



**COATESVILLE AREA SCHOOL DISTRICT
CHESTER COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT**

MARCH 2014

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE AUDITOR GENERAL





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EUGENE A. DePASQUALE
AUDITOR GENERAL

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

Mr. J. Neil Campbell, Board President
Coatesville Area School District
545 East Lincoln Highway
Coatesville, Pennsylvania 19320

Dear Governor Corbett and Mr. Campbell:

We conducted a performance audit of the Coatesville Area 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 June 3, 2010 through April 26, 2013, except as otherwise indicated in the report. Additionally, compliance specific to state subsidies and reimbursements was determined for the school years ended June 30, 2009 and June 30, 2010. 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 that the District complied, in all significant respects, with relevant requirements, except as detailed in one (1) finding noted in this report. In addition, we identified one (1) matter unrelated to compliance that is reported as an observation. A summary of the results is presented in the Executive Summary section of the audit report.

Our audit finding, observation, 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 cursive script, appearing to read "Eugene A. DePasquale".

EUGENE A. DEPASQUALE
Auditor General

March 7, 2014

cc: **COATESVILLE AREA 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 Coatesville Area School District (District) located in Chester County. Our audit sought to answer certain questions regarding the District's compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures.

Our audit scope covered the period June 3, 2010 through April 26, 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 2008-09 and 2009-10 school years.

District Background

The District encompasses approximately 75 square miles. According to 2010 federal census data, it serves a resident population of 13,100. According to District officials, the District provided basic educational services to 6,763 pupils through the employment of 610 teachers, 362 full-time and part-time support personnel, and 59 administrators during the 2009-10 school year. The District received \$42.7 million in state funding in the 2009-10 school year.

Audit Conclusion and Results

Our audit found that the District complied, in all significant respects, with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures, except for one (1) compliance related matter reported as a finding. In addition, we identified one (1) matter unrelated to noncompliance that is reported as an observation.

Finding: The District Is Facing Serious Financial Challenges, including a \$4.9 Million General Fund Deficit. Our audit of the Coatesville Area School District (District) found that from 2006 through 2012 the general fund balance decreased during the review period by more than \$31.1 million (see page 5).

Observation: The District Paid Its Former Director of Business Administration \$21,873 in Retirement Benefits He Was Not Eligible For and Did Not Conduct This Transaction Transparently. Our audit of the Coatesville Area School District (District) found that its Board of School Directors decided to pay the District's former Director of Business Administration for retirement benefits he was ineligible to receive and did not adequately inform the public about the basis for this decision (see page 9).

Status of Prior Audit Findings and Observations. There were no findings or observations in our prior audit report.

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 June 3, 2010 through April 26, 2013, except for the verification of professional employee certification, which was performed for the period September 8, 2009 through May 23, 2012.

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

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:

- ✓ Were professional employees certified for the positions they held?
- ✓ 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?

- ✓ Did the District, and any contracted vendors, ensure that 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 members free from apparent conflicts of interest?
- ✓ Were there any other areas of concern reported by independent auditors, citizens, or other interested parties?

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 state laws, regulations, 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 controls 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.

Findings and Observations

Finding

The District Is Facing Serious Financial Challenges, including a \$4.9 Million General Fund Deficit

Criteria relevant to the finding:

Section 609 of the Public School Code provides, in part:

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

Our audit of the Coatesville Area School District’s (District) annual financial reports (AFR), independent auditor’s reports (IAR), and general fund budgets for fiscal years ended June 30, 2006, 2007, 2008, 2009, 2010, 2011, and 2012 found that the District has a deteriorating general fund balance, culminating in a \$4,902,834 deficit for the fiscal year ended June 30, 2012.

Specifically, we found that over the last seven (7) years the District has had a dramatic \$31.1 million drop in its General Fund balance, putting it in an unstable financial position. Moreover, as referenced in the criteria box to the left, the District violated the Pennsylvania Public School Code (PSC) by authorizing expenditures that exceeded its budget and led to a deficit in the District’s General Fund.

Trend: Declining General Fund Balance

Year End <u>June 30</u>	Beginning <u>Fund Balance</u>	State & Local <u>Revenue</u>	Other <u>Revenues</u>	<u>Expenditures</u>	Ending <u>Fund Balance</u>	Fund Balance <u>Increase/ (Decrease)</u>
2006	\$ 13,976,318	\$ 119,160,811	\$ 5,602,029	\$ 112,544,355	\$ 26,194,803	\$ 12,218,485
2007	26,194,803	119,710,167	1,065,386	127,013,189	19,957,167	(6,237,636)
2008	19,957,167	123,098,659	4,711,576	131,644,417	16,122,985	(3,834,182)
2009	16,122,985	126,547,494	4,102,158	134,226,341	12,546,296	(3,576,689)
2010	12,546,296	130,873,580	2,938,763	141,646,314	4,712,325	(7,833,971)
2011 ¹	4,712,325	135,482,621	4,734,449	145,672,637	(743,242)	(5,455,567)
2012 ¹	(743,242)	131,025,785	4,125,843	139,311,220	(4,902,834)	(4,159,592)

The District’s poor financial condition is due primarily to its inability to control spending within the confines of its budget, which also violates Section 609 of the PSC. The District’s continual inaccurate revenue estimates compounded its financial problems (see tables below).

¹ Auditors received the District’s independent Local Audit Report for the period ending June 30, 2012, during the last day of audit fieldwork and have included the most recent general fund balance information available at the close of the audit.

Revenues: Budget vs. Actual			
Fiscal Year <u>Ended June 30</u>	Budgeted <u>Revenues</u>	Actual <u>Revenues</u>	<i>(Over)/Under <u>Budgeted</u></i>
2006	\$ 118,761,131	\$ 119,160,811	\$ 399,680
2007	117,211,829	119,710,167	2,498,338
2008	125,373,364	123,098,659	(2,274,705)
2009	128,027,390	126,547,494	(1,479,896)
2010	131,671,674	130,873,580	(798,094)
2011	138,927,618	135,482,621	(3,444,997)
2012	133,089,822	131,025,785	(2,064,037)

Expenditures: Budget vs. Actual			
Fiscal Year <u>Ended June 30</u>	Budgeted <u>Expenditures</u>	Actual <u>Expenditures</u>	<i>(Over)/Under <u>Budgeted</u></i>
2006	\$114,248,213	\$112,544,355	\$ 1,703,858
2007	124,283,277	127,013,189	(2,729,912)
2008	133,148,228	131,644,417	1,503,811
2009	133,997,685	134,226,341	(228,656)
2010	138,357,440	141,646,314	(3,288,874)
2011	145,769,032	145,672,637	96,395
2012	137,005,976	139,311,220	(2,305,244)

In addition, these over expenditures indicate that the District's budgets are based on weak assumptions and are poorly monitored. For example, the District's administration and its Board of School Directors (Board) should adopt budgets that estimate beginning fund balances based on historical indicators and on realistic expectations for future available funding during the budgetary period. Furthermore, they should use monthly budget status reports to measure and compare proposed expenditures for current operations to available funds.

Additionally, we found that the District's charter tuition costs have grown by over \$8 million from 2006 through 2012, an increase of over 75 percent.

Trend: Increasing Charter School Costs			
Year End <u>June 30</u>	Charter <u>Tuition</u>	District <u>Expenditures</u>	Charter Costs/ <u>District Expenditures</u>
2006	\$ 11,166,657	\$ 112,544,355	9.9 %
2007	12,434,804	127,013,189	9.8 %
2008	14,566,041	131,644,417	11.1 %
2009	16,022,186	134,226,341	11.9 %
2010	17,438,780	141,646,314	12.3 %
2011	18,399,277	145,672,637	12.6 %
2012	19,718,128	139,311,220	14.2 %

The District's rising charter tuition costs have negatively impacted its financial situation, and has been compounded

by the fact that, since 2011, the Commonwealth has not funded the school district reimbursement for charter school tuition costs. If the reimbursement was still in place, the District would have received at least \$3.9 million in additional revenue in the 2011-12 fiscal year.

Recommendations

The *Coatesville Area School District* should:

1. Monitor and maintain budgetary control over expenditures in compliance with Section 609 of the PSC.
2. Provide the Board with standard monthly updates on key financial benchmarks. If the District has presented this information, the Board should ensure it reviews it in detail and makes policy changes before the District's financial condition worsens.
3. Use monthly budget status reports to assess whether expenditures for the current operations are appropriate and are aligned with the District's revenues. If the District has already gathered this information and identified potential concerns, it should discuss options with the Board for addressing them immediately.
4. Adopt budgets that accurately estimate beginning fund balances through a review of information from prior fiscal years and set realistic expectations for available revenues in the budgetary period.
5. Develop a feasible and realistic plan to systematically reduce the deficit with a definite deadline to return to a positive fund balance.
6. Survey parents about why they have sent or would consider sending their children to a charter school. Use that data to develop an action plan for reducing the number of its students who are choosing to go to charter schools.
7. Monitor the costs to the District related to charter schools on a continuous basis.

8. Open a dialogue with the community to keep stakeholders informed of the financial status and health of the school district.

Management Response

Management chose not to respond to this finding.

Auditor Conclusion

The severity of the District's financial condition will require it to work to find substantial opportunities to reduce its expenditures. In doing so, the District should develop more realistic budgets and then adhere to them, so that its actual expenditures do not exceed its budgeted expenditures. In addition, the District must create a feasible plan for systematically reducing its deficit and establish a timeline for when the District will return to a positive balance. Furthermore, the District's administration should continue to explore the reasons behind why so many of its students are moving to charter schools and take action to address these causes.

Observation →

The District Paid Its Former Director of Business Administration \$21,873 in Retirement Benefits He Was Not Eligible For and Did Not Conduct This Transaction Transparently

Criteria relevant to the observation:

The taxpayers have the right to expect that their hard earned money will be spent on the education of the District's students and not on excess benefits to individuals.

Furthermore, the information in these agreements should be more transparent to the public so that taxpayers can consider such information when determining whether the Board has made decisions in the best interest of the District, the taxpayers, and the students.

Our audit of the Coatesville Area School District (District) found that its Board of School Directors (Board) decided to pay the District's former Director of Business Administration (Director) for retirement benefits he was ineligible to receive and did not adequately inform the public about the basis for this decision.

On September 27, 2006, the District's Board entered into a contract (Contract) with a private professional company (Company) to provide an individual to function as the District's acting Director for the period September 27, 2006 to June 30, 2008. On June 26, 2007, the District amended the term of the contract with the Company to commence on July 1, 2007, and end on June 30, 2011. Both contracts provided that the District would pay the Company a daily rate of \$650 upon receipt of monthly vouchers indicating the number days worked during the period.

On April 27, 2010, the District's Board entered into an employment agreement (Agreement) with the same individual who was serving as the acting Director, to serve as the District's permanent Director. The Agreement had a term of five (5) years and three (3) months, from April 1, 2010 to June 30, 2015. It included the following provisions:

- An annual salary of \$180,000.
- An annual increase in salary in the amount of at least three (3) percent of his previous years' salary.
- An additional salary increase of an amount to be determined by the Superintendent, based upon the Director's performance evaluation.

The Director's salary was \$188,010 and \$201,171, for the 2009-10 and 2010-11 fiscal years, respectively.

The Agreement also included the following provisions with regard to the termination of the Director's employment with the District:

- The Agreement may be terminated in accordance with the School Code, Chapter 3 of the Board Policy, upon resignation of the Director, or upon mutual agreement of the parties.
- Upon retirement from the District, the District will pay the Director \$40 for each accumulated and unused sick day.

Section V of the District's approved Compensation and Related Benefits Plan for Non-Certified Supervisors (Act 93) for the period July 1, 2008 through June 30, 2011, entitled Severance Pay for Retiring Administrators provides:

- B. Ten (10) years of service and less than fifteen (15) years –three (3) percent of his/her average salary for the highest three (3) years of service (emphasis added).*
- C. In addition to the above schedule . . . supervisor shall receive an incentive of \$150 per year of service provided supervisor has worked for a minimum of ten (10) years in the CASD [District] at the year of retirement (emphasis added).*
- D. In addition to the above schedule . . . supervisors with ten (10) years of service will receive \$40 per day for unused sick days (emphasis added).*
- E. Severance consideration shall also include accumulated personal and vacation days at a daily rate.*

Although the Act 93 agreement expired on June 30, 2011, the District maintained the Act 93 in effect for subsequent periods.

The District implemented an early retirement incentive program for the 2011-12 fiscal year providing that at the conclusion of the 2011-12 fiscal year any full-time professional employee who retires under the provisions of the Public School Employees' Retirement System and is at

least 53 years old with ten (10) years of service in the District would receive a payment of \$15,000. The Board retained the right to waive any and all eligibility requirements on an individual basis, at its discretion.

On June 27, 2012, after the former Director had served only two (2) years and three (3) months of the term of his Agreement, the Board approved his retirement, effective June 30, 2012, for the amount shown in the table below. However, the retirement payment included provisions the former Director was not eligible to receive because he had only worked as a District employee for two (2) years and three (3) months—and not the requisite ten (10) years.

Retirement Payment to Former Director of Business Administration			
<i>Retirement Benefit</i>	<i>Payment Actually Received</i>	<i>Eligible</i>	<i>Ineligible</i>
Unused Sick Leave Payment	45.00 days X \$40.00/day = \$1,800	X	
Unused Personal Leave Payment	3.50 days X \$773.73/day = 2,708	X	
Unused Vacation Days Payment	5.09 days X \$773.73/day = 3,938	X	
Salary Incentive	3% of highest 3 years salary = 5,823		X
Years of Service	7 years X \$150/year = 1,050		X
Retirement Incentive	15,000		X
TOTAL:	\$ 30,319	\$ 8,446	\$ 21,873

We requested an explanation from the current Board President regarding why the Board had permitted the payments of \$21,873 to which he was not entitled. We received a written response from the Board President stating that the Board waived the years of service requirement for the former Director. However, only the early retirement incentive program contained a provision permitting the Board to waive the eligibility requirements, the Act 93 agreement did not have this provision. Our review of the board meeting minutes found that these payments were not discussed at a public meeting, and therefore were not transparent to the taxpayers of the District.

Given the District’s financial position (see Finding on page 5), the District’s payment to its former Director was not in the best interest of its taxpayers. Moreover, the Board should have publicly explained why the Board permitted the unnecessary payment to the former Director.

Recommendations

The *Coatesville Area School District* should:

1. Ensure that future employment Agreements contain adequate provisions that address the compensation and benefits payable to, or on behalf of, an administrator in the event of an early retirement or termination.
2. Upon retirement of any employee, follow the provisions of the employment Agreement and pay only what is due to the employee.

The *Coatesville Area School District Board of School Directors* should:

3. Consider the taxpayers' expectation that their money will be used to educate the District's children when negotiating employee agreements.
4. Ensure that all the District's employment agreements are as transparent as possible, so that taxpayers' can evaluate their appropriateness.

Management Response

“During each of the last three fiscal years (including fiscal year 2011-2012), in an effort to strengthen both the long-term and short-term financial position of the District, the District Board elected to adopt and implement an early retirement incentive package (ERIP). The package was designed as an inducement to longer-term and presumably higher salaried employees to retire thereby reducing the District's salary and benefits expenses for the following and subsequent fiscal years in order to better leverage its limited resources and therefore more effectively fulfill its educational mandates.

Along with other incentives, the ERIP provided a \$15,000 cash retirement inducement. The program was offered to all employees within the district who met certain age and length of employment criterion subject to the caveat that the Board, at all times, retained the authority to elect to offer the program to other employees who, at the board's sole discretion, may not have met some or all of the program's requirements.

In June 2012, the Board unilaterally determined that it was in the District's best interests to replace the individual who was the District's then current Director of Business Administration. That Director of Business Administration was, at the time, employed by the District subject to the terms of a validly existing employment Agreement whose term extended through June 30 of 2015, (approximately three years after the District's desired termination date.) Among the various provisions of that Agreement was a salary in excess of \$200,000 per annum (\$600,000 in the aggregate remaining.) In an effort to minimize the amount of inherent contractual liability, and thereby more precisely performing its fiduciary duty to conserve its financial resources, the District engaged in negotiations with that employee. Those negotiations resulted in [an] Agreement whereby the said former employee waived any and all rights or claims to future compensation or other legal remedies as well as other good and valuable consideration which the District has already received, in exchange for that employee's inclusion in the aforementioned ERIP program at a rate that recognized his years as a contractor to the district as well as his services as an employee in the relevant calculation.

All of the terms and conditions of that separation were at all times known to the Board of Directors as well as the District's Administration and legal counsel. The terms and conditions of that separation agreement were subsequently discussed, voted upon, and approved by the District's Board of Directors. Both the District Administration and its Board of Directors remain keenly aware of their fiduciary duty as well as their duty of transparency of action to the public. At no time was there any effort on anyone's part to disguise or withhold from the public any of the actions described above. Besides the laws and regulations defining and covering public transparency, the District is also subject to other laws and regulations and duties governing employee confidentiality and termination. In retrospect, in this instance, the District clearly erred on the side of the later, particularity in its efforts to spare the employee excessive public embarrassment. The District recognizes that deficiency and in the future will use its best efforts to fulfill all of its legal and statutory duties requirements as advised by the Commonwealth.”

Auditor Conclusion

While employee separations always require districts to handle a variety of sensitive matters, these obligations should not negate the importance of communicating the cost of such negotiations to the taxpayers who pay for them. We are encouraged by the fact that the District has acknowledged that these concerns were not adequately addressed previously, and that it will attempt to do better in the future. We will reevaluate this issue during the District's next cyclical audit.

Status of Prior Audit Findings and Observations

Our prior audit of the Coatesville Area School District resulted in no findings or observations.

Distribution List

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

The Honorable Tom Corbett
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