



**YOUNG SCHOLARS OF CENTRAL
PENNSYLVANIA CHARTER SCHOOL
CENTRE COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT**

MARCH 2013

COMMONWEALTH OF PENNSYLVANIA
EUGENE A. DEPASQUALE - AUDITOR GENERAL
DEPARTMENT OF THE AUDITOR GENERAL



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**EUGENE A. DePASQUALE
AUDITOR GENERAL**

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

Ms. Ann Kusnadi, Board President
Young Scholars of Central Pennsylvania
Charter School
1530 Westerly Parkway
State College, PA 16801

Dear Governor Corbett and Ms. Kusnadi:

We conducted a performance audit of the Young Scholars of Central Pennsylvania Charter School (Charter School) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period July 1, 2008 through November 18, 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, 2010 and June 30, 2009, as they were the most recent reimbursements subject to audit. 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 that the Charter School complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures, except as detailed in two findings noted in this report. A summary of these results is presented in the Executive Summary section of the audit report.

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

Sincerely,

/s/

EUGENE A. DePASQUALE
Auditor General

March 1, 2013

cc: **YOUNG SCHOLARS OF CENTRAL PENNSYLVANIA CHARTER SCHOOL**
Board of Trustees



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Executive Summary

Audit Work

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

Our audit scope covered the period July 1, 2008 through November 18, 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 2009-10 and 2008-09.

Charter School Background

The Charter School, located in Centre County, Pennsylvania, opened in February 2005. It was originally chartered on February 28, 2005, for a period of five years by the State College Area School District. The Charter School's mission states: "[The Charter School] focuses on two student constituencies: those native speakers of American English who wish to engage a curriculum which fosters a global perspective and promotes appreciation and understanding of world regions, cultures, and global issues, and those whose native language is not American English, during their transitions into American educational system and culture." During the 2009-10 school year, the Charter School provided educational services to 177 pupils from 5 sending school districts through the employment of 20 teachers, 11 full-time and

part-time support personnel, and 3 administrators. The Charter School received approximately \$65 thousand in tuition payments from school districts required to pay for their students attending the Charter School in 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. However, as noted below, we identified two compliance-related matters reported as findings.

Finding No. 1: Certification Deficiencies and Failure to Comply with the 75 Percent Certified Staff Requirements of the Charter School Law. Our audit of professional employees' certificates and assignments for the 2010-11, 2009-10, and 2008-09 school year found three professional employees were assigned to administrative positions without proper certification. The Bureau of School

Leadership and Teacher Quality confirmed the professional employees were not properly certified. Additionally, our audit found that only 67 percent of professional staff was certified during the 2008-09 school year (see page 10).

Finding No. 2: Possible Ethics Act Violations. Our audit of the Charter School found four potential violations of the Public Official and Employee Ethics Act (see page 15).

Status of Prior Audit Findings and Observations. This was 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 based on its own budgeted costs, minus specified

⁸ 24 P.S. § 17-1720-A.

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

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

¹¹ 24 P.S. § 17-1745-A(d).

¹² *Id.* § 17-1745-A(f)(4).

¹³ 24 P.S. § 17-1741-A(a)(3).

¹⁴ 24 P.S. § 17-1750-A(e).

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

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

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

¹⁵ See 24 P.S. § 17-1725-A(a)(2).

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

¹⁷ See 24 P.S. § 17-1725-A(a)(5).

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

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

Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

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

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.

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

Our audit covered the period July 1, 2008 through November 18, 2010.

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

For the purposes of our audit work and to be consistent with 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.

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

- ✓ Was the Charter School in overall compliance with the Public School Code of 1949²⁰ (PSC) and the Charter School Law²¹ (Law)?
- ✓ Did the Charter School have policies and procedures regarding the requirements to maintain student health records and perform required health services, and keep accurate documentation supporting its annual health services report filed with the Department of Health to receive state reimbursement?

²⁰ 24 P.S. § 1-101 *et seq.*

²¹ 24 P.S. § 17-1701-A *et seq.*

- ✓ Did the Charter School receive state reimbursement for its building lease under the Charter School Lease Reimbursement Program, was its lease agreement approved by its board of trustees, and did its lease process comply with the provisions of the Public Official and Employee Ethics Act?²²
- ✓ Did the Charter School comply with the open enrollment and lottery provisions of the Law?
- ✓ Does the Charter School provide the services required for its special education students through outside agencies and/or through properly certified professional staff with the required instructional hours and/or training?
- ✓ Did the Charter School board of trustees and administrators, and the chartering school board members comply with the PSC, the Public Official and Employee Ethics Act, and the Sunshine Act?
- ✓ Were at least 75 percent of the Charter School's teachers properly certified and did all of its noncertified teachers meet the "highly qualified teacher" requirements?
- ✓ Did the Charter School require its noncertified professional employees to provide evidence that they are at least 18 years of age, a U.S. citizen, and certified by a licensed Pennsylvania physician to be neither mentally nor physically disqualified from successful performance of the duties of a professional employee of the Charter School?
- ✓ Did the Charter School accurately report its membership numbers to PDE and were its average daily membership and tuition billings accurate?
- ✓ Did the Charter School comply with the Law's compulsory attendance provisions and, if not, did the Charter School remove days in excess of ten consecutive unexcused absences from the Charter

²² 65 Pa.C.S. § 1101 *et seq.*

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

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

Findings and Observations

Finding No. 1

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

Charter School Law and Pennsylvania regulations relevant to the finding:

Section 17-1724-A(a) of the CSL, 24 P.S. § 17-1724-A(a), requires that “. . . [A]t least seventy-five per centum of the professional staff members of a charter school shall hold appropriate State certification.”

Section 1732-A(a) of the CSL, 24 P.S. § 17-1732-A(a), provides that charter schools shall be subject to Section 1109 of the PSC, 24 P.S. § 11-1109, which provides in part:

“Every principal . . . who devotes one-half or more of his time to supervision and administration, shall be properly certified by the Department of Public Instruction in accordance with such standards as the State Board of Education may establish.”

Our audit of professional employees’ certificates and assignments for the audit period July 1, 2008 through November 18, 2010 was performed to determine compliance with the Charter School Law (CSL), the Public School Code (PSC), Chapter 711 of the Pennsylvania Code (Chapter 711), and the Pennsylvania Department of Education’s (PDE) Bureau of School Leadership and Teacher Quality’s (BSLTQ) Certification and Staffing Policies and Guidelines (CSPG). Our audit found that the Young Scholars of Central Pennsylvania Charter School (Charter School) did not meet the requirement under the CSL that at least 75 percent of its professional staff hold appropriate state certification during the 2008-09 school year. Additionally, we found that three professional employees were assigned to administrative positions without proper certification.

Non-compliance with Seventy-Five Percent Certification 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 state certified in their area of administrative responsibility or subject area in which they teach. Instead, 67 percent of the Charter School’s professional staff had state certification during the 2008-09 school year.

Non-compliance with Principal Certification Requirement

Our audit found that three individuals were employed by the Charter School to perform the duties of a principal without holding the proper state certification or emergency permit as required by the CSL and the PSC at some time during the audit period. Specifically, one individual was not properly certified in 2008-09, another individual was not properly certified in 2009-10 and 2010-11, and yet another individual was not properly certified in 2008-09, 2009-10, and 2010-11. Moreover, all principals must hold

appropriate state certification and cannot be part of the 25 percent noncertified professional staff allowed at charter and cyber charter schools.

Certification Determination from PDE's BSLTQ

Certification deficiencies are not determined by the Department of the Auditor General. Information pertaining to the certification deficiencies was submitted to PDE's BSLTQ for review. In a letter dated January 14, 2011, BSLTQ confirmed the professional employees were not properly certified.

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.

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

Recommendations

The Young Scholars of Central Pennsylvania Charter School should require:

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 and PSC.
2. Individuals performing the duties reserved to a principal's certification hold appropriate state certification or cease from performing those duties.
3. Administrative personnel be provided with sufficient training in order to understand and manage certification

requirements as defined by the CSL, PSC, and PDE's CSPGs.

As the authorizing school district, the *State College Area School District* should:

4. Follow-up with the Charter School regarding these individuals' future administrative 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. Review the charter of the Charter School and determine whether the Charter School is violating certification terms of its approved charter with the district.

Management Response

Auditor's note: The Charter School's responses identified subsequent documents provided to the auditors throughout their management responses, which are included in the confidential audit work papers but are not attached to this public audit report.

Management stated the following:

During the December 7, 2010 meeting, the auditors presented the Charter School with a finding that included a title, "Possible Certification Deficiencies," and a table that included a professional staff listing for the 2008-09 school year containing columns for "certified" and "non-certified" with what was presumed to be average weekly hours in each entry. The table appeared to conclude that, during the 2008-09 school year, 67.42% of the Charter School's professional staff were certified leaving 32.58% as uncertified. Following the above-referenced December 7, 2010 meeting, the Charter School's [Chief Executive Officer (CEO)] CEO met with the auditor responsible for the finding and after resolving certain factual inaccuracies in the table, the auditor agreed to the figures contained in Attachment A [omitted] showing 71.56% certified professional staff for the 2008-09 school year.

The percentage of certified staff of the 2008-09 school year appeared to be calculated by totaling the actual hours worked by certified part-time professional staff and the

hours worked by certified full-time professional staff based on the assumption that such staff worked forty hours a week. That number was then divided into the sum of actual hours worked by uncertified part-time professional staff and the hours worked by uncertified full-time professional staff, again, based on the assumption that such staff worked forty hours a week. This formula is flawed if for no other reason that it underestimates actual hours worked by the Charter School's full-time professional staff. The Charter School estimates that its professional staff worked approximately fifty hours per week in 2008-09. If the actual hours worked of full-time professional staff were used in the Auditor General's calculation rather an assumption of forty hours, the Charter School would have a certification rate for 2008-09 of 75.41%. See Attachment B [omitted].

While it is assumed that the alleged certification deficiency is based on the auditors' conclusion that during the 2008-09 school year, less than 75% of the Charter School's professional staff were appropriately certified. However, at the December 7, 2010 meeting, it was further explained to the Charter School that the auditors believed that each member of the professional staff serving in an administrative capacity be required to have appropriate certification and that [the] Math teacher/Dean of Academics, did not have such certification. The Charter School disagrees with the auditors' calculations as most recently presented as well as any assertion that all administrators are required by law to maintain certification.

As this matter relates to [the Math teacher/Dean of Academics], the Charter School acknowledges that he is a member of its professional staff and thus counts toward its certification requirements. However, while certain members of the professional staff must be certified (e.g. special education staff), the dean of academics is not among them. Regardless of the Auditor General's ultimate conclusion with regard to this finding, the Charter School is proud to report that, at the time of this report, it has a certification rate among its professional staff of approximately ninety percent (90%) as evidenced by the attached chart. See Attachment C [omitted].

Auditor Conclusion

The hours used to calculate the percentage of certified staff were given to the auditor by the Charter School

administration. As far as the Charter School's assertion that its math teacher/dean of academics was not required to hold appropriate state certification, the BSLTQ has determined the professional employees cited in this finding were not properly certified as required, including the math teacher/dean of academics, because this individual was found to be performing the duties of a school principal, thus requiring certification. Consequently, the finding stands as presented.

Finding No. 2

Possible Ethics Act Violations

Relevant statutory provisions and other related criteria:

Section 1105(b) of the Public Official and Employee Ethics Act (Ethics Act) states:

“The statement shall include the following information for the prior calendar year with regard to the person required to file the statement . . .

(8) Any office, directorship or employment of any nature whatsoever in any business entity . . .

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

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

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

The General Assembly declared the following when enacting the Ethics Act: “[P]ublic office is **a public trust** and that any effort to realize personal financial gain through public office other than compensation provided by law is a violation of that trust. . . .” (see 65 Pa.C.S. § 1101.1(a)).

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

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

Our audit of the Young Scholars of Central Pennsylvania Charter School (Charter School) found potential conflicts of interest and violations of the Public Official and Employee Ethics Act (Ethics Act) resulting from transactions between the Charter School and the related nonprofit organization (nonprofit organization/landlord) it was renting its building from. The Charter School and its landlord are related party entities by way of sharing common officers. Consequently, the same individuals were involved in the approval, administration, and oversight of the lease agreement between these related parties. Moreover, these relationships may result in the Charter School being ineligible to receive state lease reimbursement for its building.

Common Officers

First, our review of the Charter School’s lease agreement found the Charter School leases the school building from a nonprofit corporation in which two members of the Charter School’s board of trustees also served as president and vice-president of the nonprofit entity acting as the landlord. According to the nonprofit corporation’s Internal Revenue Service (IRS) Form 990 Tax Filing for the years 2007 and 2008, the nonprofit corporation was created for the **sole purpose** of renting a building to the Charter School.

Second, upon our review of the Charter School board of trustees members’ Statement of Financial Interests (SFI) forms for 2008 and 2009, it was determined that two board members, who are also listed as president and vice-president of the nonprofit corporation, did not file their relationship with the nonprofit corporation on their SFI. Board members are required to fully disclose all business interests on their SFI.

Third, our review of the Charter School’s PDE-418 lease reimbursement forms for the 2009-10 school year and the nonprofit corporation’s IRS Form 990 from 2007 and 2008 found that the Charter School’s board

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

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

Section 1103(f) of the Ethics Act, 65 Pa.C.S. § 1303(f), provides that no public official or public employee or his spouse or child of any business in which the person or his spouse or child is associated shall enter into any contract valued at \$500 or more with the governmental body with which the public official or public employee is associated unless the contract has been awarded through an open and public process, including prior public notice and subsequent public disclosure of all proposals considered and contracts awarded. In such a case, the public official or public employee shall not have any supervisory or overall responsibility for the implementation or administration of the contract.

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.

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

secretary was originally listed as the president of the nonprofit corporation.

Lastly, the founder of the Charter School was originally employed by the Charter School as director on March 25, 2005, and his job title changed to chief executive officer (CEO) on June 23, 2006. On August 31, 2009, upon completion of his 2008-09 contract, the individual left his position as CEO. The individual was also serving as a member of the board of trustees beginning March 25, 2005, and as of November 18, 2010, was still serving as a member of the board of trustees.

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

Since the same individuals hold key roles with both the Charter School and the nonprofit corporation for which the Charter School is renting its building, there are potential conflicts of interest and violations of Sections 1102 and 1103 of the Ethics Act related to the landlord/tenant agreement and its transactions. Moreover, these potential conflicts of interest and related party transactions could result in the ineligibility of the Charter School to receive state rental reimbursement for its building leased from a related entity.

Information pertaining to the potential conflicts of interest and missing information on the Charter School board of trustees members’ SFIs will be forwarded to the State Ethics Commission for its review and determination. Information related to the common officers involved in the lease agreement will be

Related parties are defined by accounting principles to include:

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

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

forwarded to the Pennsylvania Department of Education’s Division of School Facilities to review the information in this audit report in comparison to the Charter School’s lease reimbursement and to determine whether the Charter School is eligible to receive state lease reimbursement.

Recommendations

The Young Scholars of Central Pennsylvania Charter School should:

1. Require all board of trustees’ members to list all business interests on their SFI form.
2. Request its solicitor provide a summary of all the board of trustees’ member’s legal requirements under the Ethics Act.
3. Ask its solicitor to review the terms of its lease agreement, as well as possible related party agreements, prior to approval.

The State Ethics Commission should:

4. Determine if the Charter School is in violation of the Ethics Act.

The Pennsylvania Department of Education should:

5. Determine whether the Charter School is eligible to receive the state lease reimbursement.

Management Response

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

Management stated the following:

The Auditor General's finding with regard to possible Ethics Act violations referenced three provisions of law. First, the finding referenced 1714-A (a) of the Charter School Law and stated that the subsection "requires the board of trustees to maintain control over the general operations of the charter school, and not the applicant, founder or a management company." Section 1714-A(a) states:

- (a) A charter school established under this act is a body corporate and shall have all powers necessary or desirable for carrying out its charter, including, but not limited to, the power to:
 - (1) Adopt a name and corporate seal; however, any name selected shall include the words "charter school."
 - (2) Sue and be sued, but only to the same extent and upon the same condition that political subdivisions and local agencies can be sued.
 - (3) Acquire real property from public or private sources by purchase, lease, lease with an option to purchase or gift for use as a charter school facility.
 - (4) Receive and disburse funds for charter school purposes only.
 - (5) Make contracts and leases for the procurement of services, equipment and supplies.
 - (6) Incur temporary debts in anticipation of the receipt of funds.
 - (6.1) Incur debt for the construction of school facilities.
 - (7) Solicit and accept any gifts or grants for charter school purposes.

24 P.S. § 17-1714-A (a). While the above-referenced statute fails to reference any requirement of the board to maintain control over school operations (powers of the board of trustees are set forth in 24 P.S. 17-1716-A), in no case has the Charter School ceded control of such

operations to individuals or entities acting in the capacity as “the applicant, founder or management company.” As the finding does accurately report, one of the Charter School’s founders served both as Director of the Charter School and then as Chief Executive Officer until August 31, 2009. During such time, [he] also served, and continues to serve, as a Board member of the Charter School. [His] service as a Board member is not prohibited by any applicable law including but not limited to the Nonprofit Corporation Law of 1988, as amended, the Public Official and Employee Ethics Act, or the Charter School’s bylaws. Note, however, to the extent that such service does present a concern for the Auditor General, the Charter School’s chief executive officer no longer serves on the Board. While it is unclear as to what this portion of the finding seeks to address, the Charter School rejects any assertion that the Board is not authorized to delegate certain powers relating to operations to its chief executive officer which, by definition, is “an individual appointed by the board of trustees to oversee and manage the operation of the charter school.” See 24 P.S. 17-1703-A.

Second, the finding references Section 1103(a) of the Ethics Act which states: “no public official or public employee shall engage in conduct that constitutes a conflict of interest.” While the finding sets forth a litany of facts regarding two Board members’ involvement, in 2007 and 2008, on the board of [the nonprofit corporation], who leases property to the Charter School and whose stated objective is “to provide access to the educational services and products that enable educational institutions to offer their students with the best quality education possible,” there are no facts that establish a conflict of interest. The mere membership on the boards of two entities that have a relationship with one another does not constitute a “conflict of interest” which is defined under the Ethics Act 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. The term does not include an action having a de minimis economic impact or which affects to the same degree a class consisting of the

general public or a subclass consisting of an industry, occupation or other group which includes the public official or public employee, a member of his immediate family or a business with which he or a member of his immediate family is associated.

65 Pa.C.S.A. § 1102

Moreover, case law at the time suggested that a conflict of interest could never be caused by membership in on nonprofit board. Rendell v. Pennsylvania State Ethics Com’n, 961 A.2d 209 (Pa.Cmwlth. 2008) rev’d 598 Pa. 557 (Pa. 2009). In Rendell, the Governor, Secretary of the Department of Conservation and Natural Resources, and Secretary of the Department of Environmental Protection sought a declaratory judgment that neither secretary would have a conflict of interest in administering grants to non-profit companies in which their respective spouses had an interest under the Ethics Act. On October 3, 2008, the court held that nonprofit organizations were not “businesses” under the Ethics Act and, thus, the secretaries’ participation in the grant-making processes that awarded funds to the nonprofits was not a violation of the Ethics Act’s prohibition against conflicts of interest. Id. at 216. While the Commonwealth Court’s ruling was ultimately reversed by Pennsylvania’s Supreme Court, the Statement of Financial Interests at issue here were all filed with the Charter School prior to the Supreme Court’s ruling. In addition to conducting Board training on the Ethics Act, the Board’s solicitor has specifically informed the Board of the Supreme Court’s November 30, 2009 ruling in Rendell and has instructed the board of its obligation to act in accordance with that ruling.

Finally, as it relates to this finding, the Auditor General noted that the two Board members discussed above failed to disclose their relationship with [the nonprofit corporation] on their 2008 and 2009 Statements of Financial Interest. The Auditor General alleges this to be a violation of Section 1105(b) of the Ethics Act which reads, “the statement shall include the following information for the prior calendar year with regard to the person required to file the statement . . . (8) [a]ny office, directorship or employment of any nature whatsoever in any business entity.” 65 Pa.C.S.A. § 1105. Note, however, that Statements of Financial Interest were filed for those two

years by the Board members in question prior to the Supreme Court's ruling in Rendell that a nonprofit corporation met the definition of a business under the Ethics Act. Nonetheless, since being alerted to the Auditor General's finding, the two Board members have submitted amended Statements of Financial Interest to the Charter School for 2007 and 2008 reflecting their membership on the board of [the nonprofit corporation]. Copies are also enclosed for your review as Attachment D [omitted].

In conclusion, the Charter School appreciates the opportunity the Auditor General has provided it to respond to the above-referenced findings. The Board also wishes to thank the Auditor General for its thorough review of the Charter School's operations. Despite the Charter School's many successes, we can and will always endeavor to do better.

Auditor Conclusion

We agree with management that Section 17-1716-A sets forth the powers of the board of trustees, and that Section 17-1714-A(a) was inadvertently provided to the Charter School at the conclusion of our audit. However, the finding is not based on the lack of board control, but rather potential conflicts of interest between the Charter School and the related nonprofit entity acting as its landlord.

Second, we disagree with management's assertion that there are no facts that establish a conflict of interest. While the common officers alone do not create a conflict, the facts suggest that a circular leasing arrangement was created between these related parties, which ultimately led to financial benefits for the Charter School and the nonprofit entity acting as its landlord. Specifically, the Charter School applied for state lease reimbursement as a result of the leasing arrangement. Moreover, the nonprofit corporation was created for the **sole purpose** of renting a building to the Charter School, and these two entities had common officers approving and administering the lease, which are additional factors suggesting potential conflicts of interest. Furthermore, although there is no explicit prohibition on a CEO simultaneously serving on the Charter School board of trustees in the Nonprofit Corporation Law or the Ethics Act, our Department highly discourages this practice. The main reasons are that it contradicts the purpose of having the CEO report to the

board as his/her employer and be accountable to the board, thereby creating real or perceived conflicts. This does not mean that the CEO should not participate actively on board matters — but as an employee, not as a board member.

Finally, we reassert the CSL’s requirement that all public officials, including the board of trustees, must file a SFI disclosing all business relationships. We note that *Rendell v. Pennsylvania State Ethics Comm’n*, 603 Pa. 292, 983 A.2d 708 (2009),²⁴ which held, in part, that the Ethics Act’s definition of “business” includes non-profit entities, as well as the prior Pennsylvania Supreme Court case you cited,²⁵ have **absolutely** no relevance to whether a charter school board member must file a SFI. The reason is that Section 1715-A(11) of the Charter School Law states that “Trustees of a charter school shall be public officials.” (*See* 24 P.S. § 17-1715-A) Therefore, the board members are fully subject to all of the provisions of the Ethics Act, including the disclosure of conflicts of interest and their financial interests. Financial disclosure is vital because it helps assure taxpayers that their public education dollars at charter schools are being spent by officials who are impartial, honest, and free of financial conflicts.

We are encouraged that the Charter School considered our recommendations, and that the two board members filed amended returns for 2007 and 2008 noting their relationship with the related nonprofit entity/landlord. As previously noted, this finding will be forwarded to the State Ethics Commission for review and final determination regarding potential violations of the Ethics Act.

²⁴ This case was decided on November 30, 2009.

²⁵ 598 Pa. 557, 958 A.2d 1044, decided October 16, 2008.

Status of Prior Audit Findings and Observations

This was our first audit of the Young Scholars of Central Pennsylvania Charter School. Therefore, there are no prior findings or observations.



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