



# **Monterey County Office of Education**

**Extraordinary Audit of the**

## **King City Joint Union High School District**

April 28, 2010





April 28, 2010

Nancy Kotowski, Superintendent  
Monterey County Office of Education  
901 Blanco Circle  
Salinas, California 93901

Dear Superintendent Kotowski:

In January 2010, the Monterey County Office of Education and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement to provide an Assembly Bill 139 extraordinary audit of the King City Joint Union High School District. Specifically, the agreement states that FCMAT will perform the following:

1. The Monterey County Office of Education requests the team to conduct an extraordinary audit of the King City Joint Union High School District and per Education Code Section 1241.5(c), the superintendent of the Monterey COE has reason to believe that fraud, misappropriation of funds, or other illegal practices may have occurred. The FCMAT team will review the district's policies and procedures related to accounts payable processing, payroll, cash management including bank deposits and revolving accounts.

This report contains the study team's findings and recommendations. We appreciate the opportunity to serve you and we extend our thanks to all the staff of the Monterey County Office of Education.

Sincerely,



Joel D. Montero  
Chief Executive Officer

FCMAT

Joel D. Montero, Chief Executive Officer

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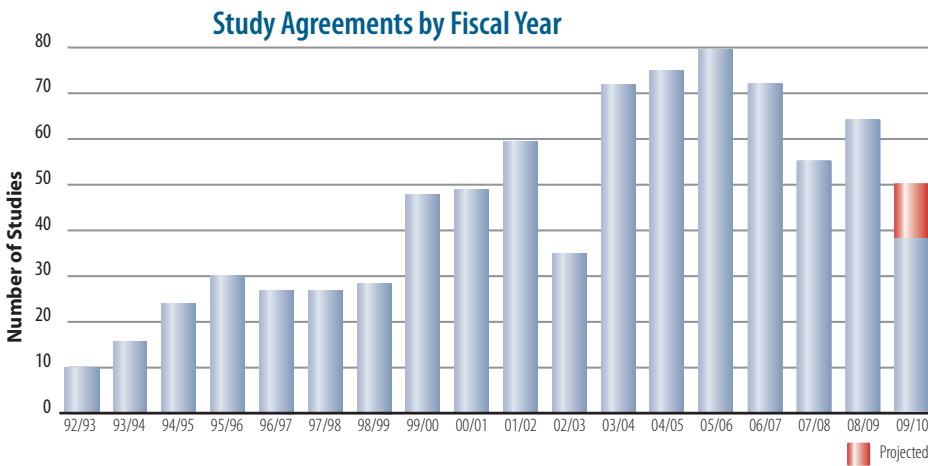
# Foreword - FCMAT Background

The Fiscal Crisis and Management Assistance Team (FCMAT) was created by legislation in accordance with Assembly Bill 1200 in 1992 as a service to assist local educational agencies (LEAs) in complying with fiscal accountability standards.

AB 1200 was established from a need to ensure that LEAs throughout California were adequately prepared to meet and sustain their financial obligations. AB 1200 is also a statewide plan for county offices of education and school districts to work together on a local level to improve fiscal procedures and accountability standards. The legislation expanded the role of the county office in monitoring school districts under certain fiscal constraints to ensure these districts could meet their financial commitments on a multiyear basis. AB 2756 provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans. These include comprehensive assessments in five major operational areas and periodic reports that identify the district's progress on the improvement plans.

In January 2006, SB 430 (charter schools) and AB 1366 (community colleges) became law and expanded FCMAT's services to those types of LEAs.

Since 1992, FCMAT has been engaged to perform nearly 750 reviews for local educational agencies, including school districts, county offices of education, charter schools and community colleges. Services range from fiscal crisis intervention to management review and assistance. FCMAT also provides professional development training. The Kern County Superintendent of Schools is the administrative agent for FCMAT. The agency is guided under the leadership of Joel D. Montero, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.



<b>Total Number of Studies.....</b>	<b>743</b>
<b>Total Number of Districts in CA.....</b>	<b>1,050</b>
Management Assistance.....	705 (94.886%)
Fiscal Crisis/Emergency .....	38 (5.114%)
Note: Some districts had multiple studies.	
Eight (8) districts have received emergency loans from the state (Rev. 12/8/09)	





# Introduction

## Background

In January 2010, the Fiscal Crisis and Management Assistance Team (FCMAT) received a request from the Monterey County Office of Education for an Assembly Bill (AB) 139 extraordinary audit of the King City Joint Union High School District. The county office, under new administrative leadership, identified potential issues of occupational fraud and abuse by district employees that included the unauthorized purchase of two laptop computers and several instances of missing cash located in the business office. The county superintendent was concerned that these issues may have violated the California Education Code section 1241.5 (b) regarding fraud, misappropriation of assets or other illegal activities. The review is conducted to determine if sufficient evidence exists to further investigate the findings, or if there is evidence of criminal activity that should be reported to the local district attorney's office for further investigation.

The study agreement between the county office and FCMAT specifies the following scope of work:

1. The Monterey County Office of Education requests the team to conduct an extraordinary audit of the King City Joint Union High School District and per Education Code Section 1241.5(c), the superintendent of the Monterey COE has reason to believe that fraud, misappropriation of funds, or other illegal practices may have occurred. The FCMAT team will review the district's policies and procedures related to accounts payable processing, payroll, cash management including bank deposits and revolving accounts.

## Study Guidelines

FCMAT provides a variety of services to school districts and county offices of education upon request. Education Code Section 1241.5(b) permits a county superintendent of schools to review or audit the expenditures and internal controls of any school district in that county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. The review or audit conducted by the county superintendent is required to be focused on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and to be conducted in a timely and efficient manner. The basis of this review is to determine if sufficient documentation exists to further investigate the findings, or if there is evidence of criminal activity that should be reported to the local district attorney's office.

## AB 139 Extraordinary Audit Findings and Classifications

Education Code Section 42638 (b) states as follows:

If the county superintendent determines that there is evidence that fraud or misappropriation of funds has occurred, the county Superintendent shall notify the governing board of the school district, the State Controller, the Superintendent of Public Instruction, and the local district attorney.

The issue of fraud can encompass an array of irregularities and illegal acts characterized by intentional deception and misrepresentation of material facts. The principal mechanisms for the deterrence of fraud or illegal practices are strong internal controls. Internal controls include the processes designed to provide reasonable assurance that the district's operations are effective and efficient; the financial information produced is reliable and that the district is operating in compliance with all applicable laws and regulations. The internal control structure includes the policies and procedures utilized by the district staff, accounting and information systems, the work environment and the professionalism of employees while conducting district work.

A material weakness is a deficiency in the internal control process whereby errors or fraud may occur. Because of the weakness, employees in the normal course of business may not detect the errors within a timely period. A material weakness also can be defined by a violation of existing laws or regulations. The following is a partial list of ineffective internal controls:

- Not separating functional responsibilities of authorization
- Unrestricted access to assets or sensitive data (e.g. cash, fixed assets, personnel records)
- Not recording transactions resulting in lack of accountability
- Not reconciling assets with the appropriate records
- Unauthorized transactions
- Unimplemented controls due to unqualified personnel
- Collusion among employees where little or no supervision exists

While all employees in the organization have some degree of responsibility for the internal controls of the district, the governing board, superintendent and senior management are ultimately responsible. This audit provides the Monterey County Office of Education with findings and recommendations regarding documented evidence that fraud has occurred.

## Audit Fieldwork

Investigating allegations of fraud requires a number of steps that include interviewing potential witnesses and assembling evidence from both internal and external sources. The FCMAT team visited the district in February 2010 to conduct interviews, collect data and review documents. Specifically, FCMAT reviewed, analyzed and tested business records including cash deposits, bank reconciliations, cash receipts, general ledger, accounts payable, vendor master list files, payroll, position control and health insurance records, financial reports and internal documents secured from various departments and from independent sources. The review process also included interviews with the state administrator, management personnel, business office staff and other district employees to develop information concerning any alleged mismanagement, fraud or abuse.

Although there are many different types of fraud, embezzlement is common when employees are in positions of trust and have access to assets. Embezzlement is the unlawful taking of property by someone that is lawfully entrusted with its possession for his or her own personal use. Common elements in all fraud include the following:

- Intent, or knowingly committing a wrongful act,
- Misrepresentation to accomplish the act,

- Reliance on weaknesses in the internal control structure, and
- Concealment to hide the act

This report is the result of the investigation.

## Study Team

The FCMAT study team was composed of the following members:

Deborah Deal, CFE  
FCMAT Fiscal Intervention Specialist  
Los Angeles, California

Margaret Rosales  
FCMAT Consultant  
Kingsburg, CA

Leonel Martínez  
FCMAT Public Information Specialist  
Bakersfield, CA

Coral Hansen, CPA/CFF, CFE  
CBIZ MHM, LLC  
Oxnard, CA



# Executive Summary

The Monterey County Office of Education requested that Fiscal Crisis & Management Assistance Team (FCMAT) assign professionals to study specific aspects of alleged fraud in the business office of the King City Joint Union High School District.

The district has been in financial and academic turmoil for several years, experiencing continual turnover of key administrative positions, ineffective governance, lack of leadership (especially in the business office), the loss of accreditation and fiscal insolvency. The county office made several efforts to intervene and provide support to ensure that the district's financial obligations were met in accordance with AB 1200 and AB 2756 fiscal oversight responsibilities. Because of the district's continued fiscal decline, Senate Bill 130 was signed into law on July 23, 2009, authorizing an emergency state loan and the appointment of a state administrator. Critical business office positions have remained vacant for long periods of time. This void in fiscal oversight and leadership has left the district's business functions in the hands of interim fiscal advisors, fiscal experts and business office clerks. Morale in the business office is extremely low.

The county office requested that FCMAT conduct a fraud investigation under the authority of Assembly Bill 139 Extraordinary Audit after receiving written allegations from the county office fiscal expert dated December 22, 2009 describing several irregularities and potential illegal activities in the district's Business Department.

In December 2008, the accounts payable clerk created an unauthorized purchase order in the district's financial system for two pink laptop computers from Dell Computers, Inc. The purchase order was issued to Dell without an authorizing signature and filled by the vendor. The laptops were picked up from the district warehouse by the accounts payable clerk.

In January 2010, while the accounts payable clerk was on medical leave, district personnel were notified that Dell had not received payment for the laptops. Further research determined the origin and issuance of the purchase order. District personnel also discovered that the accounts payable clerk voided the original purchase order in the financial system and destroyed all hard copies. District officials reported the incident to the King City Police Department, and charges were filed against the employee. In January 2010, the employee resigned after admitting to the offense.

Cash has been reported missing from the safe located in the district's business office on two separate occasions in the past 14 months. Between January 12, 2009 and January 20, 2009, \$1,261.46 in cash was determined to be missing, and between October 9, 2009 and November 20, 2009, an additional \$450 was found to be missing during reconciliation. Three employees and one temporary contracted worker were working in the business office during the time of the first theft. Two employees had access to the safe during the second occurrence, but the door to the business office and the safe at times remained unlocked during normal business hours. With no witnesses to either event, the perpetrator of the cash theft cannot be determined and FCMAT has provided procedural remedies in the report.



# Scope and Procedures

The Monterey County Office of Education defines the scope and objective of this study according to the provisions of Education Code Section 1241.5 as follows:

The Monterey County Office of Education requests the Team to conduct an extraordinary audit of the King City Joint Union High School District and per Education Code Section 1241.5(c), the superintendent of the Monterey COE has reason to believe that fraud, misappropriation of funds, or other illegal practices may have occurred. The FCMAT team will review the district's policies and procedures related to accounts payable processing, payroll, cash management including bank deposits and revolving accounts.

During interviews, FCMAT team members asked questions pertaining to policies and procedures, job responsibilities, instances of missing cash from the safe, the unauthorized ordering of laptops from Dell Computers, Inc., and open-ended questions designed to illicit information regarding any other possible irregularities.

Fraud investigations consist of gathering adequate information regarding specific allegations and performing audit test procedures to determine whether fraud has occurred, evaluating the loss associated with the fraud, and determining who was involved and how it occurred. FCMAT developed an investigation plan designed to gather evidence, determine the extent of the fraudulent activity, and identify those involved.

The following audit test procedures were performed related to cash disbursements from the accounts payable system:

- A review of open purchase orders for appropriate authorization.
- A review of paid invoices for the 2007-2008, 2008-2009 and 2009-2010 fiscal years for select vendors to verify that appropriate supporting documentation and authorization were present. The vendors selected were district employees and vendors whose goods or services could easily be converted for personal use.
- An analysis of all payments during the time period stated above to all King City vendors on the master vendor list. Payments to individuals and larger disbursements were selected for further review and extensive testing.

The following procedures and testing were performed related to cash receipts:

- For all receipts of cash from the beginning of the 2009-2010 fiscal year through February 1, 2010, the team traced the individual amount from each prenumbered receipt to the deposit detail and subsequently, to the bank statement.
- Payments made by retirees and board members for health insurance coverage were traced from the deposit detail to the general ledger. Several gaps in payment history required further testing.

The audit tests performed in the payroll and position control included:

- Comparison of actual monthly payroll registers in the business office to the district's independent position control records located in the human resources office.
- A review of budget records to determine that payroll warrants issued were for board-approved employees.

- An analysis of excessive overtime and extra time records for appropriate authorization, and compliance with policy, including the CSEA contract.

The following findings and recommendations are the result of these audit test procedures and sampling of the district's transactions.



## AB 139 Extraordinary Audit Classifications

Each audit finding is classified as a material weakness, a reportable condition or an area for management improvement. These classifications provide guidance to management in developing and strengthening existing internal controls. Strong internal controls and periodic monitoring of those controls greatly reduce the possibility of a material misstatement of the financial statements and/or a violation of existing laws or regulations. Each classification is described as follows:

Material Weakness - A material weakness is a significant deficiency or combination of significant deficiencies in internal controls that results in more than a remote likelihood that a material misstatement of the financial statements that will not be prevented or detected by the district's internal control system or by employees during the normal course of business. A material weakness may also be a violation of current laws or regulations. It is the most serious type of finding.

Reportable Condition – Control deficiencies exist when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A reportable condition is a significant deficiency in a control deficiency, or combination of control deficiencies, that adversely affects the district's ability to record, process, summarize and report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the district's financial statements that is more than inconsequential will not be prevented or detected by the district's internal control.

Management Improvement - A management improvement is not a material weakness or reportable condition, but suggests improvements to the district's operations to conform to industry best practices.

The following table lists the various internal control findings included in the financial statement findings section of the most current audit report dated June 30, 2009 and includes the prior year finding status:

Audit Findings	
2009-1 Going Concern – Material Weakness 2008-1 Not Implemented	The district’s financial situation has deteriorated to the point that a state emergency apportionment under SBI30 has been issued. The district is under the supervision and control of the state superintendent of public instruction and a state administrator has been assigned. A fiscal recovery plan has been developed. The district will begin the implementation process during this fiscal year.
2009-2 Inventory of Equipment/Capital Assets – Significant Deficiency 2008-2 Not Implemented	The district does not have a method to track inventory of items that exceed \$5,000 or more that qualify as capital assets. Since 2003, the district has not updated the inventory listing or made an inventory observation to ensure that all capital assets are accounted for.
2009-3 Purchasing – Significant Deficiency 2008-3 Partially Implemented	Various staff members are not obtaining preapproval via a purchase requisition for various expenditures. Proper segregation of duties does not exist exposing the district to a potential risk of misappropriation of funds. The financial system allows a duplicate invoice to be paid.
2009-4 Vacation/Comp Hours Carryover – Significant Deficiency 2008-4 Mostly Implemented	Improper segregation of duties. The same individual initiates, records and process payments to employees. One district employee is receiving payment for multiple duties during the same work day and hours. One instance where health insurance premiums were in arrears by \$15,015. Lack of reconciliations for health insurance and other benefits to the general ledger. Violations of the CSEA contract which outlines restrictions on allowable carryover of vacation and compensatory hours from one year to the next. Several instances noted where the hours are being carried over in excess of these limits.
2009-5 Cash Receipts – Significant Deficiency 2008-5 Partially Implemented	Bank reconciliations were not performed. The district does not periodically transfer locally deposited funds to the county treasurer. The revolving account is not balanced back to the general ledger.

The audit identifies several areas of material weaknesses and/or significant deficiencies related to the lack of internal controls.

## Internal Controls

Internal controls are the principal mechanism for preventing and/or deterring fraud or illegal acts. Illegal acts, misappropriation of assets or other fraudulent activities can include an assortment of irregularities characterized by intentional deception and misrepresentation of material facts. Effective internal control processes provide reasonable assurance that a district’s operations are effective and efficient, that the financial information produced is reliable, and that the district is operating in compliance with all applicable laws and regulations. The internal control elements provide the framework for an effective fraud prevention program. A good internal control structure includes the policies and procedures used by the district staff, adequate financial and information systems, the work environment and the professionalism of employees. In addition, the district should include the following elements in the plan:

<b>Internal Control Element</b>	
Control Environment	This includes the code of conduct; policies for ethics, hiring and promotion guidelines; oversight by management, the board or an audit committee; and investigation of reported concerns.
Fraud Risk Assessment	The establishment of fraud risks for fraudulent reporting, asset misappropriations, improper receipts or expenditures including adequate separation of duties.
Control Activities	Identify actions taken by management to prevent and identify misuse of the district's assets preventing the override of controls within the system by any employee, including management.
Information and Communication	Establish effective fraud communication for employees. Ensure that employees receive information regarding policies and opportunities to discuss ethical dilemmas.
Monitoring	Conduct ongoing monitoring and periodic performance assessments for fraud deterrence.

Examples of improper internal controls include the following:

- Failure to segregate duties and responsibilities of authorization
- Unrestricted access to assets or sensitive data
- Failure to record transactions, resulting in lack of accountability and the possibility of theft
- Unauthorized transactions, resulting in embezzlement or larceny
- Lack of monitoring or implementing internal controls by management
- Collusion among employees where little or no supervision exists

A system of internal controls consists of policies and procedures designed to provide management with reasonable assurance that the school district achieves its objectives and goals. Traditionally referred to as hard controls, these include segregation of duties, limiting access to cash, management review and approval, and reconciliations. Other types of internal controls include soft controls such as management tone, performance evaluations, training programs, and maintaining established policies, procedures and standards of conduct. The internal control environment also includes the integrity, ethical values and competence of personnel; the philosophy and operating style of management; the way management assigns authority and responsibility and organizes and develops its people; and the attention and direction provided by the governing board and executive management. Internal controls can provide reasonable but not absolute assurance that the district will succeed in achieving its goals and objectives.



# Findings and Recommendations

## Purchasing/Receiving/Accounts Payable

### Lack of Segregation of Duties

A fundamental element of internal control is the segregation of certain key duties. Adequate segregation of duties reduces the likelihood that errors will remain undetected by providing for separate processing by different individuals at various stages of a transaction and for independent review of the work.

The principle underlying segregation of duties is that no employee or group should be in a position to commit and conceal errors or fraud in the normal course of duties. In general, the principle of segregation of duties entails separating the custody of assets, authorizing or approving related transactions affecting those assets, recording or reporting related transactions, and executing the transaction activity. If any of these functions are combined in one employee, the possibility of theft increases.

Purchasing schemes provide a dishonest employee with the ability to manipulate the district's purchasing, receiving and accounts payable functions that can lead to asset misappropriation of inventory. The following are examples of methods used in a false billing scheme designed so that the district orders and pays for merchandise it does not need.

- The purchasing agent also receives the goods.
- Possible Outcome: The employee can place an order for more than is needed and keep the rest, or simply order merchandise for personal use.
- The same employee has purchasing authority for the district and also prepares the accounts payable for commercial warrants.
- Possible Outcome: The employee can create orders for personal use and make payments to the vendor.

Based on information obtained in interviews and observations by FCMAT, the district Business Department has a significant lack of segregation of duties and fiscal oversight. For example, the former accounts payable clerk collected checks and cash, made deposits, reconciled bank accounts, generated purchase orders, and prepared commercial warrants for payment to vendors.

The lack of segregated duties and multiple infractions of proper internal control procedures enabled the former accounts payable clerk to generate a purchase order for laptops, delete that purchase order from the system, receive the goods directly from the warehouse, and hide correspondence from the vendor regarding lack of payment. The team found no further irregularities in the purchasing or accounts payable functions.

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**Based on information obtained in interviews and observations by FCMAT, the district Business Department has a significant lack of segregation of duties and fiscal oversight.**

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Only two employees and one supervisor handle the district's accounting functions. Therefore, segregating duties to maintain effective internal controls is difficult. The following measures should be implemented immediately to protect the district from embezzlement in the areas of purchasing and account payable.

## Recommendations

*The district should:*

1. Consider redefining the staff's roles and responsibilities.
2. Divide the assignment of functions that lead to a lack of segregating controls between the staff where possible.
3. Consider utilizing a part-time employee to help with segregation of duties or an employee from outside the Business Department such as the receptionist, executive assistant, or information technology technician.
4. Restrict the ability to add vendors to someone outside the accounts payable function.
5. Restrict access to the purchase order module to someone other than the accounts payable clerk. This responsibility could be assigned to the manager of the department.
6. Restrict business personnel from taking delivery of goods from the warehouse.
7. Ensure that receiving personnel have goods delivered to the appropriate department only after matching the receiving documents to the signed, approved purchase order.
8. Monitor internal controls periodically to ensure compliance.

# Cash Receipts and Disbursements Management

## Cash Recording and Disbursements

The district business office receives cash and checks from a variety of sources such as developer fees, retiree and board member health insurance premiums, driver training fees, and textbook and library fines. These receipts are recorded on prenumbered receipts and then placed in a safe pending deposit.

Based on interviews and correspondence from the county office's fiscal expert, the district lacked procedures to protect the safe's contents as shown by the following.

- The door to the district's business office was left ajar, and the alarm was not activated on many occasions.
- The safe has been located at a clerk's desk and not in a locked office.
- The safe has been left open and unattended.
- Office keys and alarm codes are shared with several employees
- There is no documentation regarding which employees had the combination to the safe at any given time.
- The safe combination is not changed routinely to protect from a breach.

Based on correspondence from the fiscal expert and a review of cash-receipts documentation, cash and checks were not deposited in the bank on a timely basis. Cash was reported missing two times in the past 14 months. On January 20, 2009, \$1,261.46 that was deposited in the safe on January 12, 2009 was reported missing. On November 16, 2009, \$450 was discovered missing. Upon investigation, district personnel found that no deposits were made to the bank between October 9, 2009 and November 20, 2009, and more than \$19,000 in checks and cash was in the safe during that five-week period of time. Because of the amount of time the missing cash went unnoticed and the lack of security described above, it was deemed impossible to determine who removed the cash in either incident.

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Best practices are to deposit receipts in the bank intact daily or weekly depending on the amount of collection. This helps ensure cash is protected and can help pinpoint the time and minimize the amount of loss if misappropriation does occur.

## Recommendations

*The district should:*

1. Restrict office keys and alarm codes to key employees.
2. Ensure the office remains locked and alarmed at all times outside regular business hours.
3. Locate the safe in a separate office and ensure it remains locked at all times other than when cash and checks are secured or removed.

4. Provide the combination to the safe only to the person responsible for receiving cash and the supervisor for back up.
5. Change the combination at least quarterly to enhance security.
6. Deposit cash and checks in a timely manner at least weekly.



# Payroll, Position Control, Budget and Paid Health Insurance Benefits

## Human Resources/Payroll/Position Control /Budget

The following files were used to compare employee names to verify that only board-authorized employees were included in the position control file and as active employees in the district's budget and payroll records at the time of the FCMAT fieldwork:

- 0910\_KCJUHSD: A file created by the Human Resources Department consisting of a district personnel list of all active positions with detailed employee information on salary and benefits.
- Position Control: A file created and maintained by the district's business office management personnel for budget purposes that consists of a list of the personnel included in the 2009-10 budget divided by certificated and classified employees.
- Payroll Earning files for the fiscal years of 2006-07, 2008-09 and the year-to-date transactions for 2009-10: Files created by and forwarded to FCMAT by the county office personnel consisting of a detailed transaction list of payroll information by date of pay.
- 2009-2010 Payroll: A file generated by the district's payroll personnel that is a summary of the fiscal years' payroll activity listing the fiscal year-to-date gross pay by transaction code.
- Various selected backup documentation to support unusual transactions or excessive overtime.

FCMAT created a table listing the employee's name and full-time equivalent (FTE) hours as listed in the position control file. The table was created to verify and validate employees listed as active in the Human Resources file. In addition, this information was utilized to verify employees that received payroll warrants according to the 2009-10 payroll registers.

An analysis of this table found the following inconsistencies:

1. One certificated employee is listed in the position control file as a .33 FTE and as receiving a paycheck in the payroll file, but is not listed as an active employee in the Human Resources file.
2. Two certificated vacant positions included in the position control file are not listed as open positions in the Human Resources file.
3. Two classified employees are shown as "active" in the Human Resources file and as receiving a paycheck according to the payroll file, but neither employee was listed on the position control or budget files.
4. One classified employee was listed in the position control file, but not in the Human Resources file or the payroll file.

FCMAT found no irregularities in the payroll system with the exception of those noted above. However, the district had not periodically reconciled the position control report, budget and payroll files. These files should be reconciled regularly to ensure that all active positions are valid and properly authorized.

An additional review was performed of excessive overtime and extra pay. One classified employee had \$27,813 in gross pay on the mid-month payroll in October 2009. A review of the supporting documentation found that this payment was for 1,000 hours of compensatory time from a total accumulated balance of 1,300 hours. The supporting documentation was signed by the site administrator and fiscal expert, but did not have the signature of the state administrator as required.

Since October, this same employee has received extra pay on the tenth of each monthly payroll during the following months:

- November 2009            \$1,050
- December 2009         \$1,343
- February 2010          \$ 800

All overtime and extra time should be authorized in advance by management personnel with the authority to act on the district's behalf. The district should review overtime authorization procedures and ensure that the overtime is valid and paid only after the appropriate administrators have approved the timesheet.

The district's collective bargaining agreement with California School Employees Association (CSEA), section 5.11, states that "The employee may opt to carry over a *maximum of 40 hours* of compensatory time" from year to year. The district should enforce the contract language and develop a policy that limits the compensatory time employees may carry over annually.

## Retiree Benefit Review

FCMAT reviewed the source document file (09-10 Retiree Benefit Payments). This is a staff-generated, detailed payment history of each retiree's share of health and welfare premiums. During the review, each transaction recorded on the district's spreadsheet was verified against the daily receipts log and traced to the district's transmittal and stamped bank deposit receipt. The review found no apparent discrepancies between amounts received and amounts recorded for the bank deposits.

**The district should review overtime authorization procedures and ensure that the overtime is valid and paid only after the appropriate administrators have approved the timesheet.**

However, there is a procedural weakness regarding the entering of data and recording of the transactions on the district's spreadsheet. The detail list in the source document file was incomplete, and 27 of the 160 receipts were not entered into the "Retiree Benefit Payments" spreadsheet to track payment history. Inconsistencies in updating the district's file and maintaining current retiree-benefit information could lead to discrepancies between the district's ongoing scheduled payments of retiree premiums and reconciling the district's reimbursement of retiree costs.

The district uses the payroll system to pay health-and-welfare premiums for retirees without utilizing a contra account. A contra account is an offset account used to ensure the district receives all payments. The remaining balances in this account indicate that the district is not receiving the correct amount from each retiree or that premiums are in-arrears for plan participants.

A board member failed to reimburse the district for health insurance premiums paid on behalf of the board member. As of July 1, 2009, this board member owed the district \$13,791, resulting in

the establishment of a payment plan. In the meantime, the district paid the premiums, and the current balance due as of February 2010 was \$6,755. It should not be the business office staff's responsibility to enforce collections for plan participants. Instead, all plan participants should make premiums payments in a timely manner or be eliminated from the policy.

## **Recommendations**

*The district should:*

1. Reconcile the active payroll file with the position control and budget files periodically to ensure that only authorized personnel are paid and that all employees are accounted for in these files.
2. Ensure all overtime and extra time is authorized in advance by management personnel that have been given the authority to act on the district's behalf.
3. Develop a policy that limits the compensatory time that employees may carry over annually, and enforce the CSEA collective bargaining agreement limiting carryover of compensatory time to a maximum of 40 hours annually.
4. Assign the business office to reconcile the deposit of retiree and board member premiums to the spreadsheet that contains the history of each person.
5. Require all plan participants that pay any portion of health insurance premiums to make these payments in a timely manner.
6. Establish a contra account to ensure that the district receives all retiree payments.
7. Establish a procedure to eliminate retirees and board members from the policy if premiums payments are not made in a timely manner.
8. Ensure all supporting documentation for overtime or compensatory time has the signature of the state administrator.



## Ancillary Findings

FCMAT's scope of work was limited to reviewing the district's policies and procedures related to accounts payable processing, payroll, cash management including bank deposits and revolving accounts. However, during interviews and reviews of documentation, the team noted the following additional items that may leave the district susceptible to misappropriation of assets and fraud. The district should further investigate these issues and take corrective action.

The roles and responsibilities of the accounting staff are not clearly defined. Turnover among the small staff has left no one to handle certain responsibilities. For example, the current interim director of fiscal services and payroll clerk did not know exactly where bank reconciliations were filed, when they were last reconciled or who was responsible for reconciliation. In reviewing these files, the team noted that the ASB account reconciliation was last completed for December 2009; however, there was no preparer or reviewer signature even though a stamp for both signatures is included on the document. The team could not locate any reconciliations for the other bank accounts. The payroll clerk indicated that the files under review were the only ones containing any bank reconciliations. Timely reconciliation of all bank accounts is a key element in detecting intentional or unintentional irregularities.

The business staff has had a significant lack of guidance and supervision. The staff performs tasks that require additional training or supervision to complete accurately. For example, the state administrator indicated that he received a payroll check that incorrectly exempted him from state income tax. When this was brought to the payroll clerk's attention, she did not understand how to correct the mistake.

These examples are not intended to represent a comprehensive list of deficiencies, but are observations made by FCMAT during fieldwork.



# Conclusion

Every organization faces a variety of internal and external risks that must be identified, assessed and managed. While all employees in the organization bear some responsibility for internal controls, the governing board, upper management and now the state administrator are ultimately responsible. These leaders must demonstrate a commitment to the establishment of an effective internal-control system and proper monitoring techniques to ensure compliance. Regular external audits are a strong deterrent to mismanagement and fraud, but they cannot serve as the only method of ensuring accountability. It is imperative for the district, the state administrator and governing board to review the findings and recommendations developed during the audit to implement necessary controls and hold the responsible parties accountable.

FCMAT found significant material weaknesses in the district's internal control systems related to segregation of duties, lack of management oversight, and lack of policies and procedures governing the internal control environment, which increase the probability of fraud and/or abuse in the future.

The most recent audit report dated June 30, 2009 includes several findings related to lack of, or inadequate, internal controls. In addition, many of these findings were identified in the previous audit report and have not been resolved, or in some cases only partially implemented. These findings should be of great concern to the district, and immediate intervention is necessary to limit the risk of fraud, misappropriation of assets and illegal acts.

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**It is imperative for the district, the state administrator and governing board to review the findings and recommendations developed during the audit to implement necessary controls and hold the responsible parties accountable.**

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# Appendix

## A. Study Agreement



# FCMAT

FISCAL CRISIS & MANAGEMENT  
ASSISTANCE TEAM

CSIS California School Information Services

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## FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM STUDY AGREEMENT January 22, 2010

The FISCAL CRISIS AND MANAGEMENT ASSISTANCE TEAM (FCMAT), hereinafter referred to as the Team, and the Monterey County Office of Education hereinafter referred to as the COE mutually agree as follows:

### 1. BASIS OF AGREEMENT

The Team provides a variety of services to school districts and county offices of education upon request. Based on the passage of Senate Bill 430 and the provisions of Education Code Section 1241.5 (c), a County Superintendent of Schools may review or audit the expenditures and internal controls of any school district in his or her county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. The extraordinary audits conducted by the county superintendent shall be focused on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and shall be conducted in a timely and efficient manner.

The COE has requested that the Team provide for the assignment of professionals to study specific aspects of the King City Joint Union High School District. These professionals may include staff of the Team, County Offices of Education, the California State Department of Education, school districts, or private contractors. All work shall be performed in accordance with the terms and conditions of this Agreement.

### 2. SCOPE OF THE WORK

#### A. Scope and Objectives of the Study

The scope and objectives of this study pursuant to the provisions of Education Code Section 1241.5:

- 1) The Monterey County Office of Education requests the Team to conduct an extraordinary audit of the King City Joint Union High School District *and per Education Code Section 1241.5(c)*, the superintendent of the Monterey COE has reason to believe that fraud, misappropriation of funds, or other illegal practices may have occurred. The FCMAT Team will review the district's policies and procedures related to accounts payable processing, payroll, cash management including bank deposits and revolving accounts.

B. Services and Products to be Provided

- 1) Orientation Meeting - The Team will conduct an orientation session at the COE to brief COE management and supervisory personnel on the procedures of the Team and on the purpose and schedule of the study.
- 2) On-site Review - The Team will conduct an on-site review at the COE office and at school sites if necessary; and will continue to review pertinent documents off-site.
- 3) Progress Reports - The Team will inform the COE of material issues as the review is performed.
- 4) Draft Reports – When appropriate, sufficient copies of a preliminary draft report will be delivered to the COE administration for review and comment on a schedule determined by the Team.
- 6) Final Report - Sufficient copies of the final study report will be delivered to the COE and District following completion of the review.
- 7) Follow-Up Support - Subsequent to the completion of the study, the Team will meet with the COE at their request, to discuss the findings and recommendations of the report

3. PROJECT PERSONNEL

The study team will be supervised by Anthony L. Bridges, Deputy Executive Officer, Fiscal Crisis and Management Assistance Team, Kern County Superintendent of Schools Office. The study team may also include:

- A. Deborah Deal, FCMAT Fiscal Intervention Specialist
- B. FCMAT Consultant
- C. FCMAT Consultant

Other equally qualified consultants will be substituted in the event one of the above noted individuals is unable to participate in the study.

4. PROJECT COSTS

The cost for studies requested pursuant to E.C. 42127.8 (d) (1) shall be:

- A. \$800.00 per day for each FCMAT Team Member while on site, conducting fieldwork at other locations, presenting reports, or participating in meetings. Cost per day for outside consultants will be billed at the actual daily rate.
- B. All out-of-pocket expenses, including travel, meals, lodging, etc.
- C. The total cost of the study is estimated at \$14,000. The COE will be invoiced at

actual costs, with 50% of the estimated cost due following the completion of the on-site review and the remaining amount due upon acceptance of the final report by the COE.

- D. Any change to the scope will affect the estimate of total cost. In the event that additional investigation is required, a cost amendment to this agreement will be presented to the COE for approval.

Following completion of the review and payment by the COE to FCMAT, the COE is eligible to submit a claim for reimbursement from funds appropriated in the State budget for this purpose. The claim will be subject to final approval by the California Department(s) of Education and Finance.

Payments for FCMAT services may be reimbursed from funds pursuant to EC 1241.5 set aside for this purpose. Other payments, as when deemed necessary, are payable to Kern County Superintendent of Schools- Administrative Agent.

**5. RESPONSIBILITIES OF THE COE AND DISTRICT**

- A. The District will provide office and conference room space while on-site reviews are in progress.
- B. The District will provide the following (if requested):
  - 1) A map of the local area
  - 2) Existing policies, regulations and prior reports addressing the study request
  - 3) Current organizational charts
  - 4) Current and three (3) prior year's audit reports
  - 5) Any documents requested on a supplemental listing
  - 6) Access to original copies of student records, revenue and expenditure receipts and payments, employee compensation records, etc.
- C. The COE Administration will review a preliminary draft copy of the study. Any comments regarding the accuracy of the data presented in the report or the practicability of the recommendations will be reviewed with the Team prior to completion of the final report.

Pursuant to EC 45125.1(c), representatives of FCMAT will have limited contact with pupils. The District shall take appropriate steps to comply with EC 45125.1(c).

**6. PROJECT SCHEDULE**

The following schedule outlines the planned completion dates for key study milestones:


Orientation:	To be determined
Staff Interviews:	To be determined
Exit Interviews:	To be determined
Preliminary Report Submitted	To be determined
Final Report Submitted	To be determined
Board Presentation	To be determined

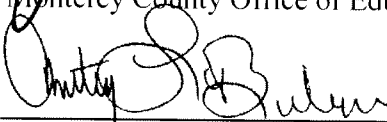
7. CONTACT PERSON

Please print name of contact person: Garry Bousum, Associate Superintendent

Telephone 831-755-0307 FAX 831-753-1686

E-mail Address gbousum@monterey.k12.ca.us

*For*  Assoc Supr 1-22-10  
 Dr. Nancy Kotowski, Superintendent Date  
 Monterey County Office of Education

 January 22, 2010  
 Anthony Bridges, Deputy Executive Officer Date  
 Fiscal Crisis and Management Assistance Team