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COMMONWEALTH OF PENNSYLVANIA

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**A Special Investigation of the  
Jefferson-Morgan School District's  
Construction of an Athletic Field House**

**December 2007**

**JACK WAGNER, AUDITOR GENERAL**

PENNSYLVANIA DEPARTMENT OF THE AUDITOR GENERAL



December 26, 2007

Donna Brown, President  
Board of School Directors  
JEFFERSON-MORGAN SCHOOL DISTRICT  
1351 Jefferson Road  
Jefferson, Pennsylvania 15344-0158

Dear Ms. Brown:

The Department of the Auditor General's Office of Special Investigations ("OSI") has completed a special investigation of Jefferson-Morgan School District's ("School District") construction of a new athletic field house. Our investigation reviewed a series of actions, occurrences, transactions, and events that occurred during the period from January 2000 to December 2005, unless otherwise noted.

During the course of this investigation, we found the following:

- The School District failed to comply with the provisions of the Public School Code of 1949, *as amended*, ("Public School Code") pertaining to construction of school buildings, because forming a nonprofit corporation to construct a school building for use by the School District does not relieve the School District or the nonprofit corporation from complying with said provisions.
- By using its own employees to construct the athletic field house, the School District violated the provision of the Public School Code prohibiting the use of district maintenance staff on construction projects with a total cost greater than \$5,000.
- The School District violated Pennsylvania's Prevailing Wage Act when it, and the nonprofit corporation created by it, did not pay, or require contractors to pay, prevailing wage rates.
- The School District violated the Pennsylvania Steel Products Procurement Act when it failed to require that the steel building it purchased for the athletic field house be constructed of steel produced in the United States.

- The School District and/or the nonprofit corporation created by it paid unemployed workers in cash for work performed on the project, and appear to have evaded the requirements of the Unemployment Compensation Act, the Workers' Compensation Act, and local, state and federal income tax laws by failing to pay premiums for unemployment and workers' compensation insurance and by failing to withhold local, state, and federal income taxes from the compensation paid to the unemployed workers.

We note that the individual who was the District's superintendent at all times relevant to this investigation is no longer in that position. However, the recommendations in this report remain valid and should be read, where appropriate, as applying to that individual's successor(s).

We urge the School District to implement all of the recommendations made in this report. The Department of the Auditor General will follow-up at the appropriate time to determine whether our recommendations have been implemented.

In addition, we are forwarding copies of this report to the Pennsylvania Department of Education, the Pennsylvania Department of Labor and Industry, the Pennsylvania Department of Revenue, and the United States Internal Revenue Service for their review and whatever further action those agencies may deem appropriate.

This report is a public document and its distribution is not limited. Additional copies may be obtained through the Department's website, [www.auditorgen.state.pa.us](http://www.auditorgen.state.pa.us).

Sincerely,

/S/

**JACK WAGNER**  
Auditor General

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## EXECUTIVE SUMMARY

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FINDINGS	RECOMMENDATIONS
<p><b><u>Finding No. 1:</u></b>  The School District failed to comply with the provisions of the Public School Code of 1949, <i>as amended</i>, (“Public School Code”) pertaining to construction of school buildings, because forming a nonprofit corporation to construct a school building for use by the School District does not relieve the School District or the nonprofit corporation from complying with said provisions.</p>	<p>We recommend that any additional work necessary to complete the project, and all future construction projects, should be done pursuant to the Public School Code and other applicable laws and regulations.</p> <p>Copies of this report are being forwarded to the Pennsylvania Department of Education and the Pennsylvania Department of Labor and Industry for whatever further action they may deem appropriate.</p>
<p><b><u>Finding No. 2:</u></b>  By using its own employees to construct the athletic field house, the School District violated the provision of the Public School Code of 1949, <i>as amended</i>, prohibiting the use of district maintenance staff on construction projects with a total cost greater than \$5,000.</p>	<p>We recommend that the Board of School Directors (“Board”) and the Superintendent adhere to the requirements of the Public School Code and other applicable laws and regulations regarding construction of school buildings in the completion of this project and in all future construction projects.</p> <p>A copy of this report is being forwarded to the Pennsylvania Department of Education for whatever further action it may deem appropriate.</p>
<p><b><u>Finding No. 3:</u></b>  The School District violated Pennsylvania’s Prevailing Wage Act when it, and the nonprofit corporation created by it, did not pay, or require contractors to pay, prevailing wage rates.</p>	<p>We recommend that the Board and the Superintendent familiarize themselves with the provisions of this law and adhere to its provisions in the completion of this project and in all future construction projects.</p> <p>A copy of this report is being forwarded to the Pennsylvania Department of Labor and Industry for whatever further action it may deem appropriate.</p>

<p><b><u>Finding No. 4:</u></b>  The School District violated the Pennsylvania Steel Products Procurement Act when it failed to require that the steel building it purchased for the athletic field house be constructed of steel produced in the United States.</p>	<p>We recommend that the Board and the Superintendent familiarize themselves with the provisions of this law and adhere to its provisions in the completion of this project and in all future construction projects.</p> <p>A copy of this report is being forwarded to the Pennsylvania Department of Labor and Industry for whatever further action it may deem appropriate.</p>
<p><b><u>Finding No. 5:</u></b>  The School District, and/or the nonprofit corporation created by it, paid unemployed workers in cash for work performed on the project, and appear to have evaded the requirements of the Unemployment Compensation Act, the Workers' Compensation Act, and local, state and federal income tax laws by failing to pay premiums for unemployment and workers' compensation insurance and by failing to withhold local, state, and federal income taxes from the compensation paid to the unemployed workers.</p>	<p>Officials of Jefferson-Morgan Athletics, Inc. appear to have violated the withholding requirements of local, state, and federal income tax laws and the requirements of the Pennsylvania Unemployment and Workers' Compensation laws.</p> <p>Copies of this report will be forwarded to the Pennsylvania Department of Revenue, the Pennsylvania Department of Labor and Industry, and the United States Internal Revenue Service for whatever further action they may deem appropriate.</p>

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## BACKGROUND AND INTRODUCTION

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The Department of the Auditor General (“Department”) conducts audits and investigations of school districts pursuant to its authority and responsibility under the Fiscal Code.<sup>1</sup> The Jefferson-Morgan School District (“School District”), located in Greene County, encompasses an area of 47.2 square miles. It has a population of 6,142, according to the 2000 census. The School District’s administrative offices are in the Junior/Senior High School at 1351 Jefferson Road, Jefferson, Pennsylvania.

In 2000, School District officials and members of the Board of School Directors (“Board”) began discussing the possibility of relocating the football field and track to the high school. The School District also discussed renovating the current athletic facility/field house or constructing a new one.

In September 2000, the School District asked a Pittsburgh-based architectural firm to submit a proposal to provide a feasibility study on locating the football field and track at either the high school or at its current location, the Central Building site. The current location consists of a football field, practice field, and the Central Building, a two-story elementary school converted to an athletic facility. There is no track facility in the School District.

The feasibility study provided the School District with the estimated costs and the advantages and disadvantages of each project. According to the study, the football field and track athletic facility could be accommodated at the high school site for an estimated construction cost of \$750,000 and for approximately 10 percent less if constructed at the Central Building site. The field house could be accommodated at either site but the cost would be dependent upon the School District’s requirements: \$200,000 for basic restrooms and storage to \$750,000 for a new facility containing restrooms, team rooms, lockers, wrestling facilities, and storage.

The School District chose to construct a new athletic field house adjacent to the current football field, but at a cost lower than the \$200,000+ price quote given in the feasibility study.

The School District asked the architectural firm to develop a cost estimate for placing a prefabricated, 10,000 square-foot metal building at the site and bid proposals were solicited. Bids regarding the prefabricated metal building were received on November 15, 2001. The School District rejected the bids based on costs and asked the architectural firm to issue an addendum for all contractors to submit bids concerning the “costs to *furnish only* the metal building” (emphasis added). Community volunteers and School District’s maintenance staff would construct the building.

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<sup>1</sup> Act of April 9, 1929, P.L. 343, No. 176, § 403, *as amended*, 72 P.S. § 403 (The Fiscal Code).

The second bid opening was held in December 2001. Again, the School District rejected all the bids as being too costly.

The third request for bids was issued in January 2001. Potential bidders were asked to provide prices for the metal building, “property site/site general” (foundations, excavation and pavement), and “site plumbing.” The School District rejected the bid submissions for the building and foundation work as too costly. The bid for “site plumbing” was rejected at a subsequent meeting.

The fourth bid proposals for the building and site work were due on March 14, 2002. The School District awarded the contracts to a construction firm, but later rescinded the offer when the construction firm could not obtain the necessary bond.

At a May 2002, meeting, the Board rejected the previously accepted bids for site plumbing and authorized the School District’s present maintenance staff to conduct the work.<sup>2</sup> The Board also approved a motion to form a nonprofit corporation with the athletic booster organization (“Boosters”) to build a field house and for future endeavors, and authorized the School District’s solicitor to work with the Boosters to establish the nonprofit corporation.

Jefferson-Morgan Athletics, Inc. (“JMA”) was incorporated the following month. It is governed by a Board of Directors and an Executive Director. At the time of our investigation, the School District’s Superintendent<sup>3</sup> was also the Executive Director of JMA, and the School District’s Business Manager was also the Business Manager of JMA. JMA also shared the School District’s business address and bookkeeping system.

In July 2002, the School District entered into a lease agreement with JMA for the construction of an athletic field house. Under the lease agreement, the School District would lease a 7.6-acre tract of land to JMA on which JMA would construct an athletic field house in accordance with applicable state laws, as well as specifications prepared by the School District. Once built, JMA would lease all athletic facilities located on the land back to the School District.

As of December 2005, the School District had funded 83% of total project costs, having contributed approximately \$635,000, which includes in-house labor costs of \$237,536. All funding sources are shown in Table No. 1.

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<sup>2</sup> The School Board members previously approved the use of the School District’s maintenance staff to construct the facility.

<sup>3</sup> We note that the individual who was the District’s superintendent at all times relevant to this investigation is no longer in that position. However, the recommendations in this report remain valid and should be read, where appropriate, as applying to that individual’s successor(s).

**Table No. 1**  
***Funding Sources for the Athletic Field House Project, as of December 2005***

<b>Entity</b>	<b>Amount Contributed</b>
JMA	\$ 17,101
Grants from the Pennsylvania Department of Community and Economic Development ("DCED")	\$110,000
School District	\$634,528
<b>TOTAL</b>	<b>\$761,629</b>

In January 2004, the Department received allegations of financial mismanagement, conflicts of interest, and violations of contracting requirements at the School District in relation to the athletic facility being constructed by JMA. The Department's Office of Special Investigations ("OSI") conducted a special investigation of the construction of the facility and the series of transactions that led thereto. The investigation included a review of pertinent records of the School District, JMA, and vendors on the project, as well as interviews of officials and employees of the School District, employees of vendors, and persons associated with JMA.

The School District was provided with a draft copy of this report for its review and comment. The School District's response is included as an appendix to this report, followed by this Department's comments on the School District's response.

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## FINDINGS AND RECOMMENDATIONS

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**Finding No. 1:**      **The School District failed to comply with the provisions of the Public School Code of 1949, as amended, (“Public School Code”) pertaining to construction of school buildings, because forming a nonprofit corporation to construct a school building for use by the School District does not relieve the School District or the nonprofit corporation from complying with said provisions.**

As currently codified, Section 758 of the Public School Code provides as follows:

**Section 758. Appropriations to nonprofit corporations for constructing school buildings.**—Whenever any school building or buildings have been rendered totally unfit for use by reason of fire, acts of God, obsolescence, overcrowding, inadequacy, or lack of facilities, or other unforeseen cause, the board of school directors of any school district shall have power to appropriate money out of the general fund of the school district to any nonprofit corporation established for the purpose of constructing school buildings for the use of the school district. Before any such money is paid over the corporation shall enter into a lease with the school district for the buildings proposed to be erected, whereby the school district shall have the right to renew such lease at stated periods at a stipulated rental and at any time during the continuance of the lease to purchase the buildings from the corporation at a stipulated price. None of the powers granted by this act shall be used by the board of school directors of any school district without the specific and written approval of the Department of [Education].<sup>4</sup>

This section was originally enacted in 1941, as an amendment to the old Public School Law of 1911, to provide school districts with an alternative method of financing the construction of new school buildings under the conditions specified therein. It was repealed and reenacted as Section 758 of the Public School Code of 1949, without substantial change. According to officials at the Pennsylvania Department of Education (“PDE”), its use has been relatively rare in recent years.

As an alternative to a school district borrowing the money for such a project and using current revenues to amortize the debt, Section 758 permits a school district, under certain circumstances, to form a nonprofit corporation to build the building and lease it to the school district. The school district is then authorized to use its current revenues to pay a rental fee for the use of the building.

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<sup>4</sup> Act of March 10, 1949, P.L. 30, No. 14, art. VII, Section 758, *as amended*, 24 P.S. §7-758 (The Public School Code of 1949).

The issue is whether the nonprofit corporation is exempt from the multitude of design, bidding, and contractual requirements with which a school district would have to comply if it were to build the building itself. While Section 758 is silent on this issue, and there are no published court decisions interpreting the provision, Section 758 does not appear to permit a school district, or the nonprofit corporation created by it, to circumvent the design, bidding, and other contractual requirements that would otherwise apply to school construction projects.

It is a basic principle of statutory construction that effect is to be given to all provisions of a statute,<sup>5</sup> and that individual provisions in a comprehensive legislative scheme are not to be read abstractly but are to be read with a view to their place in the entire structure.<sup>6</sup> Furthermore, it is presumed “[t]hat the General Assembly intends to favor the public interest as against any private interest.”<sup>7</sup>

The Public School Code is just such a comprehensive legislative scheme. An entire article of the Code – Article VII, titled “Grounds and Buildings” – is devoted to the subject of financing and construction of school buildings. A school district may finance and build its own building by issuing bonds, hiring an architect, and awarding the construction contract itself in accordance with the detailed provisions of Article VII, or it may avail itself of the financing and construction services of a municipality authority or the State Public School Building Authority.

An additional financing option is afforded by Section 758. If specific preconditions are met, a school district is permitted, with the prior “specific and written approval” of the PDE, to enter into a lease with a nonprofit corporation established for the purpose of constructing school buildings for the use of the school district, and to appropriate money out of its general fund to pay rent to the nonprofit corporation for the use of the building. The lease must be renewable at the option of the school district and give the school district the right to purchase the building at any time during the continuance of the lease at a stipulated price. The rent and the stipulated purchase price are presumably set to reflect the costs of financing.

The School District received PDE’s specific written approval to enter into the lease with JMA pursuant to Section 758 of the Public School Code in a letter dated September 12, 2002, in which the Chief of the Division of School Facilities, Bureau of Budget and Fiscal Management, wrote:

In [the School District’s] letters, you requested Departmental approval *of the proposed lease* pursuant to Section 758, rather than Section 759, of the Public School Code of 1949, as amended, so that the district could appropriate funds to this non-profit corporation for the sole purpose of constructing these facilities for use by the district. In his September 5, 2002, [*sic*] [the School District’s Superintendent] further

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<sup>5</sup> Act of December 6, 1972, P.L.1339, No. 290, § 3, 1 Pa.C.S. § 1921(a) and § 1922(2) (Statutory Construction Act of 1972).

<sup>6</sup> *Pistorius v. Travelers Insurance Company*, 348 Pa. Superior Ct. 527, 530, 502 A.2d 670, 671 (1985).

<sup>7</sup> 1 Pa.C.S. § 1922(5).

described the board's decision to build new athletic facilities because the former Central School Building is inadequate and obsolete in its existing condition.

Based on our review, *the revised lease* meets statutory requirements under Section 758 of the Public School Code of 1949, as amended, and is therefore approved. [Emphasis added.]

Section 758 merely describes the circumstances under which an alternative method of financing may be employed, but it cannot be construed to relieve the School District and/or JMA of the other requirements of Article VII governing the construction of school buildings.

Furthermore, PDE's letter of September 12, 2002, approved only the fact that *the lease* submitted for its review met the statutory requirements of Section 758 of the Public School Code. Nothing in that letter expresses or implies that the School District and/or JMA need not comply with the *other* requirements of Article VII of the Public School Code, notably the requirements:

- to obtain pre-approval from PDE of the plans and specifications for the building (24 P.S. § 7-731);
- to let the construction contracts on competitive bidding (§ 7-751(a));
- not to use district maintenance personnel in major construction projects (§ 7-751(b));
- to abide by the requirements of the Steel Products Procurement Act (§ 7-751(c));
- not to structure purchases in a piecemeal fashion to evade competitive bidding requirements (§ 7-751(f));
- to employ competent workmen at the prevailing wage of organized labor (§ 7-752);
- to require that resident laborers and mechanics be employed (§ 7-754);
- to require contractors not to discriminate in hiring (§ 7-755); and
- to require contractors to provide bond for the payment of labor, materials and equipment (§ 7-756).<sup>8</sup>

The foregoing provisions of Article VII of the Public School Code are obviously intended to protect the health and safety of the occupants of school buildings and to protect the public interest in the letting of contracts and the construction of such buildings. There is nothing in Section 758 of the Public School Code or in PDE's letter approving the lease that can be construed to relieve the School District or JMA from complying with other provisions of the law pertaining to construction of school buildings.

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<sup>8</sup> The construction of this building is also subject to the provisions of Part II of the Commonwealth Procurement Code, 62 Pa.C.S. § 3101 *et seq.*

## **Conclusions and Recommendations:**

The provisions of Section 758 of the Public School Code provided the School District with an alternative method of financing the construction of its new field house by forming a nonprofit corporation for that specific purpose. The nonprofit corporation is an agency created by the School District and is its *alter ego*. Availing itself of the provisions of Section 758 did not give the School District license to circumvent the remaining requirements of Article VII of the Public School Code, or any other statutes generally applicable to the construction of school buildings.

We recommend that any additional work necessary to complete the project, and all future construction projects, should be done pursuant to the Public School Code and other applicable laws and regulations. A copy of this report is being forwarded to the Pennsylvania Department of Education for whatever further action it may deem appropriate. As noted in future sections of the report, we are also referring this matter to the Pennsylvania Department of Labor and Industry for whatever further action that agency may deem appropriate.

**Finding No. 2: By using its own employees to construct the athletic field house, the School District violated the provision of the Public School Code of 1949, as amended, prohibiting the use of district maintenance staff on construction projects with a total cost greater than \$5,000.**

The Public School Code limits the instances in which school district maintenance personnel can be used to perform construction work to those instances in which the entire cost or value, including labor and material, is less than \$5,000.<sup>9</sup> The Superintendent was informed of this requirement by the School District's solicitor. In a letter to the Superintendent, dated May 13, 2002, the solicitor wrote:

The School Code states that the District may perform any construction work where the entire cost is less than \$5,000.00. Therefore, in order to comply with the School Code, the District should not perform work on any separate subcontract where the cost of the labor is in excess of \$5,000.00.

Clearly, the Superintendent knew that the cost of the athletic field house would be greater than the \$5,000 threshold. The original price estimates ranged from \$200,000 for a basic building with restrooms and storage to \$750,000 for a building with restrooms, locker rooms and wrestling facilities, which was the building ultimately built. However, the Superintendent continued to use the School District's maintenance staff as the primary laborers on the project. According to the Superintendent, it was less expensive to use School District personnel than to use professional contractors.

**Conclusions and Recommendations:**

The Superintendent willfully disregarded both the Public School Code and the advice of the School District's solicitor in an attempt to save money by using School District personnel on the athletic field house project. While keeping costs to a minimum is generally a worthy objective, applicable laws and regulations may not be circumvented merely to reduce costs. These laws and regulations are designed to ensure that such projects are properly designed and built at a fair and competitive price.

We recommend that the Board and the Superintendent adhere to the requirements of the Public School Code and other applicable laws and regulations regarding construction of school buildings in the completion of this project and in all future construction projects.

A copy of this report is being forwarded to the Pennsylvania Department of Education for whatever further action it may deem appropriate.

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<sup>9</sup> 24 P.S. § 7-751(b).

**Finding No. 3:      The School District violated Pennsylvania’s Prevailing Wage Act when it, and the nonprofit corporation created by it, did not pay, or require contractors to pay, prevailing wage rates.**

The purpose of the Pennsylvania Prevailing Wage Act<sup>10</sup> (“PW Act”) is to protect workers employed on public works projects from substandard wages by insuring that they receive prevailing wages.<sup>11</sup> Prevailing wages were not paid in connection with the construction of the athletic field house, even though the project met all of the elements necessary to make the project subject to the requirements of the PW Act.<sup>12</sup>

Prevailing wages are required for a “public work,”<sup>13</sup> which is defined as (a) construction, reconstruction, demolition, alteration and/or repair work other than maintenance work, (b) that is done under contract, (c) that is paid for by the funds of a public body, and (d) that has an estimated cost of at least \$25,000.<sup>14</sup>

Prevailing wages are also required if a private entity uses public funds for a public purpose proposed by a public body.<sup>15</sup> That is exactly what occurred in this situation in which JMA, a private entity, used local and state funds provided by the School District and the Commonwealth to construct an athletic field house proposed by the School District.

The athletic field house project meets all four parts of the definition of a “public work.” First, the work is a construction project. Second, the work was done “under contract,” regardless of whether the School District or JMA was the party to the contract.<sup>16</sup> Third, the Pennsylvania Department of Community and Economic Development (“DCED”) grant estimated the total cost of the project at \$366,000 and \$406,000 (\$761,629 has actually been expended as of December 2005), which is well above the \$25,000 threshold. Finally, the project was funded in whole or in part with the funds of a public body.

At the time of construction, JMA’s Executive Director was the School District’s Superintendent. JMA received funding from the School District, as well as from donations and fund-raising initiatives. Under the facts and circumstances of this case,

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<sup>10</sup> Act of August 15, 1961, P.L. 987, as amended, 43 P.S. § 165-1 *et seq.* (Pennsylvania Prevailing Wage Act).

<sup>11</sup> 43 P.S. § 165-5. The term “prevailing wages” is defined in § 165-7 of the Act as “the general prevailing minimum wage rate in the locality in which the public work is to be performed for each craft or classification of all workmen needed to perform public work contracts during the anticipated term thereof” as determined by the Secretary of Labor and Industry.

<sup>12</sup> In addition, as previously discussed in Finding No. 1, payment of prevailing wages is an express requirement of Section 752 of the Public School Code of 1949, 24 P.S. § 7-752.

<sup>13</sup> 43 P.S. § 165-5.

<sup>14</sup> 43 P.S. § 165-2(5).

<sup>15</sup> *Pennsylvania State Building and Construction Trades Council, AFL-CIO, and Central Pennsylvania Trades Council v. Prevailing Wage Appeals Board* (“*Penn National*”), 570 Pa. 96, 808 A.2d 881 (2002); *Lycoming County Nursing Home Association, Inc. v. Commonwealth, Dep’t of Labor and Industry*, 627 A.2d 238 (Pa. Cmwlth. 1993).

<sup>16</sup> *Penn National*, *supra*, 570 Pa. at 110-111, 808 A.2d at 889-890.

JMA is, in effect, the *alter ego* of the School District and is deemed to be a public body for the purposes of the PW Act.

The School District violated the PW Act by not requiring contractors on the project to pay prevailing wage rates. While School District personnel provided most of the labor on the job, contractors were hired when the maintenance staff did not have the necessary skills. For example:

- An excavating contractor performed the excavation, delivered aggregate materials, supervised the erection of the steel building, and provided rental equipment for the project. JMA paid this contractor \$28,315 for the labor and materials to cover this work.
- A concrete finishing contractor provided labor for forming and finishing the concrete for the new athletic facilities foundation and floor. JMA paid this contractor \$13,046 for this work.
- A plumbing contractor provided labor and materials for the underground sanitary drainage system and various plumbing projects and submitted \$14,834 worth of invoices. JMA paid \$7,114 for costs associated with the materials from the grant money and paid the balance of \$7,720 from other sources.
- A heating, ventilating, and air conditioning contractor provided labor and materials for the heating and ventilation systems. The value of the contract was \$35,802.

The PW Act requires that prevailing wage rates and requirements must be contained in both the bid specifications and contracts for public works projects. None of the School District's bid specifications and contracts that OSI reviewed contained such rates and requirements.

### **Conclusions and Recommendations:**

The School District failed to comply with the requirements of the Pennsylvania Prevailing Wage Act. We recommend that the Board and the Superintendent familiarize themselves with the provisions of the PW Act and adhere to its provisions in the completion of this project and in all future construction projects.

A copy of this report is being forwarded to the Pennsylvania Department of Labor and Industry for whatever further action it may deem appropriate.

**Finding No. 4: The School District violated the Pennsylvania Steel Products Procurement Act when it failed to require that the steel building it purchased for the athletic field house be constructed of steel produced in the United States.**

In 1978, the General Assembly passed the Steel Products Procurement Act<sup>17</sup> (“SPP Act”), the declared purpose of which is “to promote the general welfare and stimulate the economy of the Commonwealth and its people.”<sup>18</sup> In furtherance of this purpose, it specifically provides:

**§ 1884. Required contract provisions.**

(a) Every public agency shall require that every contract document for the construction, reconstruction, alteration, repair, improvement or maintenance of public works contain a provision that, if any steel products are to be used or supplied in the performance of the contract, only steel products as herein defined shall be used or supplied in the performance of the contract or any subcontracts thereunder.<sup>19</sup>

The term “public agency” includes school districts<sup>20</sup> and instrumentalities thereof,<sup>21</sup> and the term “steel products” is defined as “products rolled, formed, shaped, drawn, extruded, forged, cast, fabricated, or otherwise similarly processed . . . from steel made in the United States.”<sup>22</sup> In addition, the Public School Code specifically states that school districts are required to comply with the SPP Act.<sup>23</sup>

In connection with the athletic field house project, the School District purchased a prefabricated steel building (60 feet wide by 207 feet long by 14 feet high) from an out-of-state manufacturer. The purchase price was \$74,542.

OSI obtained documents from the manufacturer relating to the transaction with the School District. The documents included the building specifications provided by the School District, the School District’s purchase order, the transmittal letter sent with the deposit check, the proposal from the manufacturer with the Superintendent’s signature in section titled “Acceptance of Proposal,” and the manufacturer’s Fabrication Release, again with the Superintendent’s signature as authorized signature to proceed. Nowhere in these documents is there a reference to the SPP Act or a requirement that the building be fabricated from steel produced in the United States.

We also reviewed the standardized bid forms used to solicit bids for the project. The SPP Act was not referenced in the forms by name, nor did bid forms contain a

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<sup>17</sup> Act of March 3, 1978, P.L. 6, No. 3, 73 P.S. § 1881 *et seq.* (“Steel Products Procurement Act”).

<sup>18</sup> 73 P.S. § 1887.

<sup>19</sup> 73 P.S. § 1884(a).

<sup>20</sup> 73 P.S. § 1886, Definitions, “Public agency,” paragraph (2).

<sup>21</sup> *Id.*, paragraph (5).

<sup>22</sup> 73 P.S. § 1886, Definitions, “Steel products.”

<sup>23</sup> 24 P.S. § 7-751(c).

statement that the contractor had to comply with all applicable governmental laws and regulations.

**Conclusions and Recommendations:**

The School District violated the Steel Products Procurement Act by failing to include its required provisions in the bid documents or in the contract for the purchase of the steel building for the athletic field house project.

We recommend that the Board and the Superintendent familiarize themselves with the provisions of the SPP Act and adhere to its provisions in the completion of this project and in all future construction projects.

A copy of this report is being forwarded to the Pennsylvania Department of Labor and Industry for whatever further action it may deem appropriate.

**Finding No. 5: The School District, and/or the nonprofit corporation created by it, paid unemployed workers in cash for work performed on the project, and appear to have evaded the requirements of the Unemployment Compensation Act, the Workers' Compensation Act, and local, state and federal income tax laws by failing to pay premiums for unemployment and workers' compensation insurance and by failing to withhold local, state, and federal income taxes from the compensation paid to the unemployed workers.**

The athletic field house is a steel building on a concrete floor and foundation with interior block walls partitioning off the locker rooms and bathrooms. It was alleged that the individuals who installed the block walls were unemployed block layers collecting unemployment benefits, and that these individuals were paid in cash for their work at the field house so as not to jeopardize their unemployment compensation benefits.

Through interviews with JMA's President and Vice-President, OSI was able to establish that:

- JMA needed the services of qualified block layers to install the interior walls as none of the School District's maintenance personnel had the experience to do so.
- In July 2003, JMA obtained the services of professional block layers from the local union who were unemployed at the time.
- The block layers were paid \$3,240 in cash that originated from JMA's bank account.

OSI was unable to interview any of the block layers because none of the witnesses we interviewed could provide any names, contact information, or information about how the block layers were hired. OSI was also told that the block layers were not from the local area.

A review of JMA's bank statements did not reveal any checks made payable to cash. However, OSI discovered six checks made payable to a School District employee, a JMA Board member, their respective sons, and the two sons of JMA's President. The sum of the six checks was \$3,240, the same amount that was allegedly paid to the block layers in cash.

OSI interviewed these six individuals, each of whom stated, with slight variations, that:

- They worked on the field house project as volunteers.
- They did not expect to be paid for the work.

- They did not keep track of the total hours they volunteered, nor did they know anyone who did.
- *None* of the individuals wanted the money.
- They endorsed or cashed their checks and then gave the endorsed checks or the cash back to JMA.

Three of these individuals admitted that they had donated the amount of their checks to the unemployed block layers working on the project.

**Conclusions and Recommendations:**

JMA officials paid unemployed professional block layers hired to install the interior walls at the athletic field house in cash, and tried to disguise the payments as payments to six individuals who were actually unpaid volunteers on the project. In so doing, JMA officials appear to have violated the withholding requirements of local, state, and federal income tax laws and the requirements of the Pennsylvania Unemployment and Workers' Compensation laws.

Copies of this report will be forwarded to the Pennsylvania Department of Revenue, the Pennsylvania Department of Labor and Industry, and the United States Internal Revenue Service for whatever further action they may deem appropriate.

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**RESPONSE OF JEFFERSON-MORGAN SCHOOL DISTRICT TO  
DRAFT REPORT**

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Jefferson-Morgan School District's written response to a draft of this investigative report consists of two letters from the School District's solicitor, both of which have been reproduced in their entirety on the following pages.

The Department of the Auditor General's comments on the School District's response follow immediately after the solicitor's letters.

**RADCLIFFE & DEHAAS, L.L.P.**

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October 2, 2006

EPD/bmm  
1180

Jack Wagner, Auditor General  
Office of Special Investigations  
327 Finance Building  
Harrisburg PA 17120

Re: Jefferson-Morgan School District

Dear Mr. Wagner:

I have been authorized by the Jefferson-Morgan School District (the District") to submit its response to the draft report your office sent to the school board (the "board") on or about September 8, 2006.

Without detailing the entire history of this project, by 2001 the District's Central School Building, which was built in 1927 and was most recently being used solely as an athletic facility, was obsolete and inadequate. In 2001, the District was advised by its architects that the building did not comply with Labor and Industry regulations and of the estimated cost of renovating that building. Rather than renovate that building, the District decided to construct a new field house on its Central School property. After receiving plans and specifications for a new field house from its architect and soliciting bids, the District eventually decided that it would enter into a lease with a nonprofit, charitable corporation pursuant to which the new field house would be constructed by that corporation. The major reason for the decision to form that corporation, and to enter into such a lease, was the prospect that some substantial monetary and in-kind donations would be made to that type of organization, which would reduce the public funds necessary for the project. Another reason that corporation was formed was to establish a permanent, charitable organization to support the District's athletic and other programs.

Sections 758 and 759 of the School Code allow the District to enter into a lease with a nonprofit corporation pursuant to which school buildings and athletic facilities can be constructed, and to appropriate money from the District's general fund to such a corporation for that purpose. No matter how frequently that procedure may have been used, it was and still is permissible, and it is the District's understanding that procedure has been used in recent years by several other local school districts which constructed athletic facilities.

The District helped incorporate Jefferson Morgan Athletics, Inc. ("JMA") pursuant to the Pennsylvania Nonprofit Corporation Law. After it was incorporated, JMA applied to the Internal Revenue Service for status as a Section 501(c)(3) charitable organization, and was granted that status.

It was and is the District's position that both Section 758 and Section 759 of the School Code applied to this project because the field house is used solely as an athletic facility which is part of and ancillary to its stadium, and therefore it is not literally a "school building". Because it is required by both Section 758 and Section 759, a proposed lease between the District and JMA was submitted to the Pennsylvania Department of Education ("PDE") and PDE approved the lease on September 12, 2002. Prior to approving it, PDE requested that the lease refer to only Section 758, and that change was made to the proposed lease. After PDE approved the lease, the District and JMA signed the lease.

Paragraph 7 of the lease clearly states that JMA would construct the field house in accordance with all applicable sections of the School Code, and other applicable statutes, and PDE approved the lease with the knowledge that this athletic facility would be built by JMA.

According to your Department's report, the allegations that lead to your investigation were that there was financial mismanagement, and conflicts of interest in connection with this project. Your report does not assert that there was any conflict of interest, and therefore it appears you found no basis for that allegation. The District made a good faith effort to oversee the use of the money it provided to JMA. It is the District's belief that all public funds which were spent by it, and by JMA, were used for the purpose intended, to construct a new field house, and were accounted for. Your staff spent countless hours auditing the use of those funds. While your report cites technical problems with the form of the contract documents used by JMA, the fact that the District used its own employees to perform part of the work, and JMA's failure to withhold taxes from \$3,240.00 of the funds used to pay persons who performed a small portion of the work, your report confirms that all the funds appropriated by the District for this project were used to construct the field house and were accounted for.

The District's comments on your particular findings are as follows:

1. As stated in your report, your finding is an opinion based on your staff's interpretation of the meaning of Section 758 of the School Code rather than a finding based on the express language of that section or a judicial interpretation of that section. The District did comply with the express provisions of Section 758 in that it requested and received PDE approval before it executed the lease with JMA. PDE approved the lease with the knowledge that JMA would construct the field house.

Section 758 expressly permitted the District to appropriate its funds to JMA to build the field house and there is no finding in your report that the funds were not used for that purpose.

Without reviewing all of the other sections of the School Code you cite, Section 731 of the School Code applies to the construction of "school buildings". The District has always followed Section 731 regarding the construction and renovation of its school buildings. PDE requested information regarding this project prior to approving the lease but never requested that the plans and specifications for the field house be provided. For that reason, and because the field house was to be used solely as an athletic facility, it was the District's belief that PDE's prior approval of the plans and specifications for the field house was not required. PDE never informed the District that the procedure that it was following was not consistent with the School Code.

If PDE now takes the position that the plans and specifications for the field house had to be submitted to it for approval, the District will be on notice of that position and will follow it in future situations involving its athletic facilities.

The lease did require competitive bidding to the extent that the School Code required it, and the District made a good faith effort to ensure that JMA complied with all bidding requirements. Although your report implies that contracts or purchases were structured in a piecemeal fashion to evade competitive bidding, you made no finding that that actually occurred. To the best of the District's knowledge, all contracts and purchases for this project were properly bid by it and JMA and there was no artificial division of contracts to avoid the bidding requirements of the School Code. As the lease has expired, in the event there is any additional work to be performed on the field house, the District will make sure that that work is done in accordance with all applicable sections of the School Code and other applicable statutes.

2. The District will await any further comment from PDE regarding Finding 2. The District understands the literal language of Section 751(b) of the School Code. There are many situations in which the District can and does properly use its own personnel to perform work on its facilities rather than to employ contractors to do the work and the District's taxpayers

benefit from such work being performed by competent District employees. To the extent that District employees were used on this project, that was done in an effort to reduce the cost to the District without compromising the quality of the project.

3. The board and Superintendent will familiarize themselves with the provisions of the Prevailing Wage Act and adhere to its provisions in connection with any further work on this project, and any other project, when that Act applies.

4. The District understands the requirements of the Steel Products Procurement Act and the board was not aware that that Act was not referenced in contract documents used by JMA in connection with this project. When its architects are involved in a project, the District's architects reference such statutes in the bid documents. To the best of the District's knowledge, references to this and other applicable statutes were in the plans and specifications and other bid documents prepared by its architects for this project, and it was the District's belief the same information was being used by JMA in its bid documents. The District will ensure that reference to that Act is made in contract documents for any future project when that is required. From your report, however, it appears that you did not find that the steel used in this project was not produced in the United States.

5. The District had no knowledge of the matters described under Finding 5 and agrees that procedure should not have been followed in paying persons for work performed. To the best of its knowledge, the District follows all of the statutes cited under that finding, and will make sure they are followed by the District in connection with any future project.

Please let me know if you have any question concerning the District's position. Otherwise, please attach this letter to your report if you are issuing the report.

Very truly yours,

RADCLIFFE & DeHAAS, L.L.P.

BY

  
Ernest P. DeHaas, III

cc: Donna M. Furnier, Superintendent  
All Board Members

**RADCLIFFE & DEHAAS, L.L.P.**

ATTORNEYS AT LAW

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October 20, 2006

EPD/bmm  
1180

Jack Wagner, Auditor General  
Office of Special Investigations  
327 Finance Building  
Harrisburg PA 17120

Re: Jefferson-Morgan School District

Dear Mr. Wagner:

I am writing to supplement my October 2, 2006 letter.

As your report does not mention it, it appears that your staff may not be aware that the District submitted an application for approval of the construction of the field house facility to the Department of Education ("PDE") and that that application was approved by PDE on or about November 8, 2001. That approval was referenced in my June 24, 2002 letter to Carle Dixon Earp of PDE with which I enclosed the proposed lease between the District and Jefferson Morgan Athletics, Inc. The application submitted by the District asked that PDE approve the plans and specifications for this project. The fact that the District obtained that approval indicates that the District did provide whatever information concerning the proposed construction of the field house that PDE determined was required under the School Code in order to issue that approval.

If your staff did not review the plans and specifications for the field house prepared by the District's architect, those plans and specifications did specifically reference the application to this project of the Steel Products Procurement Act and the Prevailing Wage Act, among other requirements. It was the District's intention that those plans and specifications would be provided to and used by Jefferson Morgan Athletics, Inc.

If you have not already issued your report, but do issue it, please include this letter, as well as my October 2, 2006 letter with your report.

Very truly yours,

RADCLIFFE & DeHAAS, L.L.P.

BY

  
Ernest P. DeHaas, III

cc: Donna M. Furnier, Superintendent  
All Board Members

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## **DEPARTMENT OF THE AUDITOR GENERAL'S COMMENTS ON THE SCHOOL DISTRICT'S RESPONSE TO DRAFT REPORT**

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We appreciate the detailed response drafted by the School District's solicitor. In preparing to comment on that response, we have carefully reviewed the evidence gathered in the investigation and thoughtfully reconsidered our interpretations of the applicable law and regulations as set forth in the report. This review and reconsideration has served to confirm the validity of our findings, and, accordingly, we have not deemed it necessary to make any changes of substance to the draft report. However, in addition to a few minor edits, we have added a statement that the person who was the School District's Superintendent at all times pertinent to this investigation is no longer in that position. Nevertheless, our recommendations remain valid and should be read to apply, where appropriate, to that person's successor(s).

Our comments on the School District's response to the draft report will first address the introductory paragraphs of the solicitor's letter of October 2, 2006, and then the numbered paragraphs pertaining to the five Findings in the report. The solicitor's letter of October 20, 2006, will not be addressed separately, although reference will be made to it in the discussion of the issues to which it is addressed.

Generally speaking, we can understand the solicitor's attempt to present the School District's position in the light most favorable to the School District, but we are constrained to point out the following inconsistencies and contradictions.

The solicitor asserts that a major reason for creating JMA was "the prospect [of] some substantial monetary and in-kind donations . . . which would reduce the public funds necessary for the project." However, he fails to mention that, as of December 2005, JMA had contributed a minuscule 2 1/4 percent of the funding for the project.

The solicitor asserts: "It was and is the District's position that both Section 758 and 759 of the School Code applied to this project because the field house is used solely as an athletic facility which is part of and ancillary to its stadium, and therefore it is not literally a 'school building.'" However, the two sections apply to two entirely distinct situations and are completely independent of each other. Section 758 applies solely to "school buildings," and Section 759 applies solely to "athletic stadia." Each section requires a lease with a nonprofit entity and approval by PDE, but the similarity ends there. Indeed, PDE recognized that the only section conceivably applicable to the School District's proposal was Section 758, relating to the construction of "school buildings," and accordingly instructed the School District to remove all reference to Section 759 from its application.

He also asserts: "Paragraph 7 of the lease clearly states that JMA would construct the field house in accordance with all applicable sections of the School Code, and other

applicable statutes, and PDE approved the lease with the knowledge that this athletic facility would be built by JMA,” as if to suggest that the School District was thereby absolved of all further responsibility to ensure that the applicable statutory requirements would be followed. Our finding did not suggest that the creation of JMA to build the field house was *per se* illegal or improper. Our finding was that, notwithstanding the creation of JMA to build the field house, the School District remained responsible to ensure compliance with the provisions of the Public School Code and other statutes applicable to the construction of school buildings.

He also asserts: “The District made a good faith effort to oversee the use of the money it provided to JMA.” Certainly, the School District was in a position to closely monitor every JMA disbursement. After all, the School District’s Business Manager served in the same capacity for JMA, the School District’s Superintendent served as JMA’s Executive Director, and JMA and the School District used the same bookkeeping system. Yet, despite its “good faith effort to oversee the use of the money it provided JMA,” the School District claims in its response to Finding 5: “The District had no knowledge of the matters described under Finding 5 [relating to the scheme to disguise cash payments to unemployed block layers] and agrees that procedure should not have been followed in paying persons for work performed.”

### **Finding No. 1**

The School District’s response is adamant in its assertion that it was perfectly legal for it to create, pursuant to Section 758 of the Public School Code, a nonprofit corporation to build the field house and to appropriate School District funds to it for that purpose. This is puzzling, because the Finding did not suggest otherwise. It merely stated that the use of a nonprofit corporation to construct the building does not relieve the School District, or the nonprofit it created, from complying with other statutory provisions governing the construction of school buildings.

There then follows a lengthy digression in rebuttal to matters not contained in any Finding in the report.<sup>24</sup> Granted, the discussion of Finding 1 in the report lists some of the more significant requirements of the Public School Code regarding the construction of school buildings, but there is no suggestion that the School District violated every requirement listed. The investigation found substantial evidence to support only the violations set forth in the specific Findings of the report.

The solicitor also construes the absence of a finding in the final report of a violation of the Ethics Act as tantamount to a complete exoneration of wrongdoing. Quite to the contrary, our investigation did reveal potential conflicts of interest as defined by the Ethics Act, in that two of the six checks used to compensate the block layers (Finding 5) were written to members of the immediate families of School District employees, and four of the six checks were written to JMA Board members or members

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<sup>24</sup> This section of the response (and the solicitor’s letter of October 20, 2006) takes great pains to demonstrate that plans and specifications were submitted to PDE and ultimately approved by PDE. We made no finding on this issue, and take no exception to the District’s discussion except to point out that the plans and specifications submitted to PDE were for a higher quality, and more costly, building than was ultimately built.

of their immediate families.<sup>25</sup> The initial explanation for these payments – later proven false – was that these checks were compensation for volunteer work the payees performed on the field house project. When the payees of these checks were questioned, however, it was revealed that the payees did not expect or want to be paid for their services, and that they cashed the checks and gave the cash proceeds to JMA and ultimately to the unemployed block layers working on the project. Because the investigation ultimately showed that the purpose of issuing the checks was not to confer a pecuniary benefit on the payees, the scheme proved to be not so much a violation of the Ethics Act as a ruse to disguise compensation paid “under the table” to the unemployed block layers in violation of labor and tax law. Accordingly, this report is not being forwarded to the State Ethics Commission, but rather is being forwarded to the Pennsylvania Departments of Labor and Industry and Revenue and to the United States Internal Revenue Service for their review and whatever further action they may deem appropriate.

### **Finding No. 2**

The School District’s response to this Finding is ambiguous in that it indicates an understanding of the “literal” language of Section 751(b) but wants to await further comment from PDE on the issue.<sup>26</sup> Given the blatant violation of the provision, the District should not expect a different position from PDE.

The Finding quotes a passage from the solicitor’s letter to the Superintendent of May 13, 2002, which indicates an apparent belief that the \$5,000 limit applies not to the entire cost or value of the project, including labor and materials, but only to each “separate subcontract where the cost of the labor is in excess of \$5,000.00.” The School District’s failure to include materials and nonlabor costs in the calculation of the \$5,000 limit is clearly erroneous. It is equally erroneous to divide a construction project in a piecemeal fashion into “separate subcontract[s]” to avoid exceeding the \$5,000 limit.

Finally, we would point out that, absent a cost saving analysis, it is mere conjecture that using School District maintenance personnel to build the field house saved money.

### **Finding No. 3**

The School District apparently takes no exception to Finding 3, and we commend the School District’s Board and Superintendent for their pledge to familiarize themselves with the provisions of the Prevailing Wage Act and adhere to its provisions in all future work on this project and other projects.

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<sup>25</sup> The Ethics Act applies not only to District officials and employees, but also to the officers of JMA. Because JMA was an entity organized by the District, JMA is also included in the Ethics Act’s definition of “political subdivision,” 65 Pa.C.S. § 1102.

<sup>26</sup> Section 751(b) provides, in pertinent part: “The board of school directors in any school district may perform any construction, reconstruction, repairs, or work of any nature, where the entire cost or value, including labor and material, is less than five thousand dollars (\$5,000), by its own maintenance personnel.”

#### **Finding No. 4**

We commend the School District for its pledge to “ensure that reference to [the Steel Products Procurement Act] is made in contract documents for any future project when that is required.” However, the School District contends that the Board was not aware that the Steel Products Procurement Act was not referenced in the contract documents for the project. We believe it is clear that, because of the close relationship between the School District and JMA, the nonprofit corporation created by it, the School District knew or should have known that the contract for the prefabricated steel building purchased for the project did not reference the Act.

The School District correctly points out that we “did not find that the steel used in this project was not produced in the United States.” If the Pennsylvania Department of Labor and Industry, upon reviewing our report, deems it appropriate, it can determine the origin of the steel used in the building.

#### **Finding No. 5**

We commend the School District for recognizing that the procedures described in Finding 5 should not have been followed in paying persons for work performed and for its assurances that the statutes cited in the finding are complied with in the future. However, because the School District created JMA and the School District’s Superintendent and Business Manager were so actively involved in the affairs of JMA, we must question the solicitor’s claim that “[t]he District had no knowledge of the matters described under Finding 5.” At the very least, it is inconsistent with the solicitor’s earlier claim that “[t]he District made a good faith effort to oversee the use of the money it provided to JMA.”

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## DISTRIBUTION LIST

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This report was distributed initially to the members of the Board of Directors of the Jefferson-Morgan School District, the District's current superintendent, its solicitor, and the following:

The Honorable Edward G. Rendell  
Governor

The Honorable Gerald L. Zahorchak, D.Ed.  
Secretary of Education

The Honorable Robin L. Wiessmann  
State Treasurer

The Honorable Stephen M. Schmerin  
Secretary of Labor & Industry

The Honorable Michael J. Masch  
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The Honorable James J. Rhoades  
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United States Internal Revenue Service

Lou Ann Evans  
President  
Pennsylvania School Boards Association

The Honorable Thomas W. Wolf  
Secretary of Revenue

This report is matter of public record. Copies of this report are available through the Department of the Auditor General's website, [www.auditorgen.state.pa.us](http://www.auditorgen.state.pa.us), and from the Department's Office of Communications, 318 Finance Building, Harrisburg, Pennsylvania 17120.