

KEYSTONE SCHOOL DISTRICT
CLARION COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

MARCH 2011

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

Mr. John R. Slagle, Board President
Keystone School District
451 Huston Avenue
Knox, Pennsylvania 16232

Dear Governor Corbett and Mr. Slagle:

We conducted a performance audit of the Keystone School District (KSD) to determine its compliance with applicable state laws, regulations, contracts, grant requirements and administrative procedures. Our audit covered the period August 1, 2008 through July 1, 2010, except as otherwise indicated in the report. Additionally, compliance specific to state subsidy and reimbursements was determined for the school years ended June 30, 2008 and June 30, 2007. Our audit was conducted pursuant to 72 P.S. § 403 and in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Our audit found that the KSD complied, in all significant respects, with applicable state laws, regulations, contracts, grant requirements, and administrative procedures, except as detailed in two findings noted in this report. In addition, 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 findings, observation and recommendations have been discussed with KSD's management and their responses are included in the audit report. We believe the implementation of our recommendations will improve KSD's operations and facilitate compliance with legal and administrative requirements. We appreciate the KSD's cooperation during the conduct of the audit and their willingness to implement our recommendations.

Sincerely,

/s/

JACK WAGNER
Auditor General

March 4, 2011

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

Our audit scope covered the period August 1, 2008 through July 1, 2010, except as otherwise indicated in the audit scope, objectives, and methodology section of the report. Compliance specific to state subsidy and reimbursements was determined for school years 2007-08 and 2006-07.

District Background

The KSD encompasses approximately 126 square miles. According to 2000 federal census data, it serves a resident population of 7,589. According to District officials, in school year 2007-08 the KSD provided basic educational services to 1,225 pupils through the employment of 89 teachers, 70 full-time and part-time support personnel, and 6 administrators. Lastly, the KSD received more than \$9.2 million in state funding in school year 2007-08.

Audit Conclusion and Results

Our audit found that the KSD complied, in all significant respects, with applicable state laws, regulations, contracts, grant requirements, and administrative procedures, except for two compliance-related matters reported as findings. In addition, one matter unrelated to compliance is reported as an observation.

Finding 1: Internal Control Weakness and Errors in Reporting Social Security and Medicare Wages. The KSD failed to retain certain supporting documents and reported incorrect Social Security and Medicare data, resulting in overpayments of \$9,805 (see page 6).

Finding 2: Failure to Have all School Bus Drivers' Qualifications on File and Transportation Contractors Fail to Comply with Transportation Contracts. Our audit of the District's school bus/van drivers' current qualifications for the 2009-10 school year found that not all records were on file at the time of the audit. Additionally, six of the nine contractors did not comply with contract provisions (see page 9).

Observation: Internal Control and Logical Access Control Weaknesses. Our audit found the KSD had internal control and logical access control weaknesses (see page 12).

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

District had taken appropriate corrective action in implementing our recommendations pertaining to errors in reporting pupil transportation data (see page 16). However, we found the KSD had not taken appropriate corrective action in implementing our recommendations pertaining to errors in reporting Social Security and Medicare wages (see page 15).

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 August 1, 2008 through July 1, 2010.

Regarding state subsidy and reimbursements, our audit covered school years 2007-08 and 2006-07.

While all districts have the same school years, some have different fiscal years. Therefore, for the purposes of our audit work and to be consistent with Department of Education (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 law, regulation, contract, grant requirement, or administrative procedure. Observations are reported when we believe corrective action should be taken to remedy a potential problem not rising to the level of noncompliance with specific criteria.

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

- ✓ Were professional employees certified for the positions they held?
- ✓ In areas where the District receives state subsidy and reimbursements based on pupil membership (e.g. basic education, special education, and vocational education), did it follow applicable laws and procedures?

- ✓ 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?
- ✓ Is the District's pupil transportation department, including any contracted vendors, in compliance with applicable state laws and procedures?
- ✓ Does the District ensure that Board members appropriately comply with the Public Official and Employee Ethics Act?
- ✓ Are there any declining fund balances which may impose risk to the fiscal viability of the District?
- ✓ Did the District pursue a contract buyout with an administrator and if so, what was the total cost of the buy-out, reasons for the termination/settlement, and do the current employment contract(s) contain adequate termination provisions?
- ✓ Were there any other areas of concern reported by local auditors, citizens, or other interested parties which warrant further attention during our audit?
- ✓ Is the District taking appropriate steps to ensure school safety?
- ✓ Did the District use an outside vendor to maintain its membership data and if so, are there internal controls in place related to vendor access?
- ✓ 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 findings, observations 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.

What are internal controls?

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

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

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

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

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

Our audit examined the following:

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

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

Lastly, to determine the status of our audit recommendations made in a prior audit report released on July 23, 2009, we reviewed the KSD's response to DE dated October 12, 2009. We then performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Finding No. 1

Internal Control Weakness and Errors in Reporting Social Security and Medicare Wages

Criteria relevant to the finding:

The 1986 Budget Reconciliation Act required Local Education Agencies (LEA) to deposit Social Security and Medicare tax contributions for wages earned on or after January 1, 1987, directly to authorized depositories or Federal Reserve banks. LEAs were required to pay the full amount of the employer's tax due, including the Commonwealth's share, which was 50 percent of the employer's share of tax due for employees employed by an LEA prior to July 1, 1994, (existing employees). LEAs were subsequently reimbursed for the Commonwealth's matching share based on wages reported to DE, excluding wages paid with federal funds.

Act 29 of 1994 further changed the way in which LEAs are reimbursed for Social Security contributions. A part of the law provides that employees who have never been employed by an LEA prior to July 1, 1994, (new employees) would have Social Security employer shares reimbursed based on the LEA's aid ratio, or 50 percent, whichever is greater.

In addition, Section 518 of the Public School Code requires the retention of records for a period of not less than six years.

Our audit of Social Security and Medicare wages reported for the 2007-08 and 2006-07 school years found internal control weaknesses and reporting errors that resulted in inaccurate reports being submitted to the Department of Education (DE) for reimbursement. Reliance on these inaccurate reports resulted in overpayments to the District of \$4,630 in 2007-08 and \$5,175 in 2006-07 totaling \$9,805.

Internal Control Weakness

The District failed to retain Quarterly Reports of Social Security and Medicare Tax Contributions submitted to DE for the quarters ending December 31, 2007 and March 31, 2008, for the 2007-08 school year.

Errors

1. District personnel inaccurately identified ten employees as "new" instead of "existing" employees.
2. District personnel failed to properly report the total taxable Social Security and Medicare wages for an existing employee for the quarter ending December 31, 2007.
3. A clerical error occurred in reporting the total taxable Social Security and Medicare wages for new employees for the quarter ending June 30, 2007.

This is the second consecutive audit report to include a finding regarding errors in reporting Social Security and Medicare wages (see page 15). Although the District followed our recommendations in the prior audit report to review and revise reports for school years subsequent to those we audited, additional errors were found in the current audit.

Wages eligible for Social Security and Medicare reimbursement were incorrectly submitted to DE, resulting in overpayments of \$9,805, as follows:

| <u>Reporting Period</u> | | <u>Audited</u> | <u>Wages Subject to State Reimbursement</u> | | | <u>Reimbursement (Over)/Underpayment</u> |
|-------------------------|-------------------|----------------|---|---------------------------------|-------------|--|
| | | | <u>Reported</u> | <u>Wages (Over)/Understated</u> | <u>Rate</u> | |
| Existing Employees | | | | | | |
| 7/07 - 6/08 | * | \$3,486,926 | \$3,165,843 | \$ 321,083 | 0.031000 | \$9,954 |
| 7/07 - 6/08 | ** | \$3,496,001 | \$3,165,843 | \$ 330,158 | 0.007250 | 2,394 |
| 7/06 - 6/07 | * | \$4,108,637 | \$3,753,326 | \$ 355,311 | 0.031000 | 11,015 |
| 7/06 - 6/07 | ** | \$4,108,637 | \$3,753,326 | \$ 355,311 | 0.007250 | 2,576 |
| New Employees | | | | | | |
| 7/07 - 6/08 | * | \$2,396,672 | \$2,717,755 | \$(321,083) | 0.042854 | (13,760) |
| 7/07 - 6/08 | ** | \$2,396,672 | \$2,717,755 | \$(321,083) | 0.010022 | (3,218) |
| 7/06 - 6/07 | * | \$ 2,514,959 | \$2,870,270 | \$(355,311) | 0.042799 | (15,207) |
| 7/06 - 6/07 | ** | \$2,514,959 | \$2,870,570 | \$(355,611) | 0.010009 | <u>(3,559)</u> |
| * Social Security Wages | ** Medicare Wages | | | Total Overpayments | | <u>\$(9,805)</u> |

Recommendations

The *Keystone School District* should:

1. Retain all Quarterly Reports of Social Security and Medicare Tax Contributions on file in the District’s business office for a period of six years.
2. Establish controls to ensure that personnel hired by the District are correctly reported as “new” and “existing” employees for computation of Social Security and Medicare wages reported to DE for reimbursement.
3. Ensure accuracy of total taxable wages reported each quarter.
4. Review reports submitted after the audit period for correctness and resubmit to DE, if necessary.

The *Department of Education* should:

5. Recover the overpayments of \$9,805.

Management Response

Management stated the following:

The District is following the concerns determined within the previous audit report and recognizes the need to improve due diligence in our internal controls to ensure accurate reporting of Social Security and Medicare wages.

Finding No. 2 →

Failure to Have all School Bus Drivers' Qualifications on File and Transportation Contractors Fail to Comply with Transportation Contracts

Criteria relevant to the finding:

Pennsylvania Department of Transportation bus driver regulations require the possession of a valid driver's licenses and passing a physical examination.

Section 111 of the Public School Code requires prospective school employees who would have direct contact with children, including independent contractors and their employees, to submit a report of criminal history record information obtained from the Pennsylvania State Police. Section 111 lists convictions for certain criminal offenses that, if indicated on the report to have occurred within the preceding five years, would prohibit the individual from being hired.

Section 111(c.1) also requires an FBI fingerprint record check for all employees hired on or after April 1, 2007.

Section 6355 of the Child Protective Services Law (CPSL) requires prospective school employees to submit an official child abuse clearance statement obtained from the Pennsylvania Department of Public Welfare. The CPSL prohibits the hiring of an individual determined by a court to have a committed child abuse.

Chapter 23 of the State Board of Education Regulations states that the board of directors of a school district is responsible for the selection and approval of eligible operators who qualify under the law and regulations.

Our audit of the District's school bus/van drivers' current qualifications for the 2009-10 school year found that not all records were on file at the time of our audit. Additionally, six of the nine contractors did not comply with the contract provision requiring them to submit required bus/van driver current documentation to the District prior to the start of the school year.

Several different state statutes and regulations establish the minimum required qualifications for school bus/van drivers. The ultimate purpose of these requirements, (training, licensing and clearances), is to ensure the protection, safety and welfare of the students transported in school buses.

The nine District pupil transportation contracts required, in part, that:

Prior to the commencement of services of each year during the term of this Contract, Contractor shall furnish the Board with proper Certifications for all Drivers, including Substitute Drivers, as follows: CDL License, CDL Endorsement Card, Vehicle Registration Card, Medical Examination Card, and Driver Qualification File.

We audited qualification documents for all 22 bus/van drivers employed by the District's pupil transportation contractors. The audit found that the District's contractors did not provide copies of current physical examination forms for eight drivers, "S" endorsement cards (indicating they had completed safety training) for five drivers, and federal criminal history record clearances for two driver or alternatively, documentation to evidence why the clearances were not required. (Note: As the state adopted new clearance requirements, existing drivers were "grandfathered" from the clearance requirements.)

We also found that three current drivers 'S' endorsement cards, one driver's license and one driver's physical examination form had expired during the school year.

Although all necessary bus driver qualification documents were not on file at the District at the beginning of our audit, the District's transportation contractors provided the District with current qualifications after we alerted the District to the deficiencies.

By not having the required bus drivers' qualification documents on file, the District was not able to review the documents to determine whether all drivers were qualified to transport students. If unqualified drivers transport students, there is an increased risk to the safety and welfare of students.

The failure to have current records on file at the District was result of the District personnel's failure to ensure that the transportation contractors complied with the provisions of their contracts and certain provisions of the Public School Code.

Recommendations

The *Keystone School District* should:

1. Ensure that the District's transportation personnel review each driver's qualifications prior to that person transporting students at the beginning of or during each school year.
2. Maintain files, at the District, separate from the transportation contractors, for all District drivers, and work with the contractors to ensure that the District's files are up-to-date and complete.
3. Require the transportation contractors to adhere to provisions of the contracts and provide the District with the documents identified in the contract prior to the beginning of the school year.
4. Require District administrative personnel to ensure all bus drivers' qualifications are on file, and if not, mandate the contractors not to utilize the bus drivers until adequate documents are provided to District administrative personnel.

Management Response

Management stated the following:

The cause of the problem leading to this finding stems from the failure to examine and verify receipt of each document from each driver. A checklist has been developed to make this examination easier and more accurate each school year.

Observation

What is logical access control?

“Logical access control” refers to internal control procedures used for identification, authorization, and authentication to access the computer systems.

Internal Control and Logical Access Control Weaknesses

The Keystone School District uses software purchased from an outside vendor for its critical student accounting applications (membership and attendance). The software vendor does not have remote access into the District’s network servers located within the District. Therefore, no risk exists that unauthorized changes to the District’s data by the vendor could occur and not be detected.

However, during our review, we found that the District had the following internal control and logical access control weaknesses in the District’s system:

1. The District did not have a fully executed (signed by both parties) original contract and maintenance agreements on file for its membership and attendance software program.
2. The District does not have a written information technology (IT) security policy (or Acceptable Use Policy) in place for its users.
3. The District was unable to provide evidence that they require written authorization for adding, deleting, or changing a userID.
4. No written procedures or documentation was maintained to support the proper removal of terminated/resigned employees.
5. The District has certain weaknesses in logical access controls. We noted that the District’s system parameter settings do not require all users to change their passwords every 30 days; to use passwords that are a minimum length of eight characters and include alpha, numeric, and special characters; or to lock out users after three unsuccessful attempts and to log off the system after a period of inactivity (i.e. 60 minutes maximum).
6. Updates to the software program were not requested in writing, nor approved by District personnel.

7. The District has certain weaknesses in environmental controls in the room that contains the server that houses all of the District's data. We noted that the specific location does not have fire detection or suppression equipment.
8. No written procedures were available for entering membership and attendance information into the District's system or to support the District's reconciliation procedures to detect significant changes in the membership/attendance data. Also, documentation was not available to support reconciliation/rollforwards reviews completed by District personnel.

Recommendations

The *Keystone School District* should:

1. Prepare and retain a fully executed (signed by both parties) original contract and maintenance agreement on file for its membership and attendance software program.
2. Prepare a written IT security policy (or Acceptable Use Policy) for its employees, including vendors and consultants, and require all District employees, vendors and consultants to sign and adhere to this policy.
3. Develop policies and procedures to require written authorization when adding, deleting, or changing a userID.
4. Develop policy and maintain documentation to evidence that terminated employees are properly removed from the system in a timely manner.
5. The District should implement a security policy and system parameter settings to require all users to change their passwords every 30 days, to use passwords that are a minimum length of eight characters and include alpha, numeric, and special characters; to lock out users after three unsuccessful attempts; and to log off the system after a period of inactivity (i.e., maximum of 60 minutes).

6. Updates to the software program should be approved by District personnel prior to implementation by personnel from the contracted service provider. Additionally, written specific procedures should be developed in case an emergency change/update is needed.
7. The District should consider implementing additional environmental controls around the network server sufficient to satisfy the requirements of the manufacturer of the server and to ensure warranty coverage. Specifically, the District should install fire detectors and fire extinguishers in the computer room.
8. Develop written procedure for entering membership and attendance information into the District's system and to support the District's reconciliation procedures.

Management Response

Management stated the following:

Items listed are reasonable procedural improvements for the district to implement. The new Superintendent is already reviewing the "Acceptable Use Policy" and will take these recommendations into account before presentation to the Board for approval.

Status of Prior Audit Findings and Observations

Our prior audit of the Keystone School District (KSD) for the school years 2005-06 and 2004-05 resulted in two reported findings. The first finding pertained to Social Security and Medicare wages, and the second finding pertained to pupil transportation. 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 KSD Board’s written response provided to the Department of Education (DE), performed audit procedures, and questioned District personnel regarding the prior findings. As shown below, we found that the KSD did implement recommendations related to pupil transportation but did not implement all of the recommendations related to Social Security and Medicare wages.

| <i>School Years 2005-06 and 2004-05 Auditor General Performance Audit Report</i> | | |
|---|--|---|
| <i>Prior Recommendations</i> | <i>Implementation Status</i> | |
| <p><u><i>I. Finding No. 1: Errors in Reporting Social Security and Medicare Wages Resulted in Overpayments of \$8,587</i></u></p> <ol style="list-style-type: none"> 1. Establish controls to ensure that personnel hired by the District are correctly reported as “new” or “existing” employees for computation of Social Security and Medicare wages reported to DE for reimbursement. 2. Review reports submitted after the audit period for correctness and resubmit to DE, if necessary. 3. DE should adjust the District’s allocations to correct the overpayments. | <p>Background:</p> <p>Our prior audit found that Social Security and Medicare wages for the 2005-06 and 2004-05 school years were incorrectly reported to DE, resulting in overpayments of \$8,587.</p> | <p>Current Status:</p> <p>Our current audit of the KSD’s Social Security and Medicare wages submitted to DE for the 2007-08 and 2006-07 school years found internal control weakness and reporting errors that resulted in a finding (see Finding No. 1 in the current report).</p> <p>Based on our current audit, we concluded that the District did not implement all of our recommendations.</p> <p>As of July 1, 2010, DE had not made the adjustments to KSD’s subsidy. DE personnel stated this finding was still pending resolution at the time of the current audit.</p> |

| | | |
|--|---|---|
| <p><u>II. Finding No. 2: Errors in Reporting Pupil Transportation Data Resulted in Underpayments of \$5,071</u></p> <ol style="list-style-type: none">1. Follow Public School Code regulations when determining whether or not a pupil is nonreimbursable.2. Review any reports submitted after the audit period, and make any corrections to the reported nonreimbursable pupil total, if needed.3. DE should adjust the District's subsidy to correct the underpayments. | <p>Background:</p> <p>Our prior audit of pupil transportation data submitted to DE for 2005-06 and 2004-05 school years found errors in reporting nonreimbursable pupils. The errors resulted in total underpayments of \$5,071.</p> | <p>Current Status:</p> <p>Our current audit of the KSD's pupil transportation data submitted to DE for the 2007-08 and 2006-07 school years found clerical errors, but the errors did not result in a significant monetary effect.</p> <p>Based on our current audit, we concluded that the District did implement our recommendations.</p> <p>As of July 1, 2010, DE had not made the adjustments to KSD subsidy. DE personnel stated this finding was still pending resolution at the time of the current audit.</p> |
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Distribution List

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

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This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.

