



DANVILLE AREA SCHOOL DISTRICT
MONTOUR COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

JULY 2013

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. Allan Schappert, Board President
Danville Area School District
600 Walnut Street
Danville, Pennsylvania 17821

Dear Governor Corbett and Mr. Schappert:

We conducted a performance audit of the Danville Area School District (District) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period August 27, 2009 through March 23, 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 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 applicable state laws, contracts, grant requirements, and administrative procedures, except as detailed in one finding noted in this report. In addition, we identified two matters unrelated to compliance that are reported as observations. A summary of these results is presented in the Executive Summary section of the audit report.

Our audit finding, 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. We appreciate the District's cooperation during the conduct of the audit.

Sincerely,

/s/

EUGENE A. DEPASQUALE
Auditor General

July 10, 2013

cc: **DANVILLE 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 Danville Area School District (District). 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 District in response to our prior audit recommendations.

Our audit scope covered the period August 27, 2009 through March 23, 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 120 square miles. According to 2010 federal census data, it serves a resident population of 18,765. According to District officials, the District provided basic educational services to 2,470 pupils through the employment of 202 teachers, 143 full-time and part-time support personnel, and 15 administrators during the 2009-10 school year. Lastly, the District received \$11.4 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 applicable state laws, contracts, grant requirements, and administrative procedures, except for one compliance-related matter reported as a finding. In addition, we identified two matters unrelated to compliance that are reported as observations.

Finding: Incorrect Reporting of Nonresident Students Resulted in the District Being Underpaid \$16,906. District personnel failed to report two wards of the state students to the Pennsylvania Department of Education resulting in the District being underpaid \$16,906 (see page 6).

Observation No. 1: District Made Unnecessary Leave Payout to Former Superintendent. On August 14, 2007, the Board of School Directors of the District entered into an employment contract (Contract) with an individual (former Superintendent) to serve as the District's superintendent. The Contract had a term of three years, from August 20, 2007 through August 19, 2010. On January 12, 2010, the former Superintendent submitted a letter of intent to resign effective June 30, 2010. Based on the Superintendent's per diem rate at retirement of \$417.62, the District made payments to the Superintendent totaling \$10,858.

However, according to her contract and the Act 93 agreement, she was not required to receive payment for unused vacation days. (see page 8).

Observation No. 2: The District Financed Some of Its Debt with Interest-Rate Management (“Swap”) Agreements. On August 21, 2007, the District entered into a swap agreement related to its issuance of \$7,000,000 of bonds. To its credit, the District terminated the swap agreement effective May 25, 2011. However, the termination fee resulted in the District jeopardizing \$1,342,040 of taxpayer dollars (see page 10).

Status of Prior Audit Findings and Observations. With regard to the status of our prior audit recommendations to the District from an audit released on January 26, 2010, we found that the District had taken appropriate corrective action in implementing our recommendations pertaining to their student accounting applications (see page 12).

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 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 August 27, 2009 through March 23, 2012, except for the verification of professional employee certification which was performed for the period July 1, 2011 through February 1, 2012.

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 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 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?
- ✓ 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 local auditors, citizens, or other interested parties?

Methodology

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.

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.

The District's management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the District is in compliance with applicable laws, contracts, grant requirements, and administrative procedures. 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 applicable state laws, regulations, contracts, grant requirements, and administrative procedures 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 bus driver qualifications, professional employee certification, state ethics compliance, and financial stability.
- 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 January 26, 2010, we performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding

Incorrect Reporting of Nonresident Students Resulted in the District Being Underpaid \$16,906

Criteria relevant to the finding:

Child accounting guidelines and instructions require accurate reporting of pupil membership days, student classification, and residency information, since these are major factors in calculating various district subsidies and reimbursements.

Public School Code
Section 13-1308(c) provides, in part:

... if the Secretary of Education decides that the legal residence of any said inmates is in Pennsylvania, but cannot be fixed in a particular district, the Commonwealth shall pay the tuition of such inmate out of moneys appropriated to the Pennsylvania Department of Education by the General Assembly for the maintenance and support of the public schools of the Commonwealth.

Danville Area School District (District) personnel failed to report membership for two wards of the state students to the Pennsylvania Department of Education (PDE) for the 2008-09 school year resulting in the District being underpaid \$16,906.

The error was caused by District personnel failing to identify these individuals as wards of the state. The District sent acknowledgement forms to the school district where the student previously attended school and that district disclaimed the student. When this happens and the District cannot determine the district of residence of the parents or guardians, the District can report these students as wards of the state. Therefore, the District may obtain funding from the state.

The District's membership days for nonresident wards of the state were underreported by 356 days.

We have provided PDE with reports detailing the errors for use in recalculating the District's 1305 and 1306 children placed in private homes reimbursement.

There were no significant errors found in the 2009-10 school year.

Recommendations

The *Danville Area School District* should:

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 controls to ensure pupil membership is reported in accordance with PDE guidelines and instructions.
3. Perform an internal review of membership reports and summaries prior to submission of final reports to PDE.

4. Review subsequent years' reports and if errors are found, submit revised reports to PDE.

The *Pennsylvania Department of Education* should:

5. Adjust the District's future allocations to recover the underpayment.

Management Response

Management stated the following:

“District will provide additional training and oversight to prevent future discrepancies.”

Observation No. 1

District Made Unnecessary Leave Payout to Former Superintendent

On August 14, 2007, the Board of School Directors (Board) of the Danville Area School District (District) entered into an employment contract (Contract) with an individual to serve as the District's superintendent (former Superintendent). The Contract had a term of three years, from August 20, 2007 through August 19, 2010.

On January 12, 2010, the former Superintendent submitted a letter of intent to resign effective June 30, 2010.

The Superintendent's per diem rate at resignation was \$417.62 and she was paid for 26 unused vacation days for a total of \$10,858. However, neither her contract nor the District's Act 93 agreement, stipulate that she should be paid any amount for unused vacation pay. Therefore, her leave payout was unnecessary.

This payout of leave may have been averted, if the District had followed provisions in its original employment contract with the former Superintendent regarding the compensation and benefits payable upon her resignation.

Instead, the District paid out funds to this administrator that could have been used for an educational purpose. Therefore, this expense was not a prudent use of taxpayer funding.

Recommendations

The *Danville Area School District* should:

1. Ensure that future employment contracts are followed to protect the interests of the District's taxpayers.
2. Establish internal controls to ensure that the District's Board is made aware of all administrative payments.

Management Response

Management stated the following:

"All final leave payouts will be processed by payroll and reviewed by Business Manager referencing contractual language."

Auditor Conclusion

Once again we contend that the District's payment of \$10,858 was not contractual.

Observation No. 2

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

On August 21, 2007, the Danville Area School District (District) entered into a swap agreement related to its issuance of \$7,000,000 in bonds.

Current state law permits school districts 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 its swap agreement effective May 25, 2011, and paid \$1,342,040 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 *Danville Area 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 ‘Swap’ has been refinanced to comply with strict tax rules contained in the Internal Revenue Code and PA School Code.”

Status of Prior Audit Findings and Observations

Our prior audit of the Danville Area School District (District) released on January 26, 2010, resulted in an observation. The observation pertained to unmonitored intermediate unit system access and logical access control weaknesses. As part of our current audit, we determined the status of corrective action taken by the District to implement our prior audit recommendations. We performed audit procedures, and interviewed District personnel regarding the prior observation. As shown below, we found that the District did implement recommendations related to unmonitored intermediate unit system access and logical access control weaknesses.

Auditor General Performance Audit Report Released on January 26, 2010

Observation: **Unmonitored IU System Access and Logical Access Control Weaknesses**

Observation Summary: Our prior audit found that the District used software purchased from the Central Susquehanna Intermediate Unit 16 (IU) for its critical student accounting applications (membership and attendance). Additionally, the District's entire computer system, including all its data and IU's software were maintained on the District's servers, which are physically located at the District. The IU had remote access into the District's network servers and also provided the District with system maintenance and support.

Recommendations: Our audit observation recommended that the District:

1. Develop an agreement with the IU to provide student accounting applications and related information technology (IT) services. The agreement should cover legal, financial, organizational, documentary, performance, security, intellectual property, and termination responsibilities and liabilities (including penalty clauses). All contracts and contract changes should be reviewed by legal advisors.
2. Have a non-disclosure agreement for the local education agencies propriety information.
3. Establish separate IT policies and procedures for controlling the activities of the IU and have the IU sign the District's Acceptable Use Policy.

4. Require all IU employees sign that they agree to abide by the IT Security policy.
5. Require written authorization before adding, deleting, or changing a userID.
6. Maintain documentation to evidence that terminated employees are properly removed from the system in a timely manner.
7. Require the IU to assign unique userIDs and passwords to vendor employees authorized to access the District system. Further, the District should obtain a list of IU employees with access to its data and ensure that changes to the data are made only by authorized vendor representatives.
8. 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 include alpha, numeric and special characters. Also, the District should maintain a password history that will prevent the use of a repetitive password (i.e., last ten passwords); lock out users after three unsuccessful attempts and log users off the system after a period of inactivity (i.e., 60 minutes maximum).
9. Ensure that the upgrades/updates to the District's system are made only after receipt of written authorization from appropriate District officials.
10. Consider implementing additional environmental controls around the network server sufficient to satisfy the requirements of the manufacturer of the server and to ensure warranty coverage. Specifically, the District should install fire detectors and install fire extinguishers in the server room.

Current Status:

During our current audit procedures, we found that the District did implement the above recommendations.

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 William E. Harner
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This report is a matter of public record and is available online at www.auditorgen.state.pa.us. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 231 Finance Building, Harrisburg, PA 17120; via email to: news@auditorgen.state.pa.us.

