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## MEMORANDUM

**TO:** Members, State Board of Education

**FROM:** Natalie Grange CPA, CFE  
Internal Auditor

**DATE:** September 7, 2012

**SUBJECT:** Report on Monitoring of Spectrum Academy – Fiscal Year 2012 (Report #2012-06)

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Attached is the report on the **Monitoring of Spectrum Academy – Fiscal Year 2012 (Report #2012-06)**. The objectives of this monitoring review are explained on page one of this report.

Copies of this report will be released to the board and management of Spectrum Academy, the Utah State Board of Education, the Utah State Charter Board, and the Utah State Auditor's Office.

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



**Report No. 2012-06**

**MONITORING OF SPECTRUM ACADEMY  
FISCAL YEAR 2012**

**September 2012**

**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.....	4
3. Noncompliance with State Procurement Policy.....	5
4. Inadequate Supporting Documentation for Payroll Expenditures.....	6
Appendix A .....	7

Report 2012-06

September 7, 2012

Spectrum Academy  
575 N. Cutler Dr.  
North Salt Lake, Utah 84054

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 Spectrum Academy (the Academy) pursuant to a hotline call received by the IA department, and after a visit was conducted by Natalie Grange, Internal Audit Director and Marlies Burns, Charter School Director. The IA department visited the Academy on June 28, 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.

Based on the request, IA performed the following procedures at the Academy for fiscal year 2012, which covers the period of July 1, 2011 – June 5, 2012, the date in which we received the Academy's accounting files:

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, and 4.
2. We reviewed the process by which payroll is certified for federal programs.
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 on page 7. We have not audited the Academy's responses.

This report is intended solely for the information and use of the Utah State Board of Education, 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 Director of Finance and Development (the Director) has access to all cash and checks received, has access to the Academy's bank accounts, has custody of purchase cards and the check stock, initiates and approves disbursements, prints checks, can be the sole signer on checks, enters transactions in the general ledger system, makes adjustments or journal entries in the general ledger, authorizes disbursements, creates employees in QuickBooks, authorizes payroll, and creates the budgets and financial statements for the Academy.
  
- 2) The bookkeeper has access to all cash and checks received, enters transactions and adjustments in the general ledger system, can prepare checks, mails signed checks, prepares deposits and the bank reconciliation, and records payroll in QuickBooks.

Weaknesses exist in the fact that anyone serving in the position of the Director has the ability to authorize and record all types of transactions, has access to all cash receipts and all types of cash disbursements, and serves as the main reviewer of all financial information. These weaknesses could be manipulated to misappropriate or redirect cash receipts. Purchases could be initiated by check or through the credit card 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 payroll. We were unable to verify that any detailed review of cash disbursements, the bank reconciliation, or the accounting records are being performed by the board or the school principal which is especially critical as the Director is the primary authorizer of all transactions.

The bookkeeper has access to cash receipts, records these deposits in the accounting system and prepares the bank reconciliation. Cash receipts could be misappropriated and concealed in the general ledger or in the bank reconciliation; receipts could also not be deposited or recorded.

We did not conduct testwork regarding cash receipting controls; however, in the description of controls provided by the Academy, we are unable to verify that an independent third party reviews an original receipt record and verifies it to the revenues recorded and deposited. It also does not appear that any internal control measures are in place for cash collected outside of the front office (field trips, PayPal account for lunch, donations, carnivals, activities, etc.).

Overall, we noted a lack of documented approval for cash disbursements and purchase card transactions. We were unable to determine that anyone aside from the Director 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 Director.

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 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.

We also recommend the Academy implement a review and reconciliation process for cash receipts. The review should be sufficiently documented and a reconciliation process that compares an initial record of cash receipts received, to the amounts recorded and deposited.

**2. INADEQUATE SUPPORTING DOCUMENTATION AND INSUFFICIENT INTERNAL CONTROLS OVER EXPENDITURES**

We selected a sample of 40 transactions to test from expenditures made during fiscal year 2012. We noted the following:

- 1) Of the 40 items sampled, we noted that only one transaction had documentation of approval, which was an email authorization from the Board President. No approval documentation was obtained or retained for checks issued, aside from the "signature" of the Director on the check.
- 2) We noted three disbursements to the two principals totaling \$9,940 for which there is no documented approval by anyone other than the Director. Two payments of \$5,000 and \$2,100 were coded as signing bonuses. The \$2,100 was made payable to the landlord of one of the principals. The third disbursement totaling \$2,840 was coded as a consulting fee. It was indicated that this fee was paid while one of the principals was not a current employee. There is no supporting documentation for any of these payments, nor could authorization be found in board minutes. These payments appear to be employee and/or contractor compensation. However, because these payments were made through the checking account and not the payroll system, it is highly unlikely that they will be flagged and included in the employee/contractor's taxable income which should be summarized on the W-2 at the end of each year or in a 1099.
- 3) We noted two stipend payments to paraprofessionals totaling \$450 that did not have any supporting documentation. These payments appear to be employee compensation.

However, because these payments were made through the checking account and not the payroll system, it is highly unlikely that they will be flagged and included in the employee's taxable income which should be summarized on the W-2 at the end of each year.

- 4) We noted an ATM withdrawal totaling \$300 for which there was no supporting documentation. The Director indicated the funds were used to purchase desks out of the classified ads.
- 5) We noted a refund of \$47 to a parent on October 17, 2011 for daycare services. This expenditure was not supported by any documentation.
- 6) We noted a reimbursement to a teacher for \$30 for art supplies on March 16, 2012 that lacked supporting documentation.
- 7) We noted a reimbursement to the Director for \$52.07 on September 1, 2011 for a lunch with a potential donor and office supplies. The expenditure was coded to "services from LEA outside state."

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 purchase cards. The Academy should review and approve disbursements prior to payment, and maintain documentation of the approval process.

**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 40 items sampled, we noted seven individual purchases of items or services totaling \$96,919.65 for which verbal quotes or bids should have been obtained, based on the purchasing policies of the state. There is no bid or quote documentation at the Academy, and the Director indicated that purchases were made using personnel's best judgment. There do not appear to be any internal controls functioning to ensure that purchases are made in compliance with the state procurement code.

***Recommendation:***

We recommend that the Academy's management review and implement internal controls and board approved purchasing policies and procedures to ensure compliance with state law.

4. **INADEQUATE SUPPORTING DOCUMENTATION FOR PAYROLL EXPENDITURES**

During our review of payroll expenditures for three employees in fiscal year 2012, we noted that the Academy does not have written employment agreements for administrators. 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.

***Recommendation:***

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

# **Appendix A**



August 28, 2012

Ms. Natalie Grange, CPA, CFE  
Internal Audit Director  
Utah State Board of Education Internal Auditors

Dear Natalie

The Board of Directors of Spectrum Academy (the "Board") has reviewed your draft findings identified as Report No. 2012-06 which was prepared as a result of your internal audit conducted on June 28, 2012. The Board asked me to express our appreciation to you for the opportunity to respond to your findings, and we recognize the work that you, your team and Marlies put in to helping us identify opportunities to strengthen the accounting policies for Spectrum Academy and meet our goals of protecting the assets entrusted to us and transparency in our operations. I appreciate the opportunity to discuss the Report with you in our recent conversation. Either I or a representative of the Board will attend both the Audit Committee meeting and the Utah State Office of Education Board of Education Meeting, schedules permitting. Please let me know the date, time and place for both those meetings.

We have responded to each of the four areas you identified, and our numbered responses correspond to the numbered items in your letter.

1. SEGREGATION OF DUTIES AND INTERNAL CONTROLS OVER FISCAL OPERATIONS

You noted that when a single individual has custody and control of assets, the ability to authorize use of the assets, and recordation duties regarding the same assets, the opportunity for abuse exists. Specifically, you identified that the Director of Finance and Development (the "Director") and the bookkeeper have duties involved in two or more of these activities.

**Director:** We have removed the Director's "write" access to the accounting software (QuickBooks), thereby removing his ability to record transactions into QuickBooks. This will eliminate his ability to authorize and record all types of transactions; specifically cash receipts, cash disbursements and payroll transactions. The Director will have a supervisory role in the accounting system and will review

information prepared by the bookkeeper(s). For a description of the Director's duties regarding purchases, please see Section 2 below.

In addition to this procedural modification, the Board has instituted a policy whereby the bank reconciliations and payroll registers will be reviewed monthly by the Treasurer of the Board. The same Treasurer will have access to QuickBooks in a review capacity, without the ability to enter transactions. Further, the Treasurer will have the ability to review the work of anyone in QuickBooks. Periodic reviews will be done by the Treasurer who will brief the Board as to his findings.

**Bookkeeper:** The bookkeeper has had access to cash receipts, recordation of the deposits and preparation of the bank reconciliation. To address a possible conflict, a second bookkeeper has been hired by the school. One bookkeeper will have the duty of making and recording deposits and a second bookkeeper will prepare the bank reconciliation. This administrative change will eliminate the ability of one bookkeeper to have access to cash receipts, recordation of the receipts and preparation of the reconciliation.

**General Issues:** The Board has instituted a policy wherein all receipts of cash will be recorded in a receipt book, with a duplicate being given to the payee. Those receipts will be matched to the corresponding deposits. A deposit of cash will be made, prepared by someone other than the Director. The Director will then ensure that the amount of the deposit record matches the amount of receipts.

## 2. SUPPORTING DOCUMENTATION AND INTERNAL CONTROLS OVER EXPENDITURES

The need for more consistent documentation was noted for purchases made by Spectrum Academy. To address this issue, the Board has instituted a policy wherein all purchases must be reviewed by the Director, and approved by initialing the invoice. The Director will ensure that the procurement policy of Spectrum Academy (see Attachment 1) has been followed prior to payment being made. The purchase approval and supporting documentation will be maintained by the accounting department.

Second, you identified several transactions that were in the nature of bonuses to the school principals. You were unable to find specific approval for these payments in the Board minutes. The Board has instituted a policy that all bonuses to employees before being paid must be approved by a resolution before the Board. The only exception to this policy will be a small line item in the Board-approved budget allocating to the principals a specific amount of money to distribute to employees for "special act awards". The budget line item for any other bonus not paid under the "special act" procedure described above shall be approved by the Board prior to the disbursement of a bonus, and such payments shall be run through the payroll ledger of Spectrum Academy.

Third, you noted that as of the time of your review the school did not have Board approved written financial policies and procedures. While an informal policy has been in place, the Board is currently drafting new policies to be reviewed and voted upon by the Board in the upcoming September 12, 2012 Board meeting.

### 3. COMPLIANCE WITH STATE PROCUREMENT POLICY

You noted that of the 40 purchase transactions you sampled there were seven transactions for which verbal quotes or bids should have been obtained, but lacked documentation of the bid process. Attachment 1 is a copy of the proposed procurement policy, which, along with the financial policy described in Section 2 above, will be reviewed and voted upon by the Board in the upcoming September 12, 2012 Board meeting. This Policy complies with the requirements of Utah Code 63G-6-104 (3). The Board will periodically review purchases to ensure that the policy is being followed.

### 4. SUPPORTING DOCUMENTATION FOR PAYROLL EXPENDITURES

During your review you noted that Spectrum Academy did not have written employment agreements with the school administration. The Board has formed a committee to obtain employment agreements with the administrators before the October 2012 Board meeting, at which time the employment agreements will be reviewed, approved and executed by the Board. We note that, historically, amounts paid to the administrators remained within the amounts approved by the Board, and has been, and continues to be, commensurate with the quality and quantity of work performed by the administrators.

Again, we thank you for the opportunity to respond to your findings. Our goal is to fully address your concerns and answer any questions you may have. We would appreciate your comments and suggested changes regarding any of the policy and procedural modifications outlined above. The Board will continue to periodically review and improve the policies and procedures referred to in this Response and we welcome your involvement and review of that process.

Yours truly,



Marney DeVroom  
Chairman of the Board  
Spectrum Academy

# Spectrum Academy Purchasing Policy Overview

