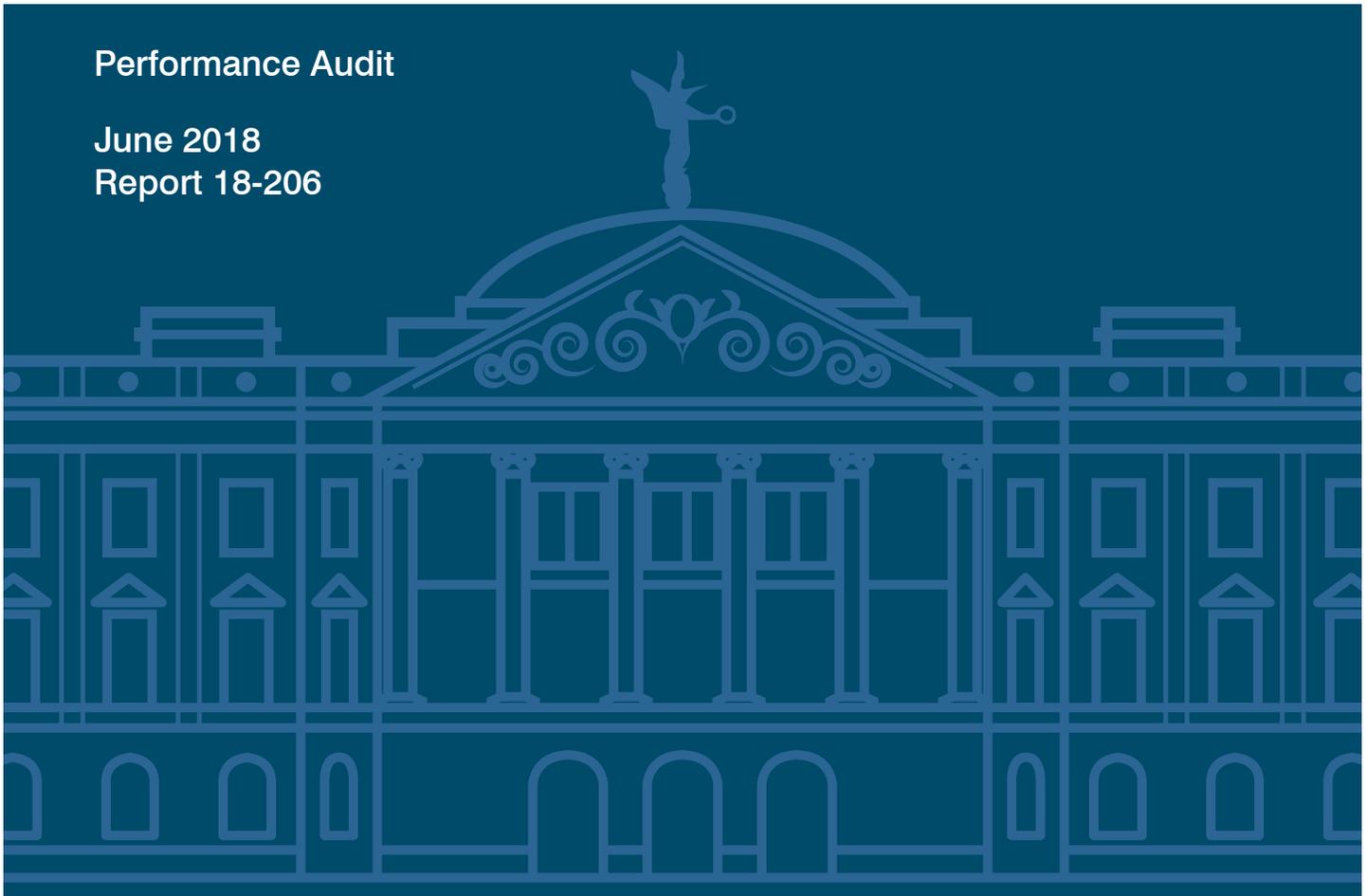


Paloma Elementary School District

Performance Audit

June 2018
Report 18-206



A Report to the Arizona Legislature

Lindsey Perry
Auditor General





The Arizona Office of the Auditor General's mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, the Office provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits and special reviews of school districts, state agencies, and the programs they administer.

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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

June 28, 2018

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Governing Board
Paloma Elementary School District

Ms. Kristin Turner, Superintendent
Paloma Elementary School District

Transmitted herewith is a report of the Auditor General, *A Performance Audit of the Paloma Elementary School District*, conducted pursuant to A.R.S. §41-1279.03. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the District agrees with all the findings and recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Lindsey Perry, CPA, CFE
Auditor General



Paloma Elementary School District

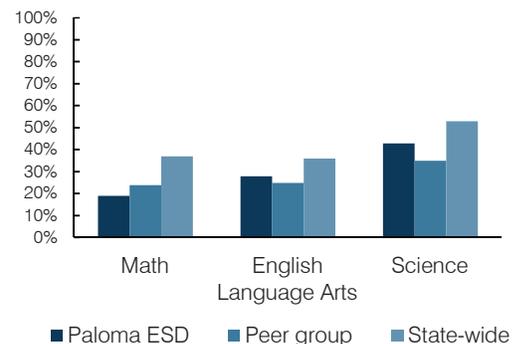
CONCLUSION: In fiscal year 2016, Paloma ESD's student test scores were similar to or higher than the peer districts' averages, and the District was reasonably efficient overall, operating with similar or lower costs in most noninstructional areas. Specifically, the District's administrative costs were lower than the peer districts' average primarily because its administrative employees performed duties in other operational areas. Despite lower administrative costs, the District needs to strengthen its purchasing and computer controls. Although the District's plant operations cost per pupil was similar to the peer districts' average, its cost per square foot was much higher because the District's buildings were older than the peer districts', on average, and older buildings tend to be less energy efficient. In addition, the District was in the process of constructing new school buildings during fiscal year 2016, which likely led to higher energy and insurance costs. The District's food service program cost per meal was lower than the peer districts' average, and the program was reasonably efficient. Additionally, the District's transportation cost per mile was similar to the peer districts' average, but its cost per rider could not be calculated because the District misreported the number of students it transported. Therefore, a determination of the District's transportation program efficiency was not possible. Finally, the District needs to improve its transportation program oversight.

Student achievement and operational efficiency

Student achievement—For very small districts such as Paloma ESD, year-to-year changes in student populations can greatly impact year-to-year student test scores. In fiscal year 2016, Paloma ESD's student test scores were similar to the peer districts' averages in Math and English Language Arts and higher in Science.

Reasonably efficient operations overall—In fiscal year 2016, Paloma ESD's administrative costs were lower than the peer districts' average primarily because its administrative employees performed duties in other operational areas. Although the District's plant operations cost per pupil was similar to the peer districts' average, its cost per square foot was much higher primarily because of higher costs for energy, insurance, and telecommunications. The District's per square foot energy costs were more than twice the peer districts' average partly because the District operated and maintained older, less energy-efficient buildings than the peer districts', on average, and it was constructing new school buildings during fiscal year 2016. Additionally, the District's food service program cost per meal was lower than the peer districts' average, but its cost per pupil was higher because it served more meals per student than the peer districts, on average. Finally, the District's transportation cost per mile was similar to the peer districts' average, but its cost per rider could not be calculated because the District misreported the number of students it transported in fiscal year 2016 for state funding purposes. Therefore, a determination of the District's transportation program's efficiency was not possible.

Percentage of students who passed state assessments
 Fiscal year 2016



Comparison of per pupil expenditures by operational area
 Fiscal year 2016

	Paloma ESD	Peer group average
Administration	\$2,146	\$2,987
Plant operations	2,508	2,523
Food service	1,098	918
Transportation	474	1,108

District needs to strengthen purchasing and computer controls

Paloma ESD needs to strengthen its purchasing and computer controls as we identified control issues in fiscal year 2016. Although we did not detect any improper transactions in the items reviewed, these poor controls exposed the District to an increased risk of errors, fraud, and data loss. Specifically:

- **Some purchases lacked proper approval**—The District did not always require proper approval prior to purchases being made. We reviewed 30 fiscal year 2016 accounts payable transactions and found 7 purchases that were made without prior approval.
- **Broad access to accounting system**—All six of the District's accounting system users had full access to the accounting system, giving them the ability to perform all accounting system functions without an independent review and approval.
- **Lack of formal IT contingency plan**—The District did not have a formal, up-to-date, and tested IT contingency plan even though it maintained critical student and accounting information on its computer network and systems.

Recommendations

The District should:

- Ensure that purchases are approved before they are made.
- Limit users' access to only those accounting system functions needed to perform their work.
- Create and implement a formal IT contingency plan.

District needs to improve transportation program oversight

In fiscal years 2016 and 2017, Paloma ESD lacked procedures to ensure that bus driver certification and bus preventative maintenance requirements were met. As a result, its regular bus driver experienced an 8-month lapse before obtaining an annual drug test for fiscal year 2017. Additionally, the District did not have documentation showing that either of its two buses received preventative maintenance services during fiscal year 2016. The District also misreported the number of students it transported for state funding purposes.

Recommendations

The District should ensure that bus driver certification and bus preventative maintenance requirements are met and accurately calculate and report riders transported for state funding purposes.



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DISTRICT OVERVIEW

Paloma Elementary School District is a rural district located approximately 80 miles southwest of Phoenix in Maricopa County. In fiscal year 2016, the District served 95 students in kindergarten through 8th grade at its one school.

In fiscal year 2016, Paloma ESD's student test scores were similar to or higher than the peer districts' averages, and the District was reasonably efficient overall, operating with similar or lower costs in most noninstructional areas.¹ However, the District needs to strengthen its purchasing and computer controls and improve its transportation program oversight.

Student achievement

In fiscal year 2016, 19 percent of the District's students passed state assessments in Math, 28 percent in English Language Arts, and 43 percent in Science. As shown in Figure 1, these scores were similar to the peer districts' averages in Math and English Language Arts and higher than the peer districts' average in Science. However, for very small districts such as Paloma ESD, year-to-year changes in student populations can greatly impact year-to-year student test scores.

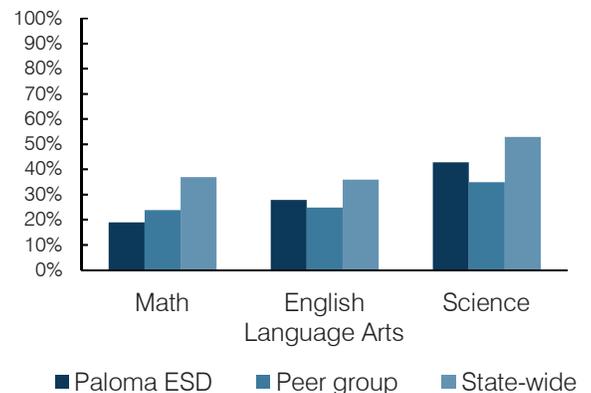
District was reasonably efficient overall but needs improvements

As shown in Table 1 on page 2 and based on auditors' review of various performance measures, in fiscal year 2016, Paloma ESD was reasonably efficient, operating with similar or lower costs in most operational areas when compared to peer districts' averages. The District spent \$3,030 less per pupil in total than its peer districts averaged but spent only about \$1,600 less per pupil on instruction. The District spent less per pupil in total primarily because it received less Maintenance and Operations monies than the peer districts. This occurred because many of the peer districts received more transportation funding than they needed to operate their transportation programs, allowing these districts to spend their additional monies in other areas, including instruction. Despite reasonably efficient operations at Paloma ESD, auditors identified opportunities for improved controls.

Lower administrative costs but improvements

needed—Paloma ESD's \$2,146 administrative costs per pupil were 28 percent lower than the peer districts' average primarily because of lower salary and benefit costs. The District spent less on administrative salaries and benefits partly because administrative employees performed duties in other operational areas. More specifically, Paloma ESD's superintendent also served as the District's principal and accounts payable specialist, and the

Figure 1
Percentage of students who passed state assessments
Fiscal year 2016
(Unaudited)



Source: Auditor General staff analysis of fiscal year 2016 test results on Arizona's Measurement of Educational Readiness to Inform Teaching (AzMERIT) and Arizona's Instrument to Measure Standards (AIMS).

¹ Auditors developed two peer groups for comparative purposes. See page a-1 of this report's Appendix for further explanation of the peer groups.

business manager served as the food service director and as a bus driver. Additionally, per pupil costs were lower because the District served 15 percent more students than the peer districts, on average. Despite the lower costs, the District needs to strengthen some of its purchasing and computer controls (see Finding 1, page 3).

Mixed plant operations costs but program reasonably efficient—Paloma ESD’s fiscal year 2016 plant operations costs were 52 percent higher per square foot than the peer districts’ average. Although its cost per square foot was much higher, its cost per pupil was similar, and the program was not inefficient. The District’s higher cost per square foot was primarily the result of higher costs for energy, insurance, and telecommunications. The District’s per square foot energy costs were more than twice the peer districts’ average partly because the District operated and maintained buildings that were 27 percent older than the peer districts’, on average, and older buildings tend to be less energy efficient. In addition, the District was constructing new school buildings during fiscal year 2016, which likely contributed to its higher energy costs. However, the District’s new, more efficient buildings should result in decreased energy costs in the future. The District’s liability insurance costs were also higher than the peer districts’ because of the ongoing construction of new buildings in fiscal year 2016. Finally, the District’s telecommunications costs were 88 percent higher than the peer districts’ average because it spent more to provide internet access for student devices.

Efficient food service program—Paloma ESD operated efficiently with a \$3.88 cost per meal that was 30 percent lower than the peer districts’ \$5.54 average. The District’s \$1,098 cost per pupil was 20 percent higher than the peer districts’ average because it served 43 percent more meals per student than the peer districts, on average.

Transportation costs were similar but improvements needed—Paloma ESD’s \$1.74 cost per mile was similar to the peer districts’ average. Other performance measures, such as cost per rider and bus capacity utilization, could not be calculated because the District misreported the number of students it transported in fiscal year 2016 for state funding purposes. Therefore, a determination of the District’s transportation program’s efficiency was not possible. However, auditors did not identify any overstaffing or any unusually high salaries or fuel or repair and maintenance costs, and combining its three bus routes to reduce costs was not practical. Although the District’s transportation program did not appear inefficient, the District needs to improve transportation program oversight to ensure that its bus drivers meet all the State’s certification requirements and that its buses receive required preventative maintenance in a timely manner (see Finding 2, page 5).

Table 1
Comparison of per pupil expenditures by operational area
Fiscal year 2016
 (Unaudited)

Operational area	Paloma ESD	Peer group average	State average
Instruction	\$6,780	\$ 8,342	\$4,145
Administration	2,146	2,987	806
Plant operations	2,508	2,523	939
Food service	1,098	918	415
Transportation	474	1,108	364
Student support	484	664	633
Instruction support	536	514	444
Total per pupil	\$14,026	\$17,056	\$7,746

Source: Auditor General staff analysis of fiscal year 2016 Arizona Department of Education student membership data and district-reported accounting data.



District needs to strengthen purchasing and computer controls

In fiscal year 2016, Paloma ESD lacked adequate purchasing and computer controls. Although auditors did not detect any improper transactions in the items reviewed, these poor controls exposed the District to an increased risk of errors, fraud, and data loss.

District lacked adequate purchasing controls

The District needs to strengthen its purchasing controls to ensure that all purchases are properly approved prior to being made. Auditors reviewed 30 fiscal year 2016 accounts payable transactions and found that 7 transactions were for purchases made before the District had completed and approved the associated purchase orders. Although no improper transactions were detected in the items reviewed, the District should ensure that an authorized employee approves all purchases prior to the ordering of goods or services, as required by the *Uniform System of Financial Records for Arizona School Districts*. This would help ensure that the District has adequate budget capacity and that expenditures are appropriate and properly supported.

District lacked adequate computer controls

In fiscal year 2016, Paloma ESD lacked adequate controls over its computer network and accounting system. Although no improper transactions were detected, these poor controls exposed the District to an increased risk of errors, fraud, and data loss.

Broad access to accounting system—Auditors reviewed the District’s fiscal year 2016 user access report for the six accounting system users and found that all six users had full access to the accounting system, giving them the ability to perform all accounting system functions without an independent review or approval. In addition, two business office users had access to administer the District’s accounting system. Administrator-level access allows the user full control over system settings, including the ability to add new users and modify the level of access users have in the system. Although auditors did not detect any improper transactions in the payroll and accounts payable transactions reviewed, such broad access exposed the District to an increased risk of errors and fraud, such as processing false invoices or adding and paying nonexistent vendors or employees.

Lack of formal IT contingency plan—In fiscal year 2016, the District did not have a formal, up-to-date, and tested IT contingency plan even though it maintained critical student and accounting information on its computer network and systems. A written and properly designed contingency plan would help ensure continued operations in the event of a system or equipment failure or interruption. The plan should include detailed information on how to restore systems in such an event. As part of a contingency plan, the District should also perform documented tests of its ability to restore electronic data files from backups, which are important to ensure continuous accessibility to sensitive and critical data.

Recommendations

1. The District should ensure that it requires an independent review and approval for all its purchases prior to the purchases being made.
2. The District should limit employees' access in the accounting system to only those accounting system functions needed to perform their job duties, including transferring administrator-level access to someone outside of the business office.
3. The District should create and implement a formal IT contingency plan and test it periodically to identify and remedy any deficiencies.



District needs to improve transportation program oversight

In fiscal years 2016 and 2017, Paloma ESD lacked adequate documentation and procedures to show that its bus drivers met certification requirements and preventative maintenance was performed on its buses in accordance with the State's *Minimum Standards for School Buses and School Bus Drivers* (Minimum Standards). The District also misreported the number of students it transported in fiscal year 2016 for state funding purposes.

District did not ensure all required drug and alcohol tests were performed

To help ensure student safety, the State's Minimum Standards administered by the Department of Public Safety require districts to ensure that bus drivers are properly certified and receive random drug and alcohol tests, annual drug tests, physical examinations, refresher training, and CPR and first aid certification. Auditors reviewed files for the District's one regular bus driver and one substitute bus driver for fiscal years 2016 and 2017 and found that the regular bus driver experienced an 8-month lapse before obtaining an annual drug test for fiscal year 2017. In addition, the District lacked records demonstrating that its bus drivers met Minimum Standards for the random drug and alcohol testing requirement. The District did not have a process in place to ensure that the required random drug and alcohol testing of bus drivers was completed. As a result, neither of its two bus drivers were randomly tested for drug or alcohol use in fiscal years 2016 and 2017. To comply with the Minimum Standards and help ensure a safe transportation program, the District should implement procedures to ensure that bus drivers meet all required standards and should maintain all documentation demonstrating compliance.

District lacked adequate documentation to demonstrate it regularly maintained buses

According to the State's Minimum Standards, districts must be able to demonstrate that their school buses receive systematic preventative maintenance. Preventative maintenance includes items such as periodic oil changes, tire and brake inspections, and inspections of safety signals and emergency exits. These standards are designed to help ensure the safety and welfare of school bus passengers, as well as extend the useful life of buses. According to the District's policy, each bus should have received preventative maintenance every 5,000 miles. However, auditors reviewed maintenance files for the District's two buses and found that the District did not have documentation showing that either bus received preventative maintenance services during fiscal year 2016. Although one district bus did not appear to have been used during fiscal year 2016, the other bus traveled almost 7,000 miles. Without this documentation, the District cannot demonstrate that it is properly maintaining its school buses according to the Minimum Standards.

District incorrectly reported eligible rather than actual riders for student transportation funding

In fiscal year 2016, Paloma ESD incorrectly reported its ridership to the Arizona Department of Education by reporting the number of students eligible for transportation rather than the number of students actually transported

as Arizona Revised Statutes §15-922 requires. Transportation funding is primarily based on miles driven, but the number of riders is also a factor in determining the per mile rate that districts receive. Although the District's inaccurate reporting in fiscal year 2016 did not affect its transportation funding, the District should ensure it is meeting state reporting requirements by reporting the actual number of students transported.

Recommendations

1. The District should develop and implement procedures to ensure that bus driver certification requirements are met and documented in accordance with the State's Minimum Standards.
2. The District should ensure that bus preventative maintenance is conducted in a systematic and timely manner and documented in accordance with district policy and the State's Minimum Standards.
3. The District should accurately calculate and report to the Arizona Department of Education the actual number of riders transported for state funding purposes.



Objectives, scope, and methodology

The Office of the Auditor General has conducted a performance audit of the Paloma Elementary School District pursuant to Arizona Revised Statutes §41-1279.03(A)(9). This audit focused on the District's efficiency and effectiveness in four operational areas: administration, plant operations and maintenance, food service, and student transportation because of their effect on instructional spending, as previously reported in the Office of the Auditor General's annual report, *Arizona School District Spending*. To evaluate costs in each of these areas, only operational spending, primarily for fiscal year 2016, was considered.² Further, because of the underlying law initiating these performance audits, auditors also reviewed the District's use of Proposition 301 sales tax monies and how it accounted for dollars spent on instruction.

For very small districts, such as Paloma ESD, increasing or decreasing student enrollment by just five or ten students or employing even one additional part-time position can dramatically impact the district's costs per pupil in any given year. As a result and as noted in the fiscal year 2016 *Arizona School District Spending* report, very small districts' spending patterns are highly variable and result in less meaningful group averages. Therefore, in evaluating the efficiency of Paloma ESD's operations, less weight was given to various cost measures and more weight was given to auditor observations made at Paloma ESD.

In conducting this audit, auditors used a variety of methods, including examining various records, such as available fiscal year 2016 summary accounting data for all districts and Paloma ESD's fiscal year 2016 detailed accounting data, contracts, and other district documents; reviewing district policies, procedures, and related internal controls; reviewing applicable statutes; and interviewing district administrators and staff.

To compare districts' academic indicators, auditors developed a student achievement peer group using poverty as the primary factor because poverty has been shown to be associated with student achievement. Auditors also used secondary factors such as district type and location to further refine these groups. Paloma ESD's student achievement peer group includes Paloma ESD and the ten other elementary school districts that also served student populations with poverty rates greater than 39 percent and that were located in towns and rural areas. Auditors compared the percentage of Paloma ESD's students who passed state assessments in each area tested to its peer groups' averages.³ Generally, auditors considered Paloma ESD's percentages to be similar if they were within 5 percentage points of peer averages and higher/lower if they were more than 5 percentage points higher/lower than peer averages.

To analyze Paloma ESD's operational efficiency, auditors selected a group of peer districts based on their similarities in district size and location. This operational peer group includes Paloma ESD and 48 other school districts that also served fewer than 200 students and were located in towns and rural areas. Auditors compared Paloma ESD's costs to its peer group averages. Generally, auditors considered Paloma ESD's costs to be similar if they were within 5 percent of peer averages, slightly higher/lower if they were within 6 to 15 percent of peer averages, higher/lower if they were within 16 to 30 percent of peer averages, and much higher/lower if they were

² Operational spending includes costs incurred for the District's day-to-day operations. It excludes costs associated with the acquisition of capital assets (such as purchasing land, buildings, and equipment), interest, and programs such as adult education and community service that are outside the scope of preschool through grade 12 education.

³ The percentage of students who passed state assessments is based on the number of students who scored proficient or highly proficient on the Arizona's Measurement of Educational Readiness to Inform Teaching (AzMERIT) Math and English Language Arts tests and those who met or exceeded the state standards on the Arizona's Instrument to Measure Standards (AIMS) Science test. Test results were aggregated across grade levels and courses, as applicable.

more than 30 percent higher/lower than peer averages. However, in determining the overall efficiency of Paloma ESD's noninstructional operational areas, auditors also considered other factors that affect costs and operational efficiency such as square footage per student and meal participation rates, as well as auditor observations and any unique or unusual challenges the District had. Additionally:

- To assess the District's financial accounting data, auditors evaluated the District's internal controls related to expenditure processing and scanned all fiscal year 2016 payroll and accounts payable transactions for proper account classification and reasonableness. Additionally, auditors reviewed detailed payroll and personnel records for all 30 individuals who received payments in fiscal year 2016 through the District's payroll system and reviewed supporting documentation for 30 of the 962 fiscal year 2016 accounts payable transactions. Auditors also evaluated other internal controls that they considered significant to the audit objectives and reviewed fiscal year 2016 spending and prior years' spending trends across operational areas.
- To assess the District's computer information systems and network, auditors evaluated certain controls over its logical and physical security, including user access to sensitive data and critical systems, and the security of servers that house the data and systems. Auditors also evaluated certain district policies over the system such as data sensitivity, backup, and recovery.
- To assess whether the District managed its transportation program appropriately and whether it functioned efficiently, auditors reviewed and evaluated required transportation reports, reviewed bus driver files for the District's two drivers, and reviewed bus maintenance and safety records for the District's six transportation vehicles and bus routing. Auditors also reviewed fiscal year 2016 transportation costs and compared them to peer districts'.
- To assess whether the District's administration effectively and efficiently managed district operations, auditors evaluated administrative procedures and controls, including reviewing personnel files and other pertinent documents and interviewing administrators about their duties. Auditors also reviewed and evaluated fiscal year 2016 administration costs and compared them to peer districts'.
- To assess whether the District managed its plant operations and maintenance function appropriately and whether it functioned efficiently, auditors reviewed and evaluated fiscal year 2016 plant operations and maintenance costs and compared these costs to peer districts'.
- To assess whether the District managed its food service program appropriately and whether it functioned efficiently, auditors reviewed fiscal year 2016 food service revenues and expenditures, including labor and food costs; compared costs to peer districts'; reviewed the Arizona Department of Education's food service-monitoring reports; and observed food service operations.
- To assess whether the District was in compliance with Proposition 301's Classroom Site Fund requirements, auditors reviewed fiscal year 2016 expenditures to determine whether they were appropriate and if the District properly accounted for them. No issues of noncompliance were identified.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General's Office expresses its appreciation to the Paloma ESD's board members, superintendent, and staff for their cooperation and assistance throughout the audit.

DISTRICT RESPONSE



Paloma Elementary School District

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June 25, 2018

Ms. Lindsey Perry, Auditor General
2910 N. 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Perry,

The Paloma Elementary School District respectfully submits its response to the Preliminary Draft Performance Audit Report for fiscal year 2016.

The findings and recommendations provided to the Paloma Elementary School District will help the district improve its operations and procedures. The District is committed to continuous improvement and the recommendations will help ensure the District continues to operate in the most efficient and effective manner possible.

The Paloma Elementary School District would like to express its appreciation for the professionalism displayed by the Arizona Auditor General's staff throughout the auditing process.

Sincerely,

Kristin Turner, Superintendent

Finding 1: District needs to strengthen purchasing and computer controls

District Response: Paloma School District agrees with the finding and all the recommendations. The District has already addressed the recommendation in regards to purchasing.

Recommendation 1: The District should ensure that it requires an independent review and approval for all its purchases prior to the purchases being made.

District Response: The District will ensure policy is followed. All purchases will be reviewed and approved prior to the purchase being made.

Recommendation 2: The District should limit employees' access in the accounting system to only those accounting system functions needed to perform their job duties, including transferring administrator-level access to someone outside of the business office.

District Response: The District will work with MCESA to limit access to the accounting program to only the roles required to perform duties.

Recommendation 3: The District should create and implement a formal IT contingency plan and test it periodically to identify and remedy any deficiencies.

District Response: The District will work with consultants towards creating and implementing a written formal IT contingency plan. The plan will include detailed information on how to restore systems in the event of system or equipment failure or interruption. The District will also maintain documentation of tests performed of its ability to restore electronic data and files.

Finding 2: District needs to improve transportation program oversight

District Response: The Paloma School District agrees with the finding and all recommendations. The District has already implement new procedures for the oversight of the transportation program.

Recommendation 1: The District should develop and implement procedures to ensure that bus driver certification requirements are met and documented in accordance with the State's Minimum Standards.

District Response: The District will work with an outside vendor to ensure that all bus driver certification requirements are met and documented. The District will ensure that all random drug and alcohol testing is completed each year.

Recommendation 2: The District should ensure that bus preventative maintenance is conducted in a systematic and timely manner and documented in accordance with district policy and the State's Minimum Standards.

District Response: The District has already implemented better procedures for documenting preventative maintenance. The District is keeping maintenance records in

each vehicle with the mileage logs. The maintenance department will ensure the State's Minimum Standards are met for all buses.

Recommendation 3: The District should accurately calculate and report to the Arizona Department of Education the actual number of riders transported for state funding purposes.

District Response: The District became aware of this issue in 2016 and immediately developed new procedures for rider documentation. The District now calculates actual riders instead of eligible riders.

