



CSIS California School Information Services

February 20, 2013

Christine L. Frazier, Superintendent
Kern County Superintendent of Schools
1300 17th Street – Cite Centre
Bakersfield, CA 93001-4533

Dear Superintendent Frazier:

The purpose of this management letter is to confirm the findings and recommendations formulated by the Fiscal Crisis and Management Assistance Team (FCMAT) for the Maple Elementary School District. In October 2012, the county superintendent entered into an amended agreement with FCMAT to perform the following:

The FCMAT Team will test all payroll data from the 2011-12 fiscal year and year to date actuals for the 2012-13 fiscal year. The review will include earnings, extra earnings, deferred net pay (10 month employees) and benefits. Testing associated with this review will be based on sample selection of the data referenced above. Sample testing and review results are intended to provide reasonable, but not absolute assurance as to the accuracy of timekeeping and payroll data. The objective of the report will be to provide findings regarding the efficiency and accuracy of the payroll data and make recommendations for the following:

1. Provide reasonable assurance that payroll transactions are entered by properly authorized personnel and that the transactions are accurately summarized for salary and benefit compensation. The FCMAT Team will obtain the data and information necessary to perform testing of various payroll records. This component will be to evaluate the effectiveness and efficiency of departmental payroll processing operations which include new hires, ghost employees, terminations, salary adjustments, overtime/comp time and leave time, federal and state taxes, unemployment, social security and other statutory benefits.
2. Provide reasonable assurance that access to the timekeeping and payroll operating system is properly secured from unauthorized changes and that the proper internal control systems are in place for data transfers between the payroll and human resources functions.
3. Evaluate the division of labor and segregation of duties between classified and management employees for the payroll function.
4. Review the payroll department work flow.
5. Review the records processing procedures and file management protocol.
6. Evaluate desk manuals and procedures for payroll functions.
7. Review the integration and use of position control with the payroll and personnel functions.

FCMAT

Joel D. Montero, Chief Executive Officer

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8. Verify that the District is in compliance with the State Teachers Retirement System of California (STRS) regarding employee/employer contributions and reporting.
9. Verify that the District is in compliance with the California Public Employees Retirement System (CalPERS) regarding employee/employer payments and reporting.
10. Review the unemployment compensation process to ensure that the District is in compliance with the payment and reporting process for the California State Office of Unemployment Compensation.
11. Ensure that the federal and state withholding allowances claimed by District employees agree with the withholding allowances entered in the payroll system as of September 30, 2012.
12. Review procedures related to deductions and payments to vendors, including but not limited to insurance carriers.
13. Review the revolving fund account. The primary objective of establishing a revolving fund is to enable agencies to disburse cash for specific events in an expedient manner. LEAs can issue checks from the revolving fund for the purpose of making payments of discount or other urgent vendor invoices; petty cash fund and change fund disbursements; and advances to employees for travel, salary or expenses.

LEAs can issue checks drawn against the revolving fund by manually issuing checks or using a check writer subsystem to automatically print checks on an agency printer. The FCMAT Team will review the following items for the district's revolving fund account

- Maintenance of a cash book
- Maintenance of a receivable ledger
- Evaluate the process and preparation of checks for vendors and employees
- Reimbursement/Replenishment of Advances
- Reconciliation process and procedures.

FCMAT conducted staff interviews at the district on October 22, 2012. Before and during the visit, the team collected and reviewed documentation. This management letter is the result of those efforts.

Background

The Maple Elementary School District, a rural single school district located in northwest Kern County, serves students in grades kindergarten through eighth grade. The district's enrollment for the 2011-12 school year was 275, with approximately 23 staff members to support all operations.

The superintendent and business manager position provide all business support, including budget, accounting, accounts payable, human resources, and payroll services. Approximately two years ago, a third position, the school site secretary, was eliminated as a budget saving measure. With the elimination of this position, the business manager maintained her existing duties and assumed those of the school site secretary such as opening district mail, with additional compensation.

In September 2012, the business manager left the district, which temporarily contracted with the Kern County Superintendent of Schools for accounts payable, accounts receivable and payroll support. The superintendent remains responsible for position control, budget, and generating state financial reports. The district has plans to hire a full-time office manager and a 5.5-hour office clerk. The office manager will be responsible for payroll, accounts payable, and human resources. The office clerk will be responsible for attendance, lunch counts, and managing general office traffic.

Payroll

Payroll is the district's most significant operating cost, accounting for 80.67% of annual expenditures in the 2010-11 fiscal year, per Ed-Data. Proper payroll internal controls and procedures ensure that employees are paid the correct salary/wages and benefits, and opportunities for errors and fraud are controlled. Some examples of payroll fraud include overstating regular or overtime hours, increasing salaries or wages without board approval, and paying personnel that do not work for the district or "ghost" employees.

According to the agreed-upon scope of the study, FCMAT attempted to test payroll data from the 2011-12 and 2012-13 fiscal years to evaluate the efficiency and effectiveness of departmental payroll processing operations, confirm internal controls, verify district compliance with the State Teachers Retirement System of California (STRS) and California Public Employees Retirement System (CalPERS), verify unemployment compensation, and confirm deductions and payments to vendors, including but not limited to insurance carriers. The team was provided with a binder of payroll prelists that lacked backup such as timecards, absence slips, employee contracts, benefit or retirement election forms, and state/federal tax withholding documentation. With the recent departure of the business manager, the district has been unable to locate various items and supporting documentation. The superintendent indicated that these documents were previously available to her for review at the beginning of the fiscal year and monthly as payroll was processed. It appears this issue is due to lack of segregated duties, cross-training, and file organization. District administration expressed frustration with the inability to locate documents on demand, but continues to sort, review, and organize office files. Without documentation to support the calculations and approvals of amounts paid to employees, the team was unable to complete the testing as agreed.

The district was unable to provide a manual or procedures of payroll functions for review. Further, since the business manager left the district employment, and the county office performs payroll duties, the team was unable to obtain detailed district office practice and procedure information. A basic position control spreadsheet was provided for review; however, it is used only to develop the budget and not to manage hiring or payroll functions. Position control, which is documentation of board-approved positions and budget assignments, is a valuable component of internal control. Variances between payroll records and position control may indicate errors, procedural weaknesses, or fraud. The district should periodically reconcile payroll and position control to identify any variances for research.

The business manager position is responsible for district payroll, human resources, and accounting duties. These duties require this position to hire and enter employees in the computerized data system, calculate and prepare payroll, and reconcile payroll accounts. Best practice is to segregate authorizations, preparation, and processing duties to minimize payroll errors and reduce the risk of a single person having access to commit payroll fraud. In small offices where it is not possible to segregate these duties, a supervisor, such as the superintendent, should review the payroll prelist and back up documentation. The superintendent reviews employee names on a payroll prelist as part of her payroll authorization process. However, she does not review back up to support the prelist. The district should review its payroll internal controls and adjust the authorization process to monitor payroll back up through sampling and reasonableness tests.

Internal controls are the foundation of sound financial management and allow districts to fulfill their educational mission while helping ensure efficient operations, reliable financial information, and legal compliance. The district should apply the following basic concepts to developing sound payroll procedures:

System of Checks and Balances

Formal procedures should be implemented to initiate, approve, execute, record and reconcile transactions. The procedures should identify the employee responsible for each step and the time period for completion. Key areas of checks and balances include payroll, purchasing, accounts payable, and cash receipts.

Separation of Duties

Adequate internal accounting procedures should be implemented and changes made as needed to separate job duties and properly protect the district's assets. No single employee should handle a transaction from initiation to reconciliation, and no single employee should have custody of an asset (such as cash or inventory) and maintain the records of related transactions.

Staff Cross-Training

More than one employee should be able to perform each job. Each staff member should be required to use accrued vacation time, and another staff member should be able to perform those duties.

Revolving Fund

Board Policy 3314.2(a) authorizes the establishment of a district revolving cash fund for use in "paying for goods, services, and other charges determined by the Board, including supplemental payments required to correct any payroll errors." Checks are generated by hand from a checkbook and require only one signature. The superintendent and business manager positions are authorized signatories on the account. Although board policy does not specify, interviews indicated the approved balance for the district revolving fund is \$500. The district should update Board Policy 3314.2(a) to formally approve and communicate the district revolving fund balance.

The district maintains one checking account to process revolving fund activity and act as a clearing account for items received for deposit with the county of Kern. The account reached a high balance of \$93,079.09 on May 8, 2012. As of the August 31, 2012 bank statement, the account held \$39,405.14. The last time the account was reconciled to approximately \$500 was July 4, 2011. Replenishment of the revolving fund activity occurs as time allows and appears infrequent. During the period reviewed, five checks totaling \$485.52 were disbursed, and no replenishment activity was identified. Transfers to the county of Kern to reconcile the clearing account activity also occur as time allows and appear infrequent. Two transfers were made during the period under review, totaling \$85,734.20. However, seven deposits totaling \$117,731.10 were deposited into the account during this same time period. The last transfer to the county of Kern to reconcile the clearing account activity occurred May 14, 2012, decreasing the account balance to \$14,804.44, which still exceeds a reasonable carrying value for a revolving cash fund in a small school district.

The business manager position generates revolving fund checks upon request and, in addition to the superintendent, is an authorized signatory on the account. The business manager also generates revolving fund replenishment checks, opens mail and collects checks for deposit, deposits checks in the clearing account, initializes transfers to the county of Kern and performs regular reconciliation procedures. Because the district does not maintain a receipt book or log of checks received for deposit, no regular reconciliation is performed to confirm all checks received are deposited. Bank statements, the current checkbook and a partially completed check register were provided for review; however, the district was unable to provide transaction documentation and reconciliation schedules. As a result, FCMAT was unable to verify the checks were for school business use. The check register included activity for four of the five checks written and did not include deposits, transfers to the county treasury, or returned item chargebacks and fees.

Further the district was unable to provide any receipt documentation for clearing account items deposited. Assigning custody of cash, record-keeping, authorization, and reconciliation duties to a single employee allows the employee to control all phases of the accounting function and increases the opportunity for errors and fraud to go undetected. In small offices where it is not possible to segregate these duties, accounting entries and bank reconciliations should be reviewed regularly by a supervisor, such as the superintendent. The district should evaluate and adjust its segregation of duties to strengthen its internal control processes and better safeguard district resources. Additionally, the district should maintain a receipt book or log of checks received for deposit and regularly reconcile the log to deposits.

Assuming a \$500 starting balance for revolving fund activity at the beginning of the period reviewed, the current balance is \$14.48. Failing to reconcile combined revolving account and clearing account activity contained in a single bank account obscures the true balance available for each purpose and may cause check and deposit activity to be accounted for in an improper reporting period. Further, preparing timely bank reconciliations provide an effective internal control for detecting accounting and banking errors and for identifying fraudulent transactions originating from outside the district. Best practice is to maintain separate accounts for the revolving fund and clearing account activity and perform monthly reconciliations, including revolving fund replenishments and clearing account transfers to the county of Kern. However, if creating separate accounts is not feasible, the district should locally track and monitor the two activities independently of each other to provide the information necessary for replenishment or transfer.

In addition to the three basic internal control concepts listed in the payroll section, the district should apply the additional following basic concepts to developing sound revolving account and clearing account procedures:

Use of Prenumbered Documents

An outside printer should print checks, sales/cash receipts, purchase orders, receiving reports and tickets. Physical controls should be maintained over the check stock, cash receipt books, and tickets. It is not sufficient to simply use prenumbered documents. A log of the documents and numbers should be maintained and reconciliation performed periodically.

Asset Security

Cash should be deposited daily, computer equipment should be secured, and access to supplies/stores, food stock, tools and gasoline should be restricted to designated employees.

Timely Reconciliations

Bank statements and account balances should be reconciled monthly by an employee independent from the original transaction and recording process. For example, the employee who processes payroll should not maintain the check stock.

This concludes FCMAT's work for the Kern County Superintendent of Schools. FCMAT extends its appreciation to the county office and Maple Elementary School District staff for their cooperation during fieldwork. If you have questions or require additional information, please contact me at (209) 336-3955.

Sincerely,



Andrea C. Alvarado
Management Analyst