PENNSYLVANIA DEPARTMENT OF THE AUDITOR GENERAL

AUDITOR GENERAL, JACK WAGNER

A Performance Audit:

SCHOOL DISTRICT OF THE CITY OF ALLENTOWN

ALTERED SUPERINTENDENT EMPLOYMENT CONTRACT

MAY 2012

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

Mr. Robert E. Smith, Jr., Board President
School District of the City of Allentown
31 South Penn Street
P.O. Box 328
Allentown, Pennsylvania 18105

Dear Governor Corbett and Mr. Smith:

The enclosed report contains the results of the Department of the Auditor General's (Department) performance audit of the School District of the City of Allentown's (also referred to as District or Allentown) altered superintendent employment contract. This performance audit covered the period August 18, 2011 through November 21, 2011, and was conducted pursuant to 72 P.S. § 403 and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. This performance audit is separate and distinct from the District's cyclical performance audits, which the Department conducts approximately every two years. The District's last cyclical performance audit was released on December 27, 2010.

Our audit found that the District complied, in all significant respects, with the applicable state laws, contracts, and administrative procedures related to our objectives, except as detailed in the two findings noted in this report. A synopsis of our results is presented in the Executive Summary section of this audit report.

The District has argued that by entering into an Agreement to Alter Employment (Agreement) with its former Superintendent it will achieve "savings over the life of [his] contract." However, the bottom line is that this Agreement cost the taxpayers of the City of Allentown, and the entire Commonwealth of Pennsylvania, nearly $300,000. Moreover, the taxpayers are receiving minimal services in exchange for their investment. Specifically, the former Superintendent, now Director of Strategic Initiatives, cannot be required to report to work for more than 10 days out of the entire year he is to remain a District employee. He will essentially be receiving his full salary for a position that appears to be significantly less than even half-time. We believe that this was an inappropriate use of public funds. Furthermore, while it is possible that the District may save money in the future, any such savings cannot truly be calculated because they are dependent on whatever contract the District's Board of Trustees (Board) enters into with a permanent superintendent. What is certain is that the Board did not serve the best interests of the taxpayers by providing the former Superintendent with such a lucrative Agreement.

While we were finalizing our audit report, the Allentown's former Superintendent was named Superintendent of the Johnstown Area School District (Johnstown), a little more than seven months after the Allentown altered his employment agreement. Media reports indicated that the Johnstown school board entered into a three-year contract with Allentown's former Superintendent, beginning July 1, 2012, for a starting annual salary of $145,000 plus 3.5 percent raises over the remaining two years.[1] However, his tenure at Johnstown will begin prior to that date because he will fill in for the current Johnstown superintendent who remains on a medical sabbatical. During that time, Allentown's former Superintendent will earn what his ailing predecessor at Johnstown would have received during the remaining months of her contract. The current acting superintendent at Johnstown will return to his former position as Assistant Superintendent.[2]

The Allentown administration has asserted that the former Superintendent's acceptance of the position at Johnstown will save Allentown at least $45,000 because it will no longer have to pay him to be the District's Director of Strategic Initiatives. We are pleased that the taxpayers will not have to continue to pay the former Superintendent's $195,000 salary for an additional five months. However, we are surprised by some of the statements made by Allentown's current Board President in reference to the original Agreement. Specifically, he has made statements indicating that Allentown's Board "was forced to give its [former Superintendent] the job [as the Director of Strategic Initiatives] due to a buyout clause in his contract."[3] In addition, Allentown's Board President stated that he wanted to "thank the Johnstown Board for taking [the former Superintendent] off our payroll," and that he would keep them [the Johnstown Board] in his prayers "so [the former Superintendent] treats them a lot better than he treated us [Allentown Board]."[4] Likewise, another current Allentown board member stated that the former Superintendent "did not understand how deeply the city's poverty affects schools," and that he "could not handle the 'nitty-gritty' details of managing the state's third largest school district."[5]

These Allentown School Board members' statements contradict what the District's administration communicated to us during the course of our audit. At that time, the Allentown's administration continually indicated that the former Superintendent's contract was not altered because of performance issues, but rather in order to save the District money. Specifically, the Agreement itself states that the District altered the former Superintendent's contract because it received significantly decreased state funding as a result of the Commonwealth's 2011–12 budget, which led to "drastically reduced faculty and staff and a remaining need to undertake measures to realize additional savings to the [District] budget." Moreover, the District's

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[1] Esack, Steve, "Ex-Allentown school's Chief Zahorchak named Johnstown superintendent," *Allentown Morning Call,* March 8, 2012, http://www.mcall/com/news/local/allentown/mc-allentown-zahorchak-johnstown - 20120308,0,4495607.story, accessed March 23,2012.
[2] Sojak, Frank, "Zahorchak hired as Johnstown Superintendent," *The Tribune Democrat,* March 6, 2012, http://tribune-democrat.com/local/x1511869211/Zahorchak-hired-as-Johnstown-superintendent, accessed March 23, 2012.
[3] Miller, Rudy, "Gerald Zahorchak to become Greater Johnstown superintendent report says," *The Express-Times,* March 8, 2012, http://www.lehighvalleylive.com/allentown/index.ssf/2012/03/report_gerald_zahorchak_to_bec.html, accessed March 23, 2012.
[4] Esack, Steve
[5] Ibid.

response to our first finding continues this same line of argument stating that "The District maintains that the Altered Agreement results in cost savings of at least $700,000 over the four (4) remaining years of the Superintendent's original contract. (See Finding No. 1, page 7)" Therefore, it would appear that the District was not at all candid with regard to why the Board spent nearly $300,000 of taxpayer dollars to alter the former Superintendent's contract.

Even more concerning, and contradictory, is the Allentown Board President's statement that the former Superintendent had "no real duties," as the Director of Strategic Initiatives. Not only is this statement troublesome because of the expectation that as stewards of taxpayers' hard-earned dollars, a school board would not agree to invest that money in a fruitless endeavor, but also because of the statement in management's response to our first finding, which indicates that "A transitional year of employment as Director of Strategic Initiatives was vital to the successful completion of the major strategic incentives and School District reorganization begun by the Superintendent in his year as Superintendent." Once again, it would appear that the District was not completely open about why it entered into the altered agreement with the former Superintendent, and truly did not act in the taxpayers' and the students' best interest.

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

Sincerely,

/s/
JACK WAGNER
Auditor General

May 22, 2012

cc: **SCHOOL DISTRICT OF THE CITY OF ALLENTOWN** Board Members

JACK WAGNER

AUDITOR GENERAL

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AUDITOR GENERAL

Executive Summary

Audit Work

In August 2011, the Department of the Auditor General began immediately auditing instances where Local Education Agencies (LEA) prematurely ended or altered the employment contracts of their chief administrators. These performance audits do not replace the regular cyclical performance audits that the Department conducts of all Commonwealth LEAs. Instead, the Department performs audits involving chief administrators in addition to each LEA's regular review. The Department will still continue to audit the early separations of all other contracted administrators as part of each LEA's regular cyclical performance audit.

The Department made this policy change because LEAs that prematurely end or alter their chief administrators' contracts frequently spend large sums of taxpayer dollars without receiving any services in return. In addition, these arrangements often involve confidentiality clauses that prevent the public from learning why the LEA undertook such an action. Conducting a performance audit of these agreements as soon as the LEAs execute them helps to ensure that taxpayers have more information about these arrangements and that these facts are available as quickly as possible.

LEA Background

The School District of the City of Allentown (District) encompasses approximately 19 square miles. According to 2000 federal census data, it serves a resident population of 106,630. According to District officials, in school year 2007-08 the District provided basic educational services to 18,234 pupils through the employment of 1,345 teachers, 880 full-time and part-time support personnel, and 71 administrators. Lastly, the District received more than $91 million in state funding in school year 2007-08.

Audit Conclusion and Results

Our performance audit found that the District complied, in all significant respects, with the applicable state laws, contracts, and administrative procedures related to our objectives (see pages 5-6). However, as noted below, we identified two matters, which we believe deserve further attention:

Finding No. 1: District Entered Into an Altered Employment Agreement with its Superintendent Worth At Least $267,000. On August 18, 2011, the Board of Directors (Board) for the School District of the City of Allentown (District) voted to enter into an Agreement to Alter Employment (Altered Agreement) with its former Superintendent. This agreement ended the former Superintendent's original five-year contract at the beginning of the second year of his tenure and rehired him as the Director of Strategic Initiatives for one year. The Altered Agreement stated that the former Superintendent's annual salary of $195,000 would remain the same, as would many of his benefits, including a tax deferred annuity worth $17,000. In addition, the Altered Agreement provided the former Superintendent with a lump sum payment of $55,000. Therefore, under the Altered Agreement, the former Superintendent was entitled to benefits worth at least $267,000. The term of this Altered Agreement was one year, from August 18, 2011 to August 18, 2012 (see page 7).

Finding No. 2: Possible Improper Reporting of Retirement Wages and Service Years. Our audit of the District's former Superintendent's employment contract and payroll records found that the District may have improperly reported ineligible retirement wages to the Public School Employees' Retirement System (PSERS) for the 2011-12 school year (see page 18).

Audit Recommendations

Finding No. 1:

The *School District of the City of Allentown's* Board should:

1. Enter into employment contracts with prospective superintendents at the three-year minimum term permitted by state law, in order to limit potential financial liability by the District and its taxpayers.

2. Ensure that future employment contracts with prospective administrators contain adequate termination provisions sufficient to protect the interests of the District and its taxpayers in the event that the employment ends prematurely for any reason.

3. Provide as much information as possible to the taxpayers of the District explaining the reasons for entering into the Altered Agreement with the former Superintendent and justifying the District's expenditure of public funds for this purpose.

4. Work with successors to the Superintendent to include in their current and future employment contracts provisions that address the compensation and benefits payable to, or on behalf of, the said administrators in the event of a premature termination of their contracts.

5. Obtain detailed documentation that illustrates the services and deliverables provided by the former Superintendent in his new capacity as Director of Strategic Initiatives.

6. Upon termination of any employee, follow the provisions of the original employment contract and pay only what is due to the employee prorated for the term of services provided.

Finding No. 2:

The *School District of the City of Allentown's* Board should:

1. Contingent upon PSERS final determination, report to PSERS only those wages allowable for retirement purposes, as stated in PSERS' Employer Reference Manual.

2. Implement procedures for reviewing all salary and contribution reports, in order to ensure that only eligible wages are being reported to PSERS for retirement contributions.

3. Require the administration to maintain all documentation to support assignments given to and performed by the former Superintendent in his new position as Director of Strategic Initiatives.

The *Public School Employees' Retirement System* should:

4. Review the Superintendent's salary payments and determine what action, if any, is necessary with regard to the

District's inclusion of his $49,367 in administrative leave payments for retirement credit.

Appendix A

The District's management response is incorporated verbatim within the body of each finding. However, for the reader's convenience, we have also included the response in its entirety in Appendix A at the back of the audit report.

JACK WAGNER

AUDITOR GENERAL

Audit Scope, Objectives, and Methodology

Scope

What is a cyclical performance audit?

Cyclical performance audits allow the Department of the Auditor General to determine whether Local Education Agencies (LEAs) are spending their state funds, including school subsidies, 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 LEA. The Department shares the results of these audits with LEA management, the Governor, the Pennsylvania Department of Education, and other concerned entities. According to the Public School Code, LEAs include all school districts, charter and cyber charter schools, intermediate units, and career and technical schools.

This performance 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, or for the Department's regular cyclical performance audit (see text box left). This performance audit focused exclusively on the circumstances surrounding the early separation of the LEA's top administrator. This audit was completed in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit covered the period August 18, 2011 through November 21, 2011.

While all LEAs have the same school years, some have different fiscal years. Therefore, for the purposes of our audit work and to be consistent with Pennsylvania Department of Education reporting guidelines, we use the term school year rather than fiscal year throughout this report. A school year covers the period July 1 to June 30.

Objectives

What is a performance audit?

Performance audits allow the Department of the Auditor General to immediately review instances where LEAs prematurely ended or altered the employment contracts of their chief administrators. These audits do not replace the Department's regular cyclical audit, but are instead, performed in addition to that review.

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 LEA's compliance with applicable state laws, contracts, 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:

✓ Did employment contracts with the superintendent or other administration officials contain adequate separation provisions sufficient to protect the interests of the LEA, its students, and its taxpayers in the event the employment of the administrators ends prematurely for any reason?

- ✓ Did the LEA provide as much information as possible to its taxpayers explaining the reasons for the superintendent's separation and justifying the expenditure of funds by or through the LEA in order to terminate the contract early?

- ✓ Did the District enter into employment contracts with the superintendent at the three-year minimum provided by state law in order to limit potential financial liability by the District and its taxpayers in the event financial liability was not adequately limited through contract provisions?

- ✓ To determine the total financial cost of the superintendent or other administration officials' early contract termination, including funds received by the District from private individuals or other entities to facilitate the buy-out.

- ✓ Was the separation agreement transparent and without confidentiality clauses so taxpayers are aware of why the termination occurred?

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, 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 and conclusions based on our audit objectives. We believe that the evidence we obtained in this audit engagement provides a reasonable foundation for our findings and conclusions based on our audit objectives.

LEA management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the LEA is in compliance with applicable laws, contracts, 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.

As part of our audit procedures, we obtained copies of employment agreements and other relevant documents associated with the top administrative official's employment. We also interviewed selected administrators and support personnel associated with LEA operations.

Findings and Observations

Finding No. 1

Criteria relevant to the finding:

Section 1073 of the Public School Code, 24 P.S. § 10-1073(a), requires school districts to enter into three-to-five-year employment contracts with their superintendents.

District Entered Into an Altered Employment Agreement with its Superintendent Worth At Least $267,000

On August 18, 2011, the Board of School Directors (Board) for the School District of the City of Allentown (District) voted to enter into an Agreement to Alter Employment (Altered Agreement) with its former Superintendent. This agreement ended the former Superintendent's original five-year contract at the beginning of the second year of his tenure and rehired him as the Director of Strategic Initiatives for one year. The Altered Agreement stated that the former Superintendent's annual salary of $195,000 would remain the same, as would many of his benefits, including a tax deferred annuity worth $17,000. In addition, the Altered Agreement provided the former Superintendent with a lump sum payment of $55,000. Therefore, under the Altered Agreement, the former Superintendent was entitled to benefits worth at least $267,000. The term of this Altered Agreement was one year, from August 18, 2011 to August 18, 2012.

The former Superintendent's original five-year employment contract was effective from July 1, 2010 through June 30, 2015. It included the following provisions regarding the termination of the Superintendent's employment:

- The Board may discharge the Superintendent for the reasons set forth in Section 1080, 24 P.S. 10-1080, of the Public School Code, as amended.[1]

- The Board shall not arbitrarily or capriciously call for the Superintendent's dismissal. He shall have the right to written charges, notice of hearing, adequate time to prepare a defense, a fair and impartial hearing, all elements of due process, and the right to appeal to a court of competent jurisdiction.

[1] *See* 24 P.S. § 10-1080 (removal for neglect of duty, incompetency, intemperance, or immorality" following a hearing with due process).

- The Superintendent may terminate the agreement at any time, by providing not less than 90 days written notice to the Board of his intention to do so.

- In the event that the original employment contract was terminated by either party, or not renewed, the District was required to pay the Superintendent full pay for all unused vacation days, up to 20 days at his final per diem pay rate, in addition to any pay and benefits required to be paid by state law.

Under the Altered Agreement, the former Superintendent was entitled to the following benefits worth at least $267,000:

- A lump sum payment of $55,000, made in exchange for the former Superintendent's willingness to end his original contract,
- No change in salary, which was $195,000 annually,
- No change in health care benefits,
- No change in membership in the Public School Employees' Retirement System (PSERS) and no change in the employer's contributions to PSERS on his behalf,
- No change in a tax deferred annuity, worth $17,000 annually,
- No change in disability insurance benefits, and
- No change in vacation, bereavement, family illness, personal, or sick leave benefits.

The Altered Agreement also required the former Superintendent to give up other benefits that he would have received under his original five-year contract, including:

- Payment in lieu of leave,
- Payment of travel accident insurance,
- Payment of membership fees and dues for professional organizations not to exceed $3,000 annually,
- Reimbursement of membership dues in community organizations not to exceed $2,000 annually,
- Reimbursement of expenses incurred in the performance of his duties,
- Payment of automobile allowance of $650 per month,
- Payment of security measures,

- Payment of severance benefits of full pay for unused vacation days up to 20 days at his final per diem rate, and
- Reimbursement of expenses for professional development, including professional meetings, conferences, seminars, workshops and conventions and the like.

According to the District's solicitor, when the Board approved the Altered Agreement, the District waived the 90-day written notice requirement. Furthermore, the solicitor indicated that the District did not use a calculation method for determining the $55,000 payout figure.

On the same date that the Board and the former Superintendent entered into the Altered Agreement, the Board entered into an agreement appointing the District's Deputy Superintendent to the position of Acting Superintendent for a period of one year (August 18, 2011 to August 18, 2012), which coincides with the former Superintendent's tenure as the Director of Strategic Initiatives. The Acting Superintendent has the option of returning to his position as Deputy Superintendent, a position for which the parties entered into a new five-year contract effective August 19, 2012, if the Board decides not to appoint him as the permanent Superintendent.

The Board appointed the Acting Superintendent at an annual salary of $170,000, which is a $27,503 increase from his original salary. However, if the Acting Superintendent stays in his position for less than a year, he will receive a salary proportionate to his time served. In addition, if he returns to his position as Deputy Superintendent under the five-year contract, his base salary will be $150,000, which is a $7,503 increase from the salary he was receiving before he became Acting Superintendent.

The District created the position of Director of Strategic Initiatives expressly for the former Superintendent, and it did not exist before the Altered Agreement was enacted. The Altered Agreement states only that this newly developed job consists of "such other matters as the Acting Superintendent, Superintendent, or Board requires, with reports to the Acting Superintendent or Superintendent and deliverables expected throughout the one-year period." In addition, it specifies the following limitations on the Director position:

- The Director shall not report to a designated office unless he is specifically required to do so in order to complete a given project,
- The Director shall be provided with office support on an as-needed basis, and
- Assignments requiring the Director to report to a designated office shall not exceed a total of 10 reporting days during the period of employment.

According to the Acting Superintendent, the District has assigned several projects to the former Superintendent in his capacity as the Director of Strategic Initiatives. These tasks include reviewing the District's plans to see if any duplication exists, monitoring grant opportunities, and researching national trends to identify best practices related to the operating requirements of alternative education school buildings. However, the District has not required the former Superintendent to submit reports detailing his day-to-day activities with regard to these assignments. Consequently, the District could not provide us with any evidence and/or documentation demonstrating that the former Superintendent had performed any daily work related to the projects discussed above. Instead, the District is going to determine whether the former Superintendent completed his assignments based on the larger deliverables and reports it expects to receive.

According to the Altered Agreement, the Board sought to terminate the former Superintendent's original contract because the District received significantly decreased state funding as a result of the Commonwealth's 2011–12 budget, which led to "drastically reduced faculty and staff and a remaining need to undertake measures to realize additional savings to the [District] budget." Furthermore, the Altered Agreement indicates that the District will be able to achieve significant financial savings in both current and future fiscal years through a reorganization of its upper management.

Nevertheless, it is difficult to understand how the District is achieving any savings in the current fiscal year through the Altered Agreement, given that it is paying the former Superintendent a $55,000 lump sum that would not have been part of his compensation under his original contract, and given that the Board increased the Acting Superintendent's previous salary by $27,503. Consequently, the Altered Agreement has in fact increased the District's expenses by at least $82,503.

Moreover, regardless of any savings the District may achieve over the long term, by prematurely ending the former Superintendent's contract, the Board has paid him $55,000 for his consent in ending that agreement. Therefore, the District's taxpayers did not receive any return on their investment, as this payment was in no way related to the former Superintendent's work.

In addition, the former Superintendent, now Director of Strategic Initiatives, will continue to receive his $195,000 salary plus a variety of benefits for an additional year, even though during that time his duties will be significantly reduced. In fact, because the former Superintendent cannot be required to report to work for more than 10 days out of the entire year he is to remain a District employee, he will essentially be receiving his full salary for a position that appears to be significantly less than even half-time. Finally, the Board's failure to establish detailed performance measures and reporting requirements for the former Superintendent's new position prevents the District's taxpayers from being assured that they are getting adequate services in exchange for an extremely high salary.

The District's Board should have better protected its interests by including clear provisions in the original contract for terminating the former Superintendent without cause. In addition, given the District's untenable financial position, the Board should not have entered into such a generous contract with the former Superintendent only a year before it decided it could not afford it. Moreover, the Board should have publicly explained why the Altered Agreement was necessary, and it should have explained why taxpayers were paying to prematurely end the former Superintendent's contract, while simultaneously assigning him to a new position within the District.[2] Likewise, the Board should have publicly justified why it was continuing to pay the former Superintendent his full salary and a variety of benefits for significantly curtailed duties. Finally, the Board should have also ensured that the Altered Agreement included a requirement that the former Superintendent provide the District with detailed reports regarding his day-to-day work as the Director of Strategic Initiatives.

Recommendations

The *School District of the City of Allentown's* Board should:

1. Enter into employment contracts with prospective superintendents at the three-year minimum term permitted by state law, in order to limit potential financial liability by the District and its taxpayers.

2. Ensure that future employment contracts with prospective administrators contain adequate termination provisions sufficient to protect the interests of the District and its taxpayers in the event that the employment ends prematurely for any reason.

3. Provide as much information as possible to the taxpayers of the District explaining the reasons for entering into the Altered Agreement with the former Superintendent and justifying the District's expenditure of public funds for this purpose.

4. Work with successors to the Superintendent to include in their current and future employment contracts provisions that address the compensation and benefits payable to, or on behalf of, the said administrators in the event of a premature termination of their contracts.

5. Obtain detailed documentation that illustrates the services and deliverables provided by the former Superintendent in his new capacity as Director of Strategic Initiatives.

6. Upon termination of any employee, follow the

[2] We note that the Altered Agreement states, "The Board acknowledges [the former Superintendent's] work was and remains satisfactory and the District made significant progress during his brief tenure." However, as discussed above, the stated reason for terminating the contract (financial constraints) is difficult to reconcile with the amount of money spent as a result of the termination.

provisions of the original employment contract and pay only what is due to the employee prorated for the term of services provided.

Management Response

The District disagrees with the Auditor General's Finding No. 1 as follows:

While it may be true that the Altered Employment Agreement was worth at least $267,755, the remaining four (4) years of value on the Superintendent's original contract was approximately $1,000,000, more than three quarters of which will now be saved by the District. The savings over the life of the contract far exceed the modest increase in payments over the 12 month term of the Altered Employment Agreement.

The Superintendent's original contract was for a period of five (5) years, not three (3) years as stated.

This error may account for the Auditor General's erroneous conclusion that the Altered Agreement increased the District's cost by $82,503, as well as, the misleading conclusion that the Altered Agreement was worth $267,755. The District maintains that the Altered Agreement results in cost savings of, at least $700,000 over the four (4) remaining years of the Superintendent's original contract. This includes the increase to the Deputy Superintendent's contract while serving as Acting Superintendent. Moreover, the $55,000 payment waives four (4) years of certain benefits, the value of which is significantly in excess of $100,000. Some of those savings are:

- Annuity Payments $48,720
- Automobile Allowance $30,550
- Medical Coverage $17,883
- Membership Fees $48,000
- Dues to Community Groups $32,000

Further savings would include loss of payment in lieu of leave, loss of travel insurance, miscellaneous expenses and loss of payment for unused vacation days.

The School District believes that the Altered Employment Agreement was negotiated in good faith and represents an efficient and effective resolution of the Superintendent's contract rights and also the needs of the District. A transitional year of employment as Director of Strategic Initiatives was vital to the successful completion of the major strategic incentives and School District reorganization begun by the Superintendent in his year as Superintendent.

Auditor Conclusion

We were aware that the former Superintendent's original contract was for five rather than three years. In fact, that is the reason we have included our first recommendation. It states that the District should limit its future financial liability by entering into the minimum three-year term with all prospective superintendents.

Regardless of the length of the former Superintendent's original contract, its terms were extremely lucrative. As a result, the issue of most concern to the District's taxpayers is undoubtedly why the Board entered into such a costly arrangement in the first place. The District itself values the four remaining years of the original contract at approximately $1,000,000. In addition, based on the terms of that agreement, we calculated that by the end of his original contract the former Superintendent would have been receiving a base salary of approximately $228,122. This amount is approximately $85,784 more than what he earned as the Commonwealth's Secretary of Education and it is approximately $50,721 more than what Governor Corbett receives to manage our entire state government.

A year into the former Superintendent's extremely generous original contract, the Board determined that the District could not afford the terms of the arrangement. As a result, it entered into an Altered Agreement with the former Superintendent. Under this agreement, the District paid the former Superintendent a $55,000 lump sum and rehired him as the Director of Strategic Initiatives for one year. In this new position, the former Superintendent kept his $195,000 salary and a variety of his benefits. All told, we determined that the Altered Agreement was worth at least $267,000. Simultaneously, the Board appointed the District's Deputy Superintendent to Acting Superintendent for a period of one year, and increased his salary by $27,503.

The District's response states that "it may be true that the Altered Agreement was worth at least $267,555." In addition, the District acknowledges what it calls a "modest increase in payments over the 12 month term of the Altered Employment Agreement." However, it disputes that this increase is $82,503, as stated in the finding. The District also asserts that any increase in payments for a year as a result of the Altered Agreement are far exceeded by the numerous cost savings the District will achieve over the remaining four years of the original contract. Savings the District says it has calculated to be at least $700,000.

While we are pleased that District has recognized the cost of the Altered Agreement, we would point out that the District's calculation of its total value is $555 more than the amount we stated in the finding. Moreover, the $82,503 increase we attribute to the Altered Agreement accounts for the $55,000 lump sum paid to the former Superintendent and the $27,503 increase to the Acting Superintendent's salary. The District has not provided any direct evidence that these figures are inaccurate, nor has it stated that they do not represent an increase. In fact, the District has concurred that an increase will take place.

We were unable to tie the savings the District provided in its response to the terms of the former Superintendent's original contract. Nevertheless, it is impossible to truly calculate any future savings without knowing the cost of a permanent replacement superintendent. The Acting Superintendent's contract extends from August 18, 2011 to August 18, 2012, or until such time as the Board of School Directors appoints a Superintendent and the Board's appointed Superintendent begins service to the District. Consequently, there is no way to predict what the Board will decide to pay a permanent superintendent when it appoints one. Even if the Board keeps the Acting Superintendent in his current position, he will still have the option to renegotiate the terms of his current contract given that it is only for a period of one year.

Moreover, while the District indicates that its calculated savings include the Acting Superintendent's salary increase, it does not appear to be taking some of his current fringe benefits into account. For example, the District's response indicates that the former Superintendent's monthly automobile allowance of $650 is among its calculated savings. However, according to the Acting Superintendent's current contract, he is receiving that same exact benefit. Therefore, unless the Board eliminates this benefit from the contract of the Acting Superintendent, and the contract of any other permanent replacements, the District would not achieve any net savings in this area. Similarly, the District's response also states that it is achieving savings by forgoing payment on the former Superintendent's professional organization dues, in an amount not to exceed $3,000. Yet, the Acting Superintendent's contract provides for the same exact benefit, so again, it appears that the District is not achieving any net savings.

In addition, the District's response points out that the Altered Agreement required the former Superintendent to give up some of the benefits in his original contract. We do not dispute this fact, given that we enumerated these discharged benefits in the finding above. However, as we also point out, the former Superintendent kept other fringe benefits, including a tax deferred annuity worth $17,000 annually.

Finally, even if future savings could be calculated, the fact remains that the former Superintendent, now Director of Strategic Initiatives, will continue to receive his $195,000 salary plus a variety of benefits for an additional year during a time when his duties will be significantly reduced. In fact, because the former Superintendent cannot be required to report to work for more than 10 days out of the entire year he is to remain a District employee, he will essentially be receiving his full salary for a position that appears to be significantly less than even half-time. Moreover, the Board's failure to establish detailed performance measures and reporting requirements for the Director of Strategic Initiatives position prevents the District's taxpayers from being assured that they are getting adequate services in exchange for an extremely high salary.

In summary, regardless of the terms of the Altered Agreement, the Board would have been better stewards of the taxpayers' money if it had not agreed to the former Superintendent's excessively lucrative contract in the first place. Moreover, the District cannot truly calculate any savings it may have achieved by ending this contract early because it has not hired a permanent replacement superintendent. Furthermore, the Board compounded the impact of its initial action by continuing to pay the former

Superintendent his equivalent salary and some benefits, for a significantly reduced set of responsibilities.

Our finding will remain as written.

Finding No. 2

Possible Improper Reporting of Retirement Wages and Service Years

Criteria relevant to the finding:

The Pennsylvania Retirement Code, 24 Pa.C.S. § 8102, provides that a "school employee" is defined as "any person engaged in work relating to a public school for any governmental entity and for which work he is receiving regular remuneration. . . ." (emphasis added)

The PSERS Employer Reference Manual (ERM), Chapter 2, states to be eligible for PSERS membership as a full-time employee, the employee must work 5 hours or more per day, 5 days per week or its equivalent. It further states to be eligible as a part-time employee, the employee must be contracted to work less than 5 hours per day, 5 days per week or its equivalent and must have their salaries and retirement deductions reported to PSERS through monthly Work Report Records. Additionally, the PSERS ERM states that independent contractors are not eligible for PSERS membership.

PSERS allows only qualified salary and wages to be included for retirement purposes. According to Pennsylvania School Employees' Retirement Board Regulations, Section 211.2, reported compensation should: "exclude . . . payments or similar emoluments which may be negotiated in a collective bargaining agreement for the express purpose of enhancing the compensation factor for retirement benefits."

Our audit of the School District of the City of Allentown's (District) former Superintendent's employment contracts, agreements and payroll records found that the District may have improperly reported ineligible retirement wages to the Public School Employees' Retirement System (PSERS) for the 2011-12 school year.

The former Superintendent's tenure prematurely ended through an Agreement to Alter Employment (Altered Agreement) effective August 18, 2011. Under this agreement, the District then rehired him as Director of Strategic Initiatives, a newly created position, for the term of one year. According to the Altered Agreement, the former Superintendent's new position consisted of performing tasks as the Superintendent or the Board requires, and producing reports and deliverables throughout the one-year period. In addition, the Altered Agreement included the following provisions regarding the former Superintendent's performance of these duties.

- He shall not report to a designated office unless specifically required to do so to complete a given project.
- He shall be provided with office support on an as-needed basis, as determined by the [former] Superintendent.
- He shall not receive assignments requiring him to report to a designated office in excess of a total of 10 reporting days during the period of employment.

Our audit found that the District currently has no documentation demonstrating that the former Superintendent has provided any services to the District since the Altered Agreement went into effect. More importantly, according to the Altered Agreement, the former Superintendent experienced no change to his original salary of $195,000, which is to be paid to him for the one-year period, less usual deductions including PSERS, and in accordance with the usual pay cycle (see Finding No. 1). Consequently, the District is continuing to report the former Superintendent's wages to PSERS as though he were still a full-time employee. He will, therefore, receive service credits for the year ending June 30, 2012. Service credits are used to determine the percentage of salary a former employee would receive in retirement payments.

According to the PSERS Reference Manual, only employees who work five hours or more a day, five days a week or its equivalent, can be considered full-time. It further states that to be eligible for participation in PSERS as a part-time employee, an individual must be contracted to work less than five hours a day, five days a week or its equivalent and must have their salaries and retirement deductions reported to PSERS monthly.

Based on the Altered Agreement's description of the former Superintendent's current duties as the Director of Strategic Initiatives, and on the fact that the District can provide no evidence that the former Superintendent has performed any daily work since the Altered Agreement went into effect, it appears that the former Superintendent's current $195,000 salary may not be eligible for inclusion in PSERS as either a full-time or a part-time employee.

Although the Board has the authority to craft the terms of a contract, it may not supersede PSERS' benefit structure. If PSERS determines the administrator's wages are not eligible retirement wages, their inclusion in PSERS will result in reporting errors and overpayments to the former Superintendent for the 2011-12 school year.

Recommendations

The *School District of the City of Allentown's* Board should:

1. Contingent upon PSERS final determination, report to PSERS only those wages allowable for retirement purposes, as stated in PSERS Employer Reference Manual.

2. Implement procedures for reviewing all salary and contribution reports, in order to ensure that only eligible wages are being reported to PSERS for retirement contributions.

3. Require the administration to maintain all documentation to support assignments given to and

performed by the former Superintendent in his new position as Director of Strategic Initiatives.

The *Public School Employees' Retirement System* should:

4. Review the Superintendent's salary payments and determine what action, if any, is necessary with regard to the District's inclusion of his $49,367 in administrative leave payments for retirement credit.

Management Response

The School District disagrees that it has improperly reported retirement wages or service time. The Director of Strategic Incentives has the same work commitment requirements as under the original Superintendent contract. No qualified wages were reported on the $55,000.00 payment inasmuch as that was a compromise for waiver of future benefits.

Should PSERS have a different determination, the School District will seek an accounting of over or under payment.

Auditor Conclusion

As stated in the recommendations above, PSERS will make the final determination regarding whether the District properly reported the former Superintendent's wages. Our concern is not with the $55,000 lump sum payment he received, but rather with the eligibility of the wages he is receiving in his new position as Director of Strategic Initiatives. We continue to contend that the former Superintendent's current $195,000 salary may not be eligible for inclusion in PSERS as either a full-time or part-time employee. We based our conclusion on the Altered Agreement's description of the former Superintendent's current duties as the Director of Strategic Initiatives, and on the fact that the District can provide no evidence that the former Superintendent has performed any daily work since the Altered Agreement went into effect.

The finding will remain as written.

APPENDIX A

Audit Responses from the School District of the City of Allentown

Bureau of School Audits

Department of the Auditor General

Management Reply Form

LEA: School District of the City of Allentown

Date Requested: 11/17/11

Audit Period: 2009-10

Date Due: 11/21/11

Finding Title: DISTRICT ENTERED INTO AN ~~The Board~~ Altered ~~its~~ Employment ~~Contract~~ AGREEMENT with the Superintendent ~~Leading to a Costly Buy-out~~ ~~of the Contract to the School District Totaling $[illegible]~~ WORTH AT LEAST $267,798

___ Management agrees with the finding.

✓ Management disagrees with the finding.

___ Management waives the opportunity to reply at this time.

MANAGEMENT COMMENTS: (Please explain the cause of the problem and note what corrective action is planned (If necessary, attach additional paper.)

```
See attached document.
```

Signatures/Date

C. Russell Mayo

Acting Superintendent, ~~Ex. Director, Director~~

~~Business Manager~~

Chief Financial Officer

FILE: MGMREPLY

VERSION: 10/1/10

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Allentown School District – Additional Response to Finding No. 1:

The District disagrees with the Auditor General's Finding No. 1 as follows:

While it may be true that the Altered Employment Agreement was worth at least $267,755, the remaining four (4) years of value on the Superintendent's original contract was approximately $1,000,000, more than three quarters of which will now be saved by the District. The savings over the life of the contract far exceed the modest increase in payments over the 12 month term of the Altered Employment Agreement.

The Superintendent's original contract was for a period of five (5) years, not three (3) years as stated.

This error may account for the Auditor General's erroneous conclusion that the Altered Agreement increased the District's cost by $82,503, as well as, the misleading conclusion that the Altered Agreement was worth $267,755. The District maintains that the Altered Agreement results in cost savings of, at least, $700,000 over the four (4) remaining years of the Superintendent's original contract. This includes the increase to the Deputy Superintendent's contract while serving as Acting Superintendent. Moreover, the $55,000 payment waives four (4) years of certain benefits, the value of which is significantly in excess of $100,000. Some of those savings are:

- Annuity Payments $ 48,720
- Automobile Allowance $ 30,550
- Medical Coverage $ 17,883
- Membership Fees $ 48,000
- Dues to Community Groups $ 32,000

Further savings would include loss of payment in lieu of leave, loss of travel insurance, miscellaneous expenses and loss of payment for unused vacation days.

The School District believes that the Altered Employment Agreement was negotiated in good faith and represents an efficient and effective resolution of the Superintendent's contract rights and also the needs of the District. A transitional year of employment as Director of Strategic Initiatives was vital to the successful completion of the major strategic incentives and School District reorganization begun by the Superintendent in his year as Superintendent.

Bureau of School Audits

Department of the Auditor General

Management Reply Form

LEA:	School District of the City of Allentown	Date Requested:	11/17/11
Audit Period:	2009-10	Date Due:	11/21/11
Finding Title:	Possible Improper Reporting of Retirement Wages and Service Years		

____ Management agrees with the finding.

X Management disagrees with the finding.

____ Management waives the opportunity to reply at this time.

MANAGEMENT COMMENTS: (Please explain the cause of the problem and note what corrective action is planned (If necessary, attach additional paper.)

The School District disagrees that it has improperly reported retirement wages or service time. The Director of Strategic Incentives has the same work commitment requirements as under the original Superintendent contract. No qualified wages were reported on the $55,000.00 payment inasmuch as that was a compromise for waiver of future benefits.

Should PSERS have a different determination, the School District will seek an accounting of over or under payment.

Signatures/Date

C. Russell Mayo

Acting Superintendent, ~~Ex. Director, Director~~

[signature]

~~Business Manager~~
Chief Financial Officer

FILE: MGMREPLY

VERSION: 10/1/10

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TOTAL P.04

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