

PERFORMANCE AUDIT

Harmony Area School District Clearfield County, Pennsylvania

September 2015



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

Dr. Jill Dillon, Superintendent
Harmony Area School District
5239 Ridge Road
Westover, Pennsylvania 16692

Mr. Jason Sunderland, Board President
Harmony Area School District
5239 Ridge Road
Westover, Pennsylvania 16692

Dear Dr. Dillon and Mr. Sunderland:

We conducted a performance audit of the Harmony Area School District (District) to determine its compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures (relevant requirements). We also evaluated the application of best practices in the area of school safety. Our audit covered the period October 15, 2011 through May 18, 2015, except as otherwise stated in the report. Additionally, compliance specific to state subsidies and reimbursements was determined for the school years ended June 30, 2011 and June 30, 2012. Our audit was conducted pursuant to Section 403 of The Fiscal Code, 72 P.S. § 403, and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found that the District complied, in all significant respects, with relevant requirements, and effectively applied best practices in the area stated above, except as detailed in two findings noted in this report. In addition, we identified one matter unrelated to compliance that is reported as an observation. A summary of the results is presented in the Executive Summary section of the audit report.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale".

Eugene A. DePasquale
Auditor General

September 4, 2015

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

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Executive Summary

Audit Work

The Pennsylvania Department of the Auditor General conducted a performance audit of the 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, grant requirements, and administrative procedures and to determine the status of corrective action taken by the District in response to our prior audit recommendations.

Our audit scope covered the period October 15, 2011 through May 18, 2015, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidies and reimbursements was determined for the 2010-11 and 2011-12 school years.

District Background

The District encompasses approximately 86 square miles. According to 2010 federal census data, it serves a resident population of 2,343. According to District officials, the District provided basic educational services to 361 pupils through the employment of 40 teachers, 23 full-time and part-time support personnel, and 7 administrators during the 2011-12 school year. The District received \$3,927,770 in state funding in the 2011-12 school year.

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, grant requirements, and administrative procedures, except for two compliance related matters reported as findings. In addition, we identified one matter unrelated to compliance that is reported as an observation.

Finding No. 1: District Personnel Failed to Verify the Accuracy of Transportation Data. Our audit of the District's 2011-12 pupil transportation records found that District personnel failed to verify the accuracy of the District's transportation data before submitting it to the Pennsylvania Department of Education (PDE). For example, District personnel did not obtain and maintain documentation from the District's bus contractors to support the data they submitted to PDE (see page 7).

Finding No. 2: Conflicts of Interest Regarding Two Board Members Also Serving as Bus Drivers. Our review of the District's board meeting minutes found that two board members have been voting on transportation-related items on a regular basis while being employed as bus drivers for the District's contracted bus company. Additionally, the two board members are related to the owner of the bus contracting company (see page 9).

Observation: The District Demonstrates Lack of Governance Regarding a Potential Financial Crisis. During our current audit of the District, we reviewed several financial indicators in an effort to assess the District's financial stability. Our review found that the District is not implementing a plan to address warning signs of a potential financial crisis. The Board of School Directors (Board) is demonstrating a lack of governance by not putting a plan in place to ensure future financial stability (see page 11).

Status of Prior Audit Findings and Observations. With regard to the status of our prior audit recommendations to the District from an audit released on April 25, 2012, we found that the District did take appropriate corrective action in implementing our recommendations pertaining to certification but did not take appropriate corrective action in implementing our recommendations pertaining to transportation issues (see page 14).

Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

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

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

Our audit covered the period October 15, 2011 through May 18, 2015, except for the verification of professional employee certification which was performed for the period July 1, 2011 through April 29, 2014.

Regarding state subsidies and reimbursements, our audit covered the 2010-11 and 2011-12 school years.

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

Objectives

What is the difference between a finding and an observation?

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

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

- ü Did the District ensure that bus drivers transporting District children at the time of the audit have the necessary driver licenses, physicals, training, background checks, and clearances as outlined in 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, and did they have written policies and procedures governing the hiring of new bus drivers?

To address this objective:

- The auditors selected the only new driver hired since the last time the Pennsylvania Department of the Auditor General audited the District and determined whether the drivers had the necessary licenses, physicals, training, background checks, and clearances.
- The auditors also requested copies of the written policies and procedures governing the hiring of bus drivers to determine that these processes included requesting background checks and clearances.

Ü Were votes made by the District's Board free from apparent conflicts of interest?

- To address this objective, the auditors reviewed the each sitting and recent board members' employment history, Statements of Financial Interest, board meeting minutes, and any known outside relationships with the District. The auditors reviewed records for nine board members for the 2010, 2011, and 2012 calendar years and ten board members for the 2013 calendar year.

Ü Were there any declining fund balances that may pose a risk to the District's fiscal viability?

- To address this objective, the auditors reviewed the District's annual financial reports, budget, independent auditor's reports, summary of child accounting, and general ledger for fiscal years 2008-09 through 2012-13.

Ü Did the District take appropriate steps to ensure school safety?

- To address this objective, the auditors reviewed a variety of documentation including safety plans, training schedules, anti-bullying policies, and after action reports to assess whether the District followed best practices in school safety and 24 P.S. §§ 13-1302-A, 13-1302.1-A,

13-1303-A, and 13-1303.1-A. Generally, the auditors evaluate the age of the plan, whether it is being practiced through training and whether the school has an after action process for trying to improve on the results of its training exercises.

Ü Did the District take appropriate corrective action to address recommendations made in our prior audit?

To address this objective:

- The auditors interviewed District administrators to determine whether they had taken corrective action.
- The auditors then reviewed documentation to verify that the administration had implemented the prior audit report's recommendations and/or observed these changes in person.
- The auditors reviewed and evaluated certification documentation for all eight teachers and administrators that did not have permanent certificates, were newly hired, or changed assignment at the time of our audit.
- The auditors reviewed the District bus transportation records from 3 of the 14 total District and contractor buses for the 2011-12 school year. For each bus selected, the auditors reviewed various data, including manufacturer, serial number, year of manufacture, and seating capacity as required under 24 P.S. § 25-2541. Daily miles, annual miles, and number of pupils were reviewed.

Methodology

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

What are internal controls?

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

- Effectiveness and efficiency of operations.
- Relevance and reliability of operational and financial information.
- Compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures.

The District's management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the District is in compliance with certain relevant state laws, regulations, contracts, grant requirements, and administrative procedures (relevant requirements). In conducting our audit, we obtained an understanding of the District's internal controls, including any information technology controls, as they relate to the District's compliance with relevant requirements that we consider to be significant within the context of our audit objectives. We assessed whether those controls were properly designed and implemented. Any deficiencies in internal controls that were identified during the conduct of our audit and determined to be significant within the context of our audit objectives are included in this report.

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

Our audit examined the following:

- Records pertaining to pupil transportation, bus driver qualifications, professional employee certification, state ethics compliance, school safety, and financial stability.
- Items such as board meeting minutes and policies and procedures.

Additionally, we interviewed select administrators and support personnel associated with the District's operations.

To determine the status of our audit recommendations made in a prior audit report released on April 25, 2012, we performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1 →

District Personnel Failed to Verify the Accuracy of Transportation Data

Criteria relevant to the finding:

Section 518 of the Public School Code (PSC), 24 P.S. § 5-518, requires retention of records, including financial account books, orders, bills, contracts, invoices, receipts, and purchase orders, for a period of not less than six years.

Section 2541(a) of the PSC, 24 P.S. § 25-2541(a), provides that “(a) School districts shall be paid by the Commonwealth for every school year on account of public transportation . . .”

Daily miles traveled, the greatest number of pupils transported, days of service, and contractor cost are integral parts of the transportation reimbursement calculation. These factors must be reported accurately to PDE in order to receive the correct reimbursement.

Our audit of the District’s 2011-12 school year’s pupil transportation records found weak administrative oversight over transportation contractors. As a result, the District’s staff failed to verify the information that it received from the bus contractors. In addition, the District failed to maintain the necessary source documentation, as required by the PSC, to support the funding received from the Commonwealth. Without this support, the auditors could not determine the accuracy of the \$366,181 of state funding received by the District for pupil transportation for the 2011-12 school year.

For example, our review found that pupil rosters were inconsistent and lacked updates as pupils were added or deleted. Due to this lack of documentation, it was not possible to determine the greatest number of students transported and the number of days the pupils were transported, which are components that PDE uses to calculate the pupil transportation reimbursement.

District transportation personnel stated that they were unaware that documentation to support totals reported to PDE needed to be maintained for audit review.

Recommendations

The Harmony Area School District should:

1. Maintain the documentation necessary to support the accuracy, completeness, and validity of the information the District reports to PDE.
2. Establish a process for verifying all of the data the District receives from the bus contractors to ensure that it is accurate, complete, valid, and retained on file for review.
3. Review subsequent school years’ transportation reports for accuracy and resubmit them to PDE if necessary.

Management Response

Management stated the following:

“The District will verify the accuracy of the transportation data on a monthly basis by logging documentation to review for accuracy. The District will also follow each bus/van to verify accuracy of the mileage turned into the District.”

Auditor Conclusion

We are pleased that the District plans to implement the necessary corrective actions to ensure the appropriate reporting of pupil transportation data and the maintenance of documentation to support the amounts reported, which is necessary to enable auditors to verify the accuracy of the reported data.

Finding No. 2

Conflicts of Interest Regarding Two Board Members Also Serving as Bus Drivers

Criteria relevant to the finding:

Section 1102 (relating to Definitions) of Pennsylvania's Public Official and Employee Ethics Act (Ethics Act), 65 Pa C.S. § 1102, defines "conflict" or "conflict of interest" as:

"Use by a public official . . . of the authority of his office or employment or any confidential information received through his holding public office or employment for the private pecuniary benefit of himself, a member of his immediate family or a business with which he or a member of his immediate family is associated."

Section 1102 of the Ethics Act also provides these further definitions:

"Business with which he is associated." Any business in which the person or a member of the person's immediate family is a director, officer, owner, employee or has a financial interest."

"Financial Interest." Any financial interest in a legal entity engaged in business for profit which comprises more than 5 percent of the equity of the business or more than 5 percent of the assets of the economic interest in indebtedness."

"Immediate Family." A parent, spouse, child, brother or sister."

Our review of the District's board meeting minutes, board-approved bus driver listings, District directories, and board members' Statements of Financial Interest found that two board members also serve as bus drivers for a private bus company that provides contracted bus services to the District and other school districts. The two board members are also related to the transportation contractor they are employed by, and have been voting on District transportation related matters. Pennsylvania's Ethics Act requires public officials, such as board members, to abstain from voting on matters that are a conflict of interest. Refer to the boxes to the left for additional information related to the Ethics Act's provisions.

Both board members are closely related to the owner of the company, who is also their employer. District personnel verified that the Vice-President of the Board is the son of the owner of the bus company and resides with the bus contractor. The other board member is the nephew of the owner of the bus company. Both board members are listed on the board-approved bus driver listings.

These two board members have been voting on transportation related items on a regular basis. One of the board members, who serves as the Vice-President of the Board, has at times abstained from voting to approve the bus contractors, but has not done so consistently. The other board member has voted on all District transportation items. Voting on matters that may result in monetary benefit to the board members' immediate family members, the bus company, and possibly the board members themselves appears to be a conflict of interest as defined in the Ethics Act and, as a result, may be a violation of the act.

Additionally, we found that both board members failed to list the bus company as a source of income on their Statements of Financial Interest for the 2010, 2011, 2012, and 2013 calendar years, which also appears to be in violation of the Ethics Act.

*Criteria relevant to the finding
(continued):*

Section 1103(j) of the Ethics Law, 65 Pa C.S. § 1103(f), provides in part:

“**Voting Conflict.**”- Any public official . . . who in the discharge of his official duties would be required to vote on a matter that would result in a conflict of interest shall abstain from voting and, prior to the vote being taken publically announce and disclose the nature of his interest as a public record in a written memorandum filed with the person responsible for recording the minutes . . .”

District transportation personnel provided a memo stating that the above two board members rarely drive for the District. However, the frequency with which the board members drive for the District is not relevant to the issue of the board members voting on matters that may benefit both an immediate family member and a business with which the board members are associated and possibly the board members themselves.

Recommendations

The Harmony Area School District should:

1. Ensure that board members abstain from voting on matters that would result in a conflict of interest and, prior to the vote being taken, publically announce and disclose the nature of his interest as a public record in a written memorandum filed with the person responsible for recording the minutes.
2. This finding will be referred to the Pennsylvania State Ethics Commission to follow up on as they deem fit.

Management Response

Management stated the following:

“School Board members will no longer be approved as bus drivers for the District.”

Auditor Conclusion

We believe that prohibiting the school board members from driving for the District is part of the necessary corrective action. However, we reiterate that the District should also ensure that all board members abstain from voting on matters that would result in a conflict of interest of a particular board member, such as matters involving a business for which he/she is an employee or that is owned by an immediate family member. We will evaluate the District’s corrective actions related to our recommendation during our next audit of the District.

Observation

The District Demonstrates Lack of Governance Regarding a Potential Financial Crisis

Criteria relevant to the observation:

District Board Policy #011, Board Governance Standard/Code of Conduct, states in part:

d.4) “Ensures that effective planning occurs by: Adopting a financial plan that considers short-term and long-term needs.”

e. 1) “Using data appropriately to make informed decisions.”

Section 2. a) “We, as members of our local Board of Education, representing all the residents of our school district, believe that: Striving toward ideal conditions for effective School Board service to our community . . .”

During our current audit of the District, we reviewed several financial indicators in an effort to assess the District’s financial stability. We found that the Board is in violation of its own District policy regarding school board governance. The District is ignoring warning signs of a potential financial crisis that were outlined by the District’s independent auditors.

Specifically, the District’s independent auditors provided a budget presentation to the Board on February 10, 2014, and warned that the District’s fund balance will be exhausted in approximately six years (i.e. 2020) if they continue to spend at their current rate. The independent auditor stated that the fund balance should never be used as a source to finance ongoing expenses and stated that the misuse of their fund balance could result in financial disaster. The independent auditor illustrated the point by informing the Board that, for the equivalent of each mill of tax taken from the fund balance (i.e. to balance the budget), a tax increase of at least two mills would be required to maintain a balanced fund balance.

As of the conclusion of our audit work at the District, the Board has not taken any action to balance the budget by raising taxes or reducing spending.

Background: Beginning in 2010, the District received a one-time series of payments totaling \$1,116,984 from a local mining company for the lease of district-owned property.

The money from the payments was placed in a separate Capital Reserve account and is currently being used to make District bond payments. According to the District’s debt service schedule, the Capital Reserve account will be exhausted by 2020, and, at that time, the District’s annual payment amounts will increase from \$192,949 to \$471,336, which is almost three times the amount the District is currently paying.

The Board has not communicated any plans regarding how they will cover the higher bond payment costs after the Capital Reserve account is exhausted.

The independent auditor's written warnings regarding the spending of the District's fund balance is supported by the Treasurer's Reports provided to the Board by the District's Business Manager. The October 2014 Treasurer's Report shows a Capital Reserve account balance of \$710,750, which indicates that the Board approved spending of \$406,234 of the \$1,116,984 received from the local mining company. This spending rate amounts to approximately 36 percent of the total amount received being spent within four years.

Furthermore, the Board hired a new Superintendent on July 1, 2012, and, within the first year, voted to amend the original three-year contract, expanding it to a four-year contract and significantly increasing the new Superintendent's salary by \$13,000 for the second year of the contract and \$14,000 for the third year. When the auditors asked for the explanation as to why the contract was increased, the Business Manager stated that she did not know because she did not have a copy of the contract and was not made aware of the reason. After receiving a similar response from the Board Secretary, we asked the Superintendent, who provided no additional information regarding the increases outlined in the amended contract.

Declining student populations coupled with increasing budgetary and actual expenditures have contributed to the District's financial problems. The District had a total population of 303 students (162 elementary and 141 secondary) during the 2014-15 school year. Student population has decreased every school year from 383 students in the 2009-10 year to the current population. Meanwhile budgeted and actual expenses have increased during this time period.

Recommendations

The *Harmony Area School District's Board* should:

1. Study the financial reports provided to the Board by the District's independent auditor and the Treasurer in order to make informed decisions regarding the

District's finances. If portions of the reports are not clear to the board members, further explanation should be requested so that Board action can be taken to address any situations that may have a negative impact on the District's financial situation.

2. Prepare a plan for the District's financial future identifying potential areas to cut costs and/or raise additional revenue. The plan should address the additional money that will be needed for the 2020 bond payments through the end of the District's obligation.
3. Adhere to existing Board policies regarding the standards of Board governance.

Management Response

Management stated the following:

“In order for the District to survive to benefit the students, the following actions will take place. Analyze enrollment. Analyze the ratio of staff per enrollment. Analyze resources vs expenditures.”

Auditor Conclusion

We are pleased that the District plans to analyze the student/teacher ratio and resources versus expenditures. We also reiterate the importance of reviewing the District's financial situation and developing a plan for the future.

Status of Prior Audit Findings and Observations

Our prior audit of the District, released on April 25, 2012, resulted in two findings. The first finding pertained to a certification deficiency, and the second finding pertained to errors in reporting pupil transportation. As part of our current audit, we determined the status of corrective action taken by the District to implement our prior audit recommendations. We performed audit procedures and interviewed District personnel regarding the prior findings. As shown below, we found that the District did implement our recommendations related to certification but did not implement our recommendations related to transportation.

Auditor General Performance Audit Report Released on April 25, 2012

Finding No. 1: Certification Deficiency

Finding Summary: Our prior audit of the District found that one professional employee was teaching with a lapsed certificate. The District was subject to a subsidy forfeiture of \$1,308 for the 2010-11 school year and \$143 for the 2011-12 school year.

Recommendations: Our audit finding recommended that the District should:

Put procedures in place to ensure all professional employees with provisional certificates apply for and receive permanent certificates before the temporary certificates expire.

We also recommended that PDE should:

Adjust the District's allocations to recover the appropriate subsidy forfeitures.

Current Status: During our current audit, we found that the District did implement our prior recommendations. The administration has developed a checklist to track nonpermanent employees. On December 27, 2012, PDE adjusted the District's allocations to recover the \$1,451 subsidy forfeitures.

Finding No. 2: Errors in Reporting Pupil Transportation Data Resulted in Reimbursement Underpayments Totaling \$16,841

Finding Summary: Our prior audit of the District's transportation records submitted to PDE found reporting errors which resulted in underpayments of

\$3,387 for the 2008-09 school year and \$13,454 for the 2009-10 school year.

Recommendations:

Our audit finding recommended that the District should:

1. Accurately report all data elements used in the calculation of pupil transportation reimbursement.
2. Provide training for transportation personnel.
3. Perform an internal review of data for accuracy prior to submission to PDE.
4. Review subsequent school years' transportation reports for accuracy and resubmit, if necessary.

We also recommended that PDE should:

5. Adjust future District allocations to correct the underpayments of \$16,841.

Current Status:

During our current audit, we found that the District did not implement our prior recommendations (see Finding No. 1 of the current audit page 7).

Based on the information provided by the District, there were additional payments received from PDE for pupil transportation in the amount of \$24,057. However, it is unclear as to whether the underpayment of \$16,841 was included in that payment.

Distribution List

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

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This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.