

BETHLEHEM AREA SCHOOL DISTRICT
NORTHAMPTON COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

AUGUST 2012

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

Ms. Michael Faccinetto, Board President
Bethlehem Area School District
1516 Sycamore Street
Bethlehem, Pennsylvania 18017

Dear Governor Corbett and Mr. Faccinetto:

We conducted a performance audit of the Bethlehem Area School District (BASD) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period October 17, 2008 through July 14, 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 and June 30, 2007. 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 BASD complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures, except as detailed in three findings noted in this report. A summary of these results is presented in the Executive Summary section of the audit report.

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

Sincerely,

/s/

JACK WAGNER
Auditor General

August 13, 2012

cc: **BETHLEHEM AREA 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 Bethlehem Area School District (BASD). 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 BASD in response to our prior audit recommendations.

Our audit scope covered the period October 17, 2008 through July 14, 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 and 2006-07.

District Background

The BASD encompasses approximately 44 square miles. According to 2000 federal census data, it serves a resident population of 108,000. According to District officials, in school year 2007-08 the BASD provided basic educational services to 15,316 pupils through the employment of 1,182 teachers, 865 full-time and part-time support personnel, and 57 administrators. Lastly, the BASD received more than \$45.8 million in state funding in school year 2007-08.

Audit Conclusion and Results

Our audit found that the BASD complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures; however, as noted below, we identified three compliance-related matters reported as findings.

Finding No. 1: District Was Overpaid \$77,122 in Alternative Education Subsidy.

Our audit of the BASD's alternative education subsidy data for the 2007-08 and 2006-07 school years found BASD personnel incorrectly reported the number of weeks that pupils were in an alternative education program, resulting in subsidy overpayments of \$48,052 and \$29,070, respectively (see page 6).

Finding No. 2: General Fund Deficit. Our review of the BASD's financial records found that the BASD's general fund balance decreased from a \$7,418,821 surplus at June 30, 2006 to a deficit of \$1,119,232 at June 30, 2009 (see page 10).

Finding No. 3: District Improperly Transferred and Expended Monies from the Capital Reserve Fund to Cover General Operating Expenditures.

Our audit of the BASD's financial records and the board of school directors' approved meeting minutes found that on September 17, 2007, the board and the BASD administration violated state law by improperly transferring \$2,500,000 from the Capital Reserve Fund to the General Fund to cover BASD's general operating expenses.

Furthermore, according to the BASD's local auditors' report for the year ended June 30, 2009, the BASD improperly paid for \$122,664 in monthly computer system maintenance from the capital reserve fund. (see page 16).

Status of Prior Audit Findings and Observations. With regard to the status of our prior audit recommendations to the BASD from an audit we conducted of the 2005-06 and 2004-05 school years, we found the BASD had taken appropriate corrective action in implementing our recommendations pertaining to Social Security and Medicare wages, (see page 18) Memorandums of Understandings, and student accounting applications (see page 19).

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 PA 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 October 17, 2008 through July 14, 2010, except for the verification of professional employee certification which was performed for the period July 1, 2009 through January 31, 2010.

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

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 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 BASD'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 use an outside vendor to maintain its membership data and if so, are there internal controls in place related to vendor access?
- ✓ Is the District's pupil transportation department, including any contracted vendors, in compliance with applicable state laws and procedures?
- ✓ 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?
- ✓ Is the District taking appropriate steps to ensure school safety?
- ✓ 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 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.

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

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.

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 bus driver qualifications, professional employee certification, 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 BASD operations.

Lastly, to determine the status of our audit recommendations made in a prior audit report released on April 24, 2009, we performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1

District Was Overpaid \$77,122 in Alternative Education Subsidy

Public School Code section and Criteria relevant to the finding:

Department of Education's (DE) guidelines and instructions on the Quarterly Expenditure Report for the Alternative Education for Disruptive Youth Grant states that reimbursement is based on the number of students participating in the program during each week of the quarter. Students attending any part of a calendar week may be counted as attending the full week.

Grant guidelines provided by DE, states in part . . . funds will be expended to create and support the Alternative Education for Disruptive Youth program only.

Alternative Education for Disruptive Youth Program guidelines provided by DE state, in part:

Applicants must provide programs for a minimum of 5 days per week and a total of twenty instructional hours per week; or a minimum of fifteen hours of instruction covering at least four of the following curricular areas: Language Arts, Mathematics, Science, Social Studies, Health or Life Skills and show that normal academic progress may be achieved in fewer than twenty hours of weekly instruction.

Our audit of the District's alternative education subsidies data for the 2007-08 and 2006-07 school years found that District personnel incorrectly reported the number of weeks that pupils were in an alternative education program and inappropriately reported pupils who attended programs that the Pennsylvania Department of Education (PDE) had not approved under its alternative education grant program. These errors resulted in state subsidy overpayments of \$48,052 and \$29,070, respectively.

The District was eligible to receive payments of \$29.92 for the 2007-08 school year and \$28.50 for the 2006-07 school year. The final subsidy amount was calculated by multiplying these figures by the number of students in the program and the number of weeks the students attended. Only PDE approved alternative education programs were eligible for reimbursement.

However, the alternative education grant reimbursement applications District personnel submitted to PDE for the 2007-08 and 2006-07 school years included clerical errors in reporting the actual weeks of attendance for students educated in its Career Academy Program. In addition, during the 2007-08 school year, District personnel submitted grant reimbursement applications that included pupils attending programs ineligible for alternative education reimbursement.

Specifically, these reports included students attending the Regional Academic Standards Academy (RASA), a program aimed at assisting children in reaching grade level proficiency. The RASA program on its own is not a PDE approved alternative education program. Therefore, those students were not eligible for reimbursement. However, RASA also includes the Pathways Program, which is designed to develop appropriate social skills and behavioral expectations. The Pathways Program is a PDE approved alternative education program, and students attending this subprogram are eligible for reimbursement. Because District personnel were unable to provide adequate

documentation to support that the students submitted for reimbursement had specifically attended that part of the Pathways program, any subsidy that the District received for those students should also be disallowed.

Similarly, in the 2007-08 and 2006-07 school years the District also inappropriately included students attending the Character, Academic and Motivation Program (CAMP), and Lifeskills and Academic Maintenance Program (LAMP) in its grant reimbursement applications for alternative education. Neither of these programs was approved by PDE, and neither met the standards for an alternative education program. For example, the CAMP program was only a temporary in school suspension program, and the LAMP program had limited instructional hours and curriculum. Therefore, both were ineligible for subsidy reimbursement.

District personnel did not operate the alternative education program in the 2008-09 school year.

Recommendations

The *Bethlehem Area School District* should:

1. Review alternative education subsidy applications prior to submission to PDE to ensure accurate reporting.
2. Maintain attendance documentation for students participating in the Pathways Program for audit.
3. Review alternative education programs and curriculum provided with PDE requirements prior to the application for program subsidy to determine eligibility.
4. Review subsequent reports submitted to PDE and revise, if necessary.

The *Pennsylvania Department of Education* should:

5. Adjust the District's allocations to recover the \$77,122 in overpayments.

Management Response

Management provided the following:

Management believes that the Alternative Education Program in BASD meets the 2003/08 PDE guidelines in that it was designed for disruptive students who could not otherwise succeed in the regular classroom. Incorporated in our Career Academy program were 3 sub groups of students. CAMP, LAMP & Pathways. The main Career Academy program operated 5 days/wk, 20 hrs/wk and included all academic areas. CAMP students spent full days in the program for disruptive behavior and received academic, family & social services, counseling, behavior modification plans. Their placement was dependent upon their success with the interventions and would return if not successful once back in their home school. Pathways students were grade 6 who displayed disregard for authority, violent or threatening behavior, suspension, truancy, etc. and who were determined to benefit from the same interventions for disruptive students. It is believed that this is in compliance with the alt. ed. guidelines. We believe that there are 10 students who should be eligible for reimbursement under the grant from the Pathways program. LAMP students were the most disruptive and attended following their adjudication. These students attended Career Academy in the evening and did receive instruction in all academic areas two days/wk. We request reconsideration of the Pathways students and the related grant subsidy for their education.

Auditor Conclusion

As stated in the body of this finding, CAMP is an in school suspension program and placement is short-term. LAMP is a program where expelled students are limited to 5 hours of instruction per week and do not receive instruction in all required curricular areas. Neither CAMP nor LAMP was approved in the alternative education program application. Documentation supporting students and the number of weeks in the Pathways Program was not available for audit. The Pathways Program was for students in sixth grade and the BASD contends there were ten students in the program.

The auditor included ten sixth grade students in the recalculation of subsidy.

Therefore, the finding will stand as presented. The District should communicate any further disagreements to PDE.

Finding No. 2

General Fund Deficit

Our review of the District’s annual financial reports, local auditor’s reports (LAR) and general fund budgets for the fiscal years ended June 30, 2007, 2008 and 2009 found that although the District had a \$7,418,821 general fund surplus as of June 30, 2006, its balance decreased to a general fund deficit of \$1,119,232 as of June 30, 2009. However, the District resolved its general fund deficit as of June 30, 2010. The LAR reported the following:

<u>Year Ending</u> <u>June 30,</u>	<u>Revenue</u>	<u>Expenditures</u>	<u>Expenditures (Over)/Under Revenues</u>	<u>Other Financing Sources</u>	<u>Adjustments</u>	<u>General Fund Surplus/ (Deficit)</u>
2006	\$ -	\$ -	\$ -	\$ -	\$ -	\$7,418,821
2007	168,451,001	172,160,203	(3,709,202)	(1,913,666)	-	1,795,953
2008	175,951,855	183,200,878	(7,249,023)	3,102,465	(819,360)	(3,169,965)
2009	185,534,857	184,167,126	1,367,731	583,002	100,000	(1,119,232)
2010	194,949,112	186,237,890	8,711,221	(1,176,997)		8,940,090

Public School Code section relevant to the finding:

Section 609 provides, in part:

No work shall be hired to be done, no materials purchased, and no contracts made by any board of school directors which will cause the sums appropriated to specific purposes in the budget to be exceeded.

Our review found that the deficit can be attributed in large part to District personnel over estimating local revenues receivable for school year ended June 30, 2008 and state revenue receivable for school year ended June 30, 2009. In addition, District personnel and the board failed to adequately monitor increased expenditures for the school years ended June 30, 2007 and 2008 resulting in total actual expenditures exceeding budgeted expenditures.

Furthermore, our review identified the following factors that contributed to the District’s financial deterioration:

- grant funds were not spent wisely or in the best interest of taxpayers;
- funds were lost due to qualified interest rate management agreements (QIRMA);
- contractual obligations for certain administrator’s life insurance policies cost the taxpayers \$675,343; and
- various deficiencies were reported in the District’s LAR for 2008-09 school year.

Grant Funds Not Spent Wisely or in the Best Interest of Taxpayers

During the 2007-08 school year, the District received an \$89,901 Project 720 state grant. Project 720 ensures that all students have access to college-prep courses in core subject areas, additional Advanced Placement courses and smaller learning environments for better one-on-one teacher-to-student interaction. Our audit found that the District spent \$66,182 of the grant funds on conferences for staff development. Professional development expenses included \$23,520 for 11 employees to attend a conference at Walt Disney World for four days in June 2008. The conference's mission was to bring professionals together to develop a rigorous and relevant education system for all students. Although, the project 720 grants have a professional development component, considering the District's difficult financial situation it would have been more prudent for it to have spent the money on its post secondary instructional expenses. Moreover, the District's administration did not provide any evidence of curricular improvements that were implemented as a result of the information obtained at the conference. Therefore, we could not identify any clear benefit as a result of the conference expenditure.

Loss of Funds Due to Qualified Interest Rate Management Agreements

According to a Special Investigation Report issued by the Department of the Auditor General in November 2009, the District's use of two QIRMAs, otherwise known as swap agreements, associated with its variable rate General Obligation Note, Series 2003, cost District taxpayers \$10.2 million more than if the District had issued a standard fixed-rate bond or note, and \$15.5 million more than if the District had simply paid the interest on the variable rate note without any QIRMAs at all. The District's losses were largely due to excessive fees and other charges, especially a \$12.3 million payment that the District had to pay to the investment bank counterparty to terminate one of the agreements during the 2008-09 school year. The swap agreement was terminated as part of the refunding of the 2003 Note on May 1, 2009. Interest rates at the time of termination favored the counterparty, not the District.

Section 4-440.1 of the PSC provides that school district funds may be invested only in the five categories of authorized investments as follows:

- US Treasury Bills
- short term obligations of the US Government or its agencies or instrumentalities
- obligations of the United States of America, the Commonwealth of PA, or any political subdivision of the Commonwealth of PA or any of their agencies or instrumentalities, backed by their full faith and credit.
- deposits in savings accounts and certain other accounts in federally insured institutions, subject to collateralization requirements for funds in excess of insurance limits.
- certain mutual funds which are themselves only invested in (1) the above authorized investments, and/or (2) repurchase agreements fully collateralized by the above authorized investments.

Contractual Obligations for Certain Administrator's Life Insurance Policies Cost the Taxpayers \$675,343

The contracts of four prior administrators and one current administrator called for the District purchasing split-dollar whole life insurance policies for each individual worth between \$250,000 and \$350,000 each. Instead, the District purchased whole-life insurance policies costing a total of \$675,343. Three of these policies were purchased over the administrator's five-year contract period, and the two other administrators' policies were purchased over nine years. However, these policies were not split-dollar whole life insurance policies as outlined in the contracts, but rather just whole life policies.

Under the whole-life type of policy, the premium payments the District makes are divided over the period of the administrators' contracts until the policy is paid in full, regardless of whether the administrator remains employed by the District. The policy is then owned by the administrator and provides coverage for his/her death benefit or can be cashed in at any time. The insured administrator's named beneficiary is then expected to repay the premium to the District. The resulting funds are then placed in an investment account and the remainder is used to make the beneficiary payments.

However, current District personnel mistakenly believed that the policies the District purchased were split-dollar whole life insurance policies rather than whole life insurance policies. Under a split dollar whole life policy, the insurance company would have reimbursed the District for the premiums prior to making payments to the insured's beneficiary. In either instance, these types of policies are not good investments for the District because there is no guarantee of a timely repayment.

Additionally, had the District purchased the split dollar life insurance policies funded in part through the investment of District funds are invested in mutual funds, which are themselves stocks and bonds, they are subject to the investment limitations of Section 4-440.1 of the Public School Code. To the extent that the District's funds are invested in stocks or any other type of investment not listed in Section 4-440.1(c), those investments are not

permissible. If the District plans to purchase split-dollar life insurance policies as contractually obligated by administrator contracts, it would not be complying with Pennsylvania law.

Findings Reported in LAR for the 2008-09 School Year

The following findings were included in the 2008-09 LAR. We believe the deficiencies included in these findings contributed to the District's deficit spending, its general fund deficit balance, and to future inadvisable financial obligations.

District personnel:

- Failed to reconcile accounts during the entire year due to management not monitoring their staff. Failure to maintain reconciliation procedures can cause an understatement or an overstatement of the fund balance.
- Failed to properly file documentation to support some disbursements. Failure to maintain original documentation can cause invalid transactions to occur without being detected within a reasonable time period.
- Attempted to defer revenue recognition to a future year for federal and state grants causing the true revenue to be understated for the year.
- Failed to monitor the activities of its self-funded medical benefit fund which resulted in an overstatement of the financial position in other funds and the understatement of financial position in this fund.

Recommendations

The *Bethlehem Area School District* should:

1. Use actual historical data and projections when budgeting for revenues and expenditures;
2. Establish a process to monitor all future District expenditures to ensure that actual expenditures are kept within budgetary limits.
3. Review grant requirements and allocate funds based on need to ensure limited money is spent in the taxpayers' best interest.

4. Review future investments to adequately evaluate the potential risk to the District and taxpayer funds.
5. Consider altering future employee contract obligations such as life insurance policies, to bring them in line with current financial trends and to ensure tax dollars are spent prudently.
6. Review the appropriateness of the purchased whole-life insurance policies and determine if they were in line with the understanding of the board when administrator contracts were approved. Discuss any possible corrective actions with the District's solicitor.
7. Develop procedures to ensure the general ledger account is properly reconciled with bank statements to ensure the District's financial position is correctly stated.
8. Maintain all original invoices relating to state reimbursements for audit.
9. Develop reconciliation procedures to ensure the accounts payable and the general fund balances are correctly stated.
10. Recognize all matching contributions received during the year as revenue.
11. Develop and adopt a policy to establish a self-insured medical reserve balance.

Management Response

Management stated the following:

The noted deficit was the result of deficit budgeting, use of fund balance for operational expenses and interest rate variations impacting the cost of variable rate debt obligations. Corrective action has been taken to increase taxation rates, reduce expenditures, and refinance variable rate debt to only include 42% of the overall debt portfolio while eliminating yield curve risk completely. It is anticipated that the deficit will be eliminated and the general fund will show a positive fund balance June 30, 2010.

Auditor Conclusion

While the District is now showing a positive general fund balance, it appears that this more secure financial position may be related to the inappropriate transfer of money from its capital reserve fund to its general fund (see Finding 3 page 16). This connection, suggests that that the District's improved financial standing may be artificial. Based on this fact, and on its recent financial difficulties, the District should adopt a conservative posture toward any and all new investments, expenditures and contract decisions for the foreseeable future. Moreover, it should immediately implement our recommendations and continue to closely monitor its financial condition.

Finding No. 3

District Improperly Transferred and Expended Moneys from the Capital Reserve Fund to Cover General Operating Expenditures

Criteria and PSC Section relevant to the finding:

Section 1432 of Title 53 of Pennsylvania Statutes grants school districts the authority to establish a Capital Reserve Fund from surplus funds of the district.

Section 1434 of the statute limits expenditures of these funds to “capital improvements and for replacement of and additions to public works and improvements, and for deferred maintenance thereof, and for the purchase or replacement of school buses, and for no other purpose.”

Section 690 of the PSC states, in part:

If for any reason the project program for which the capital reserve fund was established fails to materialize, the moneys accumulated in the fund shall be reverted to the district’s general fund in equal amounts spread over a period of five years.

As a result of the general fund deficit reported in Finding No. 2 (see page 10), the District improperly transferred and expended moneys from the capital reserve fund to cover general operating expenditures.

Our review of the District’s financial records and the board of school directors’ approved meeting minutes found that the board and District administration violated state law on September 17, 2007, by improperly transferring \$2,500,000, from the capital reserve fund to the general fund. Once general fund surpluses are transferred to the capital reserve fund, the District has no authority to transfer the funds back to the general fund to cover general operating expenses.

The District administration used the transferred funds to reimburse the general fund for various expenses due to a declining fund balance. This unauthorized transfer was caused by a misunderstanding of Section 1434 statute limits and Section 690 of the Public School Code (PSC) concerning equal payments to the general fund over five years.

Furthermore, according to the District’s Local Auditor’s Report (LAR) for the year ended June 30, 2009, District personnel improperly paid for \$122,664 in monthly computer system maintenance from its capital reserve fund.

Expenditures for computer system maintenance do not fall within any of the categories of authorized capital reserve fund expenditures in Section 1434. The LAR noted that the unauthorized capital reserve fund expenditure appeared to have been caused by human error or insufficient knowledge of proper coding of invoices.

Recommendations

The *Bethlehem Area School District* should:

1. Adhere to the provisions of Section 1434 of the Pennsylvania Statutes and Section 690 of the PSC pertaining to the usage of Capital Reserve Funds.

2. Transfer all, or a portion of the \$2,622,664 back to the Capital Reserve Fund for all reimbursed general operating expenses noted in the finding, in compliance with Section 690 of the PSC.

The *Pennsylvania Department of Education*, as the state's educational regulatory agency, should:

3. Review the finding and determine what further action, if any, should be taken due to the improper transfer.

Management Response

Management stated the following:

The current administration understands that these were not appropriate transfers of funds under the PDE and GASB Accounting Guidelines. This has been corrected, has not occurred since these events and will not happen in the future.

Status of Prior Audit Findings and Observations

Our prior audit of the Bethlehem Area School District (BASD) for the school years 2005-06 and 2004-05, resulted in two reported findings and one observation. The first finding pertained to Social Security and Medicare wages, and the second finding pertained to their Memorandum of Understanding (MOU). The observation pertained to their student accounting applications. 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 questioned District personnel regarding the prior findings and observation. As shown below, we found that the BASD did implement recommendations related to Social Security and Medicare wages, MOUs, and their student accounting applications.

School Years 2005-06 and 2004-05 Auditor General Performance Audit Report

**Finding No. 1: Errors in Reporting Social Security and Medicare Wages
Resulted in Reimbursement Underpayments of \$425,790**

Finding Summary: Our prior audit of the District's Social Security and Medicare wages reimbursement records found that reports submitted to the Pennsylvania Department of Education (PDE) were inaccurate, resulting in reimbursement underpayments of \$211,168 for the 2005-06 school year and \$214,622 for the 2004-05 school year for a total underpayment of \$425,790.

Recommendations: Our audit finding recommended the BASD should:

1. Ensure District personnel are aware of the proper procedures for correctly completing state Social Security reimbursement forms.
2. Reconcile total taxable wages for Social Security and Medicare with wages reported on the Employer's Quarterly Federal Tax Return.
3. Review reports filed for years subsequent to the audit period and, if errors are found, submit revised reports to PDE.
4. PDE should pay the District an additional \$425,790 to resolve the reimbursement underpayments.

Current Status: We followed up on the BASD's Social Security and Medicare wages records and found the BASD did take appropriate corrective action to improve Social Security reporting.

As of our fieldwork completion date of July 14, 2010, PDE had not adjusted the District's allocations to resolve the \$425,790 underpayment to the District based on Social Security errors made in the 2005-06 and 2004-05 school years.

Finding No. 2: Lack of Memorandums of Understanding

Finding Summary: Our prior audit of the District's records found that the District did not have signed Memorandums of Understanding (MOUs) with the police departments, which have jurisdiction over some school buildings.

Recommendations: Our audit finding recommended the BASD:

1. Develop and implement MOUs between the District and all appropriate local law enforcement agency(ies) and/or the Pennsylvania State Police.
2. Implement board policy to ensure MOUs are updated every two years.

Current Status: We followed up on the BASD's records and found the BASD did take appropriate corrective action to ensure the District obtained signed MOUs with the police departments, which have jurisdiction over some school buildings.

Observation: Unmonitored Vendor System Access and Logical Access Control Weaknesses

Observation Summary: Our prior audit found that the BASD 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.

Recommendations: Our audit observation recommended the BASD:

1. Require all District employees to sign that they agree to abide by the information technology Security Policy.
2. Establish separate information technology policies and procedures for controlling the activities of vendors/consultants and have the vendor sign this policy, and the District should require the vendor to sign the District's Acceptable Use Policy.

3. Implement a security policy and system parameter settings to require all users, including the vendor, to change their passwords on a regular basis (i.e., every 30 days). Passwords should be a minimum length of eight characters and alpha numeric. Also, the District should maintain a password history that will prevent the use of a repetitive password (i.e., last ten passwords). Also, the District should implement a system lockout after a specified number of unsuccessful attempts (i.e., five attempts).
4. Remove the vendors' access to the system/data after the vendor has completed their work on the system.
5. Upgrade/update the District's system after receipt of written authorization from appropriate District officials.

Current Status:

We followed up on the BASD's records and found that the BASD did take appropriate corrective action to address the system access and logical control weakness over vendor access to the District's system.

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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This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at.

