

HANOVER AREA SCHOOL DISTRICT
LUZERNE COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

APRIL 2011

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

Mr. John Pericci, Board President
Hanover Area School District
1600 Sans Souci Parkway
Hanover Township, Pennsylvania 18706

Dear Governor Corbett and Mr. Pericci:

We conducted a performance audit of the Hanover Area School District to determine its compliance with applicable state laws, regulations, contracts, grant requirements, and administrative procedures. Our audit covered the period November 15, 2008 through March 5, 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 HASD complied, in all significant respects, with applicable state laws, regulations, contracts, grant requirements, and administrative procedures, except as detailed in two 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 HASD's management and their responses are included in the audit report. We believe the implementation of our recommendations will improve HASD's operations and facilitate compliance with legal and administrative requirements. We appreciate the HASD's cooperation during the conduct of the audit and their willingness to implement our recommendations.

Sincerely,

/s/

JACK WAGNER
Auditor General

April 20, 2011

cc: **HANOVER 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 Hanover Area School District (HASD). Our audit sought to answer certain questions regarding the District's compliance with applicable state laws, regulations, contracts, grant requirements, and administrative procedures; and to determine the status of corrective action taken by the HASD in response to our prior audit recommendations.

Our audit scope covered the period November 15, 2008 through March 5, 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 HASD encompasses approximately 22 square miles. According to 2000 federal census data, it serves a resident population of 19,048. According to District officials, in school year 2007-08 the HASD provided basic educational services to 2,024 pupils through the employment of 144 teachers, 129 full-time and part-time support personnel, and 14 administrators. Lastly, the HASD received more than \$9.9 million in state funding in school year 2007-08.

Audit Conclusion and Results

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

Finding No. 1: District has a General Fund Deficit of \$1,315,398 as of June 30, 2009. Our review of the HASD's annual financial reports, local auditor's report and general fund budgets for fiscal years ended June 30, 2008 and 2009 found that the HASD's general fund balance surplus of \$413,763 at June 30, 2007, decreased to deficit fund balances of \$379,756 and \$1,315,398 respectively (see page 6).

Finding No. 2: Errors in Reporting Membership for Nonresident Children Placed in Private Homes Resulted in Reimbursement Overpayments of \$113,302. Our audit of the HASD's pupil membership reports submitted to Department of Education for the 2007-08 and 2006-07 school years found HASD personnel incorrectly reported nonresident students in both years resulting in overpayments of \$113,302 (see page 9).

Status of Prior Audit Findings and Observations. With regard to the status of our prior audit recommendations to the HASD from an audit we conducted of the 2005-06 and 2004-05 school years, we found the HASD had taken appropriate

corrective action in implementing our recommendations pertaining to nonpublic pupil transportation (see page 11), untimely update of its Memorandum of Understanding and their student accounting applications (see page 12).

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 November 15, 2008 through March 5, 2010, except for the verification of professional employee certification which was performed for the period August 8, 2008 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 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 law, regulation, 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, regulations, and defined business practices. Our audit focused on assessing the HASD's compliance with applicable 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?
- ✓ 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?

- ✓ 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 buyout 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

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, 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 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.

HASD 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.

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

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

Our audit examined the following:

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

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

Lastly, to determine the status of our audit recommendations made in a prior audit report released on October 2, 2009, we then performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1

District has a General Fund Deficit of \$1,315,398 as of June 30, 2009

Public School Code 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

Our review of the District's annual financial reports (AFR), local auditor's report, and general fund budgets for fiscal years ended June 30, 2008 and 2009 found that the District's previous general fund surplus of \$413,763 as of June 30, 2007 had decreased over the last two fiscal years leaving a general fund deficit of \$379,756 and \$1,315,398, respectively.

Our review of the District's AFR for the 2007-08 and 2008-09 school years found that expenditures exceeded revenues, resulting in the depletion of the District's general fund balance and ending in general fund deficits.

Actual expenditures compared to actual revenues, with resulting general fund balances for the period under review, were as follows:

<u>School Year</u>	<u>Revenues</u>	<u>Expenditures</u>	<u>Expenditures (Over)/</u>	
			<u>Under Revenue</u>	<u>Surplus/(Deficit)</u>
2006-07	\$22,203,519	\$21,910,362	\$ 293,157	\$ 413,763
2007-08	22,155,215	22,948,734	(793,519)	(379,756)
2008-09	22,998,599	23,934,241	(935,642)	(1,315,398)

The following factors contributed to the deficit:

- the use of the fund balance to fund current expenses;
- Hanover Area School District (HASD) students increasing their attendance at charter schools;
- increase in special education cost at the Luzerne Intermediate Unit #18; and
- local revenues and taxes have decreased and not met budgeted revenue projections.

Recommendations

The *Hanover Area School District* should:

Provide for systematic reduction of the fund balance deficit in the general fund by utilizing monthly budget status reports to scrutinize proposed expenditures for current operations and limit them to revenues available and the amounts appropriated.

Management Response

Management provided the following:

The School District's fund balance has decreased for the following reasons.

Hanover Area students have continued to increase their attendance at charter schools over the past three years. There are currently 85 to 90 students attending charter schools. The initial charter school cost being \$50,000, and for last year the cost was \$430,000.

Special Education cost(s) have increased for the District due to the providing of increased service(s), cost paid to the Luzerne Intermediate Unit #18 and other outside service organizations, such as the Youth Services Alternative Education Program. Over the last three years, the cost has increased approximately \$200,000 to \$300,000 each year. This was due to the School District's increased identification of special education eligible students and ESL services.

Local revenues and taxes had been projected to be level over the last two to three years and due to a weak local economy, revenues and taxes have decreased and not met budgeted revenue projections.

In an effort to correct the increase in charter school attendance, the School District has recognized the charter school costs to be budgeted at \$430,000 for 2009-10.

The Special Education cost increases have been addressed by hiring a school district psychologist who services and reviews the testing and the program(s) administered to our special education students. This has, in fact, reduced the number of special education students, and outside service agency costs and transportation costs.

The School District has also taken back our Luzerne Intermediate Unit #18 Program at the Junior/Senior High School, as a cost saving measure. The High School has been more closely monitoring the students it sends to the alternative education programs provided by the Luzerne Intermediate Unit #18 and the Youth Services Alternative Education Agency in an attempt to cut costs where possible.

The School District, in the current budget based on projections, should have enough budget surplus to address the 2008 surplus deficit and part of the 2009 deficit. This is based on the fact that the School District increased its real estate taxes to the maximum percentage for the current budget year and received additional stimulus funding which was not guaranteed when the budget was prepared but was made available to the School District for its use in reducing special education costs, approximately \$330,000.

Auditor Conclusion

Subsequent to our fieldwork completion date of March 5, 2010, the District resolved the general fund deficit resulting in a fund balance surplus of \$133,421 on the 09-10 AFR. We commend the District for their efforts to resolve the deficit.

Finding No. 2

Errors in Reporting Membership for Nonresident Children Placed in Private Homes Resulted in Reimbursement Overpayments of \$113,302

Public School Code and criteria relevant to the finding:

Section 2503(c) provides that:

The Commonwealth will pay tuition to districts providing education to nonresident children placed in private homes. The payments are based on the membership days reported for such children.

Pupil membership classifications must be maintained in accordance with DE guidelines and instructions, since this is a major factor in determining the district's subsidies and reimbursements.

Our audit of the District's pupil membership reports submitted to the Department of Education (DE) for the 2007-08 and 2006-07 school years found District personnel incorrectly reported nonresident membership for students in both years resulting in overpayments of \$113,302.

The errors in the 2007-08 school year occurred when District personnel overstated membership days for nonresident foster students (1305) by 332 days. This error resulted in the District being overpaid \$13,746 for the 2007-08 school year.

The errors in the 2006-07 school year occurred when District personnel overstated membership days for nonresident students by 2,295 days. This error resulted in the District being overpaid \$99,556 for the 2006-07 school year.

These errors were caused by District personnel incorrectly inputting special education students from other districts in an intermediate unit classroom at HASD as nonresident foster students (1305).

Recommendations

The *Hanover 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 DE guidelines and instructions.
3. Implement controls to verify actual membership days to computer generated reports.
4. Perform an internal review of membership reports and summaries prior to submission of final reports to DE.

5. Review subsequent year reports and if errors are found, submit revised reports to DE.

The *Department of Education* should:

6. Adjust the District's allocation to resolve the overpayments in the amount of \$113,302 for the 2007-08 and 2006-07 school years.

Management Response

Management stated the following:

Management will provide training to staff concerning proper coding of non-resident students. Management will carefully review the placement of students in the categories of 1305 or 1306. The district will establish a separate category for listing students who receive IU 18 classroom instruction within the district.

Status of Prior Audit Findings and Observations

Our prior audit of the Hanover Area School District (HASD) for the school years 2005-06 and 2004-05 resulted in one reported finding and two observations. The finding pertained to nonpublic pupil transportation, and the observations pertained to their Memorandum of Understanding and 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. As shown below, we found that the HASD did implement recommendations related to nonpublic pupil transportation, and the observations for their Memorandum of Understanding (MOU) and student accounting applications.

<i>School Years 2005-06 and 2004-05 Auditor General Performance Audit Report</i>		
<i>Prior Recommendations</i>	<i>Implementation Status</i>	
<p><u><i>I. Finding: Errors in Reporting Nonpublic Pupil Transportation Data Resulted in a Net Subsidy Overpayment of \$74,305</i></u></p> <ol style="list-style-type: none"> 1. Strengthen controls to ensure accurate reporting of nonpublic pupils transported. 2. Thoroughly reconcile all transportation data for accuracy prior to submission of reports to the Department of Education (DE). 3. Review subsequent reports submitted to DE and revise if necessary. 4. DE should adjust the District's allocations to resolve the overpayment of \$74,305. 	<p>Background:</p> <p>Our prior audit found that the HASD reported the number of nonpublic pupils transported incorrectly. The errors resulted in an overpayment of \$74,305.</p>	<p>Current Status:</p> <p>We followed up on the HASD transportation reports for nonpublic pupils and found that the HASD did take appropriate corrective action to address our prior audit recommendations.</p> <p>As of our fieldwork completion date of March 5, 2010, DE had not adjusted the District's allocations to resolve this finding.</p>

<p><u>II. Observation No. 1:</u> <u>Memorandum of Understanding Not Updated Timely</u></p> <ol style="list-style-type: none"> 1. In consultation with the solicitor, review, update and re-execute the current MOU between the District and Hanover Township Police Department. 2. Adopt a policy requiring the administration to review and re-execute the MOU every two years. 	<p>Background:</p> <p>Our prior audit of the District’s records found that the current MOU between the District and the Hanover Township Police Department was signed June 8, 2005, and has not been updated.</p>	<p>Current Status:</p> <p>We followed up on the HASD’s MOU and found the District did take appropriate corrective action.</p> <p>The MOU was last updated in February of 2010. There was also an updated MOU in November 2008.</p>
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<p><u>III. Observation No. 2:</u> <u>Unmonitored Vendor System Access and Logical Access Control Weaknesses</u></p> <ol style="list-style-type: none"> 1. Develop policies and procedures to require written authorization when adding, deleting, or changing a userID. 2. Maintain documentation to evidence that terminated employees are properly removed from the system in a timely manner. 3. Require the intermediate unit (IU) to assign 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 data are made only by authorized vendor representatives. 	<p>Background:</p> <p>Our prior audit found that the HASD 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.</p>	<p>Current Status:</p> <p>We followed up on the HASD’s student accounting applications and found that the District did take appropriate corrective action.</p>
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<p>4. Generate monitoring reports (including firewall logs) of IU and employee access and activity on their system. Monitoring reports should include the date, time, and reason for access, change(s) made and who made the change(s). The District should review these reports to determine that the access was appropriate and that data was not improperly altered. The District should also ensure it is maintaining evidence to support this monitoring and review.</p>		
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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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