

PEN ARGYL AREA SCHOOL DISTRICT
NORTHAMPTON COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

APRIL 2012

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

Mr. Bryan Scott, Board President
Pen Argyl Area School District
1620 Teels Road
Pen Argyl, Pennsylvania 18072

Dear Governor Corbett and Mr. Scott:

We conducted a performance audit of the Pen Argyl Area School District (PAASD) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period September 25, 2009 through July 15, 2011, except as otherwise indicated in the report. Additionally, compliance specific to state subsidy and reimbursements was determined for the school years ended June 30, 2010 and June 30, 2009. Our audit was conducted pursuant to 72 P.S. § 403 and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found that the PAASD complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures. However, we identified one matter unrelated to compliance that is reported as an observation. A summary of these results is presented in the Executive Summary section of the audit report.

Our audit observation and recommendations have been discussed with PAASD's management and their response is included in the audit report. We believe the implementation of our recommendations will improve PAASD's operations and facilitate compliance with legal and administrative requirements. We appreciate the PAASD's cooperation during the conduct of the audit.

Sincerely,

/s/

JACK WAGNER
Auditor General

April 25, 2012

cc: **PEN ARGYL AREA SCHOOL DISTRICT** Board Members



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Executive Summary

Audit Work

The Pennsylvania Department of the Auditor General conducted a performance audit of the Pen Argyl Area School District (PAASD). Our audit sought to answer certain questions regarding the District's compliance with applicable state laws, contracts, grant requirements, and administrative procedures; and to determine the status of corrective action taken by the PAASD in response to our prior audit recommendations.

Our audit scope covered the period September 25, 2009 through July 15, 2011, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidy and reimbursements was determined for school years 2009-10 and 2008-09.

District Background

The PAASD encompasses approximately 129 square miles. According to 2011 local census data, it serves a resident population of 11,970. According to District officials, in school year 2009-10 the PAASD provided basic educational services to 1,849 pupils through the employment of 141 teachers, 50 full-time and part-time support personnel, and 14 administrators. Lastly, the PAASD received more than \$7.9 million in state funding in school year 2009-10.

Audit Conclusion and Results

Our audit found that the PAASD complied, in all significant respects, with applicable state laws, contracts, grant requirements, and administrative procedures; however, as noted below, we identified one matter unrelated to compliance that is reported as an observation.

Observation: Noncompliance with the Public School Code Due to the Purchase of Certain Split-Dollar Life Insurance Policies.

Our audit of the PAASD investments and meetings of the school board found that the board of directors of the PAASD voted to authorize the PAASD to purchase "split-dollar" life insurance policies for the PAASD's administrators. (see page 6).

Status of Prior Audit Findings and Observations.

With regard to the status of our prior audit recommendations to the PAASD from an audit we conducted of the 2007-08 and 2006-07 school years, we found the PAASD had taken appropriate corrective action in implementing our recommendations pertaining to the lack of memorandums of understanding. We also found the PAASD had taken appropriate corrective action in implementing four of our ten recommendations pertaining to unmonitored vendor system access and logical access control weaknesses (see page 8).



Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

School performance audits allow the Department of the Auditor General to determine whether state funds, including school subsidies, are being used according to the purposes and guidelines that govern the use of those funds. Additionally, our audits examine the appropriateness of certain administrative and operational practices at each Local Education Agency (LEA). The results of these audits are shared with LEA management, the Governor, the PA Department of Education, and other concerned entities.

Our audit, conducted under authority of 72 P.S. § 403, is not a substitute for the local annual audit required by the Public School Code of 1949, as amended. We conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit covered the period September 25, 2009 through July 15, 2011, except for the verification of professional employee certification which was performed for the period July 1, 2010 to April 26, 2011.

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

While all districts have the same school years, some have different fiscal years. Therefore, for the purposes of our audit work and to be consistent with Department of Education (DE) reporting guidelines, we use the term school year rather than fiscal year throughout this report. A school year covers the period July 1 to June 30.

Objectives

What is the difference between a finding and an observation?

Our performance audits may contain findings and/or observations related to our audit objectives. Findings describe noncompliance with a statute, regulation, policy, contract, grant requirement, or administrative procedure. Observations are reported when we believe corrective action should be taken to remedy a potential problem not rising to the level of noncompliance with specific criteria.

Performance audits draw conclusions based on an evaluation of sufficient, appropriate evidence. Evidence is measured against criteria, such as laws and defined business practices. Our audit focused on assessing the PAASD's compliance with applicable state laws, contracts, grant requirements, and administrative procedures. However, as we conducted our audit procedures, we sought to determine answers to the following questions, which serve as our audit objectives:

- ✓ Were professional employees certified for the positions they held?
- ✓ In areas where the District receives state subsidy and reimbursements based on payroll (e.g. social security and retirement), did it follow applicable laws and procedures?

- ✓ In areas where the District receives transportation subsidies, is the District and any contracted vendors, in compliance with applicable state laws and procedures?
- ✓ Did the District, and any contracted vendors, ensure that its current bus drivers are properly qualified, and does it have written policies and procedures governing the hiring of new bus drivers?
- ✓ Are there any declining fund balances that may impose risk to the District's fiscal viability?
- ✓ Did the District pursue a contract buy-out with an administrator and if so, what was the total cost of the buy-out, what were the reasons for the termination/settlement, and does the current employment contract(s) contain adequate termination provisions?
- ✓ Were there any other areas of concern reported by local auditors, citizens, or other interested parties?
- ✓ Is the District taking appropriate steps to ensure school safety?
- ✓ Did the District use an outside vendor to maintain its membership data and if so, are there internal controls in place related to vendor access?
- ✓ Were votes made by the District's Board members free from apparent conflicts of interest?
- ✓ Did the District take appropriate corrective action to address recommendations made in our prior audits?

Methodology

Government Auditing Standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our observation and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observation and conclusions based on our audit objectives.

What are internal controls?

Internal controls are processes designed by management to provide reasonable assurance of achieving objectives in areas such as:

- Effectiveness and efficiency of operations;
- Relevance and reliability of operational and financial information;
- Compliance with applicable laws, contracts, grant requirements and administrative procedures.

PAASD management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the District is in compliance with applicable laws, contracts, grant requirements, and administrative procedures. Within the context of our audit objectives, we obtained an understanding of internal controls and assessed whether those controls were properly designed and implemented.

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

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

Our audit examined the following:

- Records pertaining to bus driver qualifications, professional employee certification, state ethics compliance, and financial stability.
- Items such as Board meeting minutes and reimbursement applications.

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

Lastly, to determine the status of our audit recommendations made in a prior audit report released on January 29, 2010, we reviewed the PAASD's response to DE dated August 18, 2010. We then performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Observation →

Public School Code Section relevant to the finding:

Section 4-440 sets both general and specific limits on the investment of school district funds. First, school district funds must be invested “consistent with sound business practice.” Second, such funds may be invested only in the five categories of authorized investments listed in Section 4-440.1(c).

Three of the categories of investments authorized by Section 4-440.1(c) are governmental obligations: U.S. Treasury Bills; short-term obligations of the U.S. Government or its agencies or instrumentalities; and obligations of the United States of America, the Commonwealth of Pennsylvania, or any political subdivision of the Commonwealth of Pennsylvania, or any of their agencies or instrumentalities, backed by their full faith and credit. The fourth category of authorized investments consists of deposits in savings accounts and certain other accounts in federally insured institutions, subject to collateralization requirements for funds in excess of insurance limits. The fifth category of authorized investments consists of certain mutual funds which are themselves invested only in (1) the above authorized investments, and/or (2) repurchase agreements fully collateralized by the above authorized investments.

Noncompliance with the Public School Code Due to the Purchase of Certain Split-Dollar Life Insurance Policies

Our audit of the Pen Argyl Area School District’s (PAASD) investments and meetings minutes of the school board found that the board of directors of the PAASD voted to authorize the District to purchase “split-dollar” life insurance policies for the District’s administrators. A split-dollar life insurance policy is an insurance policy purchased and owned by an employer to provide coverage for an insured employee, the death benefit of which is ultimately split between the employer and the employee’s named beneficiary. The beneficiary receives a specified amount agreed to between the employee and the employer, with any balance paid to the employer. The employer pays the annual premiums. The majority of those funds are placed in an investment account, and the remainder is for the actual cost of the insurance.

The purpose of the investment account is to generate proceeds to cover the insurance company’s fees and administrative costs during the life of the policy and return the amount of the premiums to the employer upon the employee’s death. The 2010 year-end data provided by the insurance company shows that they invest in securities and other investments whose value is subject to market fluctuation and investment risk. However, the policies state that there is a “guarantee of principal and investment return.” Therefore, the insurance company data and the policy language are contradictory. Investments subject to market fluctuation and investment risk cannot guarantee principal and investment return.

A split-dollar life insurance policy purchased by a school district and funded in part through the investment of District funds is subject to the investment limitations of Section 4-440.1 of the Public School Code. The District’s funds, through the policies, are invested in stocks, bonds and mortgages. To the extent that the District’s funds are invested in stocks or any other type of investment not listed in Section 4-440.1(c), those investments are not permissible and the District is not complying with Pennsylvania law.

Recommendations

The *Pen Argyl Area School District* should:

Re-evaluate the propriety of the split-dollar life insurance policies with respect to the Public School Code and in particular Section 4-440.1.

Management Response

Management stated the following:

The issue as the District understands it is whether the premiums paid by the District to [the insurance company] will ultimately be available to be returned to the District when a claim is submitted. Although [the insurance company] is unable to show that those premiums, which have been paid by the District, are invested dollar for dollar in accordance with the public school code they have guaranteed the return of the premiums in the event of a death of a participant.

At this point it should be noted that any premiums paid by districts, whether or not it is for split dollar life insurance or term life insurance, are not controlled by the district as it pertains to the investments of those premiums. It is our understanding that no public entity has control over how the premiums paid to an insurance company will be invested. The premiums are invested according to the companies' policy and the health of those companies is overseen by the State Insurance Commission. Therefore, the district disagrees with the observation since it bears no control over how the company invests the premium. The comfort of the case is that [the insurance company] has issued a guaranteed return of the district's premium.

Auditor Conclusion

We have reviewed the District's explanation for disagreeing with our observation. As stated above, the District's funds in the split dollar life insurance policies, are invested in investments which are not authorized by Section 4-440.1 of the Public School Code. We encourage the District to comply with the Public School Code and only invest in allowable investments.

Status of Prior Audit Findings and Observations

Our prior audit of the Pen Argyl Area School District (PAASD) for the school years 2007-08 and 2006-07 resulted in one reported finding and one observation. The finding pertained to the lack of Memorandums of Understanding and the observation pertained to unmonitored vendor system access and logical access control weaknesses. As part of our current audit, we determined the status of corrective action taken by the District to implement our prior recommendations. We analyzed the PAASD Superintendent's written response provided to the Department of Education, performed audit procedures, and questioned District personnel regarding the prior finding and observation. As shown below, we found that the PAASD did implement recommendations related to the lack of Memorandums of Understanding and did implement four of the ten recommendations related to unmonitored vendor system access and logical access control weaknesses.

School Years 2007-08 and 2006-07 Auditor General Performance Audit Report

Finding: **Lack of Memorandums of Understanding**

Finding Summary: Our prior audit of the PAASD's records found that the PAASD did not have signed Memorandums of Understanding (MOU) for three municipalities local police departments available at the time of audit.

Recommendations: Our audit finding recommended that the PAASD should:

1. In consultation with the solicitor, continue to review, update and re-execute the current MOUs between the PAASD and all local law enforcement agencies.
2. Adopt a policy requiring the administration to review and re-execute the MOU every two years.

Current Status: During our current audit procedures we found that the PAASD did implement the recommendations.

Observation: Unmonitored Vendor System Access and Logical Access Control Weaknesses

Observation

Summary:

Our prior audit found that the PAASD uses software purchased from an outside vendor for its critical student accounting applications (membership and attendance). The vendor has remote access into the District's network servers.

Recommendations:

Our audit observation recommended that the PAASD:

1. Ensure that the District's Acceptable Use Policy includes provisions for authentication (password security and syntax requirements).
2. Establish separate information technology policies and procedures for controlling the activities of vendors/consultants and have the vendor sign this policy, or the District should require the vendor to sign the District's Acceptable Use Policy.
3. Maintain documentation to evidence that terminated employees are properly removed from the system in a timely manner.
4. Implement a security policy and system parameter settings to require all users, including the vendor, to change their passwords on a regular basis (i.e., every 30 days). Passwords should be a minimum length of eight characters and include alpha, numeric and special characters. Also, the District should log users off the system after a period of inactivity (i.e., 60 minutes maximum).
5. Require the vendor to assign unique userIDs and passwords to vendor employees authorized to access the District system. Further, the District should obtain a list of vendor employees with access to its data and ensure that changes to the data are made only by authorized vendor representatives.
6. Allow access to only their system when the vendor needs access to make pre-approved changes/updates or requested assistance. This access should be removed when the vendor has completed its work. This procedure would also enable the monitoring of vendor changes.
7. Generate monitoring reports (including firewall logs) of vendor and employee access and activity on their system. Monitoring reports should include the date, time, and reason for access, change(s) made and who made the change(s). The District should review these reports to determine that the access was appropriate and that data was not

improperly altered. The District should also ensure it is maintaining evidence to support this monitoring and review.

8. Establish policies and procedures to analyze the impact of proposed program changes in relation to other business-critical functions.
9. Develop and maintain a list of authorized individuals with access to the hardware (servers) that contains the membership/attendance data.
10. Consider implementing additional environmental controls around the network server sufficient to satisfy the requirements of the manufacturer of the server and to ensure warranty coverage. Specifically, the District should have fire extinguishers in the computer room.

Current Status:

During our current audit procedures, we found that the PAASD did implement recommendations 3, 8, 9, and 10. The PAASD did not implement recommendations 1, 2, 4, 5, 6, and 7. We again recommend that the District implement all of our recommendations. We will review any further corrective action during our next audit.

Distribution List

This report was initially distributed to the superintendent of the school district, the board members, our website address at www.auditorgen.state.pa.us, and the following:

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