

HARRISBURG CITY SCHOOL DISTRICT
DAUPHIN COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

JANUARY 2013



**Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, Pennsylvania 17120-0018**

**JACK WAGNER
AUDITOR GENERAL**

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

Ms. Jennifer Smallwood, Board President
Harrisburg City School District
2101 North Front Street, Bldg 2
Harrisburg, Pennsylvania 17110

Dear Governor Corbett and Ms. Smallwood:

We conducted a performance audit of the Harrisburg City School District (HCSD) to determine its compliance with applicable state laws, contracts, grant requirements and administrative procedures. Our audit covered the period July 31, 2007 through October 15, 2010, except as otherwise indicated in the report. Additionally, compliance specific to state subsidy and reimbursements was determined for the school years ended June 30, 2008, 2007 and 2006. Our audit was conducted pursuant to 72 P.S. § 403 and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found that the HCSD complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures, except as detailed in seven findings noted in this report. In addition, we identified two matters unrelated to compliance that are reported as observations. A summary of these results is presented in the Executive Summary section of the audit report.

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

Sincerely,

/s/

**JACK WAGNER
Auditor General**

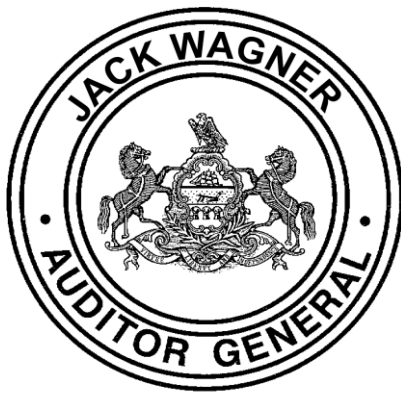
January 14, 2013

cc: **HARRISBURG CITY SCHOOL DISTRICT** Board Members



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Executive Summary

Audit Work

The Pennsylvania Department of the Auditor General conducted a performance audit of the Harrisburg City School District (HCSD). Our audit sought to answer certain questions regarding the District's compliance with applicable state laws, contracts, grant requirements, and administrative procedures; and to determine the status of corrective action taken by the HCSD in response to our prior audit recommendations.

Our audit scope covered the period July 31, 2007 through October 15, 2010, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidy and reimbursements was determined for school years 2007-08, 2006-07 and 2005-06.

District Background

The HCSD encompasses approximately 11 square miles. According to 2000 federal census data, it serves a resident population of 48,950. According to District officials, in school year 2007-08 the HCSD provided basic educational services to 8,391 pupils through the employment of 723 teachers, 209 full-time and part-time support personnel, and 60 administrators. Lastly, the HCSD received more than \$71.8 million in state funding in school year 2007-08.

On May 3, 2000, the Governor signed the Education Empowerment Act (EEA) to help struggling school districts make dramatic changes to give all Pennsylvania's children

the education they deserve and to enable all school districts to seek mandate relief. Under the EEA, the Secretary of Education used the Pennsylvania System of School Assessment (PSSA) test to identify districts with a history of low test performance, defined as districts that have a combined average of 50 percent or more students scoring in the bottom-measured group in the PSSA math and reading for the previous two years.

In a letter dated July 17, 2000, the Secretary of Education notified the superintendent that the HCSD had been included on the Education Empowerment List. The HCSD was included in this list because of the low test performance of its students in math and reading for the previous two years. Specifically, the percentage of District students scoring in the bottom-measured group was 68.1 percent.

As a result of the HCSD's placement on the list of empowerment districts, the District was required to appoint an 11 member empowerment team that was charged with developing a plan to improve the academic performance of schools and students within the HCSD. The board of directors appointed the empowerment team on August 15, 2000.

On December 4, 2000, the Secretary of Education notified the District that pursuant to Section 1707-B, as amended by Act 91 of 2000, the HCSD was certified as an empowerment district. Under the provisions of Act 91, the Mayor of Harrisburg was to appoint a five-member board of control, which would assume the day-to-day operations of the HCSD. The board of

control was appointed by the Mayor of Harrisburg and had its first meeting on December 20, 2000.

On June 30, 2010, Act 91 of 2000 expired and the elected board assumed leadership of the District.

Audit Conclusion and Results

Our audit found that the HCSD complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures except for seven compliance-related matters reported as findings. In addition, two matters unrelated to compliance are reported as observations.

Finding No. 1: Cafeteria Fund Deficit of \$517,678. Our audit found that HCSD had a cafeteria fund deficit of \$517,678 as of June 30, 2009 (see page 8).

Finding No. 2: Continued Certification Deficiencies. Our audit of the certification of 124 individuals found 39 certification deficiencies (see page 11).

Finding No. 3: District's Reimbursements Based on Child Accounting Data Were Unverifiable. Our audit of the child accounting data for the 2007-08, 2006-07, and 2005-06 school years found numerous child accounting errors, resulting in our inability to verify HCSD's entitlement to subsidies totaling \$5,179,283 (see page 15).

Finding No. 4: District Did Not Provide Students in Special Programs With Mandated Instructional Hours, in One Instance Resulting in a Loss of \$400,811 in State Funding. Our audit of HCSD's secondary level alternative education and credit recovery programs found that they did not provide the minimum mandated

990 hours for students in an alternative education program during the 2007-08 school year. This failure resulted in a loss of \$400,811 in basic education subsidy. In addition, our audit found that HCSD may not have provided the minimum mandated 990 hours of instructional time for students enrolled in the credit recovery program for the 2009-10 and 2008-09 school years (see page 22).

Finding No. 5: Lack of Memorandum of Understanding. Our audit found that HCSD did not have a signed Memorandum of Understanding with their local enforcement agency available for audit (see page 27).

Finding No. 6: Continued Weak Internal Controls in Procedures Used to Process Requests for Reimbursement. Our audit found internal control deficiencies in the processing of employee expenses, including travel, for the 2008-09 and 2007-08 school years (see page 29).

Finding No. 7: Continued Athletic Fund Deficit of \$1,405,094. Our audit found that HCSD had an athletic fund deficit of \$1,405,094 as of June 30, 2009 (see page 33).

Observation No. 1: District Continues to Increase Debt Obligations. Our audit found that HCSD had gone from a deficit balance of \$2,960,656 as of June 30, 2006, to a positive fund balance of \$2,761,201 as of June 30, 2009. However, this increase in fund balance resulted from borrowing money to fund current operations (see page 37).

Observation No. 2: The District Finances Some of Its Debt with Interest Rate Management Agreements, Which Could Jeopardize Taxpayer Funds.

Although HCSD eliminated three of its qualified interest rate agreements (swaps) during the audit period, it still had \$207 million of variable-rate debt tied to swap agreements as of June 30, 2010. This discovery is of concern because it puts a significant amount of taxpayer money at risk (see page 45).

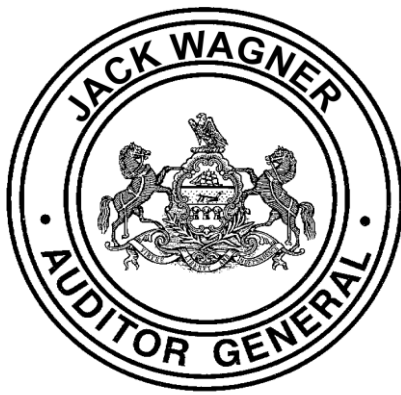
Status of Prior Audit Findings and Observations.

With regard to the status of our prior audit recommendations to the HCSD from an audit we conducted of the 2004-05, 2003-04, and 2002-03 school years, we found HCSD had taken appropriate corrective action in implementing our recommendations pertaining to:

- Inaccurate Reporting of the Number of Nonpublic Pupils Transported Resulted in Transportation Subsidy Underpayments of \$46,970 (see page 53).
- Administrative Wage Errors (see page 55).
- Social Security and Medicare Taxes Reimbursement Underpayments (see page 59).

We also found that HCSD had not taken appropriate corrective action or had only partially implemented our recommendations for some of our findings. In other cases, corrective actions were only implemented during the 2009-10 school year, and we will therefore verify their effectiveness in our next audit. These prior audit findings included:

- General Fund Deficit of \$2,960,656 (see page 50).
- Early Childhood Fund Deficit of \$3,093,804 (see page 51).
- Athletic Fund Deficit of \$944,883 (see page 52).
- Vehicle Mileage Allowances Violated Internal Revenue Service Regulations (see page 53).
- Failure to Obtain Memorandum of Understanding (see page 55).
- Unmonitored Vendor System Access and Logical Access Control Weaknesses (see page 56).
- Weak Internal Controls in Procedures Used to Process Requests for Reimbursement (see page 58).
- Certification Deficiencies (see page 60).
- Inaccurate Reporting of Membership (see page 62).
- Inadequate Computer Controls (see page 63).
- Inability to Provide Complete and/or Accurate Data Supporting Reports Submitted to the Department of Education (see page 65).
- Board Members Failed to File Statements of Financial Interests in Violation of the State Public Official and Employee Ethics Act (see page 65).



Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

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

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

Our audit covered the period July 31, 2007 through October 15, 2010, except for the verification of professional employee certification which was performed for the period July 1, 2007 through June 30, 2010.

Regarding state subsidy and reimbursements, our audit covered school years 2007-08, 2006-07 and 2005-06.

While all districts 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 (PDE) reporting guidelines, we use the term school year rather than fiscal year throughout this report. A school year covers the period July 1 to June 30.

Objectives

What is the difference between a finding and an observation?

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

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

- ✓ Were professional employees certified for the positions they held?
- ✓ In areas where the District receives state subsidy and reimbursements based on pupil membership (e.g. basic education, special education, and vocational education), did it follow applicable laws and procedures?

- ✓ In areas where the District receives state subsidy and reimbursements based on payroll (e.g. Social Security and retirement), did it follow applicable laws and procedures?
- ✓ Did the District follow applicable laws and procedures in areas dealing with pupil membership and ensure that adequate provisions were taken to protect the data?
- ✓ Is the District's pupil transportation department, including any contracted vendors in compliance with applicable state laws and procedures?
- ✓ Does the District ensure that Board members appropriately comply with the Public Official and Employee Ethics Act?
- ✓ Are there any declining fund balances which may impose risk to the fiscal viability of the District?
- ✓ Did the District pursue a contract buy-out with an administrator and if so, what was the total cost of the buy-out, reasons for the termination/settlement, and do the current employment contract(s) contain adequate termination provisions?
- ✓ Were there any other areas of concern reported by local auditors, citizens, or other interested parties which warrant further attention during our audit?
- ✓ Did the District take appropriate steps to ensure school safety?
- ✓ Did the District use an outside vendor to maintain its membership data and if so, are there internal controls in place related to vendor access?
- ✓ Did the District take appropriate corrective action to address recommendations made in our prior audits?

Methodology

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

What are internal controls?

Internal controls are processes designed by management to provide reasonable assurance of achieving objectives in areas such as:

- Effectiveness and efficiency of operations;
- Relevance and reliability of operational and financial information;
- Compliance with applicable laws, contracts, grant requirements and administrative procedures.

HCS D management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the District is in compliance with applicable laws, contracts, grant requirements, and administrative procedures. Within the context of our audit objectives, we obtained an understanding of internal controls and assessed whether those controls were properly designed and implemented.

Any significant deficiencies found during the audit are included in this report.

In order to properly plan our audit and to guide us in possible audit areas, we performed analytical procedures in the areas of state subsidies/reimbursement, pupil membership, pupil transportation, and comparative financial information.

Our audit examined the following:

- Records pertaining to pupil transportation, bus driver qualifications, professional employee certification, state ethics compliance, and financial stability.
- Items such as Board meeting minutes, pupil membership records, and reimbursement applications.

Additionally, we interviewed selected administrators and support personnel associated with HCS D operations.

Lastly, to determine the status of our audit recommendations made in a prior audit report released on April 29, 2008, we reviewed the HCS D's response to PDE dated September 20, 2010. We then performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1

Cafeteria Fund Deficit of \$517,678

Criteria relevant to the finding:

The Manual of Accounting and Related Financial Procedures for Pennsylvania School Systems notes the importance of the operating budget cycle. This process includes budget preparation, budget analysis, board approval, adoption, budget control, and budget to actual reports.

The manual addresses each part of budgeting cycle in detail; however, we would like to emphasize the following:

- The accurate estimation of revenue has a critical impact on the budget.
- Analysis of historical trends is a reliable method for the projection of revenue and expenditures for budget preparation and analysis.
- During the budget year, revenue collections and expenditures should be monitored on a monthly basis.

Our review of the District's annual financial reports and local auditor's reports for the school years ended June 30, 2009, 2008 and 2007 found the cafeteria fund had a deficit of \$517,678 as of June 30, 2009.

Actual expenditures exceeded actual available revenues for all three years of our audit, resulting in deficits as follows:

School Year Ending <u>June 30</u>	Beginning Fund <u>Balance</u>	Actual <u>Revenue</u>	Actual <u>Expenditures</u>	Ending Fund <u>(Deficit)</u>
2007	\$ 124,422	\$4,774,720	\$5,048,276	\$(149,134)
2008	(149,134)	5,009,834	5,212,410	(351,710)
2009	(351,710)	5,575,859	5,741,827	(517,678)

The revenues shown above include investment revenue, breakfast and lunch sales, state subsidy for cafeteria services, state reimbursements of the District's Social Security, Medicare and federal food subsidies and contributions, and retirement contributions for cafeteria employees.

The District provided the following eight reasons as to why expenditures exceeded revenues over the past three years:

1. Employee medical benefits have increased each year.
2. Union employees have received salary increases each year.
3. All employees, including part-time, are now entitled to 11 paid sick days per year.
4. New state regulations require the District to offer more fresh fruit, whole grains and vegetables, which are more costly.
5. Milk prices have increased each year.
6. Maintenance of cafeteria equipment and facilities is also charged to the cafeteria fund.

7. Reimbursement rates have not increased over the last three years as much as the other costs.
8. The District has not increased breakfast or lunch prices over the last three years.

All cafeteria expenditures were paid through the general fund, and the general fund was reimbursed by the cafeteria fund when revenues were received. However, the revenues have not been sufficient to support cafeteria fund expenditures, which will require the general fund to provide supplemental funding. Given the current financial condition of the general fund, the District does not have the option to compensate for cafeteria revenue shortfalls.

We recognize the importance of the District's cafeteria operations, given the fact that some of the District's students may not receive another meal beyond the one they get at school. We are not suggesting that the District curtail its cafeteria service, but rather that it should identify ways to mitigate the cafeteria fund deficit's impact on the District's overall finances.

Recommendations

The *Harrisburg City School District* should:

1. Evaluate the cafeteria fund operations to ensure revenue collection procedures and internal controls are adequate.
2. Prepare realistic budgets based on historical data to ensure revenue projections are realistic.
3. Establish a realistic plan to address the revenue shortfall that has occurred over the past three years.

Management Response

Management stated the following:

“The Harrisburg School District is a high poverty district with 90% of our students on Free & Reduced Lunch. In addition to the lunch program, the Harrisburg School District operates a full breakfast program in all of its schools. In many cases, school provided meals are the only meals our students receive. The subsidy available from the National School Lunch program does not fully cover the cost of providing food service and due to the high poverty rate, the District is unable to raise the lunch prices for those

who are not on Free & Reduced meals. This problem is further exacerbated by the recent changes in school nutrition requirements, which require higher cost meals ingredients. The District has attempted to minimize the cost by aggressively pursuing the most cost effective suppliers and operating with minimum staffing.”

Auditor Conclusion

We recognize that the high level of poverty in the District’s student population makes it much more difficult for District administrators to manage this fund. We also recognize that these issues do not likely exist to the same degree as many districts within the Commonwealth, although it is probable that certain other mid-sized urban school districts, such as those located in Reading, Erie and Allentown, have similar challenges. Nevertheless, the District needs to address these budgetary issues to ensure that its cafeteria fund does not continue to experience increasing fund deficits that the District cannot afford to cover, and which will impact the District’s overall financial position. To achieve this, the District might consider discussing these complicated issues with districts in the cities referenced above, to see if they have any suggestions on how to address problems related to managing food service in a high poverty student population.

Finding No. 2 →

Continued Certification Deficiencies

Criteria relevant to the finding:

Section 1202 of the Public School Code provides, in part:

“No teacher shall teach, in any public school, any branch which he has not been properly certified to teach.”

Section 2518 of the Public School Code provides, in part:

“[A]ny school district, intermediate unit, area vocational technical school or other public school in this Commonwealth that has in its employ any person in a position that is subject to the certification requirements of the Department of Education but who has not been certificated for his position . . . shall forfeit an amount equal to six thousand dollars (\$6,000) less the product of six thousand dollars (\$6,000) and the district’s market value/income aid ratio.”

Our audit reviewed professional employees’ certification for a selection of 124 of the District’s professional employees for the period July 1, 2007 through June 30, 2010. Ninety-one of those employees in the sample were cited in the prior report covering the school years 2004-05, 2003-04, and 2002-03, while the other 33 were new District employees. Based on this review, we determined whether the District took corrective action on the prior audit deficiencies as determined by the Bureau of School Leadership and Teacher Quality (BSLTQ), Pennsylvania Department of Education, and we also determined whether individuals employed since the last audit were properly certified. We found 39 individuals with deficiencies; 24 of these individuals were cited in our prior audit for the years ended June 30, 2005, 2004 and 2003.

As noted in the background section of this report, the District was declared an empowerment district. The Education Empowerment Act (Act 91) allows empowerment districts to employ professional staff in accordance with Section 1724-A(a) of the Charter School Law as it pertains to certification. The Charter School Law allows certain schools and districts to operate with only 75 percent of their professional staff members holding appropriate certification. On June 30, 2010, Act 91 of 2000 expired, thereby removing the 75 percent certification guidelines. Therefore, even though the deficiencies indicated in this finding may fall within the 75 percent guidelines and the District might not be subject to subsidy forfeitures, the deficiencies should still be addressed because Act 91 has expired.

Information pertaining to the certificates and assignments was submitted to BSLTQ for review. Based on BSLTQ’s final audit review dated March 31, 2011, the District had the following deficiencies:

1. Twenty-one individuals did not hold a valid emergency permit or certificate at the time of hire, or remained employed with a lapsed certificate.

2. Seven individuals were employed with emergency permits that were pending evaluation from PDE at the time of hire.
3. Eleven individuals were employed in positions without holding proper certification, as follows:
 - One individual holding only an English certificate was initially assigned to the locally-titled position of director of extended learning programs, then to the position of acting assistant principal, and finally to the position of assistant principal.
 - One individual with elementary and mid-level citizenship certificates was employed as an assistant to the principal.
 - One individual with an elementary certificate was employed as an assistant secondary principal.
 - One individual with an elementary principal certificate was assigned to the locally-titled position of supervisor of English language acquisition.
 - One individual with a mathematics certificate was employed as an English as a secondary language teacher.
 - Two individuals with biology certificates were assigned as physical science teachers.
 - One individual with certificates in special education and English was assigned to the locally-titled position of student behavior specialist.
 - One individual with a vocational instruction certificate in drafting was assigned to the position of assistant to the principal.
 - One individual with an elementary certificate was assigned to the locally-titled position of a two-way immersion teacher.
 - One individual with a special education certificate was assigned to the locally-titled position of YouthBuild coordinator/case manager.

Since BSLTQ confirmed the deficiencies, the District is subject to the following subsidy forfeitures.

<u>School Year</u>	<u>Subsidy Forfeitures</u>
2009-10	\$33,444
2008-09	30,609
2007-08	<u>28,606</u>
Total subsidy forfeitures	<u>\$92,659</u>

Recommendations

The *Harrisburg City School District* should:

1. Require the individuals cited to obtain proper certification for the positions assigned or reassign them to positions for which they are properly certified.
2. Review and determine if all current professional personnel are properly certified for their assignment.
3. Establish procedures to ensure that emergency permits are obtained in a timely manner.
4. Require all individuals employed by the District to obtain the appropriate certificate prior to starting employment with the District.
5. Submit all locally-titled positions to BSLTQ for review and determination of the appropriate certification for the positions.

The *Pennsylvania Department of Education* should:

6. Recover any subsidy forfeitures that may be levied.

Management Response

Management stated the following:

“The District hired a new Director of Human Resources in May 2011 and she has not had sufficient time to completely review the District’s past practices. In an effort to move into compliance, the District, at the conclusion of the 2009-2010 school year, terminated all employees who were working on emergency certifications. The Board minutes

from June 2010, indicated that this action was carried out and Board approved. If there are any remaining uncertified professionals, they remain due to an oversight. The Human Resource Department staff will be conducting a certification audit to ensure compliance.

“The District hiring practices were also adjusted to ensure that non-certified people are not hired and that emergency certified people are only hired after a bona fide search for a certificated individual is unsuccessful. This practice is being continued. The District is about to begin the hiring processes for two certificated positions and is requiring that candidates provide proof of certification. Anyone without proper certification, is not a qualified candidate and cannot be considered for employment in these positions.”

Finding No. 3

District’s Reimbursements Based on Child Accounting Data Were Unverifiable

Criteria relevant to the finding:

Section 1332 of the Public School Code requires that reports of enrollments, attendance, and withdrawals be maintained for all children.

Section 518 of the Public School Code requires that records be retained for a period of not less than six years.

Section 1357 of the Public School Code provides:

“The Superintendent of Public Instruction upon due hearing, after two (2) weeks’ written notice to the board of school directors affected, may withhold and declare forfeited any part, or all, of the State appropriation of any school district which refuses or neglects to comply with and to enforce the provisions of this article in the manner satisfactory to him.”

Our audit of the District’s child accounting data for the 2007-08, 2006-07 and 2005-06 school years found numerous child accounting errors resulting from computer program deficiencies, mass updates by the student information system vendor and/or the District’s technology department, and data entry and calculation. In addition, the District lacked adequate documentation in its student information system to support the reimbursements. All these deficiencies, and in particular the lack of supporting documentation, were significant enough to call into question the validity and reliability of the membership data that was reported by the District to PDE. Consequently, these deficiencies prevented us from verifying the District’s entitlement to the \$5,179,283 in the following subsidies and reimbursements, which were based on the data it reported to the Department of Education (PDE):

School Year	Subsidy		Totals
	Basic Education Funding	Special Education Subsidy	
2007-08	\$2,125,297	\$ 97,250	\$2,222,547
2006-07	922,502	173,070	1,095,572
2005-06	<u>1,726,086</u>	<u>135,078</u>	<u>1,861,164</u>
Totals	<u>\$4,773,885</u>	<u>\$405,398</u>	<u>\$5,179,283</u>

Note: The questionable subsidies were computed by deducting the prior year guarantee from the subsidy that was received.

Computer Program Deficiencies/Mass Updates

During our audit of the District’s membership data for the school years 2005-06, 2006-07 and 2007-08, we identified the following errors:

1. The number of membership days on the District’s detailed membership printouts for the 2006-07 and 2005-06 school years did not agree with the number of

membership days listed on the summary reports for those years used to report membership days to PDE.

2. Two different sets of dates appeared on the detailed membership printouts that were used to calculate student membership days.
3. Incorrect dates were forced into various data fields used to calculate membership data because the updates the vendor or technology department made to the student information system were applied to the total population of records, regardless of whether or not a change to every record was necessary.
4. The membership days for some students were duplicated.
5. Student entry and withdrawal dates, and grade totals, were not included on the 2006-07 school year detailed building membership printouts provided for audit. In addition, membership days were listed on the detailed printouts without student names or identification numbers.¹
6. Detailed building membership printouts for the 2005-06 school year listed student names for individuals who were in other buildings.
7. Detailed building membership printouts for the 2005-06 school years listed the incorrect school year for certain students, which resulted in an inaccurate reporting of membership days.
8. The membership days on a regenerated detailed membership printout for the 2006-07 school year and the corresponding summary membership report for the same year did not match with the number of membership days the District reported to PDE. For example, some students whose membership days were reported to PDE under the resident classification were listed under the nonresident classification on regenerated detailed printouts.

¹ Beginning with the 2007-08 school year, the vendor made corrections to the computer program. As a result, the membership printouts had student names associated with all of the membership days, and included the students' entry and withdrawal dates, as well as totals for each grade.

When we presented these errors to District personnel they stated that these problems were caused by deficiencies in the District's membership computer program and/or by the updates made to the membership data by the vendor and the technology department. For example, many of the incorrect dates we identified in the various data fields used to calculate membership data were caused by updates made to the student information system by the vendor or technology department, which inappropriately applied a change to the total selected population of a group of records, regardless of whether a revision to every record was necessary.

Moreover, District personnel stated that the District's pupil services and the technology departments knew about the errors prior to the deadline for submitting the District's membership data to PDE for the 2006-07 school years, but District staff was unable to correct the problems due to the following:

- Time constraints related to the mandated deadline for submitting membership data to PDE.
- Programming errors at the vendor level.
- The adoption of a new student management system (SMS) in 2006-07.

Consequently, the District's 2006-07 school year membership data **was never corrected**, and the District did not indicate that it ever made PDE aware of these errors.

District personnel did identify and manually correct membership reporting errors in the SMS for the 2007-08 school year prior to submitting that data to PDE. However, following this submission, the vendor was notified of the reporting problems and issued a software update to the SMS. This update altered some of the manual corrections District personnel made to the 2007-08 membership data, and these alterations went undetected. District personnel did not backup the 2007-08 school year membership data prior to the software vendor update. Therefore, the District was unable to reproduce the corrected 2007-08 school year membership information that it says it submitted to PDE.

Additional Data Reporting Errors

Our audit also found data entry and data calculation errors in the District's membership data that had not been previously detected or corrected by District personnel, resulting in additional inaccuracies in the membership data reported to PDE. The errors are as follows:

1. For the 2007-08, 2006-07, and 2005-06 school years, membership days were calculated by adding together membership days that were based on two or more calendars with different term lengths. The total membership days were then reported under a single term, not considering how this would impact the average daily membership of the data reported to PDE.
2. For the 2005-06 school year, membership reported to PDE was not based on the actual number of instructional days provided for some classifications of students.
3. For the 2005-06 school year, membership data for certain students was missed or omitted when District personnel prepared reports for submission to PDE.
4. For the 2005-06 school year, District personnel made a data entry error for one term when transferring membership days from the District's membership reports to the reports submitted to PDE. District personnel indicated that they discovered the error after submission to PDE, corrected their paper copy, but failed to submit the correction to PDE.

Lack of Documentation for Unexcused Absences

Our audit of 25 students with unexcused absences in excess of 100 days during the 2005-06 school year found that the District did not obtain and retain adequate documentation for 19 of the 25 students. District personnel could not provide documentation supporting that the District adequately pursued truant students, which is required to allow the District to keep students with ten consecutive days of unexcused absence on the membership reports. District personnel were able to provide copies of citation dockets obtained through the local police department for only 6 of the 25 students. District personnel stated that

they could not provide any other documentation to verify the District was adequately pursuing truants because the files containing the supporting documentation had been destroyed when the building housing these records flooded. Consequently, the District may have inappropriately received subsidies and reimbursements for these students.

All the errors described above were significant enough to call into question the validity and reliability of the membership data that the District reported to the PDE for school years 2007-08, 2006-07 and 2005-06. Therefore, the District's entitlement to the \$5,179,283 it received in state subsidies and reimbursements for those years cannot be substantiated. Moreover, the District's serious lack of documentation supporting the membership data it submitted to PDE and its pursuit of chronically truant students is a serious internal control weakness. Without this documentation, management has no assurance that the District's child accounting data was collected, recorded, and reported accurately in accordance with the PDE instructions during the 2007-08, 2006-07 and 2005-06 school years.

Recommendations

The *Harrisburg City School District* should:

1. Continue to work with the vendor to gain a better understanding of how membership data is being compiled and how membership days are calculated, in order to ensure that the membership reports are accurate.
2. Review detailed membership printouts to ensure that membership data calculations are accurate. The reviews should include, but not be limited to, confirmation that membership days are not reported in duplicate, the calendar data is accurate, and entry/withdrawal dates are accurate. If program deficiencies are noted, the vendor should be contacted to resolve the deficiencies.
3. Reconcile membership summary reports to detailed membership printouts for agreement. If errors are found, corrections to the appropriate documents should be made and used to submit accurate data to PDE.
4. Membership printouts supporting the data reported to PDE should be retained, and not regenerated.

5. District personnel should maintain adequate documentation showing that appropriate actions are being taken for students who are maintained on District membership reports after ten consecutive days of unexcused absence (i.e., unexcused absence letters sent to parents, meetings with parents, citations, or other documentation supporting that the District is trying to get the students back into school).
6. The documentation used to support student membership records should be stored in a secure location.
7. Review reports for years subsequent to the audit and if errors are found submit revised reports to PDE.

The *Pennsylvania Department of Education* should:

8. Review the propriety of the subsidies and reimbursements paid to the District, particularly for the year 2006-07 when the District knowingly submitted incorrect data.

Management Response

Management stated the following:

“The District’s Technology Department will create a yearend Child Accounting Directory on a different server to store the Child Accounting information. Access will only be granted for select Child Accounting personnel. The Technology Department will communicate with the Child Accounting Area to see if vendor updates are needed to this Directory.

“The Child Accounting Department will be required to maintain a hardcopy of data used to report membership to the Pennsylvania Department of Education (PDE). Anytime the membership changes and is reported to PDE, hardcopy reports will be processed and kept on file for audit review.

“When the vendor makes updates to the directory, District personnel will review the reports to ensure that the data the report is capturing is correct. Any errors in the report calculations will be promptly reported to the vendor for resolution. The Child Accounting Department will follow up to ensure that the problem has been resolved.

“The District is creating a Central Registration Department which will help eliminate the clerical errors that occur. This Department will be reviewing the data on a quarterly basis to correct errors and check for problems in the data.”

Finding No. 4 →

District Did Not Provide Students in Special Programs with Mandated Instructional Hours, in One Instance Resulting in a Loss of \$400,811 in State Funding

Criteria relevant to the finding:

Section 15-1501 of the Public School Code provides, in part:

“All public kindergartens, elementary and secondary schools shall be kept open each school year for at least one hundred eighty (180) days of instruction for pupils.”

22 Pa Code 11.3(a) of the State Board of Regulations states that the minimum hours of instruction time for students in grades 7-12 shall be 990 hours for the school term.

Section 15-1504(a) of the Public School Code provides, in part:

“The Secretary of Education may . . . approve . . . a school year containing a minimum of nine hundred ninety hours of instruction at the secondary level . . . as the equivalent of one hundred eighty (180) school days.

22 Pa Code 11.5(a) of the State Board of Education Regulations states:

“Students of school age may qualify for graduation by attending the public school part-time when lawfully employed part-time or when officially enrolled in a postsecondary institution part-time. For reimbursement purposes, membership in the public school shall be calculated by counting the time the students spend in the public school on a pro rata basis.”

Our audit of the District’s secondary level alternative education strategy found that the Pennsylvania Department of Education (PDE) had concluded that during the 2007-08 school year the District did not provide the minimum mandated 990 hours of instruction time for students in the alternative education program, which resulted in a loss of \$400,811 in basic education funding. Our review of the 2006-07 and 2005-06 school years did not identify similar adjustments by PDE.

In addition, our audit found that the District may also not have provided the minimum mandated 990 hours of instructional time for students enrolled in the credit recovery program for the 2009-10 and 2008-09 school years. However, the District’s lack of documentation related to attendance prevented us from determining how much time each student actually spent in the credit recovery program. Therefore, we could not recommend specific adjustments to the District’s state subsidies. Nevertheless, we could determine that the membership days for students in the credit recovery program were inappropriately combined with the membership days for the alternative education program. The two were reported to PDE together to obtain the total membership days necessary.

Based on the membership printouts dated July 6, 2010, District personnel did not reduce membership days for any students who may not have received 990 hours of instruction. As a result, the District may have received more subsidy than it was entitled to receive.

Instructional Hours for Alternative Education

Based on information obtained during the planning phase of our audit, we examined the District’s alternative education program. We found that PDE had already determined that the District had not provided the students in that program with the minimum 990 hours of instructional time in the 2007-08 school year. As a result of this determination, PDE reduced the District’s basic education subsidy for that year by \$400,811. This

reduction of subsidy was particularly difficult for the District to absorb because it occurred at a time when it was already having serious financial difficulties.

PDE approved the District's operation of an alternative education program for disruptive youth for the 2007-08 school year, and required that the students in the program receive a minimum of 990 hours of instructional time.

Based on District calculations, the District began the school year providing 5 hours and 50 minutes per day of instructional time, which should have provided the students with the required 990 hours of instructional time. However, effective December 17, 2007, the District only offered three hours per day of instructional time to students in the alternative education program. According to District personnel, this reduction in hours was an attempt at cost savings, but the District did not obtain the appropriate PDE approvals for reducing the number of hours of instruction provided by the program.

In February 2008, PDE learned from a student's parent that the District had reduced the instructional hours, and PDE subsequently notified the District that it was not in compliance with its alternative education program approval. The students in grades 8 through 11 who attended the alternative education program were reported to PDE as receiving 682 hours of instructional time, and students in grade 12 were reported as receiving 693 hours of instructional time.

Credit Recovery Program

As a result of information obtained during the planning phase of our audit, we analyzed the instructional hours provided to students in the credit recovery program. The credit recovery program operated at one building within the District during the 2009-10 and 2008-09 school years. It offered to get students back on track towards graduation when they did not have the required number of credits. Membership printouts that were provided showed students in grades 9 through 12 were educated in this program.

The credit recovery program operated in two three-hour sessions, with one session in the morning and one in the afternoon. It did not meet the requirements to be approved

as an alternative education program, nor did the District apply for any waivers of the mandated instructional hours. As a result, the District was still required to provide the students in the credit recovery program with the minimum 990 hours of instructional time mandated by the Public School Code.

According to District personnel, the child accounting staff was initially under the impression that students were in the credit recovery program for part of the day and the alternative education program for part of the day, thereby receiving a full day of instruction. As a result, child accounting personnel did not verify instructional hours for compliance. Moreover, in the 2008-09 school year membership for students in the credit recovery program was combined with membership for students in the alternative education program and reported to PDE under the same term. As a result, students in the credit recovery program were reported as having more than 990 hours of instructional time. This may not have been accurate, based on interviews with District personnel indicating that students in the credit recovery program were not necessarily in the alternative education program.

Instead, based on student schedules reviewed for the 2009-10 and 2008-09 school years, interviews with District personnel, and a lack of supporting documentation indicating otherwise, we concluded that various students appeared to be enrolled in only one session of the credit recovery program or three hours per day. Therefore, if students were only enrolled in one of the two sessions, these students would not have received the mandated 990 hours of instructional time for either the 2009-10 or the 2008-09 school years. However, we could not determine how much time students actually spent in the credit recovery program because of the District's insufficient attendance documentation. Per District personnel, beginning with the 2009-10 school year, students were required to sign into a book when they arrived and sign out when they left school. However, there was not a procedure in place that would enable the District to track the time a student left if they failed to sign out. It was confirmed the District did not have any procedure in place for the 2008-09 school year to verify the instructional time students were receiving in this program. Without being able to verify the accuracy of the instructional time or membership data

reported to PDE, we could not recommend adjustments to the District's subsidies.

As of October 5, 2010, reports for the 2009-10 school year had not been submitted to PDE. Thus, we could not determine how instructional time or membership was going to be reported by the District.

District personnel have indicated that the credit recovery program has been discontinued for the 2010-11 school year.

Recommendations

The *Harrisburg City School District* should:

1. Develop policies and procedures to ensure that minimum mandated hours are provided to all students, or that the appropriate mandate waivers are obtained from PDE prior to offering programs.
2. Contact PDE to determine how membership, attendance, and instructional time should be reported for the students in the credit recovery program for the 2009-10 and 2008-09 school years and determine what adjustments, if any, may be required to membership data submitted for those years.
3. Obtain and retain correspondence from PDE pertaining to the resolution of any membership or instructional time changes for the alternative education or credit recovery programs.
4. After receiving guidance from PDE, review the reports submitted for the 2009-10 and 2008-09 school years and submit revised reports as needed.

The *Pennsylvania Department of Education* should:

5. Provide any guidance it deems necessary to enable the District to accurately report membership and instructional hours in accordance with PDE guidelines for the alternative education and credit recovery programs for the 2009-10 and 2008-09 school years.

6. Review the propriety of the reimbursements provided to the District for the alternative education and credit recovery programs, and determine what adjustments, if any, should be made.

Management Response

Management stated the following:

“The District will require the Alternative Education Program to meet the minimum mandated 990 hours of instructional time. All Alternative Education programs will be submitted to the Pennsylvania Department of Education (PDE) for approval and will operate in accordance with the Child Accounting rules for reporting membership.

“The Credit Recovery program has been discontinued within the Harrisburg School District. Should the District re-implement the Program or a similar program, the District will make sure that it is in compliance with PDE requirements. Any student not meeting the mandated hours will be prorated as required by Child Accounting rules for reporting membership, unless waived by PDE.”

Finding No. 5 →

Lack of Memorandum of Understanding

Criteria relevant to the finding:

Public School Code Section 13-1303-A(c) provides:

“All school entities shall develop a memorandum of understanding with local law enforcement which sets forth procedures to be followed when an incident involving an act of violence or possession of a weapon by any person occurs on school property. Law enforcement protocols shall be developed in cooperation with local law enforcement and the Pennsylvania State Police.”

Additionally, the Basic Education Circular issued by the Department of Education entitled Safe Schools and Possession of Weapons, as well as the Complete All-Hazards School Safety Planning Toolkit disseminated by the Pennsylvania Emergency Management Association, contain a sample MOU to be used for school entities. Section VI, General Provisions, item B of this sample states:

“This Memorandum may be amended, expanded or modified at any time upon the written consent of the parties, but in any event must be reviewed and re-executed within two years of the date of its original execution and every two years thereafter.” (Emphasis added.)

Our current audit found that the District had not implemented our prior audit recommendations regarding the failure to obtain a signed Memorandum of Understanding (MOU) with their local law enforcement agency (see page 55). We made our recommendations in the interest of the protection of students and employees, and here reiterate those recommendations.

The failure to obtain a signed MOU with the local law enforcement agency could result in a lack of cooperation, direction, and guidance between District employees and the local law enforcement agency if an incident occurs on school property, at any school-sponsored activity, or on any public conveyance providing transportation to or from a school or school-sponsored activity. This internal control weakness could have an impact on law enforcement notification and response, and ultimately the resolution of a problem situation.

Recommendations

The *Harrisburg City School District* should:

1. In consultation with the District’s solicitor, develop and implement an MOU between the District and the appropriate law enforcement agency.
2. Adopt a policy requiring the administration to review and re-execute the MOU every two years.

Management Response

Management stated the following:

“The Harrisburg School District acknowledges that a Memorandum of Understanding has not been formally approved with the City of Harrisburg in several years. Both parties have continued to operate under the previous MOU. A draft agreement was prepared by the District and sent to the City for review in October 2010, but to this date, the District has not had a response. Recently the District sent a follow-up inquiry to the Harrisburg Chief of Police as to the status of the draft MOU and was informed that he will be following up with the City’s Legal Bureau.”

Auditor Conclusion

Although management made reference to a previous MOU, we have never received any formal approved MOU between the Harrisburg City School District and the City of Harrisburg. We continue to recommend that the District develop a formal MOU agreement, and that it re-execute this agreement every two years.

Finding No. 6 →

Continued Weak Internal Controls in Procedures Used to Process Requests for Reimbursement

Criteria relevant to the finding:

Section 516.1 of the Public School Code, which pertains to “expenses for attendance at meetings of educational or financial advantage to the district,” states in pertinent part:

“Each person so authorized to attend and attending shall be reimbursed for all expenses actually and necessarily incurred, . . . , including travel, . . . lodging, meals . . . and other incidental expenses necessarily incurred. . . . All such expenses shall be itemized and made public at the next meeting of the board. Such expenses shall be paid by the treasurer of the school district . . . upon presentation of an itemized verified statement of such expenses. . . .”

Similarly, Section 517 of the Public School Code, which pertains to “attendance of superintendents, etc., at educational conferences” states, in pertinent part:

“Each person so authorized to attend and attending shall be reimbursed for all necessary traveling and hotel expense actually incurred. . . . Such expenses shall be paid by the treasurer of the school district . . . upon presentation of an itemized, verified statement of such expenses.

District policy 333.1’s specific guidelines state in part:

“Reimbursement is for the customary and ordinary expenses of the school individual only . . .”

Our audit of the District found internal control deficiencies in the processing of travel and other employee expenses for the 2008-09 and 2007-08 school years. Deficiencies existed because the District did not adequately obtain or retain necessary documents to support the legitimacy of expenses. We reviewed the District’s documentation of 42 requests for reimbursement totaling \$12,198, and 35 requests for reimbursement totaling \$17,397, for the 2008-09 and 2007-08 school years, respectively.

We found the following deficiencies:

1. Seventeen expense reimbursement requests for the 2008-09 school year and nine expense reimbursement requests reviewed for the 2007-08 school year were submitted by administrators on behalf of other District employees. These other employees incurred travel expenses, but did not possess credit cards or had insufficient credit remaining on their personal credit cards to pay for these expenses. District personnel stated that they do not usually provide advances for these expenses due to past problems with clearing them.
2. Eighteen expense reimbursement requests for the 2008-09 school year and four expense reimbursement requests for the 2007-08 school year provided only a dollar amount; they did not provide detailed descriptions of the costs. The majority of these expenses were for meals for which only a personal credit card receipt was provided. The District did not require the receipts for all expenditures to contain detailed descriptions of the costs.
3. Fourteen expense reimbursement requests for meals in the 2008-09 school year and three expense reimbursement requests for meals in the 2007-08 school year did not list how the expense was related to District business. These expenses were primarily incurred when consultants were taken out for meals. The expense reimbursement request form does not ask for the business purpose related to the expenditure.

4. Three expense reimbursement requests for the 2008-09 school year and two expense reimbursement requests for the 2007-08 school year did not have a required vendor invoice attached. The business office accepted the personal credit card receipts in lieu of the vendor invoice.
5. Three expense reimbursement requests for the 2008-09 school year were not marked as paid by the District business office. However, there were copies of checks issued to pay these reimbursements attached to the documentation. This was due to an oversight when processing the payments.
6. Twenty-eight of the expense reimbursement requests for the 2007-08 school year did not contain the signature of the employee requesting the reimbursement. Our review did not find this deficiency for the 2008-09 school year. However, the purchase orders being used in that year did not have a space for the employee signature.
7. Two of the expense reimbursement requests for the 2007-08 school year did not contain the approving signature from the District's business office. However, we did not find this deficiency in reimbursement requests for the 2008-09 school year.

Our review of the documentation, and our discussions with management, did not find any expenditures that were not directly related to school district business. However, the failure to require adequate documentation could result in payment of expenses that are not directly related to District business and could also increase the potential that abuse could occur in the future.

Recommendations

The *Harrisburg City School District* should take the necessary steps to ensure that adequate documentation is submitted to support employee travel and other expenses. This includes, but is not limited to the following:

1. Requiring employees to submit their own requests for reimbursement.

2. Requiring receipts to be itemized in detail so that individual(s) approving the expenditures can ensure that non-reimbursable expenses are not incurred.
3. Revising the expense reimbursement form so that it requires individuals to list the business purpose of each of the expenditures incurred so individuals reviewing the form can ensure that all expenditures are for District business purposes only.
4. Ensuring that required vendor invoices are attached to the documentation to support the reimbursement.
5. Ensuring that all expense requests are marked “paid” to avoid duplicate payments.

Management Response

Management stated the following:

“In response to the prior audit finding, the District revised its reimbursement process to improve internal controls. A new expense reimbursement form was developed that required itemization of all expenses. The instructions also identified those expenses that are reimbursable and those that are not reimbursable. All expenses are required to have itemized original receipts.

“Expense forms must be signed by the employee and the employee’s supervisor before being submitted to the Business Office. Once received by the Business Office, they are verified by the Accounts Payable Clerk and returned for additional information or documentation if necessary. Once the expense forms and accompanying receipts are correct, they are given to the Business Manager for review and signature. If approved, they are given to the Accounts Payable Accountant to be processed.

“The District does not have corporate credit cards and many of our employees either do not have their own credit cards or do not have sufficient credit lines to cover travel expenses. Hotels and airlines will not take purchase orders for travel arrangements, so there are occasions where an employee will cover the cost on his or her personal credit card for another employee. The process for reimbursement is the same as it would be for the employee traveling with the additional requirement that the individual for whom the expense was paid is listed on the expense reimbursement

form and that verification is provided that the individual for whom the expense was paid actually took the approved trip.”

Auditor Conclusion

Although the District has made improvements to its reimbursement process, the following deficiencies still exist:

1. The District does not have procedures to ensure that employees are responsible for their own expenditures, rather than relying on administrators to submit expenditures on behalf of other employees. This practice is unwise because it asks one employee to take on the financial liability for another. Although we understand that purchase orders are usually not accepted by airlines and hotels, the District needs to develop another method for handling these requests. For example, the District’s business office could obtain a corporate card paid directly by the District, and is used to pay for expenditures such as hotel and airline reservations.
2. The District does not require receipts to be sufficiently itemized to ensure that the District is not providing reimbursement for non-reimbursable expenditures such as alcohol.
3. The District has not revised the reimbursement form to include the business purpose of each reimbursement request
4. The District has not required vendor invoices to be attached to the requests where applicable.

Finding No. 7

Continued Athletic Fund Deficit of \$1,405,094

Criteria relevant to the finding:

The Manual of Accounting and Related Financial Procedures for Pennsylvania School Systems notes the importance of the operating budget cycle. This process includes budget preparation, budget analysis, board approval, adoption, budget control, and budget to actual reports.

The manual addresses each part of budgeting cycle in detail; however, we would like to emphasize the following:

- The accurate estimation of revenue has a critical impact on the budget.
- Analysis of historical trends is a reliable method for the projection of revenue and expenditures for budget preparation and analysis.
- During the budget year, revenue collections and expenditures should be monitored on a monthly basis.

Our review of the District’s annual financial reports and local auditor’s reports for the fiscal years ended June 30, 2009, 2008 and 2007 found that the athletic fund had a deficit of \$1,405,094 as of June 30, 2009.

This finding is a continuation from our prior audit for the years ended June 30, 2005, 2004 and 2003, which reported that the District had a deficit in this same fund of \$944,883, as of June 30, 2006 (see page 52). Thus, this District fund has seen a 48.7 percent increase, \$460,211, in its deficit over the last three years.

Fiscal Year	Beginning Fund Balance	Revenue	Transfers in from General Fund	Expenditures	Ending Fund Balance/ (Deficit)
2007	\$ (944,883)	\$ 88,942	\$425,000	\$788,795	\$(1,219,736)
2008	*(1,218,206)	106,434	575,000	774,439	(1,311,211)
2009	(1,311,211)	103,066	575,000	771,949	(1,405,094)

*The local auditors restated the July 1, 2008, beginning fund balance because they determined the cash accounts had been understated by \$1,530 in 2006-07.

The monies shown in the revenue column above are a combination of game receipt monies, investment earnings, and the state reimbursement of Social Security Medicare and retirement contributions provided to the District for its coaches and athletic staff.

Our review of annual budgets provided by the District’s business office for the fiscal years ended June 30, 2008,

2007 and 2006 found that the District continued to underestimate its expenditures by 31 to 66 percent over the three-year period. The following chart compares the budgeted to actual expenditures:

Fiscal Year Ending June 30	Budgeted Expenditures	Actual Expenditures	Under-budgeted Expenditures	Percentage of Actual Expenditures Over Budgeted
2007	\$475,000	\$788,795	\$(313,795)	66.06%
2008	590,000	774,439	(184,439)	31.26%
2009	571,913	771,949	(200,036)	34.98%

Furthermore, when we compared actual expenditures to actual available revenues (including the general fund transfers) in the same three-year period, we found that expenditures exceeded revenues for all three years as follows:

Fiscal Year Ending June 30	Actual Revenues	Actual Expenditures	Expenditures in Excess of Revenue
2007	\$513,942	\$788,795	\$274,853
2008	681,434	774,439	93,005
2009	678,066	771,949	93,883

Thus, the Board of Control's approval of expenditures in excess of budgeted expenditures and actual revenues permitted deficit spending from the athletic fund. Additionally, the business office could not produce any documentation to show that it had used revenue projections to manage the District's expenditures, which are an important tool for accurately controlling spending so that it does not exceed revenue.

As a result, the District paid all athletic program expenditures through general fund transfers, and then reimbursed the general fund whenever it received revenues from game receipts. However, the athletic fund expenditures were in excess of the approved general fund transfers and the athletic fund remained in a deficit.

The District has continued to increase its transfers from the general fund to the athletic fund in order to pay for these cost overruns. Yet, this practice has still not covered the

athletic fund expenditures and has subsequently added to the general fund's cash flow burden (see Observation No. 1, page 37).

Transferring money from the general fund to the athletic fund when there is a deficit in the latter is a common practice among districts. However, in Harrisburg's case, the transfer of adequate funds to cover the athletic fund deficit would significantly reduce the general fund balance. Due to increased debt obligations and minimal fund balance, the reliance on general fund monies to cover the athletic fund shortfalls could result in a future general fund deficit.

The athletic fund deficit resulted from:

1. Failure to use historical data to appropriately budget.
2. Allowing expenditures to substantially exceed revenues.
3. Continuing to increase the amount of general fund transfers.
4. Inaccurately budgeted expenditures.
5. A reluctance to reduce expenditures.

The Department is not questioning the District's need for an athletic fund, or the important role that school athletics play in students' overall educational experience. Instead it is simply concerned about the continual deficits that seem to plague this District fund. In fact, several studies have demonstrated that athletics and extracurricular activities benefit children and adolescents.

For example, a study published in the August 2006 issue of *Medicine & Science in Sports & Exercise* found that "although academic achievement was not significantly related to physical education enrollment, higher grades were associated with vigorous physical activity." Similarly, a 2002 article in the *Harvard Educational Review* reported that "participation in extracurricular school activities foster school identification and commitment, which result in diverse academic outcomes, particularly for socioeconomically disadvantaged students who are least well served by the traditional educational curriculum."

Thus, we emphasize that the District should avoid athletic fund deficit spending, and ensure that it uses revenue and expenditure projections to properly manage this fund.

Recommendations

The *Harrisburg City School District* should:

1. Reevaluate the athletic program to determine why actual expenditures continue to exceed budgeted expenditures.
2. Review procedures for the monitoring of revenue and expenditures to ensure there are adequate internal controls over the collection of revenue and expenditure of funds for the athletic program.
3. Establish realistic budgets for revenue and expenditures based on historical data and the board's directives for the program.
4. Determine a method of how the amount due the general fund will be resolved.

Management Response

Management stated the following:

“For several years, the Athletic Fund was allowed to have expenditures in excess of approved budget without appropriate transfer being done from the General Fund. The District has revised its purchasing process to bring the Athletic Fund into compliance with District policies that will not allow expenditures in excess of budget unless a budget transfer is done. Additionally, several years ago, the District transferred the salaries and benefits for the Athletic Director and the Trainer from the General Fund to the Athletic Fund, but did not provide a budget to cover those expenses. Beginning with the FY 2011 year, that practice has changed and the Athletic Fund will be correctly budgeted.”

Observation No. 1 →

District Continues to Increase Debt Obligations

Criteria relevant to the observation:

Public School Code Section 24 P.S. 6-609 provides, in part:

“Whenever Federal or State funds are made available to school districts, such funds may be expended by the board of school directors for the purposes for which they are made available even though provisions therefore were not made in the annual estimates or budget of such school district.”

Section 8022 of the Local Government Unit Debt Act (LGUDA) 53 Pa. CS 8022, provides for limitations on incurring of debt, other than debt approved by electors.

For nonelectoral debt, LGUDA Section 8022(a)(3) allows a district to borrow two hundred-fifty percent of its borrowing base.

For nonelectoral debt plus lease rental debt, LGUDA Section 8022(b)(3) allows the district to borrow three hundred-fifty percent of its borrowing base.

Our review of the District’s annual financial reports (AFR), local auditor’s reports (LAR), and general fund budgets for fiscal years ending June 30, 2009, 2008 and 2007 found that the District had increased its debt obligations from \$232,473,315 as of July 1, 2006, to \$263,194,000 as of June 30, 2009. Additionally, the District issued \$9,194,000 in Qualified School Construction Bonds on October 6, 2010. With this additional debt, less the principle payments made between July 1, 2009 and October 6, 2010, the District has calculated its total outstanding debt to be \$269,154,692 as of October 6, 2010. The District has also calculated its debt limit factor to be \$293,374,275 as of June 30, 2010. Consequently, the District can only borrow an estimated \$24,219,583 in additional funds. Therefore, although the District no longer has the deficit fund balance (\$2,960,656 as of June 30, 2006) noted in our prior audit, (see page 50) its debt load is of serious concern to its financial health, even with its current positive fund balance of \$2,761,201, as of June 30, 2009.

Our current audit identified five areas of concern:

1. The District significantly increased its debt obligations to refinance its outstanding general obligation debt.
2. The District’s actual general fund revenues were less than budgeted general fund revenues for the years ended June 30, 2009, 2008 and 2007.
3. The District’s approved general fund budgets for the years ended June 30, 2010, 2009, 2008 and 2007 included inaccurate estimated beginning fund balances.
4. The District merged the early childhood fund with the general fund, effective July 1, 2007, which transferred a \$4,156,820 deficit to the general fund.
5. As of June 30, 2009, the District continued to allow the athletic and cafeteria funds to have deficits of \$1,405,094 and \$517,678, respectively (see Finding No. 1, page 8 and Finding No. 7, page 33).

1. Significantly Increased Debt Obligations

Our review of the District’s AFRs and LARs for the fiscal years ended June 30, 2007 through June 30, 2009, found that the District had increased its general obligation debt (i.e. General Obligation Bonds and Notes Payable) from \$232,473,315 as of July 1, 2006, to \$263,194,000 as of June 30, 2009, as detailed below:

Fiscal Year Ending June 30	Beginning Balance	Increases	Decreases	Ending Balance	Increase (Decrease) in Debt Balance
2007	\$232,473,315	\$ 9,000,000	\$ 5,098,319	\$236,374,996	\$ 3,901,681
2008	236,374,996	4,000,000	9,053,319	231,321,677	(5,053,319)
2009	231,321,677	258,090,000	226,217,677	263,194,000	31,872,323

Note: The beginning balance for 2007 is a restated balance, the result of an overstatement of debt principal payments.

The District’s debt increased because of its new bond issues. However, it simultaneously achieved decreases in debt through payments on the principal and the refinancing of old bonds. In addition, it paid off bonds and notes with the new bonds it issued, essentially paying debt off with new debt.

Specifically, due to significant increases in the interest rates on the District’s outstanding variable rate bond issues, which resulted from the credit downgrade of the liquidity (credit) provider, the Board of Control (BOC) approved the issuance of four 2009 bond issues to refinance all but one of the District’s outstanding bond issues, while increasing the total outstanding debt as of June 30, 2009.

The bonds issued during the 2008-09 school year were as follows:

- The \$133,765,000 Series 2009A School Revenue Bonds were for refinancing prior bond issues, for repaying a note, for terminating interest rate management agreements, and for paying the costs of issuance.

- The \$22,855,000 Series 2009B School Revenue Bonds were used for refunding a general obligation note, for funding current operations, and for paying the costs of issuance.
- The \$26,620,000 Series 2009C Federally-taxable School Revenues Bonds were used for refunding a bond issue and for paying the costs of issuance.
- The 2009A, 2009B, and 2009C bond issues (noted above) were issued at the same time, with issuance costs totaling \$4,154,278.
- The \$74,850,000 Series 2009D School Revenue Bonds were used for refunding a prior bond and for paying the costs of issuance. The costs of issuance for this bond totaled \$517,000.

While the District has not exceeded the limits established by the Local Government Unit Debt Act, if it continues to borrow money, it could become unable to meet its future financial obligations. On October 6, 2010, the District issued an additional \$9,194,000 in Qualified School Construction Bonds. These are 17-year, fixed rate federally subsidized bonds. The District pays minimal interest on these bonds and earns interest on the sinking fund. The interest earned on the sinking fund will help to reduce the balloon payment that will be due upon the maturity of the bonds. With this additional debt, the District has calculated its total outstanding debt to be \$269,154,692 as of October 6, 2010. The District has also calculated its debt limit factor to be \$293,374,275 as of June 30, 2010, which would only allow the District to borrow an estimated \$24,219,583 in additional funds.

Given the current fiscal situation of the District, the city, and the state economy overall, the increased level of estimated debt gives us serious concerns. The District estimated its debt service payments (principle and interest) between the 2009-10 school year and the 2018-19 school year as follows:

<u>School Year</u>	<u>Total Estimated Gross Debt Service Payments</u>
2009-10	\$15,084,997
2010-11	14,863,509
2011-12	14,882,126
2012-13	15,467,419
2013-14	17,622,634
2014-15	20,758,269
2015-16	20,902,337
2016-17	20,914,439
2017-18	21,330,413
2018-19	21,367,414

2. Actual Revenue Was Less Than Budgeted Revenue

Our audit found that actual revenues were less than the amounts budgeted for the 2008-09, 2007-08 and the 2006-07 fiscal years, as detailed in the following chart:

<u>Fiscal Year</u>	<u>Budgeted Revenue</u>	<u>Actual Revenue</u>	<u>Over-budgeted Revenue</u>
<u>Ending June 30</u>			
2007	\$129,677,900	\$128,473,460	\$ 1,204,440
2008	133,172,065	132,348,984	823,081
2009	144,497,224	134,318,073	10,179,151

District personnel stated that they used historical data when preparing the 2008-09 school year budget with adjustments for current economic conditions. District personnel also stated that the District relies heavily on projected grant information when determining how much to budget each year. Our review noted significant variations between budget and actual grant revenues for fiscal years ended June 30, 2009, 2008 and 2007.

3. Inaccurate Budgeting of Beginning Fund Balance

Our prior audit report discussed the BOC’s failure to use realistic beginning general fund balances in preparing the District’s budgets. The beginning fund balance was budgeted at \$0, instead of estimating the actual beginning fund balance. This practice continued through the 2007-08 school year. Our current audit found that beginning with the 2008-09 school year the District based its estimated beginning fund balance (or deficit) on the ending fund balance from the LAR for the prior completed year (i.e. the 2008-09 school year budget was based on the actual beginning fund balance for the 2007-08 school year). District personnel stated that they do not make any adjustments to the beginning fund balance based on current operations in the year the budget is prepared because the budget has to be prepared so early in the current fiscal year that adjustments cannot be accurately predicted.

The budgeted versus actual beginning fund balance is detailed in the chart below:

Fiscal Year Ending June 30	Budgeted Beginning Fund Balance	Actual/Restated Beginning Fund Balance	(Over)/Under Budgeted Fund Balance
2007	\$ 0	\$(3,558,173)	\$(3,558,173)
2008	0	650,392	650,392
2009	650,991	(592,180)	(1,243,171)
2010	(592,184)	2,761,201	3,353,385

4. Operation of Early Childhood Program

The District continued to operate its early childhood program through the 2009-10 school year. In our prior audit report, we found that as of June 30, 2006, the early childhood fund had a deficit of \$3,093,804 (see page 51). As of June 30, 2007, this deficit increased to \$4,156,820 due to the District’s revenue shortfalls. Since the early childhood fund was no longer self-funded, the District merged the early childhood fund with the general fund effective July 1, 2007, and the \$4,156,820 deficit was transferred to the general fund. This transfer resulted in a restatement of beginning general fund balance from \$4,807,212 to \$650,392. It should be noted that during the 2008-09 and 2007-08 school years the District continued

operating its early childhood program, even though expenditures were exceeding revenues by \$1,307 and \$161,809, respectively. The 2009-10 revenue and expenditure data was not available at the time of the current audit.

5. Athletic and Cafeteria Fund Deficits

The athletic and cafeteria funds had deficits as of June 30, 2009, of \$1,405,094 and \$517,678, respectively, as detailed in Finding No. 1 and Finding No. 7, respectively, of the current audit report (see pages 8 and 33). Expenditures in excess of revenues for the athletic and cafeteria funds ultimately have to be covered with general fund monies, which reduces monies available for general fund operations.

Recommendations

The *Harrisburg City School District* should:

1. Continue to use monthly budget status reports to monitor revenue and expenditure activity.
2. Continue to monitor debt obligations to avoid financial burdens on future budgets.
3. Provide for a systematic reduction of the debt obligations and decrease the financial burden on the District and the taxpayers.
4. Prepare realistic budgets based on verifiable revenue projections. Instead of budgeting grants on a speculative basis, District personnel should wait to budget speculative state and federal grant revenue and expenditures when the grants are approved.
5. Adopt budgets which more accurately estimate the beginning general fund balance in order to project the true financial condition of the District.
6. Continue to evaluate the early childhood program to determine whether the program should continue to operate given the fact that the revenues for the program do not meet program expenditures.
7. Monitor the athletic and cafeteria funds to reduce and/or eliminate operating deficits.

Management Response

Management stated the following:

“In FY [fiscal year] 2009, the District was facing financial challenges as a result of the unprecedented collapse of the financial markets. As a result of the credit downgrade of the underlying credit provider on the 2003 Variable Rate Bonds, the District faced a default status and subsequent substantial increase in interest rates on those bonds. At the same time, the District restructured all of its existing debt with the exception of the 2002 QZAB bonds with a series of fixed and variable rate bonds. The resulting restructuring provided debt service relief to the District for several years.

“Please see the following Table:

Budget Year	Pre-2009 Restructuring	Post-2009 Restructuring + 2010 QSCB
2009-10	\$23,504,102	\$15,084,997
2010-11	\$19,019,504	\$14,863,509
2011-12	\$18,843,432	\$14,882,126
2012-13	\$16,564,847	\$17,622,634

“The District did enter into an additional debt obligation in the fall of 2010 by participating in the Qualified School Construction Bond (QSCB) program through the Pennsylvania Department of Education. QSCBs are issued under the federal government’s Build America Bond program, which provides interest rate subsidies to offset the interest cost on these bonds. The bonds hold a 5% interest rate and the Tax Credit offset provided by the federal government is 4.83%, leaving the District with a net effective interest rate of .17%. These bonds are also set up to be paid from a sinking fund, the earnings of which will offset the principal payment due from the District.

“QSCBs were awarded by the Pennsylvania Department of Education on a competitive basis. District[s] had to submit proposals for projects that involved new construction, building renovation, or projects designed to provide energy efficiencies. The Harrisburg School District was selected in the first round for a series of roofing and HVAC projects that will reduce energy costs in future years and improve school building environments. The projected benefits from these projects were deemed to substantially outweigh the slight additional cost to the District’s debt burden.”

Observation No. 2 →

The District Finances Some of Its Debt with Interest Rate Management Agreements, Which Could Jeopardize Taxpayer Funds

Criteria relevant to the observation:

The Local Government Unit Debt Act, Act 177 of 1997, as amended by Act 23 of 2003 (53 Pa. C.S. § 8001 *et seq.*) authorizes local government units, including school district, to include qualified interest rate agreements in connection with the issuance of bonds and notes.

Although the District had eliminated three of its swaps deals during the audit period, it still had \$207 million of variable-rate debt tied to swap agreements as of June 30, 2010.

A 2003 amendment to the Local Government Unit Debt Act (Act 23 of 2003) permits school districts and other local government entities to enter into “qualified interest-rate management agreements,” which are commonly known as “swaps.” A swap is a contract between a school district and an investment bank in which the two parties (“counterparties”) agree to exchange interest payments, typically a floating rate for a fixed rate, to artificially create a “synthetic fixed rate” on the underlying variable-rate debt instrument that is somewhat lower than prevailing rates on conventional fixed-rate financing. In reality, however, swaps require the school district to bet on which way interest rates will move in the future, exposing the school districts’ taxpayers to risk of loss of funds if the district bets incorrectly. Moreover, swaps are loaded with a multitude of other little-understood risks that can trigger a default and expose districts’ taxpayers to liability for enormous termination fees. In addition, the complexity of the transactions requires districts to incur large financial advisory fees, legal fees, and underwriting fees to continuously monitor the highly volatile swaps market.

The District has already had a negative experience with swaps. According to the District’s Comprehensive Annual Financial Report for fiscal year ended June 30, 2009, the District has already made three termination payments to investment bank counterparties totaling \$11.5 million to get out of swaps deals that turned sour. The payments made on May 1, 2009, were in the amounts of \$6.58 million, \$4.35 million, and \$576,000.

Even more troubling is the fact that the District's remaining swaps had a net negative fair value of \$28.5 million, as of June 30, 2010, meaning that District taxpayers would have been required to pay \$28.5 million to investment bank counterparties if the District had been forced to terminate those swaps as of that date.

This Department's Office of Special Investigations issued a public report in November 2009, demonstrating the grave dangers inherent in swaps. The Bethlehem Area School District ("BASD") had entered into 13 swaps, the most of any school district in the Commonwealth, related to \$272.9 million in debt. We found that the experience with just 2 of its 13 swaps cost BASD taxpayers \$10.2 million more than if BASD had issued standard fixed-rate bonds or notes. BASD's losses were a result of excessive fees and other charges, especially a \$12.3 million termination payment that it was forced to make to an investment bank to get out of the swap deal. Furthermore, the potential financial impact associated with BASD's other 11 swaps could not be determined because the agreements were still in effect at the time of the investigation. We concluded that swaps are highly risky and impenetrably complex transactions that, quite simply, amount to gambling with public money. Furthermore, swaps are susceptible of being marketed deceptively, and they principally benefit the investment banks and the multitude of intermediaries who sell them at enormous profit to relatively unsophisticated public officials.

We recommended that the General Assembly repeal Act 23 of 2003 and outlaw the use of swaps by school districts and other local government entities. We also recommended that no local government entity should enter into or utilize swaps ever again.¹

Our position today is the same as it was when we issued our BASD report. The fundamental guiding principle in handling public funds is that they should never be exposed to the risk of financial loss. Swaps may be perfectly acceptable in the private sector where private citizens are free to decide how much risk they can tolerate when their own money is at stake. But they should have no role in

¹ On December 17, 2009, the Department sent a warning letter to all 500 school districts in this Commonwealth making the same recommendation.

government, where it is the taxpayers' money that is at stake. Public debt should be financed with fixed interest rates that are transparent, reliable, and easily understood by decision-makers and the public.

Recommendations

The *Harrisburg City School District* should:

1. Eliminate the remaining swaps as soon as it is fiscally responsible to do so and replace the debt associated with the swaps with conventional fixed-rate debt.
2. Avoid entering into any new swaps agreements in the future.

Management Response

Management stated the following:

“The District both agrees and disagrees with this finding. The Harrisburg School District does maintain several interest rate management agreements (swaps), but disagrees that they have put taxpayer funds in jeopardy. In each and every swap transaction, the District has done its due diligence and fully advised the Board of all potential risks before the transactions were approved. The due diligence includes the use of an independent financial adviser who evaluates the potential risks and the proposed fees from the swap counterparties and agents as to their appropriateness. The District also hires independent bond counsel to review all legal documents related to the transaction. The District is compliant with GASB 53 and has fully recognized any swap that does not meet the test of being an effective hedge on its financial statements. Additionally, the District has been very prudent in its use of swaps.

“Over time, the District has reduced the number of swaps it has. Prior to June 2009, the District maintained 9 swaps at a total notional amount of \$303,005,000. The District has terminated many of those swaps and currently maintains 3 swaps with a combined notional amount of \$207,180,000. Recently, the District terminated two Constant Maturity Swaps for a net return of \$3.2 M. These two swaps were in suspension mode for which the District received a \$1.4 M payment at the time of suspension. All swaps that the District has currently active are producing positive cash flows for the District and helping to offset other expenses.

“The District recognizes that, like all financial transactions, there are risks involved and believes that it follows prudent management in evaluating these risks.”

Auditor Conclusion

The District’s response is encouraging in some respects, but disappointing considered as a whole. We are certainly pleased that the District has reduced the number of its swaps from nine to three. However, we are concerned that the District still has \$207 million of its debt portfolio tied to swaps. We are especially disappointed that the District has not only refused to renounce the use of swaps in the future but also continues to defiantly characterize them as “prudent” financial transactions. No use of swaps is a prudent choice when conventional fixed-rate financing is available and at historically low interest rates.

When public funds are at stake, it is the Department of the Auditor General’s firm position that the use of swaps is fiscally imprudent. That is the reason we have asked the General Assembly to repeal Act 23 and to outlaw the use of swaps by public entities altogether, and that is the reason we sent a warning letter to all 500 school districts in this Commonwealth urging them not to enter into any more of these risky transactions. We are frankly disappointed that such a financially strapped school district as Harrisburg would ignore our advice and set such a bad example, especially after so recently paying out \$11.5 million of the taxpayers’ money to get out of soured swaps deals.

Furthermore, the fact that the District has made some money on some of its swaps is no justification for continuing to put taxpayers’ money at risk. The District may have won some money on its constant maturity swaps, but the counterparties on those swaps lost money. The tables could just as easily be turned, and the District could have been the loser. The District’s cash flow on its remaining active swaps may currently be positive, but it could turn negative literally overnight. Transactions such as these that generate both winners and losers are, in essence, no different than gambling with the taxpayers’ money.

That is why our position today is the same as it was when we issued our first report on swaps in November 2009. The fundamental guiding principle in handling public funds is that they should never be exposed to the risk of financial loss. Swaps may be perfectly acceptable in the private sector, where private citizens are free to decide how much risk they can tolerate when their own money is at stake. But they should have no role in government, where it is the taxpayers' money that is at stake. Public debt should be financed with fixed interest rates that are transparent, reliable, and easily understood by decision-makers and the public. Accordingly, we urge the District to unwind all of its remaining swaps as soon as it is fiscally responsible to do so, and we strongly urge the District to amend its Debt Policy to unequivocally and permanently renounce the use of swaps in the future.

Status of Prior Audit Findings and Observations

Our prior audit of the Harrisburg City School District (HCSD) for the school years 2004-05, 2003-04 and 2002-03 resulted in 15 reported findings as shown below. As part of our current audit, we determined the status of corrective action taken by the District to implement our prior recommendations. We analyzed the HCSD Board's written response provided to the Pennsylvania Department of Education (PDE), performed audit procedures, and questioned District personnel regarding the prior findings. As shown below, we found that the HCSD did implement recommendations pertaining to the following four findings: athletic fund deficit, inaccurate reporting of the number of nonpublic pupils transported, administrative wage errors, and Social Security and Medicare taxes reimbursement underpayments. As also shown below, we found that the HCSD did not implement recommendations related to the remaining eleven findings.

School Years 2004-05, 2003-04 and 2002-03 Auditor General Performance Audit Report

Finding No. 1: General Fund Deficit of \$2,960,656 as of June 30, 2006

Finding Summary: Our prior audit of the District's annual financial reports (AFR), local auditor reports (LAR), and general fund budgets for fiscal years ended June 30, 2006, 2005 and 2004, found that the deficit in the District's general fund increased to \$2,960,656 at June 30, 2006. The Board of Control's failure to address our recommendations in the June 30, 2003, 2002, 2001 and 2000 audit reports resulted in the continued failure to provide for a reduction of the general fund deficit and the continued use of unrealistic budgets.

Recommendations: Our audit finding recommended that the HCSD:

1. Continue to use monthly budget status reports to monitor expenditures.
2. Continue to monitor general obligation debt to avoid financial burdens on future budgets.
3. Adopt budgets which accurately estimate the beginning general fund balances in order to project the true financial condition of the District.
4. Prepare realistic budgets based on historical data and verifiable revenue projections.
5. Provide for a systematic reduction of the general fund deficit.

Current Status: Our current audit found that the District implemented our recommendations in part -- they did not implement recommendations two and five, which resulted in Observation No. 1 of our current audit report.

1. **Continue to Monitor General Obligation Debt to Avoid Financial Burdens on Future Budgets:** All increases in debt obligations were approved by the board. In April 2010, the business manager began providing the board with a monthly income statement which shows the debt service payments; however the board is not provided with any reports showing the balance of the outstanding debt (i.e. bonds and notes payable), which would make it difficult to monitor general obligation debt to avoid financial burdens on future budgets.
2. **Provide for a Systematic Reduction of the General Fund Deficit:** The District did not provide for a systematic reduction of the general fund deficit. Although the District did not have a deficit as of June 30, 2009, the District continues to refinance bond issues as detailed in Observation No. 1 of our current report (see page 37), which defers scheduled principal and interest payments until later fiscal years.

Finding No. 2: Early Childhood Fund Deficit of \$3,093,804

Finding Summary: Our prior review of the District's AFRs and LARs for the fiscal years ended June 30, 2006, 2005, 2004 and 2003 found that the early childhood fund had a deficit of \$3,093,804 as of June 30, 2006.

Recommendations: Our audit finding recommended that the HCSD:

1. Evaluate the early childhood program to determine if and how the program will continue to operate, given the fact that the program has not been self-funded since the 2003-04 school year.
2. Use monthly budget status reports to monitor revenue and expenditures activity.
3. Contact the Comptroller's Office, Labor, Education and Community Services, to determine if the early childhood program should be budgeted and accounted for in the general fund, since the program is no longer self-funded.

Current Status: Our current audit found that the District implemented all of our recommendations except for number two. Due to the incorporation of the early childhood fund into the general fund, the Board is not provided with a separate monthly budget status report that can be used to specifically monitor revenue and expenditures for the early childhood program.

Our current audit also found that the early childhood fund deficit increased from \$3,093,804 to \$4,156,820 as of June 30, 2007. This deficit was incorporated out into the general fund as of July 1, 2007, resulting in a general fund balance decrease of \$4,156,820.

The additional effects of having the early childhood program operating under the general fund are addressed in Observation No. 1 of our current report (see page 37).

Finding No. 3: Athletic Fund Deficit of \$944,883

Finding Summary: Our prior review of the District's AFRs and LARs for the fiscal years ended June 30, 2006, 2005, 2004, and 2003 found that the athletic fund had a deficit of \$994,883 as of June 30, 2006.

Recommendations: Our audit finding recommended that the HCSD:

1. Evaluate the athletic program to determine if revenue collection and reporting procedures are adequate, given the variances noted in the charts that were provided.
2. Prepare realistic budgets based on historical data and verifiable revenue projections.
3. Use monthly budget status reports to monitor revenue and expenditure activity.

Current Status: Our current audit found that HCSD did take corrective action to address the recommendations above. However, these steps were taken during the 2009-10 school year, so we did not have an opportunity to fully evaluate their effectiveness. However, our audit also found that the athletic fund deficit increased to \$1,405,094 as of June 30, 2009. We have addressed this increased deficit in Finding No. 7 of our current audit report (see page 33).

Finding No. 4: Inaccurate Reporting of the Number of Nonpublic Pupils Transported Resulted in Transportation Subsidy Underpayments of \$46,970

Finding Summary: Our prior audit of the District's pupil transportation reports as submitted to PDE for the school years of audit found errors in the number of nonpublic pupils transported in the 2003-04 and 2002-03 school years, resulting in underpayments of nonpublic pupil transportation subsidy totaling \$46,970.

Recommendations: Our audit finding recommended that the HCSD:

Prepare a complete list of nonpublic pupils each year that includes the name and bus number of each nonpublic pupil transported, in accordance with PDE instructions.

We also recommended that PDE:

Take action to resolve the underpayments of \$46,970.

Current Status: Our current audit found that District personnel began preparing a complete list of nonpublic pupils in accordance with PDE instructions. In addition, no further deficiencies were noted. Therefore, we concluded that the District did comply with our prior audit recommendations.

Our audit also found that PDE resolved the underpayments of \$46,970 on February 25, 2010.

Finding No. 5: Vehicle Mileage Allowances Violated Internal Revenue Service Regulations

Finding Summary: Our prior audit of administrator's contracts for the 2006-07, 2005-06, 2004-05, 2003-04, and 2002-03 fiscal years found that the superintendent, deputy superintendent, and assistant superintendents were paid a mileage allowance each month for travel within a 50-mile radius of the District, in lieu of being paid based on actual miles traveled. The superintendent received \$500 a month between July 1, 2002 and June 15, 2007, and the deputy superintendent and assistant superintendents received \$400 a month during their employment periods between July 1, 2002 and June 15, 2007.

District personnel processed these payments through accounts payable, instead of payroll, which resulted in no taxes begin withheld. The failure to collect and remit the appropriate taxes may have violated Internal Revenue Service (IRS) regulations.

Recommendations: Our audit finding recommended that the HCSD:

In consultation with the District's solicitor, contact the IRS regarding the proper handling of the vehicle mileage allowances which were paid through accounts payable from July 1, 2002 to June 15, 2007, and ensure that current procedures are in compliance with IRS, state and local regulations.

Current Status: Our current audit found that the District was unable to provide any documentation that its solicitor or the IRS had been contacted regarding the proper handling of the vehicle mileage allowances.

The District did request an opinion from their local auditors on what steps were needed to properly comply with our recommendation. In a letter of response dated May 15, 2008, the local auditor advised the District that the appropriate steps to account for this taxable benefit in prior years was to file a corrected W-2 (Form W-2C) for each affected employee, adding in the travel allowance. The letter stated that corrected W-2Cs, along with W-3Cs should be filed with the Social Security Administration and the Pennsylvania Department of Revenue, which would also require the individuals to file amended federal, state and local income tax returns. The District was also advised to file Form 941C, to be included with the current Form 941 to account for the Social Security taxes.

In a memo from the District's former business manager dated June 10, 2008, the District chose not to take any further action to file amended reports for the District that would subsequently lead to the filing of amended tax returns for the affected administrators.

Beginning with the June 15, 2007 payroll, District personnel began to process these vehicle mileage allowances through the payroll system and withhold taxes in compliance with IRS regulations.

Since the District chose not to amend the documents identified by the local auditors, for the dates July 1, 2002 to June 15, 2007, we again recommend that they contact the IRS for resolution of this issue for the 2002 through 2007 calendar years. In addition, we will forward our prior audit report and our current audit report to the IRS for its review.

Finding No. 6: Administrative Wage Errors

Finding Summary: Our prior audit of the administrators' wages for the 2006-07, 2005-06, 2004-05, 2003-04 and 2002-03 school years found:

- One administrator was underpaid \$6,459 for the 2005-06 school year.
- One administrator was overpaid \$3,756 and a second administrator was overpaid \$969 for the 2003-04 school year.
- One administrator was overpaid \$1,058 for the 2002-03 school year.

Recommendations: Our audit finding recommended that the HCSD:

Review each contracted administrator's wages on an annual basis and reconcile the wages paid to the wages due to each individual. If errors are noted, the wages should be adjusted accordingly.

Current Status: Our current audit found that the overpayments and underpayments were resolved.

Specifically, our current audit of five contracted administrator's wages for the 2007-08 school year found that the wages paid reconciled to the wages due for these individuals. However, we could not find evidence that the District had implemented a formal process for annually reconciling the wages of contracted administrators. This lack of evidence was due, at least in part, to the retirement of the District's long-time payroll supervisor. Consequently, we recommend that the District develop a formal written policy requiring individuals processing the District's payroll to review each contracted administrator's wages on an annual basis, and then reconcile the wages paid to the wages due for each individual.

Finding No. 7: Failure to Obtain Memorandum of Understanding

Finding Summary: Our prior audit found that the District did not have a Memorandum of Understanding (MOU) with the local law enforcement agency.

Recommendations: Our audit finding recommended that the HCSD:

1. In consultation with its solicitor, execute a MOU between the District and the local police department.
2. Adopt a policy requiring the administration to review and re-execute the MOU every two years.

Current Status: Our current audit found that the District personnel had not implemented our recommendations. The failure of the District to implement our recommendations is addressed in Finding No. 5 of our current audit report (see page 27).

Finding No. 8: Unmonitored Vendor System Access and Logical Access Control Weaknesses

Finding Summary: Our prior audit found the HCSD used software purchased from an outside vendor for its critical student accounting applications (membership and attendance). The software vendor had remote access into the District's network servers.

We determined that a risk existed that unauthorized changes to the District's data could occur and not be detected because the District was not able to provide supporting evidence that it adequately monitored vendor activity in its system. Further, the District did not have evidence that it performed formal, documented reconciliations between manual records and computerized records for membership and attendance. Since the District did not have evidence that it had adequate manual compensating controls in place to verify the integrity of the membership and attendance information in its database, the risk of unauthorized changes increased.

Recommendations: Our audit finding recommended that the HCSD:

1. Generate monitoring reports (including firewall logs) of the vendor and employee remote access and activity on its system. Monitoring reports should include the date, time, and reason for access, change(s) made and who made the change(s). The District should review these reports to determine that the access was appropriate and that data was not improperly altered. The District should also ensure it is maintaining evidence to support this monitoring and review.
2. Maintain evidence that it performs reconciliations between system generated membership and attendance reports and manually kept membership and attendance records to ensure that any unauthorized changes within the system would be detected in a timely manner.
3. Require the vendor to assign unique userIDs and passwords to vendor employees authorized to access the District system. Further, the District should obtain a list of vendor employees with remote access to its data and ensure that changes to the data are made only by authorized vendor representatives.

4. Allow remote access to its system only when the vendor needs access to make pre-approved changes/updates or requested assistance. This access should be removed when the vendor has completed its work. This procedure would also enable the monitoring of vendor changes.
5. Include in the contract with the vendor a non-disclosure agreement for the District's proprietary information.
6. Establish separate information technology (IT) policies and procedures for controlling the activities of vendors/consultants and have the vendor sign this policy, or the District should require the vendor to sign the District's Acceptable Use Policy (AUP).
7. Include provisions in the District's AUP for authentication (e.g., password security and syntax requirements).
8. Implement a security policy and system parameter settings to require all users, including the vendor, to ensure passwords are a minimum length of eight characters and include alpha, numeric, and special characters. Also, the District should maintain a password history that will prevent the use of a repetitive password (i.e., last ten passwords), lock out users after three unsuccessful attempts, and log users off the system after a period of inactivity.

Current Status:

Our current audit found that the District implemented recommendations one and three, and the District partially implemented recommendations two and eight. However, the District failed to implement the rest of the recommendations as follows:

1. Due to limited staff, District personnel are not reconciling system generated membership reports to manually kept membership records.
2. Vendor employees still have continuous, around-the-clock access to the District's system, and vendor access is not removed once a vendor employee has completed the work needed.
3. District personnel did not update the contract with the vendor to include a non-disclosure agreement for the District's proprietary information.
4. District personnel have not established separate IT policies and procedures for controlling the activities of vendors/consultants, nor have District personnel required the vendor to sign the District's AUP.
5. The District did not revise the AUP to include provisions for authentication (e.g. password security and syntax requirements).

6. District personnel are not requiring passwords to be at least eight characters in length nor are they requiring passwords to include, alpha, numeric, and special characters. Additionally, District personnel are not locking users out after a period of inactivity (e.g. 60 minutes).

We again recommend that the District take the following actions:

1. Maintain evidence that District personnel perform reconciliations between system generated membership and attendance reports and manually kept membership and attendance records to ensure that any unauthorized changes within the system would be detected in a timely manner.
2. Allow remote access to its system only when the vendor needs access to make pre-approved changes/updates or requested assistance. This access should be removed when the vendor has completed its work. This procedure would also enable the monitoring of vendor changes.
3. Ensure that the contract with the vendor contains a non-disclosure agreement for the District's proprietary information.
4. Establish separate IT policies and procedures for controlling the activities of vendors/consultants and have the vendor sign this policy, or require the vendor to sign the District's AUP.
5. Include provisions in the District's AUP for authentication (e.g., password security and syntax requirements).
6. Implement a security policy and system parameter settings to require all users, including the vendor, to ensure passwords are a minimum length of eight characters and include alpha, numeric, and special characters. Also, the District should log users off the system after a period of inactivity (e.g. 60 minutes).

Finding No. 9: Weak Internal Controls in Procedures Used to Process Requests for Reimbursement

Finding Summary: Our prior audit of the HCSD found internal control deficiencies in the processing of travel and other employee expenses that were incurred within the superintendent's office. Deficiencies existed because the District did not adequately obtain or maintain necessary documents to support the legitimacy of expenses. We discovered the deficiencies during our review of the District's documentation of 153 transactions totaling \$42,873 in expenses. The expenses were incurred by District personnel

for meals, lodging, airfare, rental fees, mileage and books. They were reimbursed during the 2006-07 fiscal year.

Recommendations: Our audit finding recommended that the HCSD:

1. Require that the purpose of expenses incurred is documented in adequate detail to show the purpose of the expenditure and how it directly relates to school district business.
2. Require that the signatures of individuals who incurred the expense are included on appropriate documents.
3. Complete travel expense vouchers.
4. Maintain documentation in an organized fashion to allow review by management for approval.

Current Status: Our current audit found that the District implemented our recommendations except for:

1. The business purpose was missing for a significant number of expenditures reviewed.
2. Documentation was provided in an organized manner; however, the review and approval by District management did not detect six additional areas of concern as noted in Finding No. 6.

The failure to implement adequate controls relating to item 1 and review concerns noted with item 2, along with additional control issues, is addressed in Finding No. 6 of our current report (see page 29).

Finding No. 10: Social Security and Medicare Taxes Reimbursement Underpayments

Finding Summary: Our prior audit of the District's 2004-05, 2003-04, and 2002-03 "Reconciliation of Social Security and Medicare Tax Contributions" forms found errors in total taxable Social Security, Medicare and federal wages reported to PDE for reimbursement for the 2002-03 school year. This error resulted in reimbursement underpayments of \$47,759.

Recommendations: Our audit finding recommended that the HCSD:

Continue to review reports prior to submitting them to PDE.

We also recommended that PDE:

Adjust the District's allocations to resolve the \$47,759 Social Security and Medicare taxes reimbursement underpayment.

Current Status: Our current audit found no significant discrepancies in the data reported to PDE for the school year ending June 30, 2007.

PDE paid the District \$47,759 on April 2, 2009, to resolve this finding.

Finding No. 11: Certification Deficiencies

Finding Summary: Our prior audit of the professional employees' certification and assignments for the period from September 2, 2004 through May 3, 2007, was performed to determine compliance with the Public School Code and Bureau of School Leadership and Teacher Quality's (BSLTQ) Certification and Staffing Policies and Guidelines. Our prior audit found 103 deficiencies.

Recommendations: Our audit finding recommended that the HCSD:

1. Require the individuals cited in the finding to obtain the proper certification or reassign them to positions for which they would be properly certified.
2. Implement all procedures identified in the District's Procedures Manual issued December 2, 1999.
3. Ensure staff involved with the certification function is properly trained in the implementation of the procedures identified above.
4. Require District personnel to submit job descriptions to BSLTQ for locally titled positions to ensure the individuals were properly certified for those positions.
5. Ensure that a properly completed professional personnel listing is prepared and updated for each school year.
6. Ensure copies of all professional employees' Pennsylvania teaching certifications are obtained and maintained in a current, updated certification log.
7. Review work histories for individuals who held temporary certificates and take appropriate action to ensure that temporary certificates do not lapse prior to the individuals obtaining permanent certification.

We also recommended that PDE:

8. Adjust the District's allocations and recover the subsidy forfeitures of \$158,051.

Current Status:

Our current audit found that recommendations 5 and 7 were implemented. However, the following were not implemented:

1. The superintendent did not require all of the individuals cited in the prior finding to obtain the proper certification or ensure that they were reassigned to positions for which they were properly certified.
2. District personnel have indicated that the procedures identified in the District's Procedures Manual issued December 2, 1999, are out-of-date and, as a result, are not being implemented.
3. Since the procedures manual is out-of-date, staff is not being trained on the implementation of the procedures.
4. District personnel stated that they have attempted to submit job descriptions to BSLTQ for locally titled positions but BSLTQ has either not responded or has not specified the certificate that is appropriate for the assignment. In addition, individuals are moved at the building level into locally titled positions, but the human resources department may not be informed prior to this occurring.
5. District personnel again could not provide certificates for all individuals.

As noted in the background section of this report, the District was declared an empowerment district. The Education Empowerment Act allows empowerment districts to employ professional staff in accordance with Section 1724-A(a) of the Charter School Law, as it pertains to certification. The Charter School Law allows certain schools and districts to operate with seventy-five percent of their professional staff members holding appropriate certification. Therefore, since the confirmed deficiencies were within the seventy-five percent guidelines, PDE subsequently deleted the confirmed deficiencies and waived the subsidy forfeiture related to this final determination.

On June 30, 2010, the Education Empowerment Act expired, thereby removing the 75 percent certification guideline. Therefore, certification deficiencies continued from our prior audit and current possible certification deficiencies are addressed in Finding No. 2 of our current report (see page 11).

Finding No. 12: Inaccurate Reporting of Membership

Finding Summary: Our prior audit of documentation supporting pupil membership reports submitted to PDE for the 2004-05, 2003-04 and 2002-03 school years found errors in resident and nonresident membership and in instructional days reported. The errors resulted in a subsidy and reimbursement net overpayment of \$234,513.

Recommendations: Our audit finding recommended that the HCSD:

1. Password protect computer files so they cannot be changed, except by authorized personnel, and revise child accounting reports if changes need to be made to computerized child accounting data.
2. Reconcile final membership reports sent to PDE to computer membership files.
3. Ensure all child accounting personnel are adequately trained in nonresident classifications.
4. Ensure all nonresident membership was accurately reported to PDE.
5. Ensure instructional days are accurately computed and reported to PDE.
6. Review reports submitted to PDE subsequent to the audit period, and if errors were found, submit revised reports to PDE.

We also recommended that PDE:

7. Adjust the District's allocations to resolve the net subsidy and reimbursement overpayment of \$234,513.

Current Status: Our current audit found that the District personnel took some corrective actions in response to our prior audit finding. However, the actions taken were not adequate to detect and correct the new errors found during our current audit, as addressed in Finding No. 3 of our current report (see page 15). We also found the District took no action on the following prior recommendations:

1. The District is password protecting archived files so that the archived files cannot be changed except by authorized personnel, which includes the vendor. However, the data in the "live" database can still be revised by unauthorized users.

2. District personnel provided documentation that reconciliation procedures were implemented during the 2006-07 school year. However, not all discrepancies identified were properly resolved and reported to PDE.

Due to additional data being available subsequent to our prior audit for the basic education funding (BEF), tuition for children placed in private homes, and special education subsidies, PDE recalculated the net overpayment of \$234,513. Additionally, the special education subsidy underpayment for the audit ended June 30, 2002 and 2001 was adjusted as follows:

- The BEF overpayment of \$284,587 was recalculated by PDE to be \$352,267 and recovered by PDE on June 1, 2009.
- The children placed in private homes net underpayment of \$37,876 was paid to the District on June 1, 2009.
- The special education underpayment of \$12,198 from our prior audit, as well as the \$450,776 underpayments relating to the June 30, 2002 and 2001 audit report, was recalculated by PDE to be \$736,215. PDE paid the District the \$736,215 as of December 31, 2009.

We again recommend that District personnel review how files are password protected to determine whether live data for completed school years can also be password protected. We also recommended that District personnel develop procedures to ensure that the coordinator of pupil services is contacted when changes are made which may affect data for completed school years.

Finding No. 13: Inadequate Computer Controls

Finding Summary: The Department of the Auditor General's Bureau of Technical Audit Services performed a review of internal controls relevant to the District's computer control environment in conjunction with the Bureau of School Audits audit of the District's operations for the years ended June 30, 2002 and 2001. Twelve recommendations were made as a result of that review. Our prior audit for the years ended June 30, 2005, 2004 and 2003 found that the District implemented only 8 of the 12 recommendations.

Recommendations: Our audit finding recommended that the HCSD:

1. Generate monitoring reports (including firewall logs) of the vendor and employee remote access and activity on its system. Monitoring reports should include the date, time, and reason for access, changes(s) made and who made the change(s). The District should review these

reports to determine that the access was appropriate and that data was not improperly altered. The District should also ensure it is maintaining evidence of this monitoring and review.

2. Require the vendor to assign unique userIDs and passwords to vendor employees authorized to access the District system. Further, the District should obtain a list of vendor employees with remote access to its data and ensure that changes to the data are made only by authorized vendor representatives.
3. Implement a security policy and system parameter settings to require all users, including the vendor, to change passwords on a regular basis (i.e. every 30 days). Passwords should be a minimum length of eight characters and include alpha, numeric, and special characters. Also, the District should maintain a password history (i.e., last ten passwords), lock out users after three unsuccessful attempts, and log users off the system after a period of inactivity (i.e., 60 minutes maximum).
4. Develop a current disaster recovery plan.

Current Status:

Our current audit found that the District implemented our recommendations, with the following exceptions:

1. District personnel did not take corrective action for requiring passwords to be a minimum length of eight characters and requiring passwords to contain alpha, numeric, and special characters. In addition, the system is not set to log users off after a period of inactivity.
2. District personnel did not develop a disaster recovery plan. The District has not had time to complete such a plan due to the critical nature of other needs.

Therefore, we again recommend that District personnel:

1. Require passwords to be at least eight characters in length.
2. Require passwords to contain alpha, numeric, and special characters.
3. Log users off the system after a period of inactivity (i.e. 60 minutes).
4. Develop a disaster recovery plan.

Finding No. 14: Inability to Provide Complete and/or Accurate Data Supporting Reports Submitted to the Pennsylvania Department of Education

Finding Summary: Our prior audit found that for the fourth consecutive audit the District was unable to provide complete and/or accurate data supporting child accounting reports submitted to PDE.

We requested the membership and attendance data the District used to create the PDE-4062 submitted to PDE for the 2004-05, 2003-04 and 2002-03 school years. For each of these school years, the District provided membership data; however, they were unable to provide attendance data and instead provided a file of absences for each year.

Recommendations: Our audit finding recommended that the HCSD:

Establish reconciliation and quality control procedures to ensure that the information provided to PDE on the membership reports is final and representative of the activities of the District. Furthermore, the data should be backed up maintained in a manner that is readily retrievable and available for use by the District and its auditors.

Current Status: Our current audit found that the District has not established reconciliation and quality control procedures to ensure that the information provided to PDE on the membership reports is final and representative of the activities of the District. This is addressed in Finding No. 3 of the current report (see page 15).

Our current audit found that data is not being adequately backed up in a manner that it can be readily retrieved and made available for use by the District and its auditors, as also addressed in Finding No. 3 of the current report (see page 15).

Finding No. 15: Board Members Failed to File Statements of Financial Interests in Violation of the State Public Official and Employee Ethics Act

Finding Summary: Our prior audit found that five of the nine elected board members and one of the five BOC members failed to file Statements of Financial Interests (SFI) for the year ended December 31, 2005, and all nine elected board members and one of five BOC members failed to file SFIs for the year ended December 31, 2004.

Recommendations: Our audit finding recommended that the HCSD's Board on Control (BOC):

1. Seek the advice of its solicitor in regard to the board's responsibility when an elected board member or BOC member fails to file a SFI.

2. Develop procedures to ensure that all individuals required to file a SFI do so in compliance with the Ethics Act.

Current Status:

Our current audit of the SFIs for calendar years 2009, 2008, 2007 and 2006 found that three elected school board members failed to file their SFIs for the 2007 calendar year, and four failed to file for the 2006 calendar year. In addition, one elected school board member filed late in 2009, 2008 and 2007 because he was on active military duty.

Our current audit also found that one and two BOC members failed to file SFIs for the 2009 and 2007 calendar years, respectively. Two BOC members filed their SFIs late, one for each of the 2008 and 2006 calendar years.

The BOC also did not seek the advice of its solicitor regarding the Board's responsibility when its members fail to file SFIs. However, the current administration consults their solicitor with questions concerning the SFIs.

In the middle of the 2008 calendar year, the board secretary developed procedures to ensure all individuals required to file an SFI do so. A report will be sent to the State Ethics Commission identifying the members who filed late or did not file their SFI.

Distribution List

This report was initially distributed to the superintendent of the school district, the board members, our website address at www.auditorgen.state.pa.us, and the following:

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