.

Consequently, the prior CEO's failure to properly identify and separately report financial transactions of the Charter School and the Center has resulted in the Charter School's inability to account for and verify past transactions made by the prior CEO. This lack of segregation of duties by the prior CEO between the Charter School and the Center could result in improper financial transactions or fraudulent activity detrimental to the future viability of the Charter School and the Center.

Non-Compliance with Ethics Filing Requirements

Furthermore, the Ethics Act specifically requires public officials and certain public employees to disclose matters on their Statements of Financial Interests (SFI) that currently or potentially create conflicts of interest with their public duties. When a public official does not make a required disclosure, the public cannot determine whether conflicts of interest exist. This in turn erodes the public's trust. There was a lack of SFIs for calendar years ending December 31, 2006 through 2009. This was reported to the Pennsylvania State Ethics Commission in a separate letter.

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* board should require personnel to:

1. Request that solicitor provide a summary of all the Charter School's legal requirements under the PSC, and the Charter School Law.

2. Seek the advice of its solicitor in regard to the board's responsibility when hiring a former board of trustee member as an employee of the Charter School.

3. Require that the Charter School strengthen controls regarding the review process of the State Ethics Commission financial disclosure statements, to help ensure detection of any potential conflicts of interest.

4. Strengthen controls to help ensure compliance with state laws regarding board of trustee members conducting business with the Charter School, public disclosure of contracts awarded, and abstention from voting on contracts with a potential conflict of interest.

5. Contact its solicitor prior to approving questionable transactions to ensure compliance with PSC.

6. Require authorization from the Charter School board of directors prior to approving unbudgeted expenditures of funds.

7. Establish procedures to ensure adequate separation of duties.

8. Ensure that Statements of Financial Interests forms are filed as required by Section 1104 of the Ethics Act.

The *State Ethics Commission* should:

9. Review actions taken by Charter School and determine if ethical violations occurred.

The *Pennsylvania Department of Education* should:

10. Improve its monitoring and oversight of charter schools.

Management Response

Management stated the following:

Is this "improper," because of the relationship of VTC (Center) and VTCSLV? If so, does the disaggregation of the Boards and Management alleviate this issue? Or, is there another reason that it is improper? VTCS would appreciate guidance on this matter, so as to eliminate any improper behavior. The [Board of Trustees] BOT will consult with Charter School counsel to review regulations and make any changes that may be necessary.

The former CEO ran the [Center], in its iterations, for 37 years. As the Founder, the Board of Trustees (BOT) deferred to her apparent expertise and success. BOT member married to CEO . . . both CEO and BOT member no longer affiliated with Charter School or Center. Relationship between Center and Charter School:

Disaggregation of Boards, management, and finances has begun, is mostly completed, and will be completed by November 19, 2010.

Spending/financial controls have been put in place: BOT will approve all spending. Within the next 60 days, the BOT will take up professional development activities for both the BOT and management to further educate both groups on ethical behavior. PA School Code of Ethics will serve as training resource.

The former CEO devised the "loan" for unknown reasons and presented it to the BOT a fait accompli. The BOT agreed to keep in place what had already been done. However, had the former CEO simply allowed the Center to bill the Charter School for psychological services rendered, instead of improperly using Center funds to defray Charter School expenses, it appears to the BOT (now) that no such financial arrangement would have been necessary. The BOT has contracted with a CPA and Professor of Accounting, to supervise an independent audit of VTCS revenues and expenses, to be conducted by an intern (under her direct supervision). The benefit in this arrangement is that the audit will be conducted at no cost to VTCS.

Additionally, the BOT will meet with out[r] regularly engaged CPA firm on November 2, 2010, to obtain further insight into VTCS finances. This comes after the BOT has taken up an extensive review of the VTCS finances and continues to hold unanswered questions.

Finally, the BOT understands that according to PA School Code, the Charter School may not loan money to any entity.

Auditor Conclusion

We appreciate the Charter School's willingness to address these areas of concern. In terms of management's questions regarding its potentially improper relationship with the Center, the State Ethics Commission is the proper state agency to answer these questions. As a post-audit agency, the Department is prohibited from giving pre-audit advice. We will follow-up on this matter during our next audit.

Finding No. 4

Internal Control Weaknesses and Lack of Documentation

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

Section 1716-A of the Charter School Law, 24 P.S. § 17-1716-A, requires the board of trustees of a charter school to exercise control over budgeting and operating procedures.

Section 1732-A of the Charter School Law, 24 P.S. § 17-1732-A, subjects charter schools to specified provisions of the PSC, including:

Section 518 of the PSC, 24 P.S. § 5-518 requires boards to retain financial records, including financial account books, bills, contracts, invoices, receipts, etc. for a period of not less than six years.

The Government Accountability Office's Standards for Internal Control in the Federal Government (Washington, D.C.: November 1999, pps. 4-5) state that "Internal control . . . serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. . . . Internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories: . . .

- Reliability of financial reporting, including: reports on budget execution, financial statements, and other reports for internal and external use."

Our review of the Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School) procedures and records found deficiencies in the following areas:

- Internal control weaknesses over general operating procedures;
- Internal control weaknesses over financial operating procedures; and
- Insufficient documentation of expenses.

Internal controls are processes designed by management to provide reasonable assurance that the Charter School is in compliance with laws, rules, acceptable accounting procedures, and sound business practices. Strong internal controls provide assurance that data is collected, recorded, and reported.

Maintenance of adequate documentation is necessary to support the relevance and reliability of information reported by the Charter School. Specifically, internal controls supporting financial accounting procedures and adequate documentation over transactions are essential to ensure that revenue and expenditures are accurately recorded, verified, and reported and that budgetary limitations are not exceeded. Moreover, strong internal controls and adequate documentation are critical to providing assurance that the Charter School is operating consistent with its approved charter and that public education dollars are being spent for their intended purpose.

Under the Charter School Law, it is the responsibility of the board of trustees to oversee operations of the Charter School, including budgeting and operating procedures. A lack of internal controls and adequate documentation weakens the board's ability to maintain proper oversight and control over the Charter School's operations. Without proper oversight, the Charter School is susceptible to mismanagement, fraud, and abuse and cannot assure it is efficiently and effectively operating in the best interest of the students and taxpayers.

The Charter School's failure to have strong internal controls over general and financial operating procedures resulted in questionable activities and transactions identified below. Further, the Charter School's failure to maintain adequate documentation of financial transactions resulted in the payment of unknown or unverifiable expenses, as indicated below:

Internal Control Weaknesses Over General Operating Procedures

Previously, only employees of the Vitalistic Therapeutic Center (Center), a related party to the Charter School, received health benefits because Charter School employees were not full-time and worked 30 hours per week. During the 2009-10 school year, the prior chief executive officer (CEO) added 10 hours of overtime to all Charter School employees to make them eligible. According to Charter School and Center personnel, the 10 hours were paid for through the Center, but health benefits were split between the Charter School and the Center. No overtime slips were used to document that the employees worked the additional 10 hours.

Two employees were not eligible for health benefits and had to pay for COBRA until the 10 hours of overtime was added. In January, 2010, the prior CEO reimbursed the employees for their payments to COBRA for the period that they were ineligible. The reimbursements were made from the Charter School's payroll account. According to Charter School personnel, the prior CEO allowed for these individual situations as special agreements.

The Charter School does not participate in the Public School Employees' Retirement System (PSERS). According to Charter School personnel, payments for retirement are to be made to an Employer Paid Retirement Plan. The current CEO stated that they found, except for two employees, no employer contributions have been made on behalf of the employees. No documentation to substantiate this claim was provided to the auditors. Under the Charter School Law, all employees of a charter school shall be enrolled in PSERS unless the Charter School has a retirement program which covers the employees or the employee is currently enrolled in another retirement program.[27]

Also, the board re-employed the prior CEO so she would be eligible for benefits. The last day for the prior CEO was May 12, 2010. In a letter dated June 30, 2010, the board informed the prior CEO that she was removed from payroll because she was no longer providing services to the Charter School. However, in the future, if she supplied the Center and/or Charter School with written confirmation that she was in fact working as per her new job duties (fund raising, applying for grants or special projects), the Charter School will put her on the payroll. The board of trustees in a letter dated June 30, 2010, further stated that her health benefits will continue. The Charter School board asked that the prior CEO and her husband, who was on the Charter School board, promptly apply for the Medicare benefits for which they qualified. The Charter School board asked to be notified in writing when their Medicare benefits take effect so they can contact the Charter School health provider, and remove them from the Charter School's plan.

In a letter dated July 12, 2010, the prior CEO asked the business manager and financial secretary to let her know if the Charter School can have her covered under its health plan. The prior CEO noted that she applied for Social Security and Medicare and expected a response soon regarding her coverage. The prior CEO noted that she will be choosing Medigap coverage and the Charter School will only be responsible for July's monthly payment. The prior CEO stated that at least two prior boards said they would cover her health benefits. The prior CEO stated that because she is receiving benefits, it's the law that she be employed by the Charter School. The prior CEO also noted that she had extended sick pay due and would mark her last month for that. She said she used few sick days over the years.

Internal Control Weaknesses Over Financial Operating Procedures

Our review of Charter School accounts found several transactions between the Charter School and the Center. The Charter School did not have financial control procedures to ensure its transactions were appropriate. There were no

[27] 24 P.S. § 17-1724-A(c).

invoices or any oversight over these transactions. Sometimes, funds were transferred between the two entities via phone creating a difficulty in following funds. Furthermore, the Charter School's current CEO notified us that an independent auditor currently reviewing the charter school's finances discovered $10,000 in revenue not recorded in the Charter School's books of account.

The Charter School's independent auditor notes that monthly financial statements for the Charter School states that management has elected to omit substantially all of the disclosures required by Generally Accepted Accounting Principles (GAAP) due to the Charter School's relationship with the Center and lack of segregation of duties and documentation,. By omitting disclosures pertaining to its relationship with the Center, the authorizing school district, parents, and other stakeholders are not provided with true and accurate information in the Charter School's financial statements that might influence their conclusions about the relationship between the Charter School and the Center and the Charter School's financial position and results of operations.

Our review found a Bank A account apparently started with a $60,000 deposit on October 3, 2008, originating from the Charter School's main account. It appears the account was not reported on public financial statements. All other Charter School accounts were at Bank B. A board member was employed at Bank A since June 21, 2007 and, according to Charter School personnel, served as senior vice president of lending. From November 28, 2008 to February 27, 2009, the account was in the Charter School's name and corresponding address. From February 27, 2009 to April 30, 2010, the account was in the name of the Charter School and the prior CEO. The address on the account was solely that of the prior CEO. From April 30, 2010 to June 30, 2010, the account was returned to the Charter School name and address, but now designated as a future building expansion account with no board approval evident. In June 2010, after we questioned the purpose of the account, we found the account was no longer designated as a building expansion account. Our review of bank statements effective June 30, 2010, found a new Bank A account was opened under name and address of the Charter School, but designated as the main account, thus no longer reserved for capital projects.

In July 2010, $64,485 was transferred from the old Bank A account to an additional Bank A account leaving a remaining balance in the old Bank A account of $60,139. This account was no longer designated as a building expansion account effective June 30, 2010. In September 2010, $40,000 was transferred from the old Bank A account to the Charter School main account to pay the Center retroactively for special education services. The balance of the old Bank A account was $20,233 at September 30, 2010. The new Bank A account balance was $64,485 at July 30, 2010. In August 2010, there were checks totaling $33,490 written for various school related expenses, leaving a balance of $30,995 in the new Bank A account.

Additionally, $100,000 and $40,000 was deposited into the Charter School's old Bank A account on October 22, 2009 and April 19, 2010, respectively. The origin of these deposits is unknown since no additional deposit documentation was available.

Section 1432 of the General Municipal Law[28] establishes that, once general fund surpluses are transferred to the capital reserve fund, districts have no authority to transfer the funds back to the general fund to cover general operating expenses. Although charter schools have not been specifically included as entities that are subject to this provision, it is mandatory that board approval be obtained prior to reserving funds and it is sound business practice to ensure the funds remain reserved for their intended purpose. Furthermore, all Charter School accounts must be kept in the name and address of the Charter School to ensure their transparency and integrity.

There were several automatic overdraft and requested transfers made from the Charter School's main account to the payroll account. These transfers were not just bi-weekly as to cover payroll expenses. According to Charter School personnel, several automatic overdraft transfers were made because no employee balanced the payroll account, so they did not know the outstanding check totals. Additional funds were regularly transferred to payroll because they always fell short since transfers were made based on bank balance, not the reconciled balance.

[28] 53 P.S. § 1432.

We found credit card payments made from the Charter School's main account for $60, $911, and $1,790 during school years 2009-10, 2008-09, and 2007-08, respectively. According to Charter School personnel, the prior CEO would use the credit card card to purchase Charter School supplies. Charter School personnel also said that the financial secretary would give the prior CEO blank checks quarterly or more frequently. Checks were to be used for quarterly taxes or to pay the credit card bill. After payment, the prior CEO either handed cancelled checks back to the financial secretary or directly to the accountant. Also, according to Charter School personnel, no one verified what the checks were written for and invoices or backup documentation was not provided. The current CEO said she contacted the bank and asked for the credit card statements because she believes that the account was under the umbrella of the Charter School, even though it was also in the name of the prior CEO. She said bank personnel told her they were only able to release them to the prior CEO. Charter School personnel said that the prior CEO also used a Center check to pay the credit card bill of $952, after the conclusion of her employment. Although we are auditing the Charter School, the close relationship between the Charter School and the Center made it difficult to separate the two.

During the 2009-10 school year, the state's share of Social Security reimbursement for employees was deposited into the food account. All other years, these state funds were deposited to the Charter School's main account. The prior CEO transferred money to the food account via phone creating difficulty in following the funds.

According to Charter School personnel, on July 3, 2008, there was $5,000 transferred from the Charter School main account to a Center business savings account. Charter School personnel stated that this Center account was closed due to inactivity and the balance was transferred to the Center's main account.

A money market account owned by the Charter School was maintained and transfers in and out of the account were made without board approval. Charter School records for some of these transfers did not specify where these transferred funds were deposited. These unspecified transfers out of the money market account totaled $20,000 during the 2007-08 and 2006-07 school years. There were additional transfers out of the money market totaling $73,000 during the 2005-06 school year with no record of where the funds were deposited.

Insufficient Documentation of Expenses

There is a lack of overall documentation regarding the Charter School expenses. The Charter School does not use purchase orders as part of their financial accounting. Invoices are not maintained for several transactions. Also, as noted throughout this report, there are no invoices for payments or documentation for transfers from the Charter School to the Center.

Two checks were written to a local jewelry store for $649 and $480 in November and December 2009, respectively. Also, a check for $236 was written to a local gift shop in October 2008. No receipts or invoices for any of these transactions were available.

Based on the aforementioned, the Charter School's lack of strong internal controls and maintenance of adequate documentation resulted in questionable business practices, unidentified expenses, and unreliable financial reporting.

These deficiencies also limited the local auditor's review of the Charter School's financial transactions and position and resulted in a financial statement of non-disclosure and non-compliance with generally acceptable accounting practices. Moreover, these deficiencies restricted the scope of our audit of the Charter School.

Consequently, the existence of these weaknesses results in the Charter School's failure to provide accountability for its operations and finances and assurance that state and local taxpayer dollars are being spent efficiently, effectively, and for their intended purpose. Furthermore, the existence of these deficiencies adversely affects the ability of the Charter School and others to prevent or detect fraud, abuse, or mismanagement at this publicly funded Charter School.

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* board should require personnel to:

1. Establish procedures to ensure proper approval and recording of overtime.

2. Only approve health benefits at meetings where specified eligibility requirements are discussed and verified.

3. Establish procedures to ensure the proper reporting and payment of retirement benefits for its employees.

4. Perform an internal audit to ensure all retirement benefits are accurate for current and former employees.

5. Report all of the disclosures required by GAAP.

6. Designate a capital expenditure fund for building projects and only transfer funds needed to use for capital expenditures following board approval.

7. Establish procedures to ensure the proper documentation of deposits and expenses.

8. Reconcile payroll accounts to ensure adequate funds remain for payroll expenses.

9. Maintain proper documentation for all bank transfers.

10. Contact their solicitor to inquire about proceedings to obtain the prior CEOs credit card records so an internal audit of expenses and payments from the Charter School account may be performed.

11. Perform an internal audit of the food account to ensure prior transfers were justified and accounted for.

12. Perform an internal audit of prior transfers between the Charter School and the Center to ensure transfers were justified and accounted for.

13. Establish procedures to ensure thorough financial accounting and adequate procedures over financial transactions.

14. Establish a process to monitor all future Charter School expenditures to ensure that actual expenditures are kept within budgetary limits.

The *Public School Employees' Retirement System* should:

15. Review actions taken by Charter School to determine past and future employee eligibility, employer contributions, and Commonwealth contributions.

The *State Ethics Commission* should:

16. Review actions taken by the Charter School and determine if ethical violations occurred.

The *Pennsylvania Department of Education* should:

17. Require charter and cyber charter schools to maintain sufficient documentation of their financial activities.

Management Response

Management stated the following:

The former CEO ran the [Center], in its iterations for 37 years. As the Founder, the Board of Trustees (BOT) deferred to her apparent expertise and success. As a result, the BOT became weak and ineffectual. In March 2010, the BOT became aware of potentially significant issues and took immediate action to remedy these issues. The BOT removed the CEO from authority, and eventually from any relationship with Vitalistic Therapeutic Charter School of the Lehigh Valley. The BOT has also restructured itself, including removing several long-term BOT members, and disaggregating itself, such that by November 19, 2010, there will no longer be any overlap of BOT members between the Center and the Charter School. The BOT has also revised the Charter School by-laws and recruited new Board members.

The BOT has appointed new management –and Acting CEO—and, a new Principal. The BOT will run an open, competitive search for a permanent CEO within the next 60 days. The BOT executive committee has met, and will continue to meet, weekly with Charter School management to develop and implement new policy, some of which has already been completed, as follows: 1) management has developed and revised P&P, which is being implemented.

New job descriptions have been written and will be used for future employee performance evaluations.

Most critically (and most difficult/time-intensive and expensive), the BOT and management are effecting institutional cultural change.

BOT/Management is not sure where monies came from. Under prior CEO, Center and Charter School funds were co-mingled. The BOT believes that, most likely, the fund balance derived from Center funds improperly supporting Charter School expenses, while simultaneously the Center was not permitted to bill the Charter School for psychological services rendered to Charter School for non- [deleted company name]-paid students. As a result, funds that should have been spent on operating costs accumulated in the reserve fund account. After the former CEO was relieved of duties, the BOT mistakenly believed, in part, based on the prior CEO's comments that the fund balance was for the purposes of construction of a proposed addition to the Charter School. The BOT, therefore labeled the account as such, since the BOT believed this was proper. It quickly came to the attention of the BOT, this was not, in fact, what the funds were purposed, and thus the BOT, in an attempt to be transparent and forthcoming, re-titled the account.

The BOT is currently engaged in disaggregating funds, and is aware of the 8% limit for reserve funds. As previously mentioned, the disaggregation of funds will be completed no later than November 19, 2010.

Finding No. 5

Lack of Adherence to the Vitalistic Therapeutic Charter School of the Lehigh Valley's Governance Structure

Criteria relevant to the finding:

Section 702(b) of the Sunshine Act, 65 Pa.C.S. § 702(b), relating to (Legislative findings and declaration), provides, in part:

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

Section 713 of the Sunshine Act, 65 Pa.C.S. § 713, states:

"A legal challenge under this chapter shall be filed within 30 days from the date of a meeting which is open, or within 30 days from the discovery of any action that occurred at a meeting which was not open at which this chapter was violated, provided that, in the case of a meeting which was not open, no legal challenge may be commenced more than one year from the date of said meeting. The court may enjoin any challenged action until a judicial determination of the legality of the meeting at which the action was adopted is reached. Should the court determine that the meeting did not meet the requirements of this chapter, it may in its discretion find that any or all official action taken at the meeting shall be invalid. Should the court determine that the meeting met the requirements of this chapter; all official action taken at the meeting shall be fully effective."

The approved Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School) renewal effective September 1, 2005, and terminated June 30, 2010, includes an understanding between the board of trustees of the Charter School and the board of school directors of the Allentown City School District (ACSD), its authorizing school district. The following 10 sections of the 41-section agreement were not followed:

1. The board of trustees (BOT) shall operate the Charter School in accordance with the provisions of the Charter School Law, 24 P.S. 17-1701 *et seq.* and any applicable amendments thereto enacted during the term of this charter and any regulations applicable to charter schools. Further, the Charter School shall fully and faithfully comply with the representations and assurances made in its Application for Renewal as finally presented to the ACSD board or as modified via this charter (see also Finding Nos. 1 to 3).

2. All persons elected or appointed as members of the BOT for the Charter School shall serve without pay and shall not engage in any business transaction with, be employed by, or receive any payment for services rendered to the Charter School during said term of this Charter (see also Finding No. 3).

3. The mechanism for the selection of the members of the BOT of the Charter School shall be in accordance with the application submitted by the BOT and approved by the board of school directors as may be amended from time to time by the Charter School's Articles of Incorporation or By-Laws.

4. The chief executive officer (CEO) of the Charter School shall serve as a non-voting member of its BOT; however, that position may have compensation fixed by a majority vote of the BOT of the Charter School.

5. The Charter School BOT shall meet no less than bi-monthly. The Charter School BOT shall generate

complete and accurate minutes of each meeting and shall promptly forward copies of those minutes to the ACSD Board of School Directors each month.

6. The Charter School BOT shall conduct all of its meetings in full compliance with the Sunshine Act, 65 Pa S.C. § 701-§ 716. The BOT shall not allow votes to be cast by proxy in violation of 65 Pa.C.S. § 705 (relating to recording of votes).

7. The Charter School shall report to the ACSD when an ACSD student has accrued 3 or more days of unexcused absences. The Charter School shall provide the board of school directors during each school year, a monthly report regarding attendance, absences, enrollment, or withdrawal of all students who attend the Charter School and reside or live within the ACSD.

8. At least 75 percent of the Charter School's professional staff shall hold appropriate state certification (see also Finding No. 2).

9. As required by § 910(23)(A)(1) of the No Child Left Behind Act, the BOT of the Charter School shall ensure that its school staff complies with certification requirements established by Section 1724-A of the Pennsylvania Charter School Law (relating to School staff)[29] (see also Finding No. 2).

10. The Charter School BOT shall approve all payments to vendors at public meetings.

Lack of Board Oversight

We found that Charter School records, including board meeting minutes, failed to demonstrate that the BOT maintained operational control of the Charter School, including oversight of financial transactions. The Charter School's lack of proper accounting procedures could result in improper expenditures and reporting, and its lack of board oversight of operational activities could lead to misuse of public school resources and a failure to effectively manage public funding.

[29] 24 P.S. § 17-1724-A.

Our review of board minutes for the period July 1, 2006 through July 23, 2010, found a lack of board participation and control in almost every aspect of the Charter School operations. Minutes of board meetings evidenced that the prior CEO conducted daily and monthly activities, including hiring or dismissing teachers, setting salaries, and incurring debt, then informed board members some of the business she conducted. Recordings of meetings evidenced no official votes were taken on Charter School activity. Making decisions for the board and informing them of certain decisions after the fact does not allow the public to witness open discussions and official board actions, which violates the Sunshine Act.

A list of items that should be included in official minutes was provided by the School Board Secretary's Handbook published by the Pennsylvania School Board Secretaries Association, 2005 edition. We found that the charter School's minutes were severely under-documented and did not contain many of the items that should be included in meeting minutes. Examples of items not included in the Charter School's minutes include information such as:

1. The substance of all official actions including roll call votes taken.

2. A list of all persons present at all board meetings, regular and special.

3. Names of citizens who appeared and the subject of their commentary.

4. The board's approval of the minutes of previous meeting.

5. Budget listed in detail.

6. All budgetary transfers with board approval.

7. Monthly treasurer's report, with all Investments.

8. Monthly bills, with an account code number and what was/is to be paid.

9. Depository(ies) designated yearly.

10. Contracts exceeding $100, all transportation contracts, professional and support personnel contracts, insurance policy contracts.

The lack of documentation and recording of votes in the board minutes also made it difficult to determine who was actually serving on the board during a specific period.

Furthermore, we requested a sample of advertisements for board meetings to ensure the public was aware of all meetings. We did find some advertisements, but were unable to obtain documentation to show the meetings for dates requested were advertised. Without this documentation made it impossible to verify the public was afforded the right to attend all meetings for which business was discussed or acted upon as provided in the Pennsylvania Sunshine Act. Failure to hold an open meeting could result in a court action where the determination could be made to find all official action at the meeting invalid.

Finally, failing to cast or record votes for any resolution and failing to hold open meetings violates the Pennsylvania Sunshine Act.

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* board should require personnel to:

1. Establish procedures to ensure the Charter School is operating within its approved governance structure.

2. Review the list of items that should be included in official minutes provided by the School Board Secretary's Handbook to ensure that adequate documentation is maintained to evidence the board has control over the operations of the Charter School.

3. Maintain documentation to demonstrate that the Charter School advertised all public board meetings.

4. Review requirements and implement procedures to ensure the board complies with the Sunshine Act.

The *State Ethics Commission* should:

5. Review actions taken by the Charter School and determine if ethical violations occurred.

The *Pennsylvania Department of Education* should:

6. Make appropriate recommendations to the Governor or and General Assembly on ways to improve the oversight and governance structure of charter and cyber charter schools.

Management Response

Management stated the following:

The former CEO ran the [Center], in its iterations for 37 years. As the Founder, the Board of Trustees (BOT) deferred to her apparent expertise and success. As a result, the BOT became weak and ineffectual. In March 2010, the BOT became aware of potentially significant issues and took immediate action to remedy these issues. The BOT removed the CEO from authority, and eventually from any relationship with Vitalistic Therapeutic Charter School of the Lehigh Valley. The BOT has also restructured itself, including removing several long-term BOT members, and disaggregating itself, such that by November 19, 2010, there will no longer be any overlap of BOT members between the Center and the Charter School. The BOT has also revised the Charter School by-laws and recruited new Board members.

The BOT has appointed new management –and Acting CEO—and, a new Principal. The BOT will run an open, competitive search for a permanent CEO within the next 60 days. The BOT executive committee has met, and will continue to meet, weekly with Charter School management to develop and implement new policy, some of which has already been completed, as follows: 1) management has developed and revised P&P, which is being implemented. New job descriptions have been written and will be used for future employee performance evaluations.

Most critically (and most difficult/time-intensive and expensive), the BOT and management are effecting institutional cultural change.

Finding No. 6

Inadequate Transportation Procedures Regarding Bus Drivers' Qualifications

Criteria relevant to the finding:

Section 111 of the Public School Code, 24 P.S. § 1-111, requires prospective school employees who would have direct contact with children, including independent contractors and their employees, to submit a report of criminal history record information obtained from the Pennsylvania State Police. Section 111 lists convictions for certain criminal offenses that, if indicated on the report to have occurred within the preceding five years, would prohibit the individual from being hired.

Similarly, Section 6355 of the Child Protective Services Law (CPSL), 23 Pa.S.A. § 6355, requires prospective school employees to submit an official clearance statement obtained from the Department of Public Welfare. The CPSL prohibits the hiring of an individual determined by a court to have an indicated or founded report of child abuse.

Additionally, as of April 1, 2007, under Act 114 of 2006 (*see* 24 P.S. § 1-111(a.1)), public and private schools have been required to review federal criminal history record information (CHRI) records for all prospective employees and independent contractors who will have contact with children, and make a determination regarding the fitness of the individual to have contact with children. The Act requires the report to be reviewed in a manner prescribed by the Pennsylvania Department of Education. The review of CHRI reports is required prior to employment, and includes school bus drivers and other employees hired by independent contractors who will have contact with children.

Several different state statutes and regulations establish the minimum required qualifications for school bus drivers. The ultimate purpose of these requirements is to ensure the protection, safety and welfare of the students transported in school buses. We reviewed the following five requirements:

1. possession of a valid driver's license;

2. completion of school bus driver skills and safety training;

3. passing a physical examination;

4. lack of convictions for certain criminal offenses; and

5. official child abuse clearance statement.

The first three requirements were set by regulations issued by the Pennsylvania Department of Transportation. As explained further under criteria, the fourth and fifth requirements were set by the Public School Code of 1949, as amended (Public School Code), and the CPSL, respectively. In addition, when bus drivers change employers, they must obtain new clearances.

We reviewed the personnel records of all 13 full and part-time drivers currently employed by the Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School).

Our review of Act 34 (Criminal History Clearance) found one driver did not have this clearance on file.

Our review of Act 151 (Child Abuse Clearance) found two drivers did not file for the clearance, and two drivers filed two-three years prior to employment with the Charter School.

Our review of Act 114 (Federal Bureau of Investigation Clearance) found three drivers did not file for the clearance, and one driver filed for the clearance and only provided the printed receipt indicating the clearance was performed; however, no results were available.

Our review of physical examination certificates found one driver did not have a current, valid physical examination certificate on file.

Our review of serious crimes beyond five years found that one driver was convicted of a serious crime. This was beyond the five year look back period, and employment is not barred.

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* should:

1. Immediately obtain the missing documentation referred to in our finding in order to ensure that drivers transporting students for the Charter School possess proper qualifications.

2. Ensure that the Charter School's transportation coordinator reviews each driver's qualifications prior to that person transporting students.

3. Maintain files for all Charter School drivers and ensure that the files are up-to-date and complete.

Management Response

Management stated the following:

Files will be reviewed and brought into compliance within eight weeks.

Finding No. 7

Failure to Develop Memorandum of Understanding with Local Law Enforcement

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

Section 13-1303-A(c) of the PSC, as amended November 17, 2010, 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 effective date of this amended provision was **February 15, 2011**. The "office" refers to the Office for Safe Schools within the Pennsylvania Department of Education. The term "biennially" means "an event that occurs every two years."

Prior to enactment of additional Memorandum of Understanding (MOU) requirements on November 7, 2010, all public schools were required to develop a memorandum of understanding with local law enforcement.

Our audit of the Vitalistic Therapeutic Charter School of the Lehigh Valley's (Charter School) records found that the Charter School did not have a signed Memorandum of Understanding (MOU) with the two local police departments 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 law. The Charter School was established as a regional charter, located in Bethlehem, providing education to students in full-time kindergarten classes and grades 1 through 3. The Charter School also provided education to students in part-time kindergarten classes in Allentown. All classes were held in Bethlehem beginning with the 2010-11 school year.

The failure to obtain a signed MOU with all local law enforcement agencies could result in a lack of cooperation, direction, and guidance between Charter School employees and law enforcement agencies if an incident occurs on school grounds, at any school sponsored activity, or 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.

Moreover, recently enacted amendments to the safe schools provisions of the PSC expand upon the requirement to develop a MOU with local law enforcement and necessitate public schools to biennially update and re-execute a MOU and file it with the Pennsylvania Department of Education's Office of Safe Schools on a biennial basis, beginning with the first filing deadline of June 30, 2011.

During our current audit, on May 25, 2010, Charter School personnel and the Bethlehem Police Department signed an MOU.

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* should:

1. Continue to develop a MOU with all police departments having jurisdiction over school property pursuant to the terms prescribed by law.

2. In consultation with its solicitor, review new requirements for a MOU and other school safety areas under the PSC to ensure compliance with amended Safe Schools provisions enacted November 17, 2010.

3. Adopt an official board policy requiring administration to develop a MOU with all police departments having jurisdiction over school property and biennially update and re-execute each MOU and file a copy with the Pennsylvania Department of Education's Office of Safe Schools on a biennial basis, beginning with the first filing deadline of June 30, 2011.

Management Response

Management stated the following:

This issue has been corrected, as of 5/25/10.

Observation

Vitalistic Therapeutic Charter School of the Lehigh Valley Is Operating with a 48 Percent Unreserved-Undesignated General Fund Balance

What is an unreserved-undesignated fund?

"Unreserved-undesignated" represents that portion of the general fund balance that is not legally or otherwise segregated for specific or tentative future use.

Source: Pennsylvania Department of Education, "*Manual of Accounting and Financial Reporting for PA Public Schools - Chart of Accounts*," Revised July 1, 2008.

Why is the unreserved-undesignated general fund balance important?

The general fund balance is a measure of net financial assets and an important aspect in considering a school's financial well being. The unreserved-undesignated portion of the fund balance is particularly important because it represents a cash flow that is readily available for use for unanticipated costs and financial emergencies.

What are the financial requirements of charter schools?

Charter schools must comply with financial reporting requirements like all public school entities in Pennsylvania, including the annual filing of a General Fund Budget, Annual Financial Report and an audit.

Source: Pennsylvania Department of Education, "*Manual of Accounting and Financial Reporting for PA Public Schools –Special School Entities (Chapter 18).*" May, 2005.

As part of our review, we found that the Vitalistic Therapeutic Charter School of the Lehigh Valley (Charter School) had unreserved-undesignated general fund balances of $583,719 and $421,268 for the 2008-09 and 2007-08 school years, respectively. The unreserved-undesignated general fund balance increased from $345,333 at June 30, 2007. Generally, this money can be used for spending at the charter school's discretion.

According to audited financial statements, the Charter School had annual expenditures of $1,221,119 and $1,044,701 for the 2008-09 and 2007-08 school years, respectively. The cumulative unreserved-undesignated general fund balance for the 2008-09 and 2007-08 school years were 48 and 40 percent of its cumulative annual expenditures, respectively. By way of comparison, school districts are prevented under state law from raising taxes if they have a cumulative unreserved-undesignated fund balance of more than 8 to 12 percent of their annual expenditures. These limits help ensure that the Commonwealth spends taxpayer funds responsibly and equitably, and that the school districts return excess payments to the Commonwealth.

Currently, the Charter School Law does not limit charter schools' unreserved-undesignated fund balances, so the Charter School's carry-over balance is permissible. In fact, a large fund balance may be an indicator of financial health and credit worthiness.

However, like all other public school entities, charter schools must be fiscally accountable to the Commonwealth and comply with financial reporting requirements. As such, we have noted the Charter School's large unreserved-undesignated fund balance because our audit found that the Charter School had internal control weaknesses over general operating procedures, internal control weaknesses over financial operating procedures, lack of adherence to the Charter School's governance structure, lack of board oversight, loans for related party operating expenses, related party rental agreements, capital fund transfers, insufficient documentation of expenses, and lack of segregation of duties. These weaknesses were noted in Finding Nos. 3, 4 and 5 of this report.

Without adequate internal controls there is no assurance that financial transactions are recorded in compliance with Generally Accepted Accounting Principles (GAAP). Moreover, we found that Charter School records, including board meeting minutes, failed to demonstrate that the board of trustees maintained operational control of the Charter School, including oversight of financial transactions. The Charter School's lack of proper accounting procedures could result in improper expenditures and reporting, and its lack of board oversight of operational activities could lead to misuse of public school resources and a failure to effectively manage public funding.

Because a charter school's unreserved-undesignated general fund balance includes taxpayer dollars by way of tuition payments received from sending school districts, it is vital to Pennsylvania's public educational system that these discretionary funds are properly monitored and accounted for. The state law's failure to limit charter school fund balances does not negate the charter school's responsibility to comply with generally accepted standards of fiscal management and financial reporting requirements, nor does it minimize the importance of ensuring that taxpayer dollars are spent responsibly and for their intended purpose.

Recommendations

The *Vitalistic Therapeutic Charter School of the Lehigh Valley* should:

1. Implement internal controls to ensure that financial transactions recorded in the accounting records are in compliance with GAAP.

2. Ensure adequate documentation of the components of internal control over financial management.

3. Maintain adequate supporting documentation for all disbursements.

4. Establish policies and procedures to ensure a segregation of duties and prudent financial management.

5. Establish policies and procedures, including Board policies, to ensure that the board of trustees maintains oversight of the Charter School and that decision-making is not in the sole control of an executive director/chief executive officer (CEO) and/or management company.

6. Charter schools must not turn over complete control to the executive director/CEO, which can lead to misuse of school resources and a failure to effectively manage public funding.

Management Response

Management stated the following:

Management stated that this is no longer true. The Board of Trustees (BOT) and Management are not sure where monies came from. Under the prior CEO, Center and Charter School funds were co-mingled. The BOT believes that, most likely, the fund balance derived from Center funds improperly supporting Charter School expenses, while simultaneously the Center was not permitted to bill the Charter School for psychological services rendered to Charter School for non-Magellan-paid students. As a result, funds that should have been spent on operating costs accumulated in the reserve fund account. After the former CEO was relieved of duties, the BOT mistakenly believed, in part, based on the prior CEO's comments that the fund balance was for the purposes of construction of a proposed addition to the Charter School. The BOT, therefore labeled the account as such, since the BOT believed this was proper. It quickly came to the attention of the BOT, this was not, in fact, what the funds were purposed, and thus the BOT, in an attempt to be transparent and forthcoming, re-titled the account.

The BOT is currently engaged in disaggregating funds, and is aware of the 8% limit for reserve funds. As previously mentioned, the disaggregation of funds will be completed no later than November 19, 2010.

Status of Prior Audit Findings and Observations

This is our first audit of the Vitalistic Therapeutic Charter School of the Lehigh Valley. Therefore, there are no prior findings or observations.

JACK WAGNER
AUDITOR GENERAL

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