



**SCRANTON CITY SCHOOL DISTRICT
LACKAWANNA COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT**

OCTOBER 2013

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE AUDITOR GENERAL



Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen

EUGENE A. DePASQUALE
AUDITOR GENERAL

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

Mr. Robert Sheridan, Acting Board President
Scranton City School District
425 North Washington Avenue
Scranton, Pennsylvania 18503

Dear Governor Corbett and Mr. Sheridan:

We conducted a performance audit of the Scranton City School District (District) to determine its compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures (relevant requirements). Our audit covered the period January 14, 2010 through November 30, 2012, except as otherwise indicated in the report. Additionally, compliance specific to state subsidies and reimbursements was determined for the school years ended June 30, 2010 and June 30, 2009. Our audit was conducted pursuant to Section 403 of The Fiscal Code, 72 P.S. § 403, and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found significant noncompliance with relevant requirements, as detailed in the three audit findings and two observations within this report. A summary of the results is presented in the Executive Summary section of the audit report. These findings and observations include recommendations aimed at the District and a number of different government entities, including the Pennsylvania Department of Education and the Pennsylvania Department of Health.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale".

EUGENE A. DEPASQUALE
Auditor General

October 30, 2013

cc: **SCRANTON CITY SCHOOL DISTRICT** Board of School Directors

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Executive Summary

Audit Work

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

Our audit scope covered the period January 14, 2010 through November 30, 2012, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidies and reimbursements was determined for the 2009-10 and 2008-09 school years.

District Background

The District encompasses approximately 26 square miles. According to 2010 federal census data, it serves a resident population of 76,065. According to District officials, the District provided basic educational services to 9,661 pupils through the employment of 769 teachers, 365 full-time and part-time support personnel, and 42 administrators during the 2009-10 school year. Lastly, the District received \$52 million in state funding in the 2009-10 school year.

Audit Conclusion and Results

Our audit found significant noncompliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures, as detailed in the three audit findings and two observations within this report.

Finding No. 1: Membership Reporting Errors and a Lack of Internal Controls Resulted in the District Not Receiving Their Entitled Subsidy. Our audit of the Scranton City School District's (District) pupil membership reports for the 2009-10 and 2008-09 school years found errors and a lack of internal controls over the reporting process. District personnel inaccurately reported resident and non-resident membership. In addition, they failed to reconcile preliminary data reports from the Pennsylvania Department of Education (PDE) with their student information system reports, which resulted in incorrect data being reported on their final membership reports. The reconciliation of these preliminary data reports is a basic internal control measure, which should have caught many of the errors reported to PDE. The District had a similar finding in its last Department audit report (see page 6).

Finding No. 2: Transportation Reporting Errors Resulted in Reimbursement Underpayments to the District Totaling \$260,111 and Overpayments to a Contractor Totaling \$3,282. Our audit of the Scranton City School District's (District) contracted pupil transportation records found discrepancies in reports submitted to the Pennsylvania Department of Education for the 2009-10 and 2008-09 school years.

These discrepancies resulted in the District receiving net reimbursement underpayments of \$113,596 and \$146,515 for the 2009-10 and 2008-09 school years, respectively. Additionally, our audit found that the District overpaid one contractor by \$3,282 (see page 10).

Finding No. 3: Continued Errors in Health Services Data Resulted in Reimbursement Overpayments of \$125,011. Our audit of the Scranton City School District's (District) health services reimbursement requests for the 2009-10 and 2008-09 school years found that the District had inaccurately reported its average daily membership to the Pennsylvania Department of Health. These errors resulted in reimbursement overpayments of \$120,088 and \$4,923 for the 2009-10 and 2008-09 school years, respectively. Consequently, these errors resulted in a total overpayment of \$125,011 (see page 13).

Observation No. 1: Transportation Contractors Continued to be Paid Significantly Over State Formula. Our audit of the Scranton City School District's (District) transportation records for the 2009-10 and 2008-09 school years found that the District paid two of its bus contractors significantly more than the state formula allowance calculated by the Pennsylvania Department of Education. This action may have resulted in an unnecessary expenditure of taxpayer funds (see page 15).

Observation No. 2: The District Financed Some of Its Debt with Interest-Rate Management ("Swap") Agreements. On November 22, 2004, the Scranton City School District entered into agreements related to its issuance of \$9,860,000 and \$56,420,000 of bonds (Series of 1998) and (Series of 2001), respectively, an

arrangement known as an interest-rate management or swap agreement. Swaps are legal financial instruments that form a contract between a school district and an investment bank, speculating on the direction interest rates will move, as well as on other unpredictable factors. Swaps can be a very risky investment that may cost districts money if they fail to properly judge the direction interest rates will move (see page 17).

Status of Prior Audit Findings and Observations. With regard to the status of our prior audit recommendations to the Scranton City School District (District) from an audit released on February 24, 2012, we found that the District had taken or attempted to take appropriate corrective action in implementing our recommendations pertaining to the former Superintendent contract buyout (see page 20), inadequate control over student activity funds (see page 21), and vendor access and logical access control (see page 23). However, the District did not take appropriate corrective action in implementing our recommendations pertaining to pupil membership (see page 19), health services (see page 21), and transportation contractors being paid significantly over state formula (see page 24).

Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

School performance audits allow the Pennsylvania 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 Section 403 of The Fiscal Code, 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 January 14, 2010 through November 30, 2012, except as otherwise indicated in the audit.

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

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 District's compliance with certain relevant state laws, regulations, 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:

- ✓ In areas where the District received state subsidies and reimbursements based on pupil membership (e.g. basic education, special education, and vocational education), did it follow applicable laws and procedures?
- ✓ Did the District have sufficient internal controls to ensure that the membership data it reported to PDE through the Pennsylvania Information Management System was complete, accurate, valid, and reliable?

- ✓ In areas where the District received state subsidies and reimbursements based on payroll (e.g. Social Security and retirement), did it follow applicable laws and procedures?
- ✓ In areas where the District received transportation subsidies, were the District and any contracted vendors in compliance with applicable state laws and procedures?
- ✓ Did the District, and any contracted vendors, ensure that their current bus drivers were properly qualified, and did they have written policies and procedures governing the hiring of new bus drivers?
- ✓ Were there any declining fund balances that may pose a risk to the District's fiscal viability?
- ✓ Did the District pursue a contract buy-out with an administrator and if so, what was the total cost of the buy-out, what were the reasons for the termination/settlement, and did the current employment contract(s) contain adequate termination provisions?
- ✓ Did the District take appropriate steps to ensure school safety?
- ✓ Did the District have a properly executed and updated Memorandum of Understanding with local law enforcement?
- ✓ Were votes made by the District's Board of School Directors free from apparent conflicts of interest?
- ✓ Were there any other areas of concern reported by independent auditors, citizens, or other interested parties?
- ✓ Did the District take appropriate corrective action to address recommendations made in our prior audit?

Methodology

What are internal controls?

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

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

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

The District's management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the District is in compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures (relevant requirements). In conducting our audit, we obtained an understanding of the District's internal controls, including any information technology controls, as they relate to the District's compliance with relevant requirements that we consider to be significant within the context of our audit objectives. We assessed whether those controls were properly designed and implemented. Any deficiencies in internal control that were identified during the conduct of our audit and determined to be significant within the context of our audit objectives 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 and reimbursements, pupil transportation, pupil membership, and comparative financial information.

Our audit examined the following:

- Records pertaining to pupil transportation, pupil membership, bus driver qualifications, professional employee certification, state ethics compliance, financial stability, reimbursement applications, tuition receipts, and deposited state funds.
- Items such as board meeting minutes and policies and procedures.

Additionally, we interviewed select administrators and support personnel associated with the District's operations.

Lastly, to determine the status of our audit recommendations made in a prior audit report released on February 24, 2012, we performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1 →

Membership Reporting Errors and a Lack of Internal Controls Resulted in the District Not Receiving Their Entitled Subsidy

Criteria relevant to the finding:

Pupil membership classifications must be maintained and reported in accordance with the Pennsylvania Department of Education's (PDE) guidelines and instructions, since membership is a major factor in determining state subsidies and reimbursements. Beginning in 2009-10, PDE required that child accounting data be collected in a database called the Pennsylvania Information Management System (PIMS).

According to PDE's *PIMS User Manual*, all Pennsylvania local education agencies must submit data templates in PIMS to report child accounting data. PIMS data templates define fields that must be reported. Four important data elements from the Child Accounting perspective are: District Code of Residence; Funding District Code; Residence Status Code; and Sending Charter School Code. In addition, other important fields used in calculating state education subsidies are: Student Status; Gender Code; Ethnic Code Short; Poverty Code; Special Education; Limited English Proficiency Participation; Migrant Status; and Location Code of Residence. Therefore, PDE requires that student records are complete with these data fields.

Our audit of Scranton City School District's (District) pupil membership reports submitted to the Pennsylvania Department of Education (PDE) for the 2009-10 and 2008-09 school years found that the District lacked the internal controls necessary to ensure that the data reported was complete and accurate. For example, District personnel failed to reconcile preliminary data reports from PDE with their student information system reports, which resulted in incorrect data being reported on their final membership reports. The reconciliation of these preliminary data reports is a basic internal control measure, which should have caught many of the errors reported to PDE. The District had a similar finding in its last Department audit report. This lack of proper internal controls resulted in the District being overpaid \$31,860 over the two year period.

The PDE bases all local education agencies' (LEA) state subsidy calculations on the student record data it receives in the Pennsylvania Information Management System (PIMS). PIMS is a statewide longitudinal data system or "data warehouse," designed to manage and analyze individual student data for each student served by Pennsylvania's Pre-K through Grade 12 public education systems.

PDE began calculating the LEA's state subsidy using the data that LEAs enter into PIMS beginning in the 2009-10 school year. Therefore, it is vitally important that the student information entered into this system is accurate, complete, and valid. LEAs must have strong internal controls in place to ensure the integrity of this data and to mitigate the risk of erroneous reporting. Without such controls, the LEA cannot be assured it receives the proper state subsidy.

Additionally, according to the *Federal Information System Controls Audit Manual*, a business entity should implement procedures to reasonably assure that: (1) all data input is done in a controlled manner; (2) data input into the application is complete, accurate, and valid; (3) incorrect information is identified, rejected, and corrected for subsequent processing; and (4) the confidentiality of data is adequately protected.

Our audit identified errors in the District's membership reporting for both resident and nonresident children in the 2009-10 school year. For example, the District overstated the resident membership for all of its grade levels, including pre-kindergarten, half-time and full-time kindergarten, elementary, secondary, and vo-tech. In addition, District personnel incorrectly reported 272 resident days as institutionalized nonresident days. District personnel also underreported membership days for nonresident students in pre-kindergarten, elementary and secondary grade levels.

District personnel also improperly coded students' resident districts. For example, the staff listed the District as the district of residence for one foster child who attended school in the District for only 30 days. In another instance, District personnel improperly reported the district of residence for children placed in the District by court order.

The result of these errors was that the District was underpaid \$41,229 for the 2009-10 school year.

In addition, District personnel double reported membership days for nonresident institutionalized wards of the state, which resulted in the District reporting an additional 620 secondary days membership. We were unable to determine if there was any effect on the subsidies provide to these students' districts of residence since, as discussed above, this information was not correctly recorded. We also found that nine secondary days for institutionalized wards of the state were over reported for the Dunmore School District.

Finally, the District incorrectly coded membership days for two non-resident district-paid tuition students. The District reported itself as the district of residence when in fact one day should have been reported for Delaware Valley School District for elementary, and 50 days should have been reported for Valley View School District kindergarten full-time.

Our audit identified similar errors in the District's membership reporting for both resident and nonresident children in the 2008-09 school year. For example, District personnel overstated resident membership days for all grade levels, including pre-kindergarten, half-time kindergarten and full-time kindergarten. In addition, the District over stated membership days for non-resident children placed by court order for the elementary and the secondary grade levels.

These errors resulted in the District being overpaid \$9,369.

PDE has been provided a report detailing the errors for use in recalculating the District's subsidies.

Recommendations

The *Scranton City School District* should:

1. Establish internal controls that include reconciliations of the data that is uploaded into PIMS.
2. Verify that the Preliminary Reports from PDE are correct and if not correct, revise and resubmit child accounting data so that the Final Reports from PDE are correct.

The *Pennsylvania Department of Education* should:

3. Revise all reports that have been incorrectly completed and adjust the District's subsidies affected by the errors.

Management Response

Management stated the following:

“Scranton School District was operating with an outdated student data information system. In addition, the District data was not synched with special education data.

In September of 2012, the District purchased upgrades to this software which includes enhanced features to increase data integrity. The updates will align both special education and regular education data, which will increase the congruency of information and eliminate inaccuracies when submitting through PIMS.

The allocation of reporting responsibilities between the District and [the] Intermediate Unit have also been defined and clarified since 2009.

Additional support staff is being considered in order to accurately track the entry and withdrawal data for students. Processes related to identifying 'District of Residence' for students within the [detention centers] and Juveniles Incarcerated in Adult Facilities (JIAF) have been defined and outlined with streamlined paperwork. Increased support has been utilized in order to more accurately 'acknowledge' or 'disclaim' the over 160 students who attend outside institutions.

Training and support is being accessed through professional organizations to increase staff capacity as well.

A Facilitated Self Assessment of [detention centers] and JIAF is currently occurring to increase the accuracy and the integrity of managing pupil membership. Training of guidance staff regarding pupil attendance has occurred.”

Auditor Conclusion

We commend the District for taking steps to try to address our recommendations. We will evaluate these new processes during our next cyclical audit. The finding will stand as written.

Finding No. 2

Transportation Reporting Errors Resulted in Reimbursement Underpayments to the District Totaling \$260,111 and Overpayments to a Contractor Totaling \$3,282

Criteria relevant to the finding:

Transportation data must be maintained in accordance with Chapter 23 of the State Board of Education's regulations, 22 Pa. Code Chapter 23, entitled "Pupil Transportation" and the Pennsylvania Department of Education guidelines and instructions, since this data determines the District's transportation subsidies.

The number of days transported, miles vehicles travel with and without pupils, pupil data such as public hazardous and public nonhazardous, and the amount paid to contractors are all integral parts of the transportation formula. In addition, nonpublic pupil data generates a portion of the transportation subsidy.

Our audit of the Scranton City School District's (District) pupil transportation records found errors in the reports submitted to the Pennsylvania Department of Education (PDE) for the 2009-10 and 2008-09 school years. These errors resulted in net reimbursement underpayments of \$113,596 and \$146,515 for the 2009-10 and 2008-09 school years, respectively. Additionally, we found that the District overpaid one contractor for both years of audit.

For the 2009-10 school year, District personnel:

- Incorrectly reported manufacturer's serial numbers and year of manufacture for 51 contracted vehicles.
- Underreported miles vehicles traveled with pupils by a net of 170.4 miles per day for the 49 contracted vehicles reported.
- Underreported miles vehicles traveled without pupils by a net of 250.5 miles per day for the 51 contracted vehicles reported.

For the 2008-09 school year, District personnel:

- Underreported miles vehicles traveled with pupils by a net of 231.5 miles per day for the 53 contracted vehicles reported.
- Underreported miles vehicles traveled without pupils by a net of 264.3 miles per day for the 53 contracted vehicles reported.

The errors were caused by District personnel's failure to reconcile District mileage routes with the transportation contractor's reports. As a result of the reporting errors, the District was underpaid a net total of \$260,111.

In addition to these errors, our audit found that the District overpaid one transportation contractor because District personnel failed to verify an annual increase calculation. Specifically, the District's contract with one of its transportation contractors includes an annual 3-percent inflationary increase, and an annual 4-percent fuel adjustment increase based on the price of fuel. Our audit found that the contractor used the previous year's calculated rate as the current year's base cost before adding the inflationary and fuel adjustment increases, instead of subtracting out the 4 percent fuel adjustment, which is based on the fuel costs from that year.

This compounding calculation resulted in the District paying its transportation contractor a daily per bus rate of \$237.41 instead of \$211.03 for the 2008-09 school year, and \$254.31 instead of \$217.36 for the 2009-10 school year. Based on this calculation, we found that the contractor was overpaid \$1,884 and \$1,398 for the 2009-10 and 2008-09 school years, respectively. Furthermore, the District renewed the agreement with an addendum to the old contract and not all parties signed the addendum.

PDE has been provided reports detailing the errors for use in recalculating the District's transportation reimbursement.

Recommendations

The *Scranton City School District* Board of School Directors should require District personnel to:

1. Review mileage records, pupil counts, and contractor payment data for vehicles providing transportation to and from school to ensure accurate reporting of data that is in compliance with PDE reporting guidelines.
2. Implement a system of final review to ensure accurate reporting of transportation data to PDE.
3. Review transportation reports submitted for subsequent years and submit revisions, if necessary.
4. Establish a process for verifying that all contractor rates are properly calculated prior to the payment of invoices.
5. Require all parties agreeing to a contract extension to sign the contract extension.

6. Request repayment from the contractor for amounts overbilled for the 2008-09 and 2009-10 school years.

The *Pennsylvania Department of Education* should:

7. Adjust the District's transportation allocation to resolve the net underpayment of \$260,111.

Management Response

Management stated the following:

"I have made it mandatory that Transportation Contractors complete mileage reports once a month beginning October 2012 and ending May 2013, that must be submitted monthly.

- Review mileage records, pupil counts, and contractor payment data for vehicles providing transportation to and from school to ensure accurate reporting data that is in compliance with the Pennsylvania Department of Education reporting guidelines.
- I have implemented a system of final review to ensure accurate reporting data. I have provided worksheets supplied by my office and approved by the Pennsylvania Department of Education and documentation provided by drivers, including buses and vans. Information from these worksheets will then be used in completing information for the Pupil Data worksheet.
- I will also review transportation reports submitted for subsequent years and submit revisions, if necessary.
- Review all monthly transportation bills submitted by the contractors to ensure that we have been billed for the correct amount of runs and days."

Auditor Conclusion

We commend the District for taking steps to try to address our recommendations. We will evaluate these new processes during our next cyclical audit. The finding will stand as written.

Finding No. 3

Continued Errors in Health Services Data Resulted in Reimbursement Overpayments of \$125,011

Criteria relevant to the finding:

Section 2505.1 of the Public School Code, 24 P.S. § 25-2505.1, as last amended by Act 25 of 1991, provides for a reimbursement of actual costs for health services, with a maximum reimbursement of \$1.60 for medical services, and \$7 for nurse services for each child enrolled in a school for the entire term, and a proportionate share for each child enrolled for a part of the school term. In addition, Act 25 established that school districts would receive an additional uncategorized reimbursement for health services of \$9.70 multiplied by the district's average daily membership.

Our audit of the Scranton City School District's (District) health services reimbursement requests found that in the reports the District filed with the Pennsylvania Department of Health (PDH), the District inaccurately reported average daily membership (ADM). These errors resulted in reimbursement overpayments of \$120,088 for the 2009-10 school year, and \$4,923 for the 2008-09 school year, for a grand total of \$125,011 in overpayments.

These reporting errors were caused by District personnel's failure to compare the actual ADM to the reports generated by the District's computer system, in order to verify that the information had been entered correctly.

The District overstated its ADM for the 2009-10 and 2008-09 school years, as follows:

<u>School Year</u>	<u>Average Daily Membership</u>		
	<u>Reported</u>	<u>Audited</u>	<u>Overstated</u>
2009-10	17,108.085	10,544.750	6,563.335
2008-09	11,838.030	11,569.006	269.024

The overpayments for the 2009-10 and 2008-09 school years are as follows:

<u>School Year</u>	<u>Overstated ADM</u>	<u>Medical (\$1.60/day)</u>	<u>Nurse (\$7/day)</u>	<u>Act 25 (\$9.70/day)</u>	<u>Adjustment</u>	<u>Total</u>
2009-10	6,563.335	\$10,501	\$45,943	\$63,664	\$20	\$120,088
2008-09	269.024	430	1,883	2,610		<u>4,923</u>
						\$125,011

It is the responsibility of the District's management to have the proper policies and procedures in place to verify that student data that collected and submitted for state reimbursement is accurate. Without these internal controls, the District cannot be assured that it is receiving the appropriate state reimbursement.

PDH was provided a copy of this finding through the Pennsylvania Department of Education for use in making the necessary reimbursement adjustments.

Recommendations

The *Scranton City School District* should:

1. Report ADM for all students for whom comprehensive health records are maintained.
2. Perform an internal review of the membership and health services data prior to submitting reports to PDH.
3. Review reports for school years subsequent to the audit period and, if similar errors are found, submit revised reports to PDH.

The *Pennsylvania Department of Health* should:

4. Adjust the District's allocations to resolve the reimbursement overpayments of \$125,011 for the 2009-10 and 2008-09 school years.

Management Response

Management stated the following:

“Upgraded software that incorporates state reporting was purchased in September of 2012. Nursing staff has received training regarding upgraded software and reporting mandated services for pupils in September of 2012.

During school years 2008-09 and 2009-10, clerical staff was responsible for interpreting and reporting health service data. Staff turnover during subsequent years created confusion regarding reporting responsibilities.

Starting with the school year 2012-13, administrative staff will account for all data reported regarding student health.”

Auditor Conclusion

We commend the District for taking steps to try to address our recommendations. We will evaluate these new processes during our next cyclical audit. The finding will stand as written.

Observation No. 1

Transportation Contractors Continued to be Paid Significantly Over State Formula

Criteria relevant to the observation:

The Pennsylvania Department of Education’s final formula allowance provides for a per vehicle allowance based on the year of manufacture of the vehicle chassis, the approved seating capacity, number of trips the vehicle operates, the number of days pupils were transported, the approved daily miles driven, any excess hours and the greatest number of pupils transported. The final formula allowance is adjusted annually by an inflationary cost index.

The District receives the lesser of the final formula allowance for the vehicles or the actual amount paid to the contractor, multiplied by the District’s aid ratio.

Our audit of the Scranton City School District’s (District) transportation records for the 2009-10 and 2008-09 school years found that the District paid two of its bus contractors significantly more than the state formula allowance calculated by the Pennsylvania Department of Education (PDE). This action may have resulted in an unnecessary expenditure of taxpayer funds. Our prior audit report also found that transportation contractors were paid significantly over the state formula.

PDE prepares a final formula allowance for each school district, which it uses to determine reimbursement for transportation services. This allowance is based on a number of factors, including the approved daily miles driven, the age of the vehicles, and the greatest number of pupils transported. Each district then receives the lesser of the final formula allowance for the vehicles or the actual amount paid to the contractor, multiplied by its aid ratio.

The District paid two contractors significantly more than its calculated formula allowance. These amounts were as follows:

	<u>2009-10 School Year</u>		<u>2008-09 School Year</u>	
	<u>Contractor A</u>	<u>Contractor B</u>	<u>Contractor A</u>	<u>Contractor B</u>
Contracted Cost	\$2,336,763	\$776,007	\$2,287,824	\$721,608
State Allowance	948,714	263,486	606,866	113,829
Difference	\$1,388,049	\$512,521	\$1,680,958	\$607,779
% Over State Allowance	<u>146.3%</u>	<u>194.5%</u>	<u>276.9%</u>	<u>533.9%</u>

While bidding of pupil transportation service is not required under state law, competitive bidding can result in a lower cost to District taxpayers. Moreover, since PDE provides a state allowance, it would be prudent for the District to consider that the money that goes towards the transportation contract is local and state tax revenue that is not going towards educating the children of the District.

Recommendations

The *Scranton City School District* should:

1. Consider bidding transportation contracts to determine if taxpayers would benefit from a more favorable contract for the District.
2. Be cognizant of the state's final formula allowance prior to negotiating transportation contracts.

Management Response

Management stated the following:

“The Scranton School District continues to utilize its current contractor to provide Pupil Transportation in spite of the state formula due to the School District being an urban setting with some buses only traveling less than two miles in duration.

The School District has mandated that the buses run multiple runs and compensate the contractor based on the cost of the bus on a daily rate as opposed to the per run formula driven payment. The School District in comparison to other districts of similar size and population pay a per bus cost that is in line with other districts of the same population and urban status.

Also the School District is able to obtain the maximum amount of vehicle reimbursement due to the fact that the current contractor updates the entire fleet of buses every three years. This allows that there are no vehicles at any given time exceeding three years of age which provides for additional safety and allows maximum per vehicle reimbursement.”

Auditor Conclusion

We continue to recommend that the District consider bidding transportation contracts while keeping the state's final formula allowance in mind. We also reiterate that each dollar that goes to a transportation contract that is many times over the state's final formula allowance is a dollar that is not going towards educating the District's students.

Observation No. 2

The District Financed Some of Its Debt with Interest-Rate Management (“Swap”) Agreements

Criteria relevant to the observation:

Act 23 of 2003 explicitly permitted local government units like school districts to enter into “qualified interest rate management agreements,” commonly referred to as interest rate swaps, or just swaps, which are a type of derivative. Please see 53 Pa.C.S. § 8281.

On November 22, 2004, the Scranton City School District (District) entered into swap agreements related to its issuance of \$9,860,000 and \$56,420,000 of bonds (Series of 1998) and (Series of 2001), respectively.

The taxpayers have the right to expect their hard earned money to be spent on the education of students of the commonwealth and not for the benefit of any individual.

Current state law permits school districts and other local government units to enter into qualified interest-rate management agreements, known more commonly as “swaps”. Swaps are financial instruments that form a contract between a school district and an investment bank, speculating on the direction interest rates will move, as well as on other unpredictable factors. Specifically, the party to the contract that guesses correctly about whether interest rates will go up or down gets paid by the party to the contract that guesses incorrectly. This is called a swap interest payment. The amount of money changing hands is determined by several factors, including the amount of the debt associated with the swap and the overall fluctuation of interest rates.

Swaps allow school districts to enter into variable-rate debt financing, and thereby take advantage of low interest rates, while at the same time mitigating the possibility of those same interest rates rising. However, swaps are complicated, financial instruments that can cost money if the District judges incorrectly on which way interest rates will move. Likewise, districts can end up paying financial advisors, legal fees, and underwriting fees, especially if these services are not competitively bid and evaluated for independence. Additionally, swaps can cause districts to pay large termination fees to the investment banks.

For example, the District terminated one of its swap agreements effective February 23, 2011, and paid \$1,181,800 in termination fees, and partially terminated a second swap agreement effective March 23, 2011, and paid \$5,340,000 in termination fees. Whenever the District terminates a swap, it

should weigh the cost of these fees against the potential long-term costs of maintaining the investment.

Recommendations

The *Scranton City School District* should:

Consider all the risks, including potential termination fees, when entering into any new swap agreements in the future.

Management Response

Management stated the following:

“The Scranton School District in 2004 entered into two SWAP Agreements as a way for the School District to finance future capital improvement projects and to allow the District to be financially creative. The method of SWAPS was both approved and endorsed by the Commonwealth of Pennsylvania.

In 2008, when the first SWAP was called, the School District issued fixed rate debt minimizing the School Districts exposure to the market. The 2011 SWAP which was called in April 2011, at the time the School District restructured its existing debt and was able to successfully reduce the value of the 2011 SWAP thus further reducing the exposure of the School District to the Financial Market conditions.

The School District continues to monitor the remaining portion of the SWAP to ensure that at a time it is economically advantageous to the School District it will issue fixed rate debt thus eliminating the remaining portion SWAP.”

Status of Prior Audit Findings and Observations

Our prior audit of the Scranton City School District (District), released on February 24, 2012, resulted in five findings and one observation. The first finding pertained to pupil membership reporting, the second finding pertained to an improper vacation leave payout, the third finding pertained to health services data errors, the fourth finding pertained to inadequate controls over student activity funds, and the fifth finding pertained to unmonitored vendor access to the District's computer network. The observation pertained to overpaying transportation contractors. As part of our current audit, we determined the status of corrective action taken by the District to implement our prior recommendations. We performed audit procedures and interviewed District personnel regarding the prior findings and observation. As shown below, we found that the District did implement or attempted to implement many of our recommendations related to the contract buyout, inadequate control of student activities, and vendor access and logical access control. However, the District did not implement any of our recommendations related to pupil membership, health services data, and transportation contractors being paid significantly over state formula.

Auditor General Performance Audit Report Released on February 24, 2012

Finding No. 1: Errors in Reporting Pupil Membership Resulted in a \$234,491 Net Subsidy and Reimbursement Overpayment

Finding Summary: Our prior audit of the District's pupil membership reports submitted to the Pennsylvania Department of Education (PDE) for the 2006-07 school year found errors in the District's reporting of resident membership days, resulting in a net overpayment of \$234,491 in subsidies and reimbursements. Errors also occurred in the 2007-08 school year. However, we were unable to determine the dollar amount since the 2007-08 basic education funding formula from PDE was not yet available at the time of our audit.

Recommendations: Our audit finding recommended that the District:

1. Provide regular in-service training to staff responsible for recording and reporting membership. This training should emphasize the importance of maintaining accurate records and the relationship of membership data to state subsidies and reimbursements.
2. Strengthen internal controls to ensure pupil membership is reported in accordance with PDE guidelines and instructions.
3. Implement internal controls to compare the actual membership days to the reports generated by the District's membership computer

software, in order to verify that the information has been correctly entered.

4. Perform an internal review of membership reports and summaries prior to submission of final reports to PDE.
5. Review reports submitted in subsequent years and if errors are found, submit revised reports to PDE.

The *Pennsylvania Department of Education* should:

6. Adjust the District's future allocations to recover the net overpayments for the 2007-08 and 2006-07 school years.

Current Status: During our current audit, we found that the District did not implement our recommendations regarding pupil membership reporting. A repeat finding was written (see Finding No. 1).

Finding No. 2: District Improperly Paid Retiring Superintendent For Vacation Days

Finding Summary: Our prior audit of the former Superintendent's retirement incentives found that the District improperly paid the former Superintendent for vacation days accumulated during the 2007-08 school year.

Recommendations: Our audit finding recommended that the District:

1. Require the former Superintendent to repay the \$9,649 he improperly received for the 20 vacation days.
2. Upon the retirement of any employee, follow the provisions of the original employment contract and pay only what is due to the employee prorated for the term of services provided.

Current Status: During our current audit, we found that the District had attempted to implement our recommendations regarding the improper payment for vacation days. However, District personnel failed to deduct the amount of the payment from the former Superintendent's check, which had been agreed upon by both parties. The deduction is now scheduled to be completed in 2013.

Finding No. 3: Errors in Health Services Data Resulted in a Net Reimbursement Underpayment

Finding Summary: Our prior audit of the District’s 2007-08 and 2006-07 school years’ health services reimbursement requests found that the District inaccurately reported average daily membership (ADM) to the Pennsylvania Department of Health (PDH) when reporting the number of children receiving dental hygiene services.

These errors resulted in a reimbursement underpayment of \$12,839 for the 2007-08 school year, and a reimbursement overpayment of \$8,720 for the 2006-07 school year. Consequently, these errors resulted in a net underpayment of \$4,119.

Recommendations: Our audit finding recommended that the District:

1. Report ADM for all students for whom comprehensive health records are maintained.
2. Perform an internal review of the membership and health services data prior to submitting reports to PDH.
3. Review reports for school years subsequent to the audit period and, if similar errors are found, submit revised reports to PDH.

The *Pennsylvania Department of Health* should:

4. Adjust the District’s allocations to resolve the reimbursement net underpayments of \$4,119 for the 2007-08 and 2006-07 school years.

Current Status: During our current audit, we found that the District did not implement our recommendations regarding the reporting of health services data. A repeat finding was written (see Finding No. 3).

Finding No. 4: Continued Inadequate Control of Student Activity Funds

Finding Summary: Our prior audit of the District’s student activity records for the 2008-09 school year found that the District failed to implement our recommendations from the prior audit. Specifically, the high school activity fund treasurer that was previously cited continued to fail to follow established guidelines for providing adequate controls over the student activity funds (SAF). Furthermore, the activity fund treasurer did not maintain adequate supporting documentation for the management of the SAF.

Recommendations:

Our audit finding recommended that the District:

1. Develop written procedures to ensure that negative balances are not permitted to occur in student activity accounts.
2. Require that all schools use approved purchase orders evidencing student approval of expenses.
3. Require that all purchase orders are complete and have adequate descriptions.
4. Require that documentation is maintained for all activity accounts received from advisors prior to deposit.
5. Require that deposit slips are maintained for audit.
6. Ensure that proper invoice and disbursement documentation is maintained and attached to purchase orders.
7. Ensure only student related account items are purchased through the student activity account and that student control is evidenced.
8. Ensure monies from graduated classes are handled properly in accordance with policy.
9. Require the custodian and treasurer to purge inactive accounts and disburse balances in accordance with District policy.
10. Ensure only student related monies are included in the student activity account.
11. Discontinue the use of personal credit cards for SAF purchases by student advisors.
12. Require the treasurer to send revised SAF financial reports to the Board for approval after any revisions by the local auditors.
13. Require the treasurer and custodian of student activity funds to become familiar with and comply with provisions of current Board Policy No. 618 for Special Purpose Funds.

Current Status:

During our current audit, we found that the District did implement our recommendations pertaining to adequate controls over its student activity funds.

Finding No. 5: Unmonitored Vendor System Access and Logical Access Control Weaknesses

Finding Summary: Our prior audit found that the District uses software purchased from an outside vendor for its critical student accounting applications (membership and attendance). The software vendor has remote access into the District's network servers. Since the District does not have adequate manual compensating controls in place to verify the integrity of the membership and attendance information in its database, the risk of unauthorized changes are increased.

Recommendations: Our audit finding recommended that the District:

1. Contain a non-disclosure agreement in the contract with the vendor for the District's proprietary information.
2. Develop policies and procedures to require written authorization when adding, deleting, or changing a userID.
3. Maintain documentation to evidence that terminated employees are properly removed from the system in a timely manner.
4. Implement a security policy and system parameter settings to require all users, including the vendor, to change their passwords on a regular basis (e.g., every 30 days). Passwords should be a minimum length of eight characters. Also, the District should maintain a password history that will prevent the use of a repetitive password (e.g., last ten passwords); lock out users after three unsuccessful attempts, and log users off the system after a period of inactivity (e.g., 60 minutes maximum).
5. Generate monitoring reports of the vendor activity on the District's 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 they are maintaining evidence to support this monitoring and review.
6. Perform reconciliations between system generated membership and attendance reports and manually kept membership and attendance records (i.e., absence records) to ensure that any unauthorized changes within the system would be detected in a timely manner.

Current Status: During our current audit, we found that the District did implement our recommendations to address their student accounting applications.

Observation: Transportation Contractors Paid Significantly Over State Formula

Observation
Summary:

Our prior audit of the District’s transportation records for the 2007-08 and 2006-07 school years found that the District paid two of its bus contractors significantly more than the state formula allowance calculated by PDE. This action may have resulted in an unnecessary expenditure of taxpayer funds.

Recommendations:

Our audit observation recommended that the District:

1. Consider bidding transportation contracts to determine if taxpayers would benefit from a more favorable contract for the District.
2. Be cognizant of the state’s final formula allowance prior to negotiating transportation contracts.

Current Status:

During our current audit, we found the District did not implement our recommendations to address the transportation contractors being paid significantly over the state formula allowance. A repeat observation was written (see Observation No. 1).

Distribution List

This report was initially distributed to the Superintendent of the District, the Board of School Directors, our website at www.auditor.gen.state.pa.us, and the following stakeholders:

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

The Honorable Carolyn Dumaesq
Acting Secretary of Education
1010 Harristown Building #2
333 Market Street
Harrisburg, PA 17126

The Honorable Robert M. McCord
State Treasurer
Room 129 - Finance Building
Harrisburg, PA 17120

Ms. Lori Graham
Acting Director
Bureau of Budget and Fiscal Management
Pennsylvania Department of Education
4th Floor, 333 Market Street
Harrisburg, PA 17126

Dr. David Wazeter
Research Manager
Pennsylvania State Education Association
400 North Third Street - Box 1724
Harrisburg, PA 17105

Mr. Tom Templeton
Assistant Executive Director
School Board and Management Services
Pennsylvania School Boards Association
P.O. Box 2042
Mechanicsburg, PA 17055

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