

# PERFORMANCE AUDIT

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## Lehighton Area School District Carbon County, Pennsylvania

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October 2020



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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**EUGENE A. DePASQUALE  
AUDITOR GENERAL**

Mr. Jonathan J. Cleaver, Superintendent  
Lehigh Area School District  
1000 Union Street  
Lehigh, Pennsylvania 18235

Mr. Larry Stern, Board President  
Lehigh Area School District  
1000 Union Street  
Lehigh, Pennsylvania 18235

Dear Mr. Cleaver and Mr. Stern:

We have conducted a performance audit of the Lehigh Area School District (District) for the period July 1, 2014 through June 30, 2018, except as otherwise indicated in the audit scope, objective, and methodology section of the report. We evaluated the District's performance in the following areas as further described in Appendix A of this report:

- Financial Stability
- Transportation Operations
- Right-to-Know
- Administrator Separations
- Bus Driver Requirements

The audit was conducted pursuant to Sections 402 and 403 of The Fiscal Code (72 P.S. §§ 402 and 403), and in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Those 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.

Our audit found that the District applied best practices in the areas listed above and complied, in all significant respects, with relevant requirements, except as detailed in our two findings noted in this audit report. A summary of the results is presented in the Executive Summary section of the audit report.

We also evaluated the application of best practices in the area of school safety. Due to the sensitive nature of this issue and the need for the results of this review to be confidential, we did not include the results in this report. However, we communicated the results of our review of school safety to District officials, the Pennsylvania Department of Education, and other appropriate officials as deemed necessary.

Our audit findings 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 relevant requirements.

Mr. Jonathan J. Cleaver  
Mr. Larry Stern  
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We appreciate the District's cooperation during the course of the audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale", with a long horizontal flourish extending to the right.

Eugene A. DePasquale  
Auditor General

September 9, 2020

cc: **LEHIGHTON AREA SCHOOL DISTRICT** Board of School Directors

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## Executive Summary

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### **Audit Work**

The Pennsylvania Department of the Auditor General conducted a performance audit of the Lehigh Area School District (District). Our audit sought to answer certain questions regarding the District's application of best practices and compliance with certain relevant state laws, regulations, contracts, and administrative procedures.

Our audit scope covered the period July 1, 2014 through June 30, 2018, except as otherwise indicated in the audit scope, objectives, and methodology section of the report (see Appendix A). Compliance specific to state subsidies and reimbursements was determined for the 2014-15 through 2017-18 school years.

### **Audit Conclusion and Results**

Our audit found that the District applied best practices and complied, in all significant respects, with certain relevant state laws, regulations, contracts, and administrative procedures, except for two findings.

**Finding No. 1: The District had a Cumulative Deficit Which Reduced Its General Fund Balance by More Than \$13 Million Over the Five Years Reviewed.** Our review of the District's financial position over a five-year period revealed that the District's General Fund balance decreased at an alarming rate. The District's General Fund balance was \$14,270,505 as of June 30, 2015. Due to a cumulative deficit over the period of our review, the District's General Fund balance decreased to \$874,439 as of June 30, 2019. (See page 7).

**Finding No. 2: The District's "No Cost" Partnership with Private Education Company Cost the District More Than \$3 Million.** In the 2014-15 school year, the District voted to

consolidate its elementary schools and renovate its middle and high schools. In addition to the construction and renovations, the District planned to implement Science, Technology, Engineering, and Math (STEM) academies at the elementary, middle, and high schools. In 2014, the District applied for the Qualified Zone Academy Bond (QZAB) Program from the Pennsylvania Department of Education and was approved for \$8.5 million. The District applied for another QZAB in 2016 and was approved for \$6.8 million. To comply with the requirements of the QZAB program, the District partnered with a private education company who pledged to give the District the required 10% of the bond proceeds as an in-kind donation.

The District entered into additional agreements with the private company in conjunction with the QZABs. Unbeknownst to many District officials, including Board members, these agreements cost the District more than \$3 million. The agreements stipulated that the private company would assist the District in setting up STEM programs and provide the District with services, stipends, and rewards. The District failed to monitor the agreements to ensure that it received goods and services in accordance with the agreements. With regard to the 2016 agreement for which the District paid \$1.36 million, the District did not receive any of the agreed upon services, stipends, rewards, etc. (See page 21).

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

## Background Information

School Characteristics 2018-19 School Year*	
County	Carbon
Total Square Miles	67
Number of School Buildings	3 <sup>1</sup>
Total Teachers	184
Total Full or Part-Time Support Staff	134
Total Administrators	14
Total Enrollment for Most Recent School Year	2,310
Intermediate Unit Number	21
District Career and Technical School	Carbon Career & Technical Institute

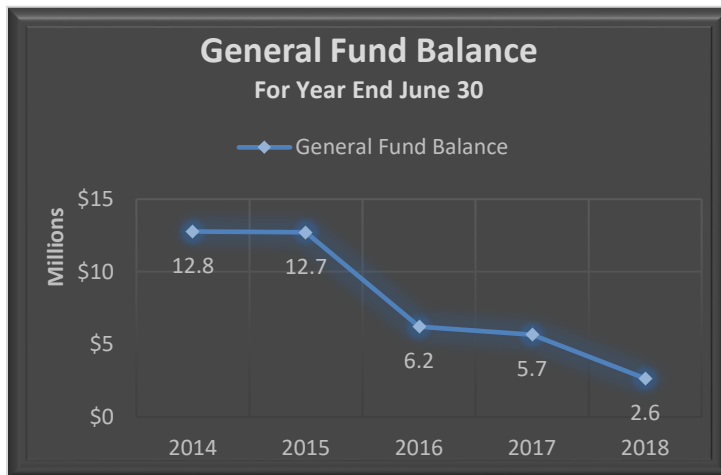
\* - Source: Information provided by the District administration and is unaudited.

### Mission Statement\*

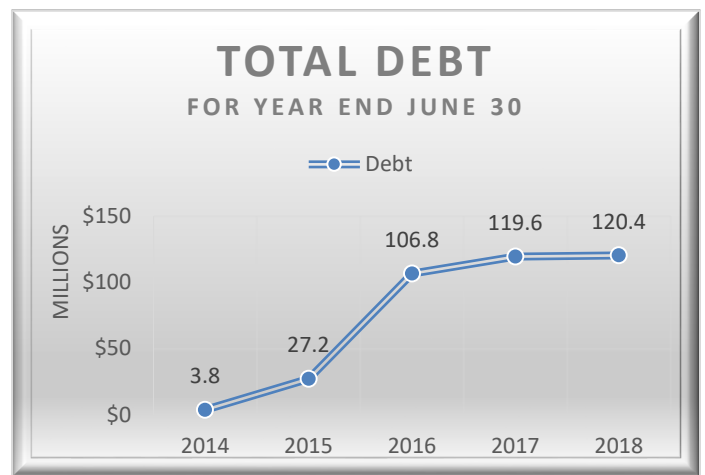
Partnering with students, families, and community to provide opportunities for life-long success through academic excellence and individual growth in a safe and supportive environment.

## Financial Information

The following pages contain financial information about the Lehigh Area School District (District) obtained from annual financial data reported to the Pennsylvania Department of Education (PDE) and available on PDE's public website. This information was not audited and is presented for **informational purposes only**.



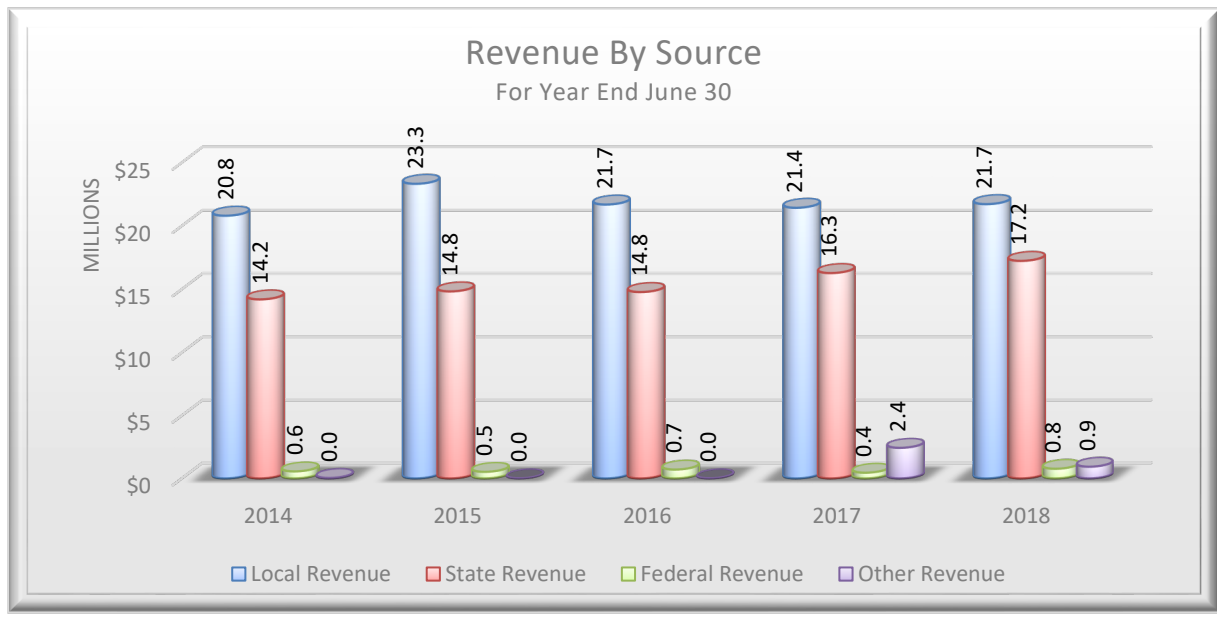
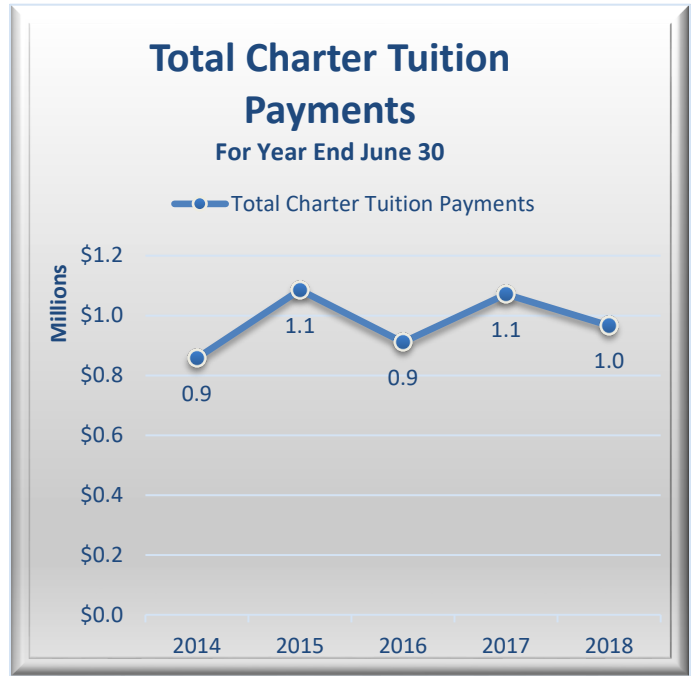
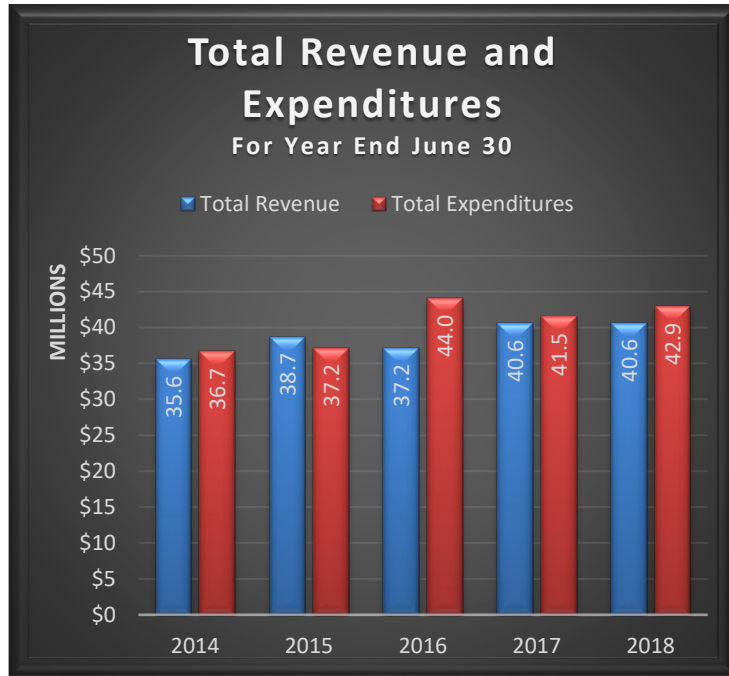
**Note:** General Fund Balance is comprised of the District's Committed, Assigned and Unassigned Fund Balances.



**Note:** Total Debt is comprised of Short-Term Borrowing, General Obligation Bonds, Authority Building Obligations, Other Long-Term Debt, Other Post-Employment Benefits, Compensated Absences and Net Pension Liability.

<sup>1</sup> The District consolidated the four elementary schools into one building. Therefore, the District currently only has one high school, one middle school, and one elementary school.

## Financial Information Continued

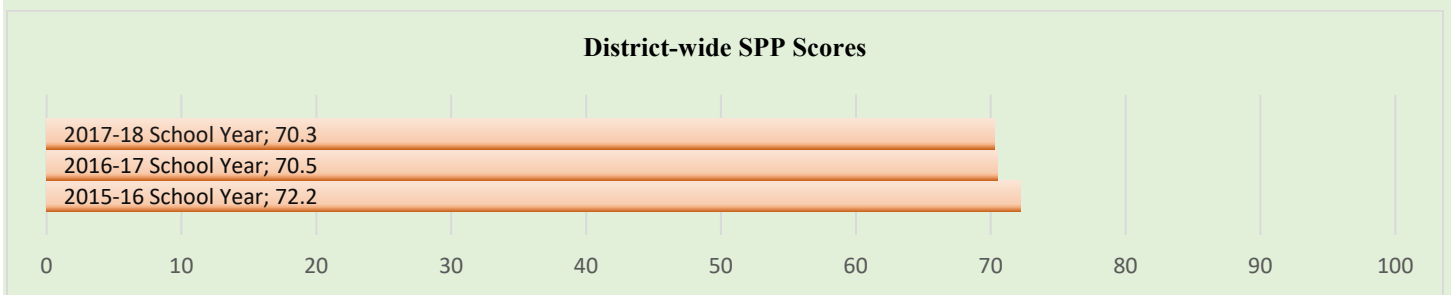


## Academic Information

The graphs on the following pages present the District-wide School Performance Profile (SPP) scores, Pennsylvania System of School Assessment (PSSA) scores, Keystone Exam results, and 4-Year Cohort Graduation Rates for the District obtained from PDE's data files for the 2015-16, 2016-17, and 2017-18 school years.<sup>2</sup> The District's individual school building scores are presented in Appendix B. These scores are provided in this audit report for **informational purposes only**, and they were not audited by our Department.

### **What is a SPP score?**

A SPP score serves as a benchmark for schools to reflect on successes, achievements, and yearly growth. PDE issues a SPP score annually using a 0-100 scale for all school buildings in the Commonwealth, which is calculated based on standardized testing (i.e., PSSA and Keystone exam scores), student improvement, advance course offerings, and attendance and graduation rates. Generally speaking, a SPP score of 70 or above is considered to be a passing rate.<sup>3</sup>



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<sup>2</sup> PDE is the sole source of academic data presented in this report. All academic data was obtained from PDE's publically available website.

<sup>3</sup> PDE started issuing a SPP score for all public school buildings beginning with the 2012-13 school year. For the 2014-15 school year, PDE only issued SPP scores for high schools taking the Keystone Exams as scores for elementary and middle scores were put on hold due to changes with PSSA testing. PDE resumed issuing a SPP score for all schools for the 2015-16 school year.

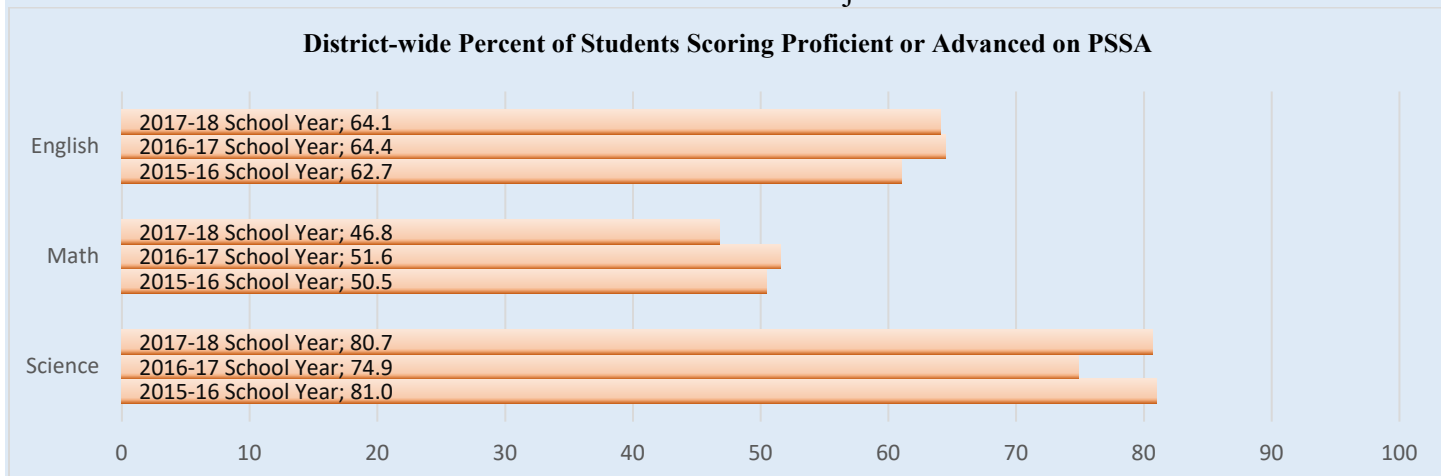


## Academic Information Continued

### What is the PSSA?

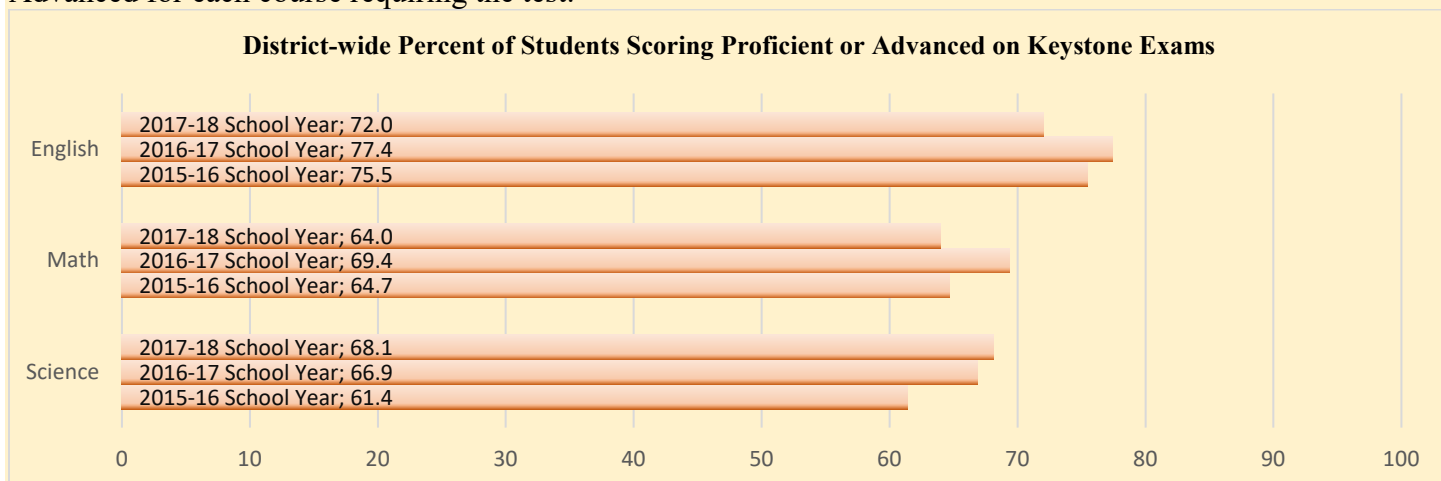
The PSSA is an annual, standardized test given across the Commonwealth to students in grades 3 through 8 in core subject areas, including English, Math and Science. The PSSAs help Pennsylvania meet federal and state requirements and inform instructional practices, as well as provide educators, stakeholders, and policymakers with important information about the state's students and schools.

The 2014-15 school year marked the first year that PSSA testing was aligned to the more rigorous PA Core Standards. The state uses a grading system with scoring ranges that place an individual student's performance into one of four performance levels: Below Basic, Basic, Proficient, and Advanced. The state's goal is for students to score Proficient or Advanced on the exam in each subject area.



### What is the Keystone Exam?

The Keystone Exam measures student proficiency at the end of specific courses, such as Algebra I, Literature, and Biology. The Keystone Exam was intended to be a graduation requirement starting with the class of 2017, but that requirement has been put on hold until the 2020-21 school year.<sup>4</sup> In the meantime, the exam is still given as a standardized assessment and results are included in the calculation of SPP scores. The Keystone Exam is scored using the same four performance levels as the PSSAs, and the goal is to score Proficient or Advanced for each course requiring the test.

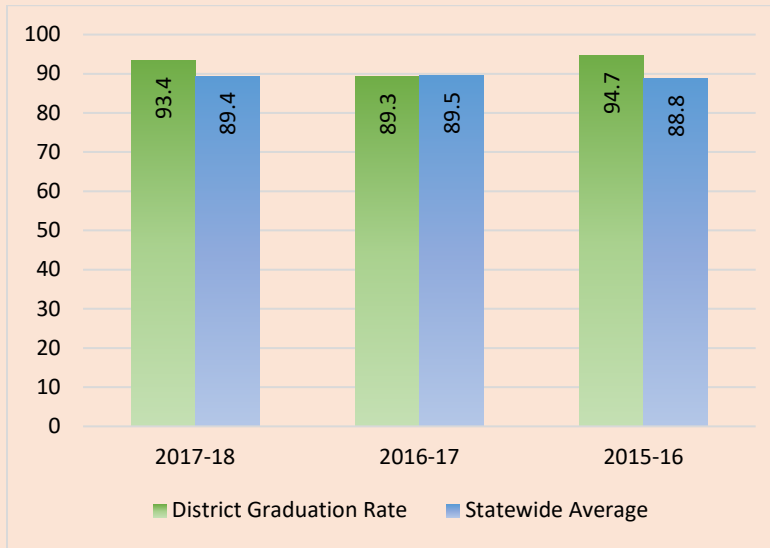


<sup>4</sup> Act 158 of 2018, effective October 24, 2018, amended the Public School Code to further delay the use of Keystone Exams as a graduation requirement until the 2021-22 school year. See 24 P.S. § 1-121(b)(1).

## Academic Information Continued

### What is a 4-Year Cohort Graduation Rate?

PDE collects enrollment and graduate data for all Pennsylvania public schools, which is used to calculate graduation rates. Cohort graduation rates are a calculation of the percentage of students who have graduated with a regular high school diploma within a designated number of years since the student first entered high school. The rate is determined for a cohort of students who have all entered high school for the first time during the same school year. Data specific to the 4-year cohort graduation rate is presented in the graph below.<sup>5</sup>



<sup>5</sup> PDE also calculates 5-year and 6-year cohort graduation rates. Please visit PDE's website for additional information:

<http://www.education.pa.gov/Data-and-Statistics/Pages/Cohort-Graduation-Rate.aspx>.

## Findings

### Finding No. 1

### The District had a Cumulative Deficit Which Reduced Its General Fund Balance by More Than \$13 Million Over the Five Years Reviewed

#### *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 school directors which will cause the sums appropriated to specific purposes in the budget to be exceeded.” See 24 P.S. § 6-609.

**The Government Finance Officers Association (GFOA)** has developed Budgeting Best Practices for School Districts. Among the best practices are:

**General Fund Reserve.** School districts should establish a formal process on the level of the unrestricted fund balance that should be maintained in the general fund as a reserve to hedge against risk.

The GFOA recommends, at a minimum, that school districts maintain an unrestricted fund balance in their general fund of no less than two months of regular General Fund operating expenditures and operating transfer out.

Our review of the Lehigh Area School District’s (District’s) financial position over a five-year period revealed that the District’s General Fund balance decreased at an alarming rate. The District’s General Fund balance was \$14,270,505 as of June 30, 2015. Due to a cumulative deficit over the period of our review, the District’s General Fund balance decreased to \$874,439 as of June 30, 2019.

The District’s decreasing General Fund balance was due to the failure to budget for capital expenditures coupled with an increase in debt service payments as a result of issuing \$62 million dollars of bonds during our audit period. The District’s aggressive capital outlay has reduced District reserves and put the District in an unenviable financial position. The District’s Board of School Directors (Board) had the foresight to commit a portion of its fund balance to offset rising pension and Other Post-Employment Benefits (OPEB) costs; however, the District exhausted those reserves to pay for the construction of a new stadium. The District will have to develop future budgets to create a surplus to cover these rising costs.

We reviewed several financial benchmarks, including the General Fund balance, operating position, and financial ratios, to evaluate changes in the District’s financial position over a period of five years from July 1, 2014 through June 30, 2019.

#### **Declining General Fund Balance**

The District’s General Fund balance consisted of **four** distinct classifications:

- 1) Nonspendable<sup>6</sup>
- 2) Committed<sup>7</sup>
- 3) Assigned
- 4) Unassigned

<sup>6</sup> *Nonspendable Fund Balances* are amounts that cannot be spent because they are either in a non-spendable form, or legally or contractually required to be maintained in tact such as inventory. *Source: PDE Chart of Accounts for PA Local Educational Agencies.*

<sup>7</sup> *Committed Fund Balances* are amounts constrained to be used for a specific purpose as per government’s highest level of decision making authority such as the school board, board of directors, board of trustees, etc. Note: A Board Resolution is required. Constraint can also be removed or changed by an equal level action. *Source: PDE Chart of Accounts for PA Local Educational Agencies.*

*Criteria relevant to the finding  
(continued):*

Budgeting and maintaining adequate fund balances allow school boards and superintendents to maintain their educational programs and services with level tax adjustments. They also provide financial stability in emergency situations so that it is certain that employees and vendors are paid on time. Fund balances reduce interest expense or interim borrowing. In addition, stable fund balance history appeals more to underwriters and other creditors when construction projects are undertaken and the school district must enter the bond market.

The Pennsylvania School Boards Association in its *Overview of Fiscal Health* for the 2013-14 school year provided the following fiscal benchmarks.

- Financial industry guidelines recommend that fund balances be between five percent and ten percent of annual expenditures.

The nonspendable fund balance consists of the District's inventory and prepaid expenditures, neither of which are available for the District's use to meet current obligations. The District's prepaid expenditure balance consisted of over \$3 million that was wired to the National Education Foundation (NEF) as payment for two separate five-year agreements related to the District's STEM academies.<sup>8</sup> The District paid NEF \$1,712,250 in December 2014 and another \$1,360,000 in July 2017. These agreements were signed in conjunction with the issuance of the Qualified Zone Academy Bonds (QZAB). Refer to Finding No. 2 for more details on these agreements.

The committed funds are those funds that the Board assigns for a specific purpose. In a proactive measure to be prepared for rising pension and employee benefit costs, the Board passed a resolution in June 2013 committing \$8 million to cover these costs in the future. Specifically, Board Resolution No. 12/13-04 states:

*Be it resolved that the Lehigh Area School District Board of Education directs the administration to commit a portion of its current General Fund Unassigned Fund Balance into a committed fund balance for PSERS rate stabilization and to fund future OPEB liability obligations.*

Table 1 below details the annual General Fund balance for each of the **four** classifications.

**Table 1**

Lehigh Area School District General Fund Balance Composition					
Fiscal Year Ended June 30	Nonspendable	Committed	Assigned <sup>9</sup>	Unassigned	Total
2015	\$1,543,428	\$6,400,000	\$3,049,176	\$3,277,901	<b>\$14,270,505</b>
2016	\$1,202,309	\$ 0	\$3,049,176	\$3,169,130	<b>\$ 7,420,615</b>
2017	\$ 860,570	\$ 0	\$2,978,968	\$2,681,172	<b>\$ 6,520,710</b>
2018	\$1,605,690	\$ 0	\$ 203,590	\$2,443,351	<b>\$ 4,252,631</b>
2019	\$ 2,526	\$ 0	\$ 0	\$ 871,913	<b>\$ 874,439</b>

As illustrated in Table 1, the District's General Fund balance has deteriorated during the period reviewed. During the 2015-16 school year, the Committed Fund balance was reduced to zero even though the District did not incur pension/OPEB costs up to the previous Committed Fund

<sup>8</sup> STEM is an acronym for Science, Technology, Engineering, and Math.

<sup>9</sup> The District's assigned fund balance is to assist in balancing the budget and to cover rising pension costs.

*Criteria relevant to the finding  
(continued):*

- Operating position is the difference between actual revenues and actual expenditures. Financial industry guidelines recommend that the district operating position always be positive (greater than zero).

**PDE's Chart of Accounts  
Section 830 Committed Fund  
Balance**

Amounts constrained to be used for a specific purpose as per government's highest level of decision making authority such as the school board, board of directors, board of trustees, etc. Note: Board Resolution required. Constraint can also be removed or changed by an equal level action.

balance. Therefore, it appears that the District used those committed funds for a purpose other than pension/OPEB costs. Furthermore, the Board did not pass a resolution to remove or change the original commitment for the funds to be used for other expenditures, such as the \$6.2 million stadium project. During the 2018-19 fiscal year, the independent local auditors posted a prior period adjustment to reduce the fund balance by \$1,601,675 to correct the overstated prepaid expenditures for the wire transfers to NEF.

***Noncompliance with best practices:*** The adequacy of an unassigned fund balance in the general fund can and should vary from one school district to the next and should take into consideration each district's own unique circumstances. Nevertheless the GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain a general fund balance of no less than two months of regular general fund operating revenues or regular general fund operating expenditures plus transfers out.

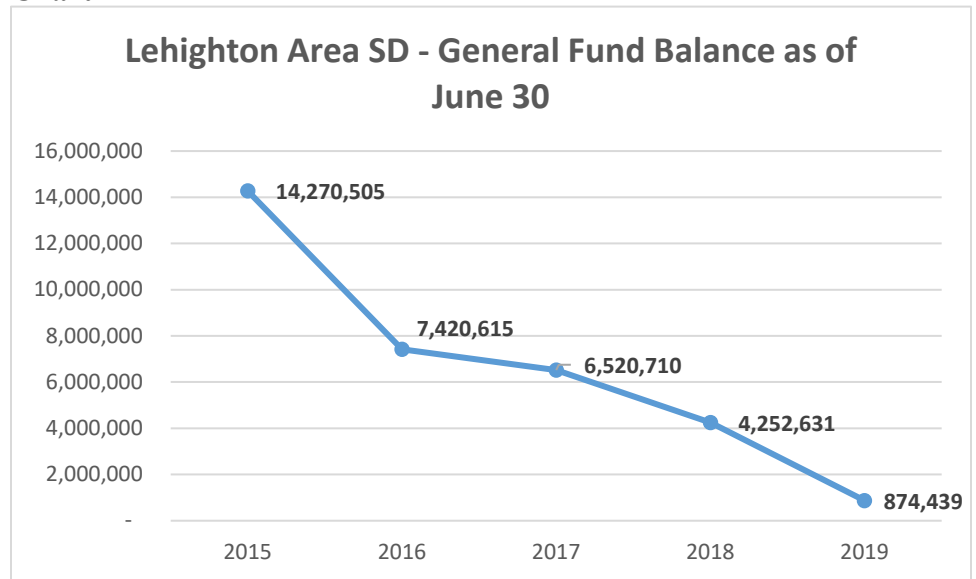
The District's General Fund balance did not meet best practices for four out of the five years of the audit period. The District's unrestricted General Fund balance as of June 30, 2019 was only \$871,913, which is significantly less than the fund balance recommended by GFOA.<sup>10</sup> More specifically, the District's operating expenditures and transfers out as of June 30, 2019 were \$43,901,736, which equates to an estimated \$3.6 million in monthly expenditures. Therefore, GFOA guidelines would recommend the District maintain an unrestricted fund balance of \$7.2 million. The District's June 30, 2019 fund balance doesn't come close to covering one month's worth of expenditures, let alone the recommended two months.

Not only did the District fail to follow best practices in regard to a minimum fund balance, the District did not comply with its own board policy for the 2018-19 fiscal year. The District has a fund balance policy with guidelines stating that the District will strive to maintain an unassigned General Fund balance of not less than 5% and not more than 8% of the budgeted expenditures for that fiscal year.<sup>11</sup> To comply with its policy, the District's June 30, 2019 fund balance should have been approximately \$2.2 million—far more than the actual \$871,913 balance. Chart 1 illustrates the sharp decline in the District's General Fund balance over the audit period.

<sup>10</sup> Unrestricted fund balance consists of Committed, Assigned, and Unassigned Fund balances.

<sup>11</sup> Lehigh Area School District's *Board Policy No. 620 - Fund Balance*.

**Chart 1**



***No reserves for future pension and OPEB costs:*** School districts, like individuals, should have a “rainy day fund” to deal with emergencies or unforeseen needs, unanticipated expenses, and disruptions to revenue. The District’s Board was aware of the impending pension and OPEB obligations as evidenced by committing almost 50% of its reserve for these future costs to achieve tax stability and continue to provide its students with a quality education. However, in the 2015-16 school year, the District and its Board decided to use a significant portion of the funds reserved for future pension and OPEB costs for an *unbudgeted* stadium construction project. That decision resulted in a sharp decline in total fund balance from fiscal year 2014-15 to 2015-16 and also depleted the District’s reserves. Pension and OPEB costs will continue to rise and the District has to determine how it will subsidize these rising costs, as well as its increased debt burden in the future years since it no longer has the reserve funds.

### **Declining Operating Position**

A school district’s operating position is an important indicator of a district’s financial health and is determined by comparing total operating revenues to total operating expenditures. The result of total expenditures and other financing uses exceeding total revenues and other financing sources is a deficit.

The following table shows the District's total cumulative deficit that occurred during the review period.

**Table 2**

Lehigh Area School District General Fund Operating Position <sup>12</sup>						
	(A)	(B)	(C)	(D)	(E)	(F)
Fiscal Year Ended June 30	Total Revenue	Total Operating Expenditures	Operating Surplus (A-B)	Debt Service and Capital Outlay	Other Financing Sources/(Uses)	Total Surplus/(Deficit) (C-D+E)
2015	\$ 38,665,862	\$ 34,142,145	\$ 4,523,717	\$ 2,301,112	(\$ 724,910)	\$ 1,497,695
2016	\$ 37,156,585	\$ 34,667,615	\$ 2,488,970	\$ 9,234,819	(\$ 104,041)	(\$ 6,849,890)
2017	\$ 38,148,752	\$ 35,933,663	\$ 2,215,089	\$ 5,434,558	\$2,319,564	(\$ 899,905)
2018	\$ 39,711,717	\$ 38,648,394	\$ 1,063,323	\$ 3,795,314	\$ 463,912	(\$ 2,268,079)
2019	\$ 41,423,164	\$ 38,817,434	\$ 2,605,730	\$ 5,084,301	\$ 702,054	(\$ 1,776,517)
<b>Total:</b>	<b>\$195,106,080</b>	<b>\$182,209,251</b>	<b>\$12,896,829</b>	<b>\$25,850,104</b>	<b>\$2,656,579</b>	<b>(\$10,296,696)</b>

As shown in Table 2, the District had a total deficit for each year reviewed except for the 2014-15 fiscal year. The District had a total surplus in the 2014-15 fiscal year primarily because it raised taxes by 1.2% and received additional revenue from its health insurance consortium. More specifically, the District requested and received surplus distributions of approximately \$3.3 million from the Pennsylvania Schools Health Insurance Consortium (PSHIC) for the 2013-14 and 2014-15 fiscal years.<sup>13</sup> The District continued to receive surplus distributions totaling approximately \$1.5 million through the 2016-17 fiscal year. These surplus distributions offset medical expenditure costs which kept instructional expenditures relatively flat until the District pulled out of the PSHIC in the 2017-18 fiscal year.

In 2015-16, the District had a total deficit of **\$6,849,890** primarily due to the District's decision to proceed with the construction of a new multi-purpose stadium costing \$6.2 million even though that project was not included in the 2015-16 budget.<sup>14</sup> According to the District, it expected to realize savings from the consolidation of its four elementary schools. However, only minimal savings have occurred to date. The decrease in operating surplus, coupled with an increase in annual debt service and aggressive capital outlay, led to a cumulative total deficit of **\$10,296,696**.

<sup>12</sup> Information obtained from the District's Independent Auditor's Report, Statement of Revenue, Expenditures and Changes in Fund Balance, for the fiscal years ending 2015 through 2019. We did not perform procedures to verify the accuracy of the amounts presented.

<sup>13</sup> The District received a 2013-14 surplus distribution of \$1,830,397 and recorded it as local revenue. The District received the 2014-15 surplus distribution of \$1,487,317 and used those funds to offset medical expenditures.

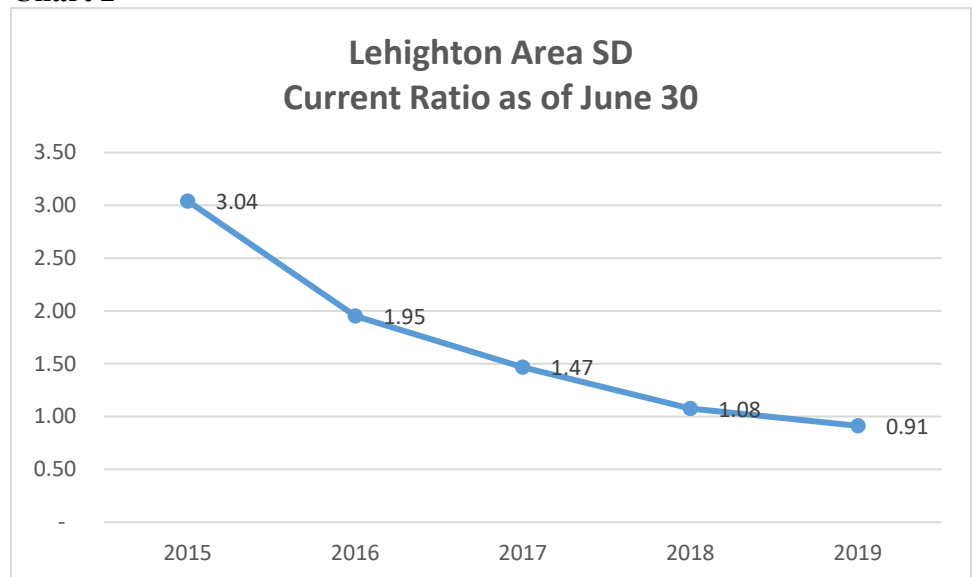
<sup>14</sup> The new multi-purpose stadium project was approved on May 26, 2015 by Board Resolution for a cost of \$6,264,296.

## Low Current Ratio

The District's current ratio (current assets/current liabilities) significantly declined during our period of review.<sup>15</sup> In accordance with best business practices, a current ratio below 2 is considered weak. A current ratio under 1 is especially troubling because that means liabilities exceed assets. The District's current ratio was 0.91 as of the 2018-19 fiscal year end. Potential creditors use this ratio to measure a district's ability to pay its short-term debts.

As discussed earlier in the finding, the District had a significant prepaid expense balance due to prepayment of the NEF Agreement.<sup>16</sup> We did not include this prepaid balance as a current asset for this calculation as these funds are not available to pay the District's short term obligations. The low current ratio, which is indicative of dwindling available resources, led the District to consider issuing Tax Anticipation Notes (TAN) to assist with cash flow demands in 2018-19. In order to avoid issuing a TAN, the District delayed payments to certain vendors until sufficient revenue was received. The following chart illustrates the District's current ratio over the five-year audit period.

**Chart 2**



<sup>15</sup> Current assets and current liabilities amounts were obtained from the District's Independent Auditor's Report, *Balance Sheet – Governmental Funds*. The current portion of long-term liabilities was obtained from the *Statement of Net Position*, for fiscal years ending 2013 through 2017. We did not perform procedures to verify the accuracy of the amounts presented.

<sup>16</sup> The District entered into two 5-year agreements with NEF but it paid for the entire 5-year terms of agreement up front (in 2014 for the first agreement and in 2017 for the second agreement); therefore, the prepaid balance will be systematically expensed over the 5 year term.

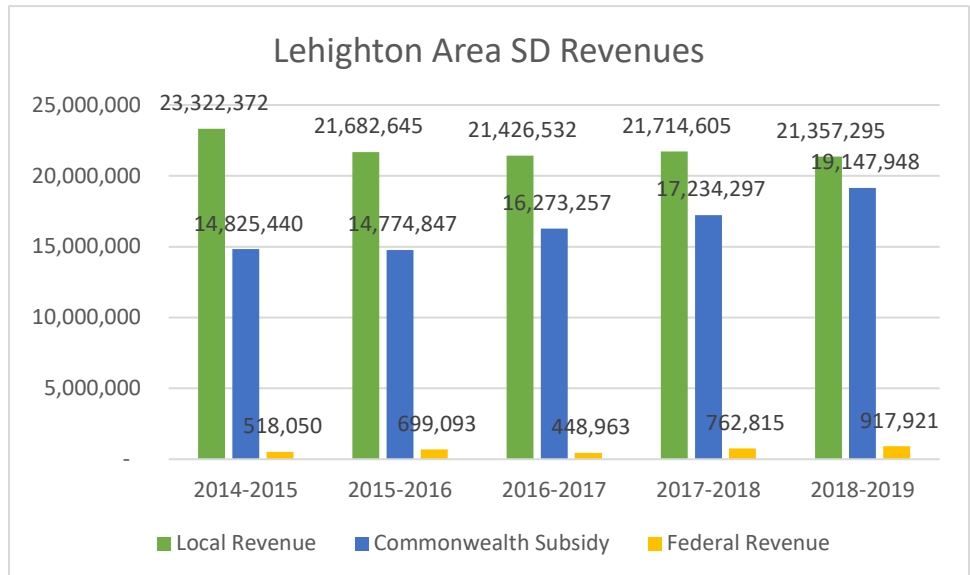


## Revenues

The District has two main revenue sources: local revenues and Commonwealth subsidies. Local revenues are primarily generated from property taxes and comprised over 52 percent of the District's total revenue in the 2018-19 fiscal year. The District raised taxes by 1.2% in 2014-15 and maintained the same millage rate for the remainder of the audit period. The District's local revenue decreased by 8%, or approximately \$2 million, over the five year period analyzed. As mentioned previously, this decrease is due to an additional reimbursement from PSHIC for approximately \$1.8 million that was recorded as a local revenue source in the 2014-15 school year but was not available in subsequent years.

Revenue from the Commonwealth comprised over 46 percent of the District's total revenues in the 2018-19 fiscal year. The District's Commonwealth subsidy increased by 29% or approximately \$4.3 million over the five-year period analyzed. Federal revenue comprised less than 2% of the District's total revenue. Overall, the District's total revenue increased by 7% over the audit period. Chart 3 shows the District's revenue sources for each year of the audit period.

**Chart 3**



## Expenditures

District expenditures are categorized into **five** major functions:<sup>17</sup>

- 1) Instructional
- 2) Support services

<sup>17</sup> An additional category of "Other" includes Refunds of Prior Year Receipts, which is not a major function within the District's operations.

- 3) Non-instructional
- 4) Capital outlay
- 5) Debt service

The District's operational expenditures (instructional, support services, and non-instructional services) increased from \$34.1 million in the 2014-15 fiscal year to \$38.8 million in the 2018-19 fiscal year or a 15% increase. According to the District, instructional expenditures increased significantly from 2016-17 to 2017-18 due, in part, to a 7% or \$740,000 increase in teacher's salaries. During the audit period, debt service increased by 97%, as the District issued approximately \$62 million in bonds. During the 2016-17 fiscal year, the District made an additional payment of \$1,991,000 to pay off the 2014 General Obligation Note. The total of \$8.5 million in capital outlay was not offset by bond proceeds, as the proceeds were recorded in the Capital Projects fund. These expenditures are detailed in the table below.

**Table 3**

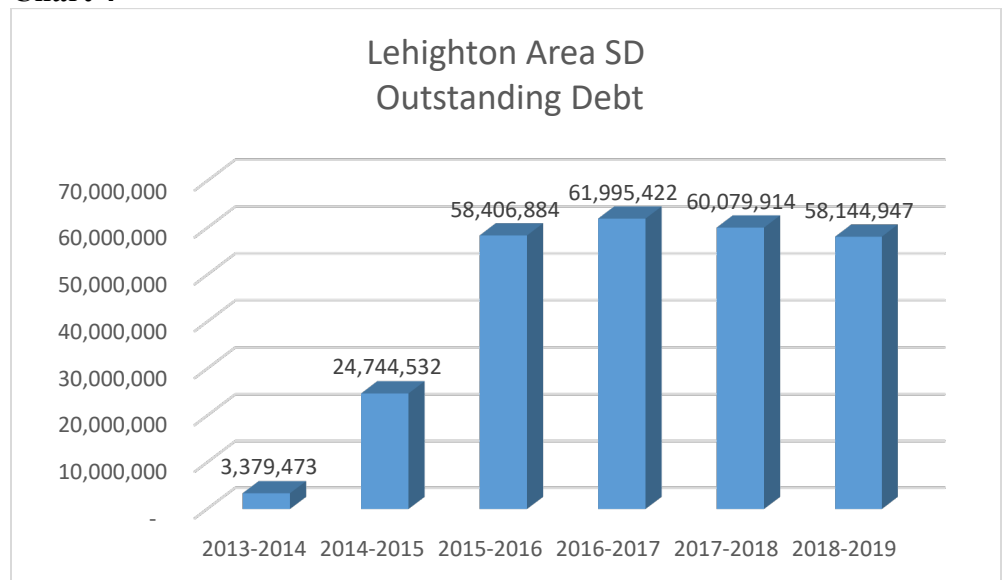
Lehigh Area School District Total Expenditures <sup>18</sup>						
	Fiscal Years Ended June 30					
<b>Total Expenditures</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>Totals</b>
Instructional	\$23,059,559	\$23,552,117	\$24,130,749	\$26,343,456	\$26,558,554	<b>\$123,644,435</b>
Support Services	\$10,241,665	\$10,195,041	\$10,882,430	\$11,251,580	\$11,210,135	<b>\$ 53,780,851</b>
Non-instructional Services	\$ 840,921	\$ 920,457	\$ 920,484	\$ 1,051,510	\$ 1,048,745	<b>\$ 4,782,117</b>
<b>Total Operational Expenditures</b>	<b>\$34,142,145</b>	<b>\$34,667,615</b>	<b>\$35,933,663</b>	<b>\$38,646,546</b>	<b>\$38,817,434</b>	<b>\$182,207,403</b>
Capital Outlay	\$ 388,512	\$ 6,448,697	\$ 301,125	\$ 16,878	\$ 1,306,774	<b>\$ 8,461,986</b>
Debt Service	\$ 1,912,600	\$ 2,786,122	\$ 5,133,433	\$ 3,778,436	\$ 3,777,527	<b>\$ 17,388,118</b>
Other	\$ 0	\$ 0	\$ 0	\$ 1,848	\$ 0	<b>\$ 1,848</b>
<b>Grand Total</b>	<b>\$36,443,257</b>	<b>\$43,902,434</b>	<b>\$41,368,221</b>	<b>\$42,443,708</b>	<b>\$43,901,735</b>	<b>\$208,059,355</b>

<sup>18</sup> Information obtained from the District's Independent Auditor's Report, *Statement of Revenue, Expenditures and Changes in Fund Balance*, fiscal years ending June 30, 2015 through 2019. We did not perform procedures to verify the accuracy of the amounts presented.

## Increasing Debt Service Payments

The District's debt climbed from \$3.3 million as of July 1, 2014 to \$58 million as of June 30, 2019. The District and the Board approved the issuance of General Obligation Bonds totaling \$47,055,000 and Qualified Zone Academy Bonds (QZAB)<sup>19</sup> totaling \$15,249,000 during our audit period. The bond proceeds were recorded into the Capital Projects fund in each respective year. The District's total proceeds of \$62,304,000 were used to consolidate the four elementary schools, renovate the High School and Middle School, and implement STEM Academies throughout the District. The District's debt increase is illustrated in Chart 4 below:

**Chart 4**



Due to the additional borrowings, the District's minimum annual debt service payments increased from \$1.9 million in 2014-15 to \$3.8 million as of June 30, 2019.

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<sup>19</sup> The Qualified Zone Academy Bond (QZAB) Program was established under Section 226 of the federal Taxpayer Relief Act of 1997 (H.R. 2014). This federal program allows for certain schools, known as education zone academies, to finance the renovation of school facilities, purchase equipment, and, if allowed by state law, provide up-to-date technology and instructional materials on an interest-free, or nearly interest-free, basis through the allocation of tax credits.

The following table shows the District's future debt service payments as of June 30, 2019.<sup>20</sup>

**Table 4**

<b>Lehigh Area SD Debt Service Payments to Maturity</b>			
<b>Fiscal Year Ended</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
<b>2020</b>	\$ 1,953,771	\$ 3,073,106	\$ 5,026,877
<b>2021</b>	\$ 1,979,771	\$ 3,080,928	\$ 5,060,699
<b>2022</b>	\$ 2,011,771	\$ 3,094,519	\$ 5,106,290
<b>2023</b>	\$ 2,038,771	\$ 3,102,888	\$ 5,141,659
<b>2024</b>	\$ 2,070,771	\$ 3,099,207	\$ 5,169,978
<b>2025-2029</b>	\$10,757,854	\$12,206,931	\$ 22,964,785
<b>2030-2034</b>	\$11,249,109	\$ 8,265,849	\$ 19,514,958
<b>2035-2039</b>	\$11,908,955	\$ 5,648,311	\$ 17,557,266
<b>2040-2044</b>	\$14,174,174	\$ 1,775,188	\$ 15,949,362
<b>Total</b>	<b>\$58,144,947</b>	<b>\$43,346,927</b>	<b>\$101,491,874</b>

As depicted in Table 2 shown earlier, the District's operating surplus declined from \$4.5 million in 2014-15 to \$2.6 million in 2018-19. The future debt service payments will require the District to plan and accurately budget to meet these requirements.

### **Overspending the Budget**

The Public School Code (PSC) requires all school districts to annually develop a general fund budget. In addition, the PSC prohibits school districts from spending more than the amount budgeted.<sup>21</sup> As illustrated in Table 5, the District failed to comply with the PSC when its actual expenses exceeded its budgeted expenses for four out of the five years reviewed.

<sup>20</sup> The information was obtained from the District's Independent Auditor's Report accompanying Notes to the Financial Statements. We did not perform procedures to verify the accuracy of the amounts presented.

<sup>21</sup> See 24 P.S. § 6-609.

The table also shows that the District cumulatively overspent the budgeted amounts by more than \$12.4 million during the audit period.

**Table 5**

Lehigh Area School District General Fund Total Expenditures Budget to Actual Comparison			
Fiscal Year Ended June 30	Actual Expenditures	Budgeted Expenditures	(Under)/Over Budget
2015	\$ 36,443,257	\$ 36,804,689	(\$ 361,432)
2016	\$ 43,902,434	\$ 38,548,582	\$ 5,353,852
2017	\$ 41,368,221	\$ 39,170,228	\$ 2,197,993
2018	\$ 42,443,708	\$ 40,639,765	\$ 1,803,943
2019	\$ 43,901,735	\$ 40,484,461	\$ 3,417,274
<b>Total</b>	<b>\$208,059,355</b>	<b>\$195,647,725</b>	<b>\$12,411,630</b>

It is important for the District to accurately budget expenditures due to its direct impact on the budgeted General Fund balance. The budgeted General Fund balance is integral to the discussion of millage rate modifications and operational changes, and it is essential that this number be as accurate as possible.

We found that the primary reasons expenditures exceeded budgeted amounts in the 2015-16 fiscal year was due to the unbudgeted \$6.2 million construction of the new multi-purpose stadium. In 2016-17, the District again failed to budget for \$300,000 of construction expenses and under-budgeted debt service by approximately \$2.8 million because it decided to pay off a 2014 Note.<sup>22</sup> In its 2017-18 budget, the District reduced the amount of its budgeted line items below the previous year's actual expenditures, which caused the District to come in over budget by \$1,000,154 in special education and \$837,377 in operation and maintenance of plant services.

## Conclusion

In summary, the District's financial position declined significantly over the review period. We found that a substantial increase in debt service payments, as well as increases in other operational expenses, led to a significant decrease in the District's General Fund balance. We also found that the Board approved the stadium project and other construction projects but did not budget for these projects. Failing to budget for projects costing the District taxpayers' millions of dollars paints an unrealistic picture of the District's financial position and affects the District and its Board's ability to make sound operational decisions. In addition, the District's local revenue decreased during our audit period, which is concerning due to the increase in annual debt service and

<sup>22</sup> The District transferred \$2.4 million from the Capital Projects fund to the general fund to cover a portion of these costs.

construction costs. To help ensure a secure financial future going forward, the District must develop more accurate and realistic budgets that account for the rising debt service requirements and operational costs.

### **Recommendations**

The *Lehigh Area School District* should:

1. Prepare a multi-year budget that reduces expenditures or increases revenue to allow the District to achieve operating surpluses.
2. Monitor the approved fiscal budget in comparison to actual revenues and expenses and report to the Board any cost overruns or revenue shortfalls to allow the Board to make necessary adjustments.
3. Display the multi-year budget prominently on its website for the public so that taxpayers and District officials can publicly discuss the details of the budget at open meetings.
4. Ensure that the Board votes on a resolution to amend the specific purpose for committed funds before the District can use those funds for other reasons.

### **Management Response**

District management provided the following response:

While the District acknowledges the past budgeting and spending practices, prior to the commencement of the State Audit, the District had already begun to take many steps to improve its budgeting and spending practices. In March 2019, the District hired a new Business Administrator. The new Business Administrator immediately took steps to improve the district's practices including, but not limited to, the following:

- Business Administrator provided training to the board on Fund Balance, what it is and what it isn't (i.e. it is not a separate bank account that can just be drawn upon without prior budgeting; expenditures must be properly budgeted for as part of the budgeting process). **(Meeting Date June 19, 2019)**
- Business Administrator provided the Board with a multi-year comparison of the District's actual versus budgeted expenditures and revenues, pointing out the significant overspending in the past five years. **(Meeting Date June 3, 2019)**
  - Business Administrator established 2019-20 and 2020-21 budgets based on actual expected costs; the budget was built from existing collective bargaining agreements and review of historical expenditures and known and expected expenditure increases.

- The 2019-20 General Fund Budgeted Expenditures were \$43,891,495; \$3,197,034 higher than the 2018-19 General Fund Budgeted Expenditures of \$40,694,461. However, the 2019-20 Budget closely aligned with the actual spending of the prior year (2018-19) of \$43,901,735. The 2019-20 and 2020-21 General Fund Budgets align with actual expected spending, whereas the former years' budgets did not align with the actual spending.
- The Business Administrator provided the Board with direct discussions of the requirement of creating a balanced budget, informing the Board of potential options to creating and maintaining balanced budgets. **(Meeting Date June 15, 2020)**
- The Board was also provided with additional financial reporting to include monthly reporting of both revenues and expenditures (during the periods under State Audit the Board most often only received expenditure reporting). The Board was also provided with additional expenditure reporting, expenditure reporting by object, in order to provide an easier to understand budget to actual analysis.
- In 2019-20, the Business Administrator addressed deficiencies within the business office related to invoicing of other school districts for Lehigh Area School District's education of a student from another School District; a total of \$1,102,147.74 was billed to other school districts for school years 2017-18 and prior, a balance of \$1,004,932.21 remains owed to the Lehigh Area School District, collection efforts are ongoing. Procedures were also put in place to ensure invoices are timely mailed in the school year in which the education is delivered.
- Business Administrator utilized public bidding procedures for supplies purchases to obtain most competitive pricing.
- Business Administrator also ensured that the District's requests for Plan Con reimbursements were brought up-to-date and remain up-to-date, as the District had a number of instances in which Plan Con reimbursements were not appropriately filed in prior fiscal years. The Business Administrator addressed incomplete filings related to prior years totaling \$1,777,049.82 in Plan Con reimbursements.
- The Business Administrator has also created a multi-year financial projection taking into account expected increases.

The Lehigh Area School District concurs with, and if not already in process, will put in place the state audit recommendations.

## **Auditor Conclusion**

We are pleased that the District acknowledged its weaknesses in past budgeting and spending practices and has implemented corrective actions including developing multi-year budgets, approving balanced budgets based on actual expected expenditures, and providing the Board with monthly revenue and expenditure reports. Although the management response did not specifically address our other recommendations, we are encouraged that management agreed with the recommendations and intends to implement them. Implementing all of our recommendations should help put the District on a path to regain financial stability. We will evaluate the effectiveness of the District's corrective actions during our next audit.



## Finding No. 2

## The District's "No Cost" Partnership with Private Education Company Cost the District More Than \$3 Million

### *Criteria relevant to the finding:*

Section 508 (relating to Majority vote required; recording) of the Public School Code requires the following, in part: The **affirmative vote of a majority of all the members of the board** of school directors in every school district, duly recorded, showing how each member voted, shall be required in order to take action on the following subjects:--

**\*\*\*Creating or increasing any indebtedness.\*\*\*Entering into contracts of any kind...**where the amount involved exceeds one hundred dollars (\$100).**\*\*\*Failure to comply with the provisions of this section shall render such acts of the board of school directors void and unenforceable.**" (Emphases added.)  
See 24 P.S. § 5-508.

### QZAB Program Guidelines

The federal program allows for certain schools, known as education zone academies, to finance the renovation of school facilities, purchase equipment, and if allowed by state law to provide up-to-date technology and instructional materials on an interest-free, or nearly interest-free basis through the allocation of tax credits.

In the 2014-15 school year, the District voted to consolidate its elementary schools and renovate its middle and high schools. In addition to the construction and renovations, the District planned to implement Science, Technology, Engineering, and Math (STEM) academies at the elementary, middle, and high schools. In 2014, the District applied for the Qualified Zone Academy Bond (QZAB) Program from the Pennsylvania Department of Education (PDE) and was approved for \$8.5 million.<sup>23</sup> The District applied for another QZAB in 2016 and was approved for \$6.8 million. The QZAB Program allowed the District to receive interest-free, or nearly interest-free, bonds to finance its construction projects. One of the conditions of eligibility for the QZAB Program required the District to obtain a written commitment from private entities for a cash and/or in-kind contribution having a present value of not less than 10% of the bond proceeds.<sup>24</sup>

In order to fulfill this requirement for each bond issuance, the District entered into an agreement with the National Education Foundation (NEF).<sup>25</sup> NEF not only pledged the required 10% but in exchange for a separate agreement with its for-profit subsidiary, CyberLearning, NEF agreed to extend its in-kind commitment for five years. The separate agreement resulted in the District paying NEF approximately 20% of each of the QZAB bond proceeds.<sup>26</sup> The District wired a total of **\$3,072,250** to NEF during our audit period.

<sup>23</sup> Note that the federal QZAB Program is applied by each participating state-level education agency, which in this case is PDE. According to PDE, their role is strictly limited to reviewing and approving the QZAB applications with no monitoring function.  
[https://www.education.pa.gov/Teachers%20-%20Administrators/School%20Construction%20and%20Facilities/Pages/Qualified-Zone-Academy-Bond-\(QZAB\)-Program.aspx](https://www.education.pa.gov/Teachers%20-%20Administrators/School%20Construction%20and%20Facilities/Pages/Qualified-Zone-Academy-Bond-(QZAB)-Program.aspx) Accessed 09/2/2020.

<sup>24</sup> <https://www.irs.gov/tax-exempt-bonds/qualified-zone-academy-bonds-faqs> Accessed 9/2/2020.

<sup>25</sup> According to its website: The National Education Foundation (NEF) is a 501 (c) (3) nonprofit organization, headquartered in metropolitan Washington, D.C. Founded in 1989, NEF is the world's leading nonprofit organization bridging the STEM, employment, digital and academic divides by providing high quality affordable 21st Century online/blended education to millions of students.  
<https://www.cyberlearning.org/> Accessed 9/2/2020.

<sup>26</sup> Although CyberLearning is the for-profit subsidiary of NEF, the two entities are considered to be one and the same. The websites and invoices we reviewed show that the names are used interchangeably, therefore, for clarity throughout this finding we will refer to both entities as solely NEF.

*Criteria relevant to the finding  
(continued):*

***Private Contribution Requirement:***

The local education agency must receive written commitments and enters into a partnership with a private entity to entities to design a program with the goal of enhancing the academic curriculum, increasing graduation and employment rates, and preparing students for college and the workforce.

The partner must make qualified contribution having a reasonable fair market value of not less than 10 percent of the proceeds of the bond issue. These contributions must be relevant to the academy and may be comprised of cash, goods, services, internships, etc.

**NEF Match Letter**

“As your 10% match partner, we are willing to pledge an in-kind contribution having a present value as of the date of the issuance of the [bond amount], which exceeds 10% of the proceeds of the bond issue.... This contribution will continue for every year of our formal partnership which now stands at five years.... Our Contribution will be to assist you in the formation of a QZAB CyberLearning STEM+ Academy which will provide online course content described below...

Choose from 18 K-12 course packages containing 2,500 high quality courses. Each course package contains several courses. For any course package, the course content value of \$70 for a 12-month 24x7 unlimited access is well below the market value.... We will donate annually xxxx course package IDs (one course package ID provides access to all the courses in a course package to one user).

According to several current and former District officials we interviewed, it was their understanding that the District’s partnership with NEF to participate in the QZAB program and set up a STEM academy was at “**no cost**” to the District. It was their understanding that the in-kind contribution provided by NEF included software licenses, stipends for teachers, incentives for students, and other support services. However, we found that according to the commitment letter, NEF’s in-kind contribution was limited to software licenses referred to as “course package IDs.” It was the District that actually paid for the stipends, incentives, and other support services when it entered into agreements with NEF at a cost of 20% of the QZAB bond proceeds.

These separate agreements were signed by the Superintendent and the former Business Manager; however, we could not find any evidence that these agreements were presented to the Board for approval as required by the Public School Code (PSC).<sup>27</sup> While the Superintendent acknowledged that he signed the agreements, he believed the agreements were part of the QZAB Program and he did not realize that the District had to forward 20% of the bond proceeds to NEF. He further explained that the partnership with NEF was presented to him as a no cost to the District deal because NEF would be making in-kind donations. The remainder of this finding details the facts around each of the two QZAB bonds, the NEF Agreements, and the specific STEM Academies.

**QZAB No. 1 – Elementary/Middle School Bond**

In 2014, the District applied for a QZAB to consolidate the elementary schools and renovate the middle school, as well as implement a STEM academy in these schools. As discussed earlier, to be eligible for a QZAB, the District had to partner with a private business who would provide an “in-kind” contribution of 10% of the QZAB proceeds. The District partnered with NEF, the “nationally recognized provider of the in-kind match” for the required contribution. Included with the QZAB application packet was a “match” letter from NEF certifying that it would make an in-kind contribution to the District of “course package IDs” valued at \$70 each for a total value of 10% of the QZAB amount. The District’s application was reviewed by PDE, and the District was approved for an \$8,449,000 QZAB.

<sup>27</sup> See 24 P.S. § 5-508.

As shown in Table 1, NEF’s in-kind contribution should have been valued at \$844,900 in order to comply with QZAB requirements. The match letter also indicated that NEF would continue donating the annual course IDs for five years for a total in-kind contribution of 50% of the QZAB application amount.

**Table 1**

Lehigh Area School District 2014 QZAB NEF Pledged In-kind Contribution	
<b>Bond Proceeds</b>	\$ 8,449,000
<b>NEF 10% In-Kind Match</b>	\$ 844,900
<b>NEF In-kind Contribution:</b>	
<b>Cost per License</b>	\$70
<b># of Licenses pledged</b>	12,070
<b>Total annual value of pledge</b>	\$ 844,900
<b>Total value over 5-years</b>	\$ 4,224,500

During a phone interview, an NEF official informed us that the in-kind contribution, or the course package IDs, provided to the District were *SuccessMaker* software licenses which NEF purchased and donated annually. In addition, the NEF match letter stated that the courses were “high quality K-12 STEM+ courses mapped to the Common Core standards and PENNSYLVANIA state standards.” According to NEF’s match letter, one course package ID provided access to all the courses in a course package to one user.

The first QZAB was for the STEM programs in the middle and elementary schools, and there were approximately 1,300 students enrolled each year in these STEM programs. Therefore, even after factoring in licenses for teachers and parents, it is difficult to understand the need for over 12,000 annual licenses when each person only needs one license to access all courses.

Table 2 below shows the student enrollment numbers for the elementary and middle schools STEM Academy where the *SuccessMaker* licenses were used.

**Table 2**

Lehigh Area School District 2014 QZAB NEF <u>Actual</u> In-Kind Contribution			
School Year	Number of Licenses (Enrollment)	Cost per license	Total In-Kind Contribution
2014-15	777	\$70	\$ 54,390
2015-16	1,367	\$70	\$ 95,690
2016-17	1,347	\$70	\$ 94,290
2017-18	1,253	\$70	\$ 87,710
2018-19	1,264	\$70	\$ 88,480
5-Year Total	6,008	\$70	\$420,560

According to data provided by the District, cumulative enrollment for the elementary/middle school STEM Academy was 6,008 students over the five years, and with each student receiving one license each year, the total in-kind donation would be valued at \$420,560 —significantly less than the \$4,224,500 pledged by NEF.

During our interviews with the NEF official, we asked if NEF provided any other in-kind contributions that would be considered as part of the required 10% of the bond proceeds. The official stated that NEF also provided access to licenses for the community to use; however the official could not provide any evidence that the District’s “community” ever used any of the licenses. When we questioned District officials about the community licenses, they responded that to the best of their knowledge, no community licenses were actually provided by NEF.

Without any evidence that NEF provided these community licenses, coupled with the fact that the value of the *SuccessMaker* licenses donated over the five years was less than a half a million dollars (\$420,560), it appears that NEF did not donate the full 10%, or \$844,900, that was required by the QZAB Program.<sup>28</sup>

#### Separate Agreement to assist with STEM Academy

According to the NEF official we interviewed, NEF extended its in-kind contribution for five years in exchange for the District agreeing to sign a “Solution Site License” agreement (Agreement). It was through this Agreement that NEF’s for-profit subsidiary, CyberLearning, agreed to

<sup>28</sup> According to PDE officials, their agency staff did not in any manner monitor to ensure that the 10% in-kind donations actually occurred because the QZAB program was a federal program. PDE’s responsibility was limited to reviewing and approving the QZAB applications.

provide the District with the following services to help support the District's STEM Academy in the elementary/middle schools:

- Personalized Learning in K-12 STEM+
- Stipends for onsite director
- Learning Management System (tracks student activities and progress)
- Mentoring Program
- Motivational rewards for students, teacher, and parents
- Training for participating teachers and directors
- Tech Support

We interviewed several current District officials, including the STEM coordinator, and former and current Board members to ask questions about the District's partnership with NEF. Every person we interviewed indicated that it was their understanding that the services bulleted above were provided by NEF as part of the in-kind donation. What was not widely understood by those we interviewed was that the District had a separate agreement with NEF that resulted in the District paying NEF more than 20% of the bond proceeds, or \$1.7 million, for these services.

The District set up a STEM Academy in its middle and elementary schools and worked in partnership with NEF to monitor the students' progress over the five-year term of the Agreement. The District had weekly calls with mentors to discuss the students' progress through the Learning Management System. The District also received stipends for the STEM Academy director, the superintendent, former business manager, and teachers, as well as payments for motivational awards (incentives) for students and teachers. According to data provided by the District, it received the following payments from NEF over the Agreement's five-year period covering the 2014-15 through 2018-19 school years.<sup>29</sup>

**Table 3**

Lehigh Area School District Payments from NEF/CyberLearning			
Years	Stipends	Incentives	Totals
2014-15	\$17,000	\$ 46,637	\$ 63,637
2015-16	\$19,115	\$ 21,829	\$ 40,944
2016-17	\$17,000	\$ 25,000	\$ 42,000
2017-18	\$17,000	\$ 24,960	\$ 41,960
2018-19	\$ 8,053	\$ 10,566	\$ 18,619
Totals	\$78,168	\$128,992	\$207,160

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<sup>29</sup> We requested this same information from NEF but they did not provide the information and instead directed us back to the District to obtain the details about the amount of stipends and incentive payments.

We asked NEF to provide us with the value of the other services (i.e., mentoring, student progress tracking, etc.) and it was unable to do so. So, while the District did receive stipends and incentive payments totaling over \$207,000 as well as other services of undetermined value from NEF, the cost for these payments and services was not borne by NEF, as believed by most District personnel. Instead, the District paid NEF \$1.7 million for these stipends, incentives, and other services. Refer to Finding No. 1 for details of how this payment affected the District's financial position.

### **QZAB No. 2 –High School Bond**

The District applied for the QZAB Program again in 2016, this time to request funds for renovations at the high school. In its application, the District indicated that it would set up a STEM Academy at the high school. NEF once again pledged the required 10% in-kind contribution in the form of software licenses referred to as course package IDs. The District was approved for a \$6.8 million QZAB. As shown in Table 4, NEF's minimum in-kind contribution should have been valued at \$680,000 in order to comply with QZAB requirements. The match letter also indicated that NEF would continue donating the annual course IDs for five years for a total in-kind contribution of 50% of the QZAB application amount.

**Table 4**

Lehigh Area School District 2016 QZAB NEF <u>Pledged</u> In-kind Contribution	
<b>Bond Proceeds</b>	\$ 6,800,000
<b>NEF 10% In-Kind Match</b>	\$ 680,000
<b><i>NEF In-kind Contribution:</i></b>	
<b>Cost per License</b>	\$70
<b># of Licenses pledged</b>	9,714
<b>Total annual value of pledge</b>	\$ 680,000
<b>Total value over 5-years</b>	\$ 3,400,000

When we questioned District officials about how many course IDs NEF donated for the high school STEM program, we were informed that as of February 2020, NEF **did not** donate any course IDs for the high school. District officials explained that after receiving the QZAB funds and renovating the high school to accommodate a STEM Academy, the District made a decision to use a different software package for the high school STEM program.

Since NEF's 10% in-kind contribution was for *SuccessMaker* and/or *GradPoint* software licenses, and the District opted to use a different software package, NEF agreed to pay 50% of the cost for the new software

licenses as its in-kind donation. The District purchased software from *Creative Learning Systems* at a cost of \$175,000 and NEF subsequently reimbursed the District \$87,500.

In addition, although NEF had agreed to continue its in-kind donation annually for five years, that did not happen. According to the NEF official we interviewed, NEF's in-kind contribution related to the second QZAB was the \$87,500 reimbursement for the software licenses that the District purchased and another \$21,600 paid to the District for an evaluation of the SmartLab that the District implemented at the high school. Therefore, the total value of NEF's in-kind contribution to the District thus far is \$109,100—far less than the required 10% in-kind contribution of \$680,000 and the five year pledged commitment of \$3.4 million.

#### Separate Agreement to assist with STEM Academy

Just as it did with the STEM program in the elementary and middle schools, the District signed a “Solution Site License” Agreement with NEF to support the STEM program at the high school. The cost to the District for this Agreement was 20% of the bond proceeds, or \$1,360,000. This Agreement, signed by the Superintendent and former Business Manager in July 2016, was similar to the 2014 Agreement previously discussed with all the exact same types of payments and services.

Our review of available records, as well as interviews with an NEF official and numerous District employees, disclosed that NEF did not provide the District with the deliverables outlined in the second Agreement. Specifically, NEF did not provide the stipends, rewards, mentors, tech support, etc. as stipulated in the second Agreement. Therefore, the District paid NEF \$1.36 million and did not receive anything in return. The NEF official we interviewed in February 2020 acknowledged that NEF “owes” the District payments and services and stated that the District only has approximately 1.5 years (i.e., until the end of the 2020-21 school year) remaining in the term of the Agreement to collect on those services.

In summary, in regard to the second QZAB, it appears that not only did the District not receive the full amount of in-kind contributions pledged by NEF, it also did not receive any payments and services for the \$1.36 million it paid NEF.

#### No Board Approval and No Contract Monitoring

We reviewed the board meeting minutes and found that the QZAB application packets were presented to the Board, but the Agreements with NEF were not included in the QZAB application packets. We found no evidence that the Agreements were presented to the Board separately, as a stand-alone contract or transaction that would have required the Board's review and approval. Therefore, these Agreements were never explicitly approved by the full Board, which is in noncompliance with the PSC,

which clearly requires the “affirmative vote of a majority of all the members of the board of school directors...duly recorded, showing how each member voted” for the creation of any District indebtedness and entering into contracts of any kind exceeding \$100.<sup>30</sup>

We also found that upon issuance of the bonds, the District wired NEF the payment of \$1.7 million for the first Agreement in December 2014 and \$1.36 million for the second Agreement in July 2017. Due to the significant amount of funds that were wired, we reviewed the board meeting minutes to determine if the Board approved the wire transfers to NEF. The former Board President and the former Business Manager signed the wire transfer form; however, we found that the payment itself was not explicitly approved by the Board. Instead, we found that the payments were listed with all the other regular checks/payments for the month. The December 2014 wire transfer was listed on the payment schedule for Board approval at the January 26, 2015 meeting. And the July 2017 wire transfer was presented for Board approval at the August 28, 2017 meeting. It appears that no one on the Board questioned the detailed transaction list which showed the large wire transfer payments to NEF.

In addition to not obtaining Board approval for the actual Agreements, the Agreements were not monitored to ensure that the District received all the goods and services for which it paid. As previously discussed, with regard to the first Agreement, the District did receive funds from NEF for stipends and motivational rewards, and it received mentoring services as well as program evaluation services, all related to the STEM Academy in the middle and elementary schools. However, because the District failed to implement monitoring procedures over the first Agreement, it could not be assured that it received all of the services that cost the District \$1.7 million.

The lack of monitoring procedures also resulted in the District failing to ensure that it received the deliverables for the second Agreement related to the high school STEM Academy. The District was unaware that it did not receive any of the services that it paid more than \$1.36 million for until we brought it to their attention. Further, the District was unaware that NEF had not made in-kind donations equal to 10% of the bond proceeds.

At this juncture, the District has two options to consider. One is to immediately contact NEF to request a refund of the \$1.36 million it paid for services it never received. The other option is that the District should work with NEF to immediately start obtaining the payments and services outlined in the second Agreement since it only has until the end of the 2020-21 school year to collect on these deliverables.

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<sup>30</sup> See 24 P.S. § 5-508.



## Conclusion

The District and its Board failed to perform proper due diligence when it issued the QZAB bonds and signed the Agreements with NEF. By not ensuring the full Board's awareness of the intricacies of the Agreements and related transactions through communication with the Board, coupled with the failure to obtain a direct affirmative vote of a majority of all the board members as required by the PSC, the District failed to be accountable and transparent to its taxpayers with regard to expenditures totaling more than three million dollars.

Furthermore, the District failed to implement adequate monitoring procedures that could have ensured that the District received all the payments and services that it paid for. We found that the lack of monitoring was due in part to District officials misunderstanding of the partnership with NEF, which they believed was at "no cost" to the District. Information posted on NEF's websites may have further complicated the District officials' understanding of the partnership. For example, we found a press releases on NEF's website indicating that NEF awarded Lehighton a \$4.2 million grant.<sup>31</sup> When we questioned the NEF official about this supposed grant, he indicated that "grant" was not the correct terminology. The supposed "grant" was actually the pledged in-kind contribution related to the first QZAB, or \$844,900 each year for five years totaling \$4,224,500.

District officials and the Board must do more to ensure that they fully understand all agreements that they execute with any external entity. Further, all non-routine agreements should be reviewed for form and legality by the District's solicitor, and the Board must explicitly approve any agreements or contracts as required by the PSC, especially those that cost the District millions of dollars.

## Recommendations

The *Lehighton Area School District* should:

1. Immediately contact NEF and request a refund of the \$1.36 million it paid to NEF for payments and services it never received **OR** work out an arrangement to immediately begin receiving the deliverables outlined in the executed Agreement.
2. Ensure that all contracts and agreements are reviewed and approved by the full Board as required by the Public School Code.
3. Ensure that the District solicitor reviews all non-routine contracts and agreements prior to submission to the Board for approval.

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<sup>31</sup> <https://www.qzab.org/nef-cyberlearning-awards-stem-grant-to-lehighton-area-school-district/> Accessed 9/2/2020

4. Implement contract monitoring procedures to ensure that the vendors provide all the deliverables in accordance with contract terms and conditions.

### Management Response

District management provided the following response:

The District acknowledges and accepts the finding related to the National Education Foundation (“NEF”). However, the District Administration and the Board stipulate they failed to receive accurate information related to the cost of the NEF contract from NEF or the District’s former Business Administrator. The presentation and progression of the NEF relationship included the following deficiencies:

- Guidelines regarding the agreement as presented by NEF and the former Business Administrator indicated to the District Administration and the Board that the agreement was at no cost to the District.
- The former Business Administrator presented the contract to the Superintendent for signature as part of the QZAB process. While the Superintendent acknowledges he signed the contract without clearly understanding the contract, he did that as he relied on NEF’s and the former Business Administrator’s statements that the cost of the contract was zero. The Superintendent also trusted that the former Business Administrator had reviewed the contract.
- The Superintendent and Board’s belief that the NEF agreement was at zero cost to the District was supported by the following:

- NEF/QZAB website<sup>32</sup> which contains the following language:

*NEF offers **QZABS** for Sustainability/energy projects in your School District. You receive World-class **STEM** Academy and sustainable energy program at **NO COST** to You.*

- Times News Article<sup>33</sup> with the following headline:

*NEF Cyberlearning Awards STEM Grant to Lehighton Area School District - the \$4.2 million Grant will prepare students better for College and Workforce.*

- The Superintendent’s first notification of a payment request from NEF was an email dated July 10, 2019.
  - The Superintendent was subsequently provided an email exchange between the former Business Administrator and

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<sup>32</sup> <https://www.qzab.org/>

<sup>33</sup> <https://www.tnonline.com/20150626/students-thrive-in-stem-program/>

NEF, dated Saturday, February 23, 2019, whereby the former Business Administrator indicated to NEF that the invoice payment would be made out of the 2019-20 Budget.

- The current Business Administrator, upon review of the invoice and discussions with District Administration, found no evidence that the invoice should be paid and as such no payment was made to NEF.
- Once the Superintendent received knowledge that payments were previously made to NEF, the Superintendent consulted with District counsel, District counsel sent a letter to NEF regarding request for items/services received from NEF.
  - No written response has yet been received from NEF
- As for the payments made to NEF, the District Administration and Board, as a whole, were not notified timely of the payments made and as such had no knowledge that payments were made to NEF. According to the Assistant Business Administrator and verified with supporting documentation:
  - The wire transfers sent to NEF were not approved by the Superintendent, the wires were authorized by the former Business Administrator and former Board President.
  - The wire transfers were also not presented timely to the School Board for approval as part of the monthly bill payment approvals, the wire transfers were not submitted as part of the monthly bill payment approvals until the month after the wire transfers had already been initiated and sent to NEF.
    - The current Business Administrator has since changed wire procedures, the only amounts that are expended via wire transfer are debt service payments. Wire transfers are approved by the School Board President and/or Superintendent and evidenced by supporting documentation (i.e. Debt Service Invoices and/or Debt Amortization schedules) prior to approval.
- The Lehigh Area School District has attempted to recover costs from NEF; these attempts are ongoing.

The Lehigh Area School District concurs with and going forward will follow the state audit recommendations.

### **Auditor Conclusion**

We acknowledge Management's description of events surrounding the payments to NEF. We also note that while the District had its solicitor send a letter to NEF to obtain detailed information related to what goods and services NEF provided to the District in exchange for the more than \$3 million it paid to NEF, the District had not received a written response from NEF as of August 5, 2020. In its response, the District noted that it has attempted to recover costs from NEF and these attempts are ongoing. We reiterate our recommendation that the District take the necessary actions to recoup the **\$1.36 million** it paid to NEF related to the agreement

for which NEF did not provide the deliverables, including services, stipends, rewards, and other expected benefits.

While the District did not specifically respond to all of our recommendations, management did state that they agreed with our recommendations and intend to implement them going forward. We will evaluate the effectiveness of the District's corrective actions during our next audit.

## **Status of Prior Audit Findings and Observations**

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

## Appendix A: Audit Scope, Objectives, and Methodology

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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 (PDE), and other concerned entities.

Our audit, conducted under authority of Sections 402 and 403 of The Fiscal Code,<sup>34</sup> is not a substitute for the local annual financial 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. Those 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.

### Scope

Overall, our audit covered the period July 1, 2014 through June 30, 2018 with updates to the financial data through June 30, 2019. In addition, the scope of each individual audit objective is detailed on the next page.

The Lehigh Area School District's (District) 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, and administrative procedures (relevant requirements).<sup>35</sup> In conducting our audit, we obtained an understanding of the District's internal controls, including any information technology controls, if applicable, that we considered 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.

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<sup>34</sup> 72 P.S. §§ 402 and 403.

<sup>35</sup> 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; and compliance with certain relevant state laws, regulations, contracts, and administrative procedures.

## Objectives/Methodology

In order to properly plan our audit and to guide us in selecting objectives, we reviewed pertinent laws and regulations, board meeting minutes, annual financial reports, annual budgets, new or amended policies and procedures, and the independent audit report of the District's basic financial statements for the fiscal years July 1, 2014 through June 30, 2018. We also determined if the District had key personnel or software vendor changes since the prior audit.

Performance audits draw conclusions based on an evaluation of sufficient, appropriate evidence. Evidence is measured against criteria, such as laws, regulations, third-party studies, and best business practices. Our audit focused on the District's effectiveness and/or compliance in the areas detailed below. As we conducted our audit procedures, we sought to determine answers to the following questions, which served as our audit objectives:

### **Financial Stability**

- Based on an assessment of financial indicators, was the District in a declining financial position, and did it comply with all statutes prohibiting deficit fund balances and the over expending of the District's budget?
  - ✓ To address this objective, we reviewed the District's annual financial reports, General Fund budgets, and independent auditor's reports for the 2014-15 through 2018-19 fiscal years. The financial and statistical data was used to calculate the District's General Fund balance, operating position, charter school costs, debt ratio, and current ratio. These financial indicators were deemed appropriate for assessing the District's financial stability. The financial indicators are based on best business practices established by several agencies, including Pennsylvania Association of School Business Officials, the Colorado Office of the State Auditor, and the National Forum on Education Statistics. In addition, we reviewed board policies, board meeting minutes, and interviewed District personnel.

Conclusion: We found that the District experienced a significant decline in its financial position. In addition, we identified a significant "prepaid expense" balance that led us to expand our objective to review the District's contracts with National Education Foundation (NEF) (see below). The results of our procedures for this objective can be found in Finding No. 1 beginning on page 7 of this report.

- Did the District ensure that its partnership/contract with NEF and CyberLearning, as part of the Qualified Zone Academy Bonds (QZAB) issuances, were properly reviewed, approved, and monitored?
  - ✓ To address this objective, we reviewed the District applications for 2014 and 2016 QZAB and the District's partnership agreements with NEF to set up a Science, Technology, Engineering, and Math (STEM) academies in the elementary, middle and high schools. The bonds, agreements, and supporting documentation related to the STEM programs were reviewed for proper approval, execution, and monitoring to determine if the District received the goods and services contained within the agreements. We also reviewed board meeting minutes and accompanying board reports. In addition, we interviewed an NEF official, PDE personnel, the current and former Board President, the current and former Business Managers, and the Superintendent.

Conclusion: We found that the District's contracts with NEF were not properly reviewed, approved, and monitored. The results of our procedures for this objective can be found in Finding No. 2 beginning on page 21 of this report.

### **Transportation Operations**

- Did the District ensure compliance with applicable laws and regulations governing transportation operations, and did the District receive the correct transportation reimbursement from the Commonwealth?<sup>36</sup>
  - ✓ To address this objective, we interviewed District personnel to gain an understanding of the District's procedures for transportation reimbursements, transportation personnel job responsibilities, and job training. We randomly selected 8 of the 25 vehicles used to transport District students during the 2017-18 school year<sup>37</sup> to determine if transportation data was accurately reported to PDE.<sup>38</sup> We obtained the mileage data, student counts, and the contractor monthly invoices from August 2017 through June 2018. We verified the accuracy of the data on the District's average calculation worksheets, the PDE-1049, and the PDE-2518 reports submitted to PDE for the 2017-18 school year. In addition, we also reviewed the transportation contract for the main contractor that was in effect for the audit period to determine if the contract contained language regarding the documentation the contractor needed to provide to the District for reporting of data to PDE.
  - ✓ We also reviewed all 18 nonpublic students reported to PDE as transported by the District during the 2017-18 school year. We reviewed student lists and individual requests for transportation to ensure that these nonpublic students were accurately reported to PDE and the District received the correct amount of supplemental transportation reimbursement.

Conclusion: The results of our procedures for this objective did not disclose any reportable issues.

### **Right to Know**

- Did the District comply with the relevant requirements of its Right-to-Know Board Policy?
  - ✓ To address this objective, we reviewed board policies and the District's Right-to-Know request log from November 2017 through September 2019. We analyzed the date the requests were received and dates of the District's response to determine if the District addressed the requests in a timely manner. In addition, we reviewed the Right-to-Know information on the District's public website to determine if the District posted all required information.

Conclusion: The results of our procedures for this objective did not disclose any reportable issues.

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<sup>36</sup> See 24 P.S. §§ 13-1301, 13-1302, 13-1305, 13-1306; 22 Pa. Code Chapter 11.

<sup>37</sup> While representative selection is a required factor of audit sampling methodologies, audit sample methodology was not applied to achieve this test objective; accordingly, the results of this audit procedure are not, and should not be, projected to the population.

<sup>38</sup> Ibid.



### **Administrator Separations**

- Did the District ensure that all individually contracted employees who separated employment from the District were compensated in accordance with their contract? Also, did the District comply with the Public School Code<sup>39</sup> and the Public School Employees' Retirement System (PSERS) guidelines when calculating and disbursing final salaries and leave payouts for these contracted employees?
  - ✓ To address this objective, we reviewed board meeting minutes, board policies, the employee contract, leave records, and payroll records for the only administrator who separated employment from the District during the period July 1, 2014 through September 13, 2019. We determined if the final salary and leave payout was in accordance with the individual employee contract. We also determined if the leave payout complied with the PSERS guidelines.

Conclusion: The results of our procedures for this objective did not disclose any reportable issues.

### **Bus Driver Requirements**

- Did the District ensure that bus drivers transporting District students had the required driver's license, physical exam, training, background checks, and clearances<sup>40</sup> as outlined in applicable laws?<sup>41</sup> Also, did the District have written policies and procedures governing the hiring of new bus drivers that would, when followed, provide reasonable assurance of compliance with applicable laws?
  - ✓ To address this objective, we randomly selected 10 of the 49 bus drivers transporting District students as of September 10, 2019.<sup>42</sup> We reviewed documentation to ensure the District complied with the requirements for bus drivers. We also determined if the District had written policies and procedures governing the hiring of bus drivers and if those procedures, when followed, ensure compliance with bus driver hiring requirements.

Conclusion: The results of our procedures for this objective did not disclose any reportable issues.

### **Safe Schools**

- Did the District comply with requirements in the Public School Code and the Emergency Management Code related to emergency management plans, anti-bullying policies, and memorandums of understanding with local law enforcement?<sup>43</sup> Also, did the District follow best practices related to physical building security and providing a safe school environment?<sup>44</sup>
  - ✓ To address this objective, we reviewed a variety of documentation including, safety plans, evidence of physical building security assessments and school climate surveys, training

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<sup>39</sup> 24 P.S. § 10-1073(e) (2) (v).

<sup>40</sup> Auditors reviewed the required state, federal and child abuse background clearances that the District obtained from the most reliable sources available, including the FBI, the Pennsylvania State Police and the Department of Human Services. However, due to the sensitive and confidential nature of this information, we were unable to assess the reliability or completeness of these third-party databases.

<sup>41</sup> 24 P.S. § 1-111, 23 Pa.C.S. § 6344(a.1), 24 P.S. § 2070.1a *et seq.*, 75 Pa.C.S. §§ 1508.1 and 1509, and 22 *Pa. Code Chapter 8*.

<sup>42</sup> While representative selection is a required factor of audit sampling methodologies, audit sample methodology was not applied to achieve this test objective; accordingly, the results of this audit procedure are not, and should not be, projected to the population.

<sup>43</sup> 24 P.S. § 13-1301-A *et seq.*, 35 Pa.C.S. § 7701.

<sup>44</sup> 24 P.S. § 13-1301-A *et seq.*

schedules, anti-bullying policies, safety committee meeting minutes, and memorandums of understanding with local law enforcement.

Conclusion: Due to the sensitive nature of school safety, the results of our review of this objective area are not described in our audit report, but they were shared with District officials, PDE's Office of Safe Schools, and other appropriate law enforcement agencies deemed necessary.<sup>45</sup>

- Did the District comply with the fire and security drill requirements of Section 1517 of the Public School Code?<sup>46</sup> Also, did the District accurately report the dates of drills to PDE and maintain supporting documentation to evidence the drills conducted and reported to PDE?
  - ✓ To address this objective, we obtained and reviewed the fire and security drill records for the 2018-19 school year. We determined if a security drill was held within the first 90 days of the school year for each building in the District and if monthly fire drills were conducted in accordance with requirements. We also obtained the *Accuracy Certification Statement* that the District filed with PDE and compared the fire and security drill dates reported to PDE to the supporting documentation.

Conclusion: The results of our procedures for this portion of the objective did not disclose any reportable issues.

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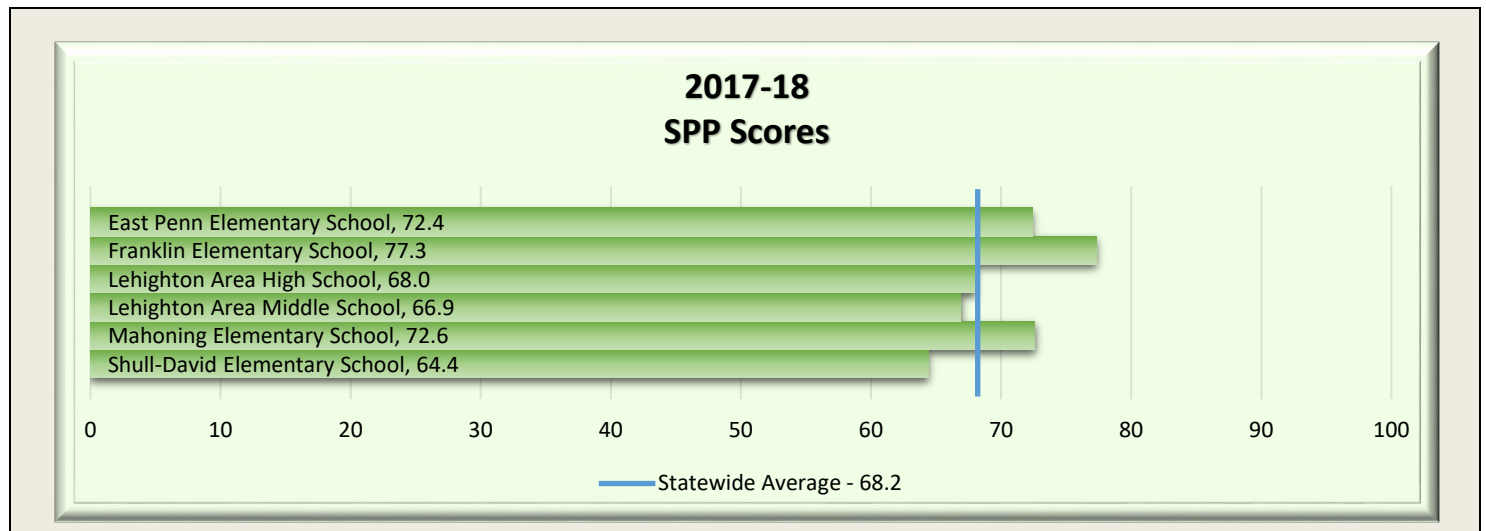
<sup>45</sup> Other law enforcement agencies include the Pennsylvania State Police, the Attorney General's Office, and local law enforcement with jurisdiction over the District's school buildings.

<sup>46</sup> 24 P.S. § 15-1517.

## Appendix B: Academic Detail by Building

Benchmarks noted in the following graphs represent the statewide average of all public school buildings in the Commonwealth that received a score in the category and year noted.<sup>47</sup> Please note that if one of the District's schools did not receive a score in a particular category and year presented below, the school will not be listed in the corresponding graph.<sup>48</sup>

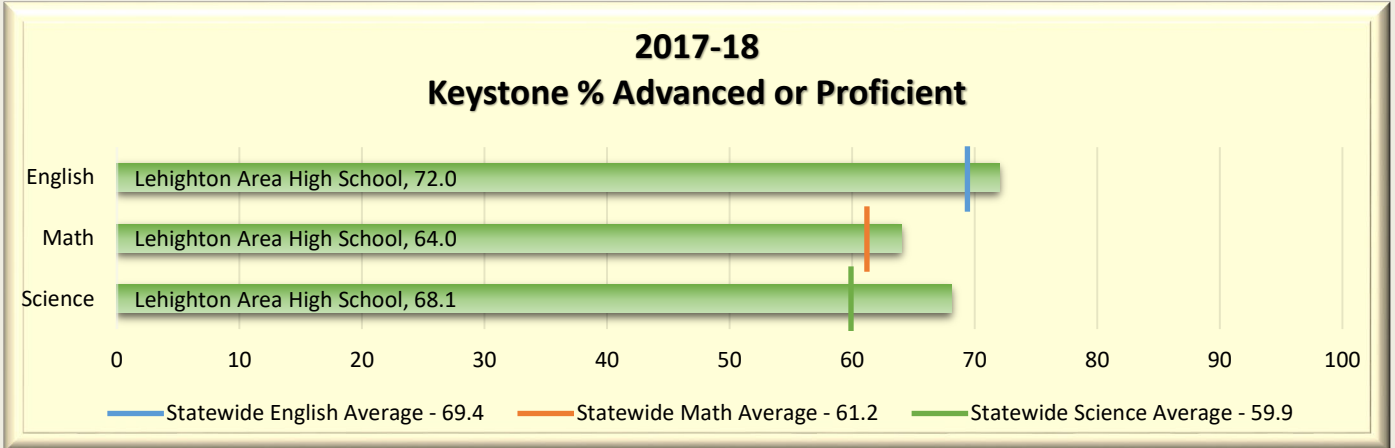
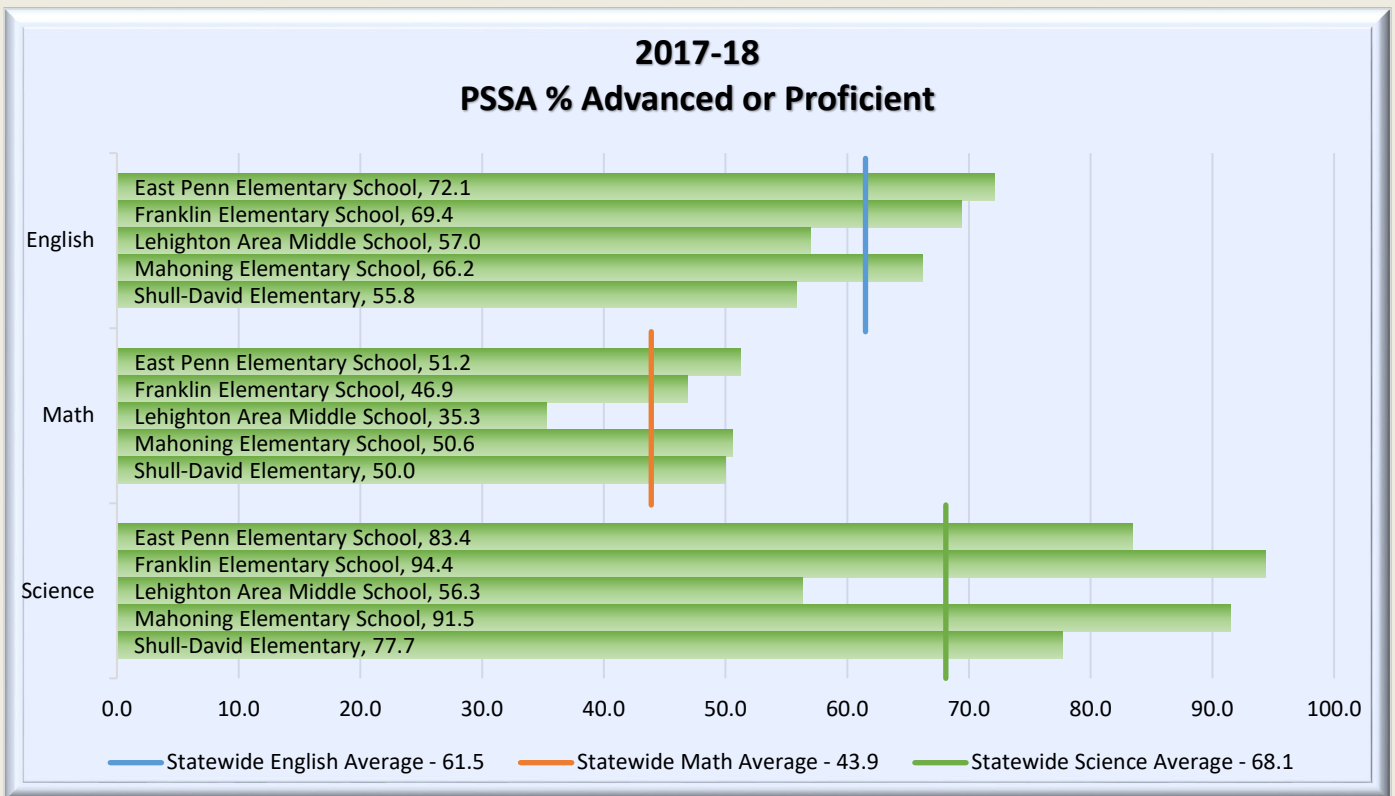
### Academic Data School Scores Compared to Statewide Averages



<sup>47</sup> Statewide averages were calculated by our Department based on individual school building scores for all public schools in the Commonwealth, including district schools, charters schools, and cyber charter schools.

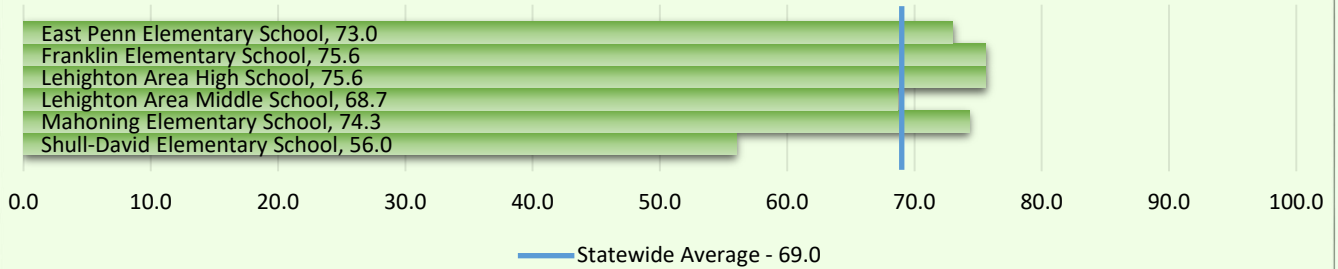
<sup>48</sup> PDE's data does not provide any further information regarding the reason a score was not published for a specific school. However, readers can refer to PDE's website for general information regarding the issuance of academic scores.

**Academic Data**  
**School Scores Compared to Statewide Averages (continued)**

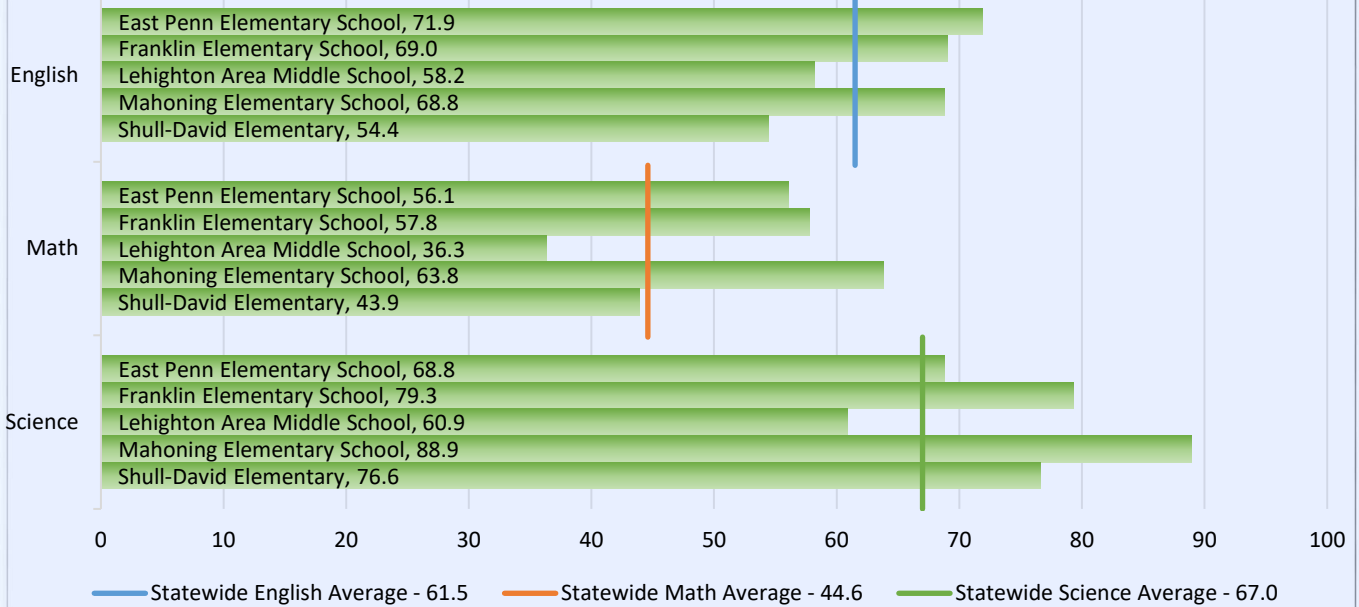


**Academic Data**  
**School Scores Compared to Statewide Averages (continued)**

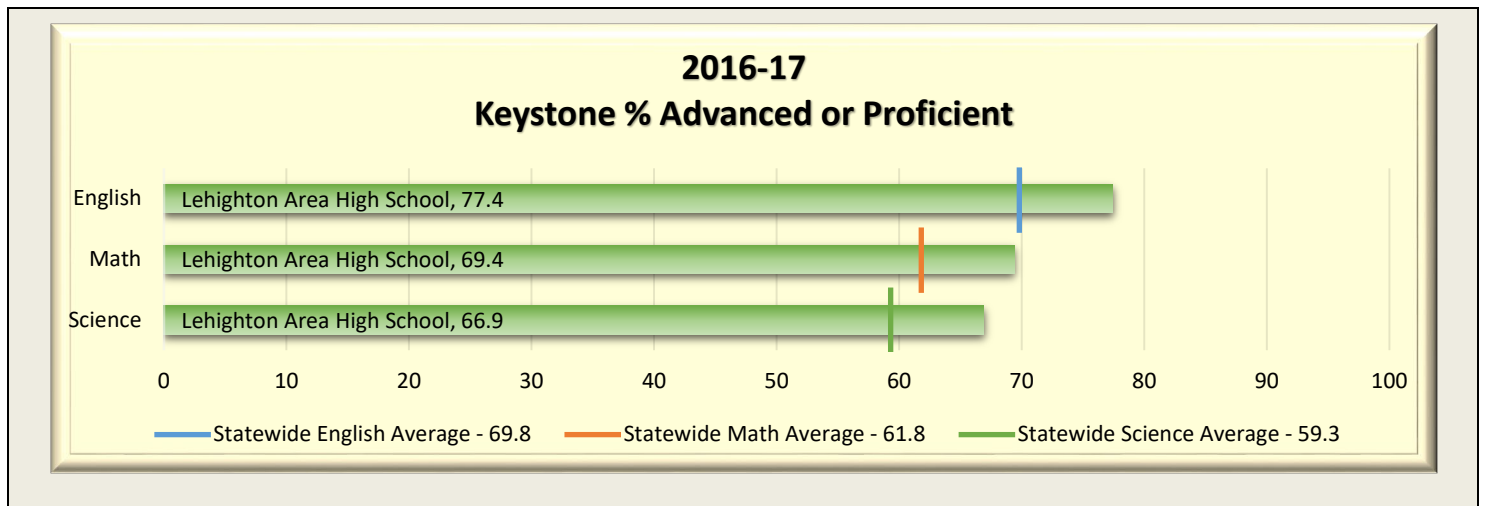
**2016-17  
SPP Scores**



**2016-17  
PSSA % Advanced or Proficient**

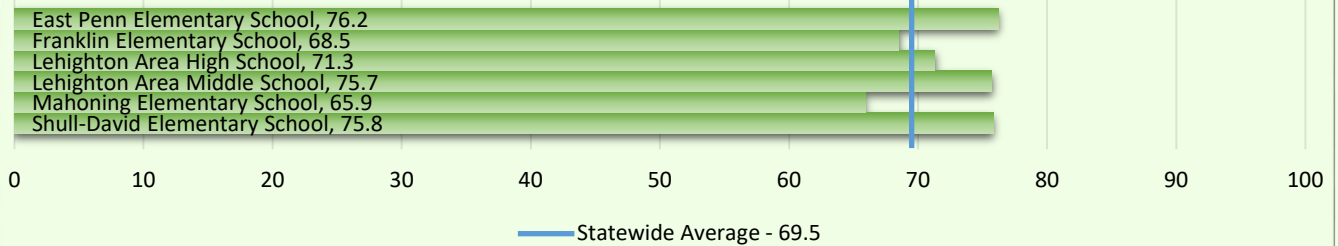


**Academic Data**  
**School Scores Compared to Statewide Averages (continued)**

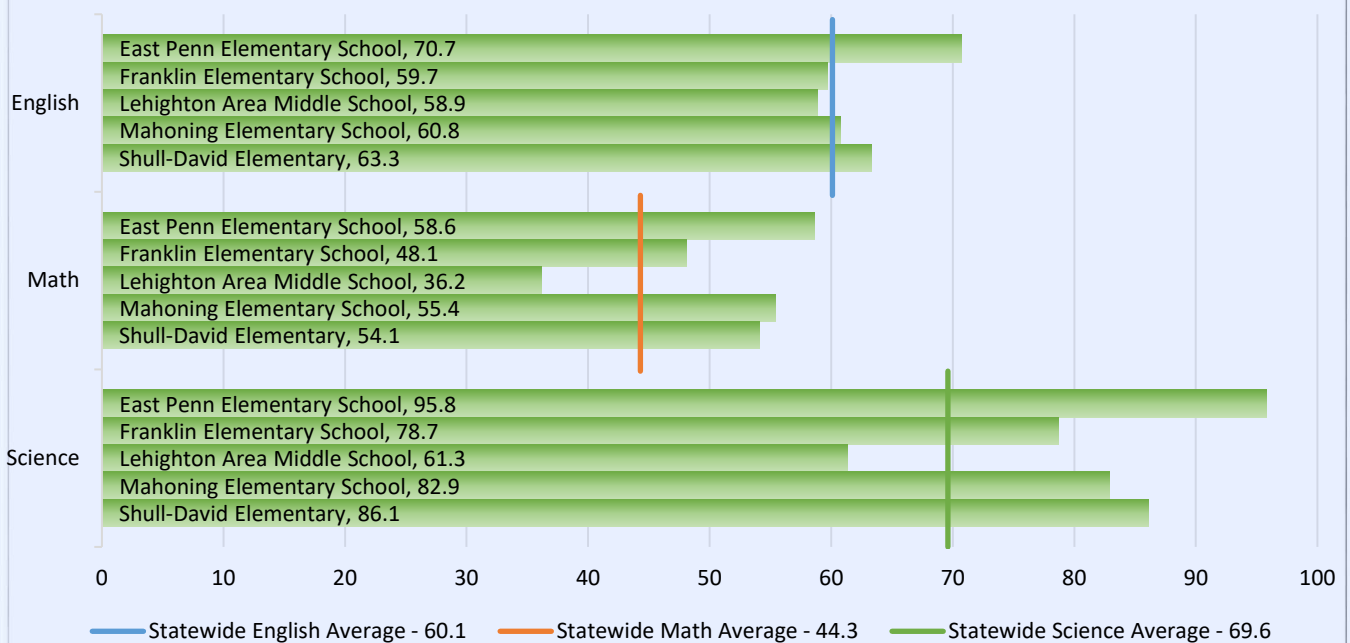


**Academic Data**  
**School Scores Compared to Statewide Averages (continued)**

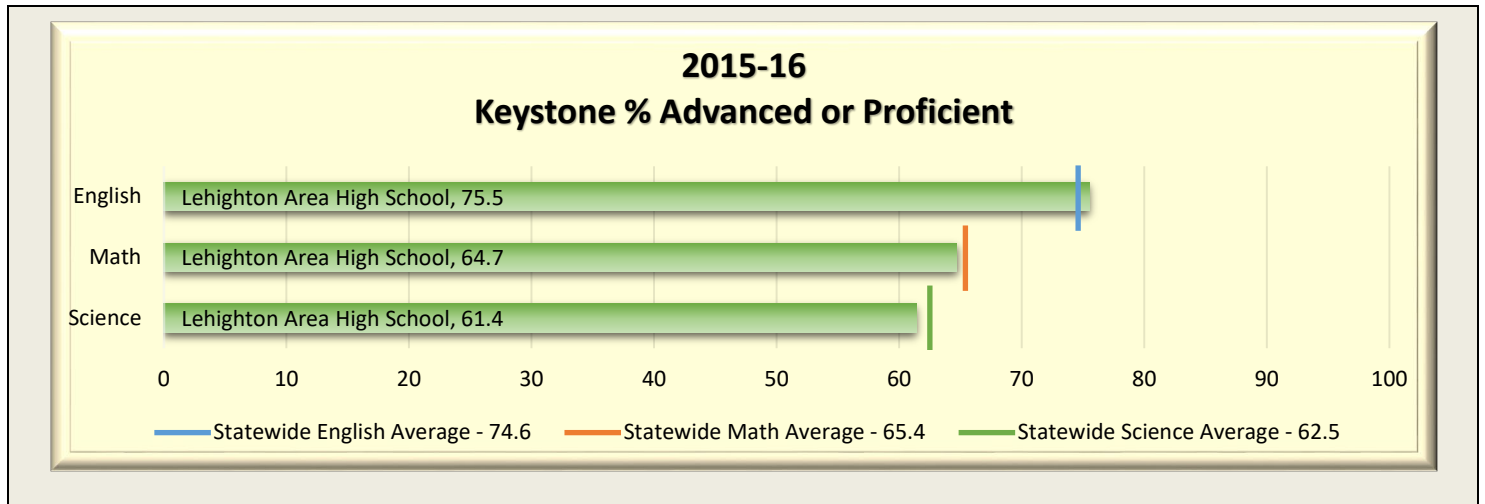
**2015-16  
SPP Scores**



**2015-16  
PSSA % Advanced or Proficient**



**Academic Data**  
**School Scores Compared to Statewide Averages (continued)**





## Distribution List

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This report was initially distributed to the Superintendent of the District, the Board of School Directors, and the following stakeholders:

**The Honorable Tom W. Wolf**

Governor  
Commonwealth of Pennsylvania  
Harrisburg, PA 17120

**The Honorable Pedro A. Rivera**

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**The Honorable Joe Torsella**

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