

**REPORT TO THE
UTAH STATE BOARD OF EDUCATION**



Report No. 2012-08

**MONITORING OF SALT LAKE ARTS ACADEMY
FISCAL YEAR 2012**

January 10, 2013

Audit performed by:

Utah State Board of Education Internal Auditors

Natalie Grange CPA, CFE

Jaime Barrett MAcc

Table of Contents

	Page
Report	1
Findings and Recommendations.....	3
1. Inadequate Segregation of Duties and Internal Controls Over Fiscal Operations	3
2. Inadequate Supporting Documentation and Insufficient Internal Controls Over Expenditures.....	5
3. Noncompliance with State Procurement Policy.....	7
4. Insufficient Payroll Certification Process	7
5. Inadequate Internal Controls Over the Academy's Accounts.....	7

January 10, 2013

Salt Lake Arts Academy
844 South 200 East
Salt Lake City, Utah 84111

Dear Board Members:

State Board of Education Rule 277-116-4(E) authorizes the Internal Audit (IA) department to perform audits recommended by the Audit Committee of the Utah State Office of Education (USOE). Internal Audit was instructed to perform a review of Salt Lake Arts Academy (the Academy) pursuant to a request made by the Academy, and after an initial visit conducted by Natalie Grange, Internal Audit Director. The IA department visited the Academy on May 17 and August 16, 2012, met with members of the Academy's Board on August 29, 2012, and conducted a follow-up visit on November 20, 2012.

The purpose of this limited review is to assess the control environment over major accounting areas, compliance with procurement policies and funding restrictions, and review payroll and expenditure transactions. Internal Audit performed the following procedures at the Academy for fiscal year 2012, which covers the period of July 1, 2011 – June 30, 2012:

1. We reviewed certain aspects of the Academy's internal controls in major accounting areas such as cash receipts, cash disbursements, and payroll. We haphazardly selected cash disbursements, journal entries, and payroll transactions to review for appropriateness. Please see findings 1, 2, 3, 4, and 5.
2. We reviewed the process by which payroll is certified for federal programs. Please see finding 4.
3. We reviewed the Academy's bank statements for fiscal year 2012, and bank statement reconciliations for the same period.
4. We reviewed contracts for compliance with state or school purchasing policies and proper disclosure. Please see finding 3.
5. We reviewed the board minutes for fiscal year 2012.
6. Other compliance issues as considered necessary.

These procedures were more limited than would be necessary to express an audit opinion on compliance or on the effectiveness of the Academy's internal control or any part thereof. Furthermore, these procedures were more limited than would be necessary to provide absolute

assurance that no errors or misappropriations occurred. Accordingly, we do not express such opinions. Alternatively, we have identified the procedures we performed and the findings resulting from those procedures. Had we performed additional procedures or had we made an audit of the effectiveness of the Academy's internal controls, other matters might have come to our attention that would have been reported.

The findings resulting from the above procedures are included in the attached findings and recommendations section of this report. Responses provided by the Academy are included in this section. We have not audited the Academy's responses.

We commend the Academy's Board and management for contacting the USOE for assistance when internal control and documentation matters were discovered. In our follow-up visit in November 2012, we observed substantial improvement in many of the areas noted in the findings that follow. We encourage the Academy to continue to develop policies and process which strengthen their internal control environment and mitigate the various financial risks.

This report is intended solely for the information and use of the Utah State Board of Education, the State Charter School Board, and the Board and management of the Academy and is not intended to be and should not be used by anyone other than these specified parties.

By its nature, this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not also various strengths and accomplishments. If you have any questions, please contact me at (801) 538-7813.

Sincerely,

A handwritten signature in cursive script that reads "Natalie Grange".

Natalie Grange CPA, CFE
Internal Auditor, Utah State Office of Education

FINDINGS AND RECOMMENDATIONS

1. INADEQUATE SEGREGATION OF DUTIES AND INTERNAL CONTROLS OVER FISCAL OPERATIONS

During our review of controls at the Academy, we noted the following segregation of duties conflicts:

- 1) The Business Manager has access to all cash and checks received, has access to the Academy's bank accounts, has custody of the check stock and the credit card machine, has access to the Academy's PayPal account, initiates disbursements, prints checks, enters transactions in the general ledger system, makes adjustments or journal entries in the general ledger, creates employees in QuickBooks, authorizes payroll, and creates the budgets and financial statements for the Academy.
- 2) The Director has access to all cash and checks received, has access to the Academy's bank accounts, has custody of the credit card, has access to the Academy's PayPal account, approves disbursements, is the majority signor on checks, has unlimited check authorization levels, takes the deposit to the bank, and reviews the bank reconciliation.

Weaknesses exist in the fact that anyone serving in the position of the Business Manager has the ability to authorize and record all types of transactions, and has access to all cash receipts and all types of cash disbursements. These weaknesses could be manipulated to misappropriate or redirect cash receipts. Purchases could be initiated by check and concealed in the general ledger. Hours worked or salaries could be adjusted in QuickBooks and go undetected because there is no independent review of detailed payroll. We were unable to verify that any detailed review of cash disbursements, the bank and credit card reconciliation, or the accounting records are being performed by the Board.

The Director has access to cash receipts and the bank accounts, has custody of the credit card, is the majority signor on checks, has unlimited check authorization level, and takes the deposit to the bank. There is no oversight over the transactions initiated and approved by and for the Director.

We did not conduct testwork regarding cash receipting controls; however, it does not appear that any internal control measures are in place for cash collected outside of the front office (fundraisers, PayPal account, donations, activities, etc.).

We were unable to determine that anyone aside from the Business Manager reviews transactions, adjustments, and journal entries in the general ledger or the approved payroll transactions monthly. We noted that there does not appear to be a detailed review of transactions initiated by the Director. We were unable to verify that a review of the QuickBooks file is being performed by anyone aside from the Business Manager.

We recognize that it is impractical for the Academy to achieve full segregation of duties due to budget constraints and the small numbers of business office employees; however, mitigating

controls, such as reviews by the Director or Board, should be implemented to reduce the risks associated with overlapping duties. Insufficient controls increase the risk that errors, waste, or misappropriations could occur without detection.

Recommendation:

The Academy should segregate duties where possible and implement compensating controls to mitigate the risks associated with segregation of duties weaknesses over cash disbursements, cash receipts, and payroll. These controls should be documented in the Academy's policies. The review or reconciliation process should include a review of supporting documentation (receipts, packing slips and invoices, deposit slips, etc.). The Academy should maintain sufficient documentation of the controls implemented to ensure that authorization, review, and reconciliation processes can be verified.

We recommend that the Academy implement a review and approval process for purchase card and disbursement transactions, payroll, and journal entries. Review and approval should occur prior to the execution of the transaction and be performed by someone with supervisory authority over the person initiating the transaction. This approval process should be appropriately documented.

November 2012 Update:

During our most recent visit, we noted cash count sheets being utilized in the cash receipts process and approval was noted on the sampled cash disbursements. However, we were unable to verify if the Academy had implemented adequate internal controls over adjustments or journal entries as these had yet to be performed. We did not note any review or approval by the Board or Board Treasurer on the Academy's bank or credit card statements, QuickBooks file, or a detailed review of cash disbursements. The issues noted above had not been fully resolved by the November 2012 visit.

Salt Lake Arts Response:

Regarding journal entries, we have instituted the procedural safeguard: All general journal entries are presented to the principal, who is informed about the transaction and its implications, and who will then sign off on it.

Each month the Board finance committee receives reconciled bank statements along with reconciled credit card statements (and corresponding receipts) for spot checking. They also review any cash disbursements that occur in the form of checks or EFTs. No check is issued without first recording the liability based on an original invoice. In the case of teacher or office supplies, a supply order form has to be submitted for approval to the principal, and is then ordered by the office manager. The business manager records the liability, pays the bill and the principal signs the check with all the supporting documentation attached. The finance committee has access to all of this documentation at any time. Any purchase above \$1,000 has to be approved via a bidding process, and the check is signed by two signatories. These changes are reflected in our policies.

The finance committee also receives a payroll summary, detailing the actual payroll paid for that month by employee. A report issued by week for all deposits is also included

(includes all payment methods). The finance committee can request a QuickBooks generated bank register for any given period, at any time.

QuickBooks is also periodically checked by knowledgeable finance committee members.

2. INADEQUATE SUPPORTING DOCUMENTATION AND INSUFFICIENT INTERNAL CONTROLS OVER EXPENDITURES

We selected a sample of 50 transactions to test from expenditures made during fiscal year 2012. We noted the following:

- 1) Of the 50 items sampled, we noted that only three transactions had documentation of approval, which were on contracts or on an email authorization from the Director. No approval documentation was obtained or retained for checks issued, aside from the “signature” of the Director on the check. We noted that the Academy requires Board approval for purchases over \$5,000 and the Director and Board Treasurer for purchases exceeding \$1,000, although we did not note approval from the Board or Board Treasurer on these purchases.
- 2) We noted two credit card payments for travel expenses and laptops for which there is no documented approval by anyone. The credit card transactions were originally entered into the accounting system as a lump sum without any individual transaction detail and classified as teacher supplies. The Academy was unable to provide any supporting documentation to substantiate these charges.
- 3) We noted nine check payments totaling \$33,895 for various purchases for MacDocs, facility rentals, refunds, cash boxes, flight changes, and payment to some past students for cleaning out the Academy’s basement. The Academy was unable to provide any supporting documentation to substantiate these charges.
- 4) We noted three electronic fund transfers totaling \$41,416.73 for IRS withholdings for which there is no documented approval or supporting documentation. The only documentation provided was the transfer shown on the bank statement.
- 5) We noted a payment for \$282.96 for which there was no supporting documentation for desks, chairs, and tables.
- 6) We noted a payment for tickets with supporting documentation for \$3,166.58; however, the check was written for \$3,073.68. The Academy was unable to explain the \$92.90 difference.
- 7) We noted two payments written to cash for \$1,200 for student’s food allotments and for \$250 for cash to start up cash box for which there is no supporting documentation. The checks were cashed in order to provide the students with a food allotment at the Shakespeare competition and provide a cash box for a fundraiser.
- 8) We noted a reimbursement to an employee for \$1,640.11 for travel expenditures for which there was no supporting documentation. The only supporting documentation provided was a credit card statement.
- 9) We noted a payment written to a brewing company for \$93.56 for a donation for the Academy’s Gala. *Utah Code 53A-3-501(1) and (b)* states that “a person may not possess or drink an alcoholic beverage in those portions of any building, park or

stadium which are being used for an activity sponsored by or through any part of the public education system.” The only supporting documentation was an email.

- 10) We noted a payment for \$175 for renting a swim club for a graduation party for which there was no supporting documentation. The only provided documentation was emails inquiring renting the facility.

We selected a sample of payroll charges for four employees and two pay periods throughout fiscal year 2012. We noted the following:

- a. We noted that the Academy did not have a written employment agreement for its previous Business Manager. This document should establish the employee’s salary and benefits, work schedule, and employment expectations. LEAs are required to maintain sufficient supporting documentation to substantiate expenditures made from Federal or State funds.

At the time of our review, the Academy did not have any Board approved written financial policies and procedures. The lack of documentation and process to obtain approval for expenditures indicates that internal controls are not functioning appropriately. Insufficient source documentation could result in improper classification or unallowable costs. Failure to properly approve expenditures could result in misappropriation, errors, or misclassification in the accounting records. It is also an indication that the internal control environment within the Academy is not functioning.

Recommendation:

We recommend that the Academy review and implement adequate internal controls over cash disbursements. These controls should address proper approval processes and the requirements for sufficient documentation. We recommend that the Academy establish specific policies governing purchases made with the checks and credit cards. The Academy should review and approve disbursements prior to payment, and maintain documentation of the approval process.

We recommend that the Academy ensure its personnel files contain accurate employment agreements for all of its employees to support payroll expenditures.

November 2012 Update:

During our most recent visit, we noted documentation of approval for expenditures, sufficient supporting documentation, and more robust Board policies and procedures for current year expenditures. The Academy has begun using a payroll servicing company. The Board appears to have made significant changes to their cash disbursement policies and procedures. The continued compliance with their new process should resolve the issues previously identified. However, the Academy did not have employee agreement in place for all employees in November 2012.

Salt Lake Arts Response:

The Academy has an employment agreement with every employee except the principal. The board will review and approve the principal’s employment contract in the upcoming

January 2013 board meeting. All new employees are e-verified and background checked, including parents and substitutes who come in contact with students.

3. NONCOMPLIANCE WITH STATE PROCUREMENT POLICY

Utah Code 63G-6-104 (3) requires LEAs to comply with state procurement policy or develop a more restrictive policy. During fiscal year 2012, the Academy did not have a Board approved policy governing procurement. Thus, the Academy should have been making purchases in compliance with the state procurement policy.

Of the 50 items sampled, we noted three individual purchases of items or services totaling \$4,368.48 for which verbal quotes or bids should have been obtained, based on the purchasing policies of the state. We were not provided any bid or quote documentation at the Academy. There do not appear to be any internal controls functioning to ensure that purchases are made in compliance with the state procurement code.

November 2012 Update:

During our most recent visit, we noted that the Academy implemented a purchasing policy in compliance with the state procurement policy.

4. INSUFFICIENT PAYROLL CERTIFICATION PROCESS

During our review of payroll expenditures made during fiscal year 2012, it was noted that the Academy is not performing payroll certifications in compliance with the Office of Management and Budget (OMB) Circular A-122. Employees who work solely on a single Federal award must have semi-annual certifications to support their salaries and wages. Employees who work on more than one Federal award must have personnel activity reports (PARs). Circular A-122 Appendix B 8.m(2) states that PARs must document the total actual activity of the employee after-the-fact, “be signed by the employee,” and the reports “must be prepared at least monthly.”

The current PARs form used by the Academy lists the employee’s name, check amount, pay period, and check number; however, the individual employees do not account for their actual total daily activity. Furthermore, the lack of total daily activity entries do not provide for sufficient documentation of the total amount of time charged nor does it provide adequate documentation of the time charged to each specific grant. The employee is also not approving an after-the-fact determination of their time, as required by OMB A-122.

November 2012 Update:

During our most recent visit, we noted that the Academy implemented a payroll certification process that is in compliance with OMB Circular A-122.

5. INADEQUATE INTERNAL CONTROLS OVER THE ACADEMY’S ACCOUNTS

We noted the following when reviewing cash disbursements and cash receipt transactions during fiscal year 2012.

- a. There do not appear to be any independent internal controls over journal entries and transfers. Journal entries and transfers have inadequate or no supporting documentation or unclear explanation for why accounts were adjusted.
- b. We noted that a teacher is the designated check signor for disbursements relating to the Director. Although segregating duties so the Director is not approving their own disbursements is accurate, the individual should have supervisory authority over the Director. A better alternative is to have a Board member or the Board Treasurer be the alternative check signor.
- c. We noted that the Director has unlimited check signing authority, although the cash policy states that amounts in excess of \$10,000 requires two signatures.
- d. The Board of the Academy is meeting quarterly which may be appropriate, but the Board may want to consider meeting more frequently to exercise fiduciary responsibilities over their finances, including reviewing and approving bank and credit card reconciliations, providing oversight of the Director's responsibilities, and spot checks over cash disbursements and cash receipts.
- e. It appears that the Academy's policies and procedures are not adopted by its Board.
- f. We noted that the Academy incurred \$61,752.51 in penalties, interest, and liens. It appears that the Academy was not timely filing its Utah withholding and federal payroll taxes. In addition, \$982.65 was paid in finance charges on the Academy's credit cards.
- g. The Academy does not have a standard timecard form for hourly employees to complete for each pay period. The employee and their immediate supervisor should review and sign the form.

November 2012 Update:

During our most recent visit, we noted that all of the issues noted above have been resolved through policy changes and adoption of those policies, consultation with the IRS, State Tax Commission, and legal counsel, and modifications of current practices.

The remaining items are unresolved:

- h. The Academy utilizes PayPal for its fundraising efforts. There does not appear to be a review, approval, or reconciliation process over this revenue stream.
- i. We noted that no one other than the Business Manager, who is recording transactions in the accounting system, is reviewing the QuickBooks file. An individual with supervisory authority over the administration of the Academy should be periodically reviewing the QuickBooks file.
- j. We noted that the Academy's policies and procedures do not include a travel policy, a credit card policy, or a fundraising or donation policy. Policies should be adopted by the Board and reviewed annually. Employees should be made aware of the Academy's policies and procedures to ensure compliance.

Recommendation:

The Academy should continue to work on resolving items h-j above to ensure sufficient internal controls over fundraising efforts, journal entries, and sufficient review and approval of cash disbursements, gifts, and donations.

Salt Lake Arts Response:

The PayPal account has been closed and was not used in 2012. We are currently using an integrated system with Intuit, where the donations are going directly to the bank account. This will be updated to a Google Merchant account in the new year, which offers more substantive options. Further control is already addressed above.

QB review, other than business manager, this is now a standard part of the monthly finance committee's review.

The board approved a travel and credit card policy in October 2012; and we will submit a donation policy at the next board meeting. Board has already instituted and has been reviewing policies on an annual basis.