

WALLENPAUPACK AREA SCHOOL DISTRICT
WAYNE COUNTY, PENNSYLVANIA
PERFORMANCE AUDIT REPORT

JUNE 2012

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

Mr. John F. Spall, Board President
Wallenpaupack Area School District
2552 Route 6
Hawley, Pennsylvania 18428

Dear Governor Corbett and Mr. Spall:

We conducted a performance audit of the Wallenpaupack Area School District (WASD) to determine its compliance with applicable state laws, contracts, grant requirements, and administrative procedures. Our audit covered the period November 9, 2007 through September 14, 2009, 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 WASD 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 WASD's management and their responses are included in the audit report. We believe the implementation of our recommendations will improve WASD's operations and facilitate compliance with legal and administrative requirements. We appreciate the WASD's cooperation during the conduct of the audit and their willingness to implement our recommendations.

Sincerely,

/s/

JACK WAGNER
Auditor General

June 19, 2012

cc: **WALLENPAUPACK 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 Wallenpaupack Area School District (WASD). 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 WASD in response to our prior audit recommendations.

Our audit scope covered the period November 9, 2007 through September 14, 2009, 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 WASD encompasses approximately 320 square miles. According to 2000 federal census data, it serves a resident population of 20,738. According to District officials, in school year 2007-08 the WASD provided basic educational services to 4,113 pupils through the employment of 351 teachers, 173 full-time and part-time support personnel, and 28 administrators. Lastly, the WASD received more than \$11.6 million in state funding in school year 2007-08.

Audit Conclusion and Results

Our audit found that the WASD 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: Potential Conflict of Interest. Our audit of WASD records for the calendar years ended December 31, 2008 and 2007 found that three school board members also serve on the board of the WASD's designated depository. Starting in 2003, the WASD entered into investment agreements with proceeds paid to the WASD's designated depository. Board members approving WASD transactions that generate funds for the designated depository in which they are associated give the appearance of a conflict of interest (see page 6).

Status of Prior Audit Findings and Observations. With regard to the status of our prior audit recommendations to the WASD from an audit we conducted of the 2005-06 and 2004-05 school years, we found the WASD had taken appropriate corrective action in implementing our recommendations pertaining to ethics act and hiring violations (see page 9).



Audit Scope, Objectives, and Methodology

Scope

What is a school performance audit?

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

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

Our audit covered the period November 9, 2007 through September 14, 2009.

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 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 WASD'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?
- ✓ 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 buy-out with an administrator and if so, what was the total cost of the buy-out, reasons for the termination/settlement, and do the current employment contract(s) contain adequate termination provisions?
- ✓ Were there any other areas of concern reported by local auditors, citizens, or other interested parties which warrant further attention during our audit?
- ✓ Is the District taking appropriate steps to ensure school safety?
- ✓ Did the District take appropriate corrective action to address recommendations made in our prior audits?

Methodology

What are internal controls?

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

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

Government Auditing Standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our 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.

WASD 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 and pupil transportation.

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.

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

Lastly, to determine the status of our audit recommendations made in a prior audit report released on February 25, 2008, we reviewed the WASD's response to DE dated February 10, 2009. We then performed additional audit procedures targeting the previously reported matters.

Findings and Observations

Observation

Criteria relevant to the observation:

Section 324(a) of the Public School Code (PSC) provides, in part:

No school director shall, during the term for which he was elected or appointed, as a private person engaged in any business transaction with the school district in which he is elected or appointed. . . .

Furthermore, Section 1103 of the Public Official and Employee Ethics Act (Ethics Act) states:

No public official or public employee shall engage in conduct that constitutes a conflict of interest.

Ethics Act, 65 Pa.C.S. § 1101 *et seq.*, requires all candidates for public office, public officials and certain public employees to complete a Statement of Financial Interests for the preceding calendar year annually, no later than May 1st of each year they hold their positions and of the year after leaving such positions.

Potential Conflict of Interest

Our audit of District records for the calendar years ended December 31, 2008 and 2007 found that three school board members also served on the board of one of the District's designated depositories which was assigned for general fund deposits. One of the District's board members is also the president of the designated depository.

In 2003, the District entered into investment agreements with proceeds paid in to the District's designated depository. The three board members abstained from approving the bank they are associated with as the District's designated depository; however, they did vote on the investment agreements which generate funds that are deposited into that bank. Board members approving District transactions that generate funds for the designated depository in which they are associated give the appearance of a conflict of interest.

The potential violation of Section 324 of the Public School Code (PSC) and the Ethics Act resulted because the District is confident all transactions approved by the board were conducted within the requirements of the PSC and Ethics Act.

Public office is a public trust sustained by assuring the people of the impartiality and honesty of public officials and public employees. Accordingly, the Ethics Act specifically requires public officials and certain public employees to disclose matters on the Statement of Financial Interests that currently or potentially create conflicts of interest with their public duties. The three board members did file Statements of Financial Interests for all years in question disclosing their affiliation with the District's designated depository.

A copy of this observation will be forwarded to the State Ethics Commission for additional review and investigation as it deems necessary.

Recommendations

The *Wallenpaupack Area School District* board should:

1. Seek the advice of its solicitor in regard to the board's responsibility when conducting transactions that result in a benefit to interrelated businesses.
2. The State Ethics Commission should investigate these potential conflicts and determine if further action is necessary.

Management Response

Management stated the following:

The alleged conflict of interest relates to the use of [Bank 1], which was one of several bank depositories for district funds appointed by the school board for 2007-08. As noted in the 6/4/07 Minutes, [the three board members in question] abstained from that appointment. [One board member] is the President and CEO of [Bank 1], and [the other two board members] are on the bank's board of directors. There is no conflict of interest raised in the Audit as to the appointment of the [Bank 1] as a bank depository for the District. The potential conflict of interest apparently arose in the review of the "Interest Rate Management Agreement" relating to the district's General Obligation Notes, Series A of 2005 and its General Obligation Bonds, Series AAA of 2005, (hereinafter the "2008 Swap transaction") which is referred to in the minutes of the January 25, 2008 special meeting of the board as the "Swap Resolution." I am also providing copies of the 6/16/08 and 7/2/09 board meeting minutes, which show that [Bank 1] was again appointed as one of a number of the District's bank depositories for the 2008-2009 and 2009-2010 school years, again with the District board members in question abstaining.

I have reviewed the Swap Resolution with the District solicitor, as well as bond (special) counsel for that transaction, and we all concur that [Bank 1] was never appointed to any role in that transaction, nor authorized to be paid any fee in conjunction with the Swap Resolution transaction. The only reference to [Bank 1] in the 2008 Swap Transaction is a “Confirmation Letter” issued by [Bank 2], which entered into the ISDA Master Agreement with the district to implement the 2008 Swap transaction. That letter, dated 1/31/08, references the [Bank 1] as the bank depository where funds paid to the district, pursuant to the 2008 Swap Transaction, are to be delivered.

[Bank 1] had no active role in the 2008 Swap Transaction and is not identified nor even mentioned in the Swap Resolution voted on the District Board of Directors on January 25, 2008. For that reason, there was no cause for the District directors in question – [the three board members] – to abstain from voting on the 2008 Swap Resolution. The letter of 1/31/08 from [Bank 2], is the only reference to [Bank 1] and it was not part of the 2008 Swap Resolution acted on by the District board. [Bank 1] did not receive any fees as the result of the 2008 Swap Transaction and was only the bank designated to receive deposits for payments from the transaction.

Auditor Conclusion

The designated depository did not issue the swap agreement. However, on December 17, 2009, the Auditor General issued a letter to all districts urging the districts to stop using swap agreements and to terminate any active swaps and refinance with conventional debt instruments. He further recommended that districts assess the financial consequences on their districts and taxpayers. We continue to urge the District to implement our recommendations regarding swap agreements.

As stated earlier in the observation, potential conflict of interest issues will be forwarded to the State Ethics Commission for additional review and investigation as it deems necessary.

Status of Prior Audit Findings and Observations

Our prior audit of the Wallenpaupack Area School District (WASD) for the school years 2005-06 and 2004-05 resulted in one reported finding pertaining to the Ethics Act and hiring violations. 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 WASD Superintendent's written response provided to the Department of Education (DE), performed audit procedures, and questioned District personnel regarding the prior finding. As shown below, we found that the WASD did implement recommendations related to the Ethics Act and hiring violations.

School Years 2005-06 and 2004-05 Auditor General Performance Audit Report

Finding: **Ethics Act and Hiring Violations**

Finding

Summary:

Our prior audit of District records for the calendar years ended December 31, 2006 and 2005 found that a former board member did not file his Statement of Financial Interests form for calendar year ended December 31, 2006. Moreover, this same board member resigned from the board on September 11, 2006 and was employed as the director of buildings and grounds effective October 10, 2006. The former board member was elected to serve in his public position beginning November of 2003, and his term was to expire December of 2007.

Recommendations: Our audit finding recommended that the WASD:

1. Develop procedures to ensure that all individuals required to file Statements of Financial Interests forms do so in compliance with the Ethics Act.
2. Seek the advice of its solicitor in regard to the board's responsibility when a board member fails to file a Statement of Financial Interests.
3. Seek the advice of its solicitor in regard to the board's responsibility when hiring a former board member as an employee of the District.
4. Strengthen controls to ensure board members who leave the District complete the required Statements of Financial Interests prior to their departure.

Current Status: We followed up on the WASD's Statement of Financial Interests forms and board minutes and found that the District did take appropriate corrective action to ensure that the board was in compliance with the Ethics Act.

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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