

COMMUNITY CONSOLIDATED SCHOOL
DISTRICT 89

**RISK ASSESSMENT AND
INTERNAL CONTROL DOCUMENTATION –
EXECUTIVE SUMMARY**

AS OF APRIL 30, 2010

PROJECT SCOPE AND OBJECTIVES:

Consolidated Community School District 89 (the “District”) secured the services of Baker Tilly Virchow Krause, LLP (“Baker Tilly”) to conduct an assessment to complete documentation of the District’s internal control structure over major transactions classes. The purpose of the review is as follows:

- > Understand the current approach to managing these key financial functions;
- > Document key gaps in internal controls or best practices; and
- > Indicate necessary changes in process; task/staffing assignments, and/or system functionality to achieve the desired process state.
- > Review specific accounting issues upon request of the District

A key consideration for this evaluation is the recent implementation of a new financial system that is in progress. While there are some changes that should be made regardless of the system in place, other changes do rely on the specific capabilities inherent in the District’s financial system. This was not a system assessment and, therefore, we cannot attest to or comment on the actual functionality of the current or any potential system; however, we have outlined some specific system functionalities that are critical and expected when working with established and fully implemented ERP systems

SUMMARY OF INTERNAL CONTROL FINDINGS:

Baker Tilly completed a detailed walkthrough of the key financial processes of the District. This included payroll, accounts payable, revenue, cash reconciliations, treasury, financial close, and general technology controls. The following are the key issues we noted as it relates to internal control.

- Lack of Segregation of Duties – the District potentially has adequate staffing to segregate certain functions to increase control capability but current job responsibilities do not currently allow for this
- Control Environment – there are currently no avenues for employees to confidentially communicate financial concerns or instances of fraud to management or the board
- Uncontrolled Access to Confidential Information – sensitive personal information including social security numbers is maintained by the district in an unsecured manner
- Technology Gaps – the District has an unsecured wireless network connection that can be accessed by anyone within the wireless network range, which exacerbates the issue of having sensitive information in an unsecured manner

A detailed analysis of each financial section is contained within an appendix to this report. The following pages highlight key findings from that report.

KEY INTERNAL CONTROL FINDINGS:

1. Control Environment

Comments:

With an increased focus on accountability and assessing risks in financial matters, the District has taken steps to assess risks with a review of their internal controls. However, there are currently no avenues for employees to communicate concerns confidentially to management or the board.

Recommendation:

Establishing a Whistleblower Policy provides employees with a confidential and anonymous method of submitting concerns regarding fraud, corruption, or other wrongdoings. The State of Illinois has whistleblower laws that can be incorporated into a District policy. Guidance of the District's attorney is recommended.

2. Lack of Segregation of Duties and Appropriate Controls – Financial System

Comments:

Segregation of duties is a basic key control and often one of the most difficult to achieve. It is used to prevent or detect errors and any misuse of funds. Proper segregation of duties means that no one individual should have control over two or more phases of any one process. At School District 89, the Accounting Coordinator acts in a System Administrator capacity that grants her full access to all aspects in the software, including having access to individual logins and passwords for system users.

Recommendation:

Segregate the following duties: authorizing a transaction, maintaining custody, record keeping and reconciliation. For example, the accounting coordinator should not deposit cash (includes currency, checks/money orders, coin) and reconciling bank statements.

In addition, an employee independent of financial record keeping should be assigned the duty of password control as soon as possible. The Alio system has a feature that allows staff to change a password immediately after a temporary password has been assigned, however this feature has not been activated. Staff should be aware that if they are not prompted for a new password, security could be compromised.

KEY INTERNAL CONTROL FINDINGS (continued):

3. Lack of Segregation of Duties and Appropriate Controls – Payroll

Comments:

The Payroll and Human Resource functions are not segregated. The Payroll Specialist enters employees, enters/changes employee pay rates, processes payroll, distributes payroll, prepares the direct deposit transmission and may activate a terminated employee. There is no review of payroll prior to disbursement.

Recommendation:

Ideally, segregation of duties would be controlled by the financial software system through systematic approvals whereas no one process could continue throughout, without additional review. Human Resources functions and Payroll functions would be separated by departments. Additionally, the Assistant Superintendent of Finance should review the payroll prior to final processing. The review would include reviewing an exception report and monitoring the changes in the payroll. Additionally, key controls should be established which require the payroll to be compared to something other than the former payroll but rather to a position control or budget document which clearly outlines an anticipated changes in positions, deductions, salary levels, and/or unique position circumstances (e.g. leave of absence, etc).

4. Lack of Segregation of Duties and Appropriate Controls – Accounts Payable / Vendor Maintenance

Comments:

The Accounts Payable Clerk has the ability to enter new vendors and pay invoices. Although the Accounting Coordinator must provide a password prior to issuance of checks by the Accounts Payable Clerk, there is no review of the invoices /bills list prior to entering the password, leaving a gap in the control. Without the control of reviewing vendor invoices as well as removing access of creating a new vendor, there is a risk of entry of a fraudulent vendor, creating a fraudulent invoice and issuing authorized payment.

Recommendation:

All bill lists and invoices should be reviewed prior to disbursement. A check log should be maintained to ensure that all checks are listed and have been reviewed.

5. Unsecured Access to Business Office Network

Comments:

The District has an unsecured wireless network connection that can be accessed by anyone within the wireless network range. Access to the District's network should be protected from unauthorized users.

Recommendation:

The unsecured wireless connection should be secured and a guest login policy be implemented to allow visitors to temporarily access the network as necessary.

KEY INTERNAL CONTROL FINDINGS (continued):

6. Unsecured Access to Confidential Information

Comments:

Forms with social security numbers and employee bank account numbers are kept in unlocked locations. The Payroll Specialist records employee direct deposit for transmission to the bank on an unsecured jump drive. Several years of employee W2 forms are kept in an unlocked file cabinet. The District may be held financially responsible if these records are compromised and used for identity theft, or other fraudulent activities.

Recommendation:

Immediately delete records from the jump drive and discontinue use. Once direct deposit files are transferred to the bank, and payroll has been processed successfully, the direct deposit files should be deleted. Additionally, if the W2 file transmission has been sent successfully to the government at year-end, those files should be filed immediately in a secure location with limited access. Ideally, only relevant business office staff should have access.

7. Business Office Staffing Levels

Comments:

While we did not perform a complete Business Office review, and are not aware of the staff duties outside of the key financial processes, we have provided a segregation of duties matrix in Appendix B, which may aid the District in determining the proper staffing levels to implement needed controls. Additionally, the following reassignment of duties would increase process and review controls in the Alio system using systematic controls.

Recommendation:

Current duties of the Accounting Coordinator for cash receipts and bank reconciliations could be delegated to other staff (accounts payable and payroll). The Accounting Coordinator would enter reclassifying journal entries, act as the controller and review all work completed by the accounts payable and payroll departments, and assist the Business Manager as necessary.

Review by the Accounting Coordinator would include ensuring that supporting documentation is authorized, reasonable and matches the final output. The Business Manager would review all journal entries and bank reconciliations.

Some of the duties of the Payroll Specialist should be transferred to the Human Resources Benefits Clerk for control purposes. This would include entering and changing employee demographics as well as salary/wage information and benefits information. The duties of the Payroll Specialist would be to ensure HR input is accurate, enter timesheets, enter voluntary deductions, and process bi-weekly payroll. Human Resources should monitor FMLA, and payroll could still monitor the related entitlements with a proper review by the Accounting Coordinator. These changes would be facilitated by making the Accounts Payable position a full FTE from its current part-time status.

KEY INTERNAL CONTROL FINDINGS (continued):

8. Monthly Financial Reports

Comments:

Monthly financial reports presented to the Board of Education are compiled manually. There have been instances where the information contained within the reports was incorrect and/or did not add up properly. This has called into question the reliability of the reports the Board has been using to assess financial condition and make related decisions.

Recommendation:

We recommend that the District work with its software provider, Alio, to develop a dashboard report that can be generated directly from the Alio accounting system. This process will ensure that the data is complete and accurate.

Additionally for clear review of the District's financial status, reporting could include, an itemization of investments including rate of return, purchase date, maturity date, and amount of collateral maintained. Cash and investment balances by fund can be reconciled to the District's bank account balances. Any reconciling items such as outstanding checks, wires in transit, and deposits in transit can be noted by bank account.

While the current payroll report summarizes each payroll's gross and net payroll amounts across all funds, the District may consider separating amounts by fund to allow for identification and comparison of payroll expenditures for any specific month.

A summary of disbursements over a specific threshold be provided to the Board for any non-payroll liability vendors to provide additional information to the Board for any large disbursements that are paid to a vendor during the month.

ACCOUNTING ISSUES REVIEW:

At the Superintendent's request, Baker Tilly also reviewed specific accounting issues, which are summarized as follows:

Analysis of Liability Accounts

Based upon the review of the activity recorded in the liability accounts and the system settings on payroll benefit and deduction codes we have isolated the source of the errors within the system. The incorrect balances within the District's balance sheet and income statement are attributable to the incorrect processing of vendor liability checks and incorrect settings within the payroll system's benefit and deduction codes. We recommend that a detailed analysis of the account activity within all of the liability accounts be performed on a monthly basis from July 1, 2009 through present to identify any adjusting journal entries that are necessary to correct the incorrect processing of vendor liability payroll checks and the allocation of payroll related expenditures and liabilities.

ACCOUNTING ISSUES REVIEW (continued):

Analysis of General Ledger Account Structure and Bank Account Structure

A review of the district's general ledger account structure and use of bank accounts noted that numerous improvements could be made to improve efficiency and control. We recommend that the District perform a detailed review over the chart of accounts and inactivate old accounts and accounts that are no longer compliant with the Illinois Program Accounting Manual. Account numbers that have an incomplete or inaccurate description should be corrected with the proper description within the system. The District should also review the cash and investment account structure on the balance sheet so that specific accounts can be reconciled to specific bank accounts.

Analysis of Capital Project Fund Balance

Baker Tilly reviewed the balance in the Capital Project Fund to determine if it appeared reasonable as of April 21, 2010. Based upon the above reconciliation between the District's internal records and the report provided by IHC Construction Company LLC it appears that the records can be tied out to each other within approximately \$11,000 and that the District's estimated ending balance in the Capital Project Fund will be approximately \$735,000 once all invoices and retainage is closed out by IHC.

Detailed results of these specific reviews are as follows:

ANALYSIS OF LIABILITY ACCOUNTS:

Baker Tilly received information from the District's interim Business Manager that several liability accounts on the District's balance sheet had unexplained balances. A detailed review of the activity in the liability accounts was performed to determine the cause and the following issues were identified:

- Due to the need of a two-stage software conversion, it was noted that Payroll was processed in SDS from July 1, 2009 through December 31, 2009. This was necessary so that proper record keeping could be maintained for W-2 compliance.
- After each payroll was processed in SDS an adjusting journal entry file was created for the account distribution of the payroll. This journal entry was uploaded into Alio to ensure that the account distribution for each payroll was maintained in Alio, as this system will be the primary system for reporting in FY 2010.
- Employee payroll checks were processed from SDS and the vendor checks relating to Payroll were processed from Alio. These vendor checks were processed manually by the accounts payable clerk in Alio. This manual process required the accounts payable clerk to code the account distribution and amount for each check from a report obtained from SDS.

ANALYSIS OF LIABILITY ACCOUNTS (continued):

- Based upon the review of several transactions the Baker Tilly engagement team identified that the vendor checks prepared manually by the Accounts Payable clerk appear to have not been processed against the proper liability accounts within the accounting software.
- During the review of the payroll system settings for benefit and deduction codes within the software it was noted that several codes were incorrectly setup.
 - IMRF board paid expenditures were being allocated to the IMRF Fund, however, the liability for these expenditures were being processed from the Education, Operations and Maintenance, and Transportation Fund.
 - FICA board paid expenditures were being allocated to the IMRF Fund, however, the liability for these expenditures were being processed from the Education, Operations and Maintenance, and Transportation Fund.
 - Medicare board paid expenditures were being allocated to the IMRF Fund, however, the liability for these expenditures were being processed from the Education, Operations and Maintenance, and Transportation Fund. Medicare benefit expenditures should be charged to the same Fund from which the employee's salary was processed.
 - These system-setting errors have created incorrect balances in the IMRF, Education, Operations and Maintenance, and Transportation Fund's Cash and Liability account balances on the balance sheet and within expenditures on the income statement.

Based upon the review of the activity recorded in the liability accounts and the system settings on payroll benefit and deduction codes we have isolated the source of the errors within the system. The incorrect balances within the District's balance sheet and income statement are attributable to the incorrect processing of vendor liability checks and incorrect settings within the payroll system's benefit and deduction codes.

We recommend that a detailed analysis of the account activity within all of the liability accounts be performed on a monthly basis from July 1, 2009 through present to identify any adjusting journal entries that are necessary to correct the incorrect processing of vendor liability payroll checks and the allocation of payroll related expenditures and liabilities. The District should correct the benefit and deduction code settings within the payroll system so that expenditures and liabilities are accounted for in the proper Fund moving forward. The District should also consider working with its auditors to ensure that the correct adjustments are made and properly reflected in the year-end financial statements.

ANALYSIS OF ACCOUNT STRUCTURE:

Baker Tilly obtained a chart of accounts report from the Alio system and reviewed the account structure and descriptions. We obtained and reviewed the March bank reconciliations and March bank statements for all of the District bank accounts. A vendor demographic file was obtained for all the vendors established within the software.

- During our review, it was noted that several account descriptions are missing and in some cases not detailed enough for a system user to determine the purpose of the account. Several of these account numbers are no longer necessary, as they are not compliant with the Illinois Program Accounting Manual; other accounts are no longer utilized by the District and are not budgeted for any use.
- During the review of the District's balance sheet, it was noted that several cash and investment accounts were being maintained for each Fund. In some cases, several accounts had large positive balances that had to be aggregated with several accounts that had large negative balances in order to determine the proper balance at a point in time. It was noted that several of these accounts needed to be aggregated together in order to perform a bank reconciliation and that in other cases only one account was associated with a specific bank. This practice was due to the way the District's bank account structure is currently organized, in addition to system settings that are currently in place to record receipts and disbursement in specific cash and investment accounts
- During the review of the District's vendor file in the accounting software it was noted that there are several vendors in the system that were carried over from the old accounting software that the District did not utilize in fiscal year 2010. It was also noted that several vendors established in the system did not have complete demographic information.

We recommend that the District perform a detailed review over the chart of accounts and inactivate old accounts and accounts that are no longer compliant with the Illinois Program Accounting Manual. Account numbers that have an incomplete or inaccurate description should be corrected with the proper description within the system.

The District should review the cash and investment account structure on the balance sheet so that specific accounts can be reconciled to specific bank accounts. The District may consider reorganizing the current bank account structure to increase efficiencies in managing the District's assets while ensuring that the proper blend of liquidity and rate of return on investments is achieved. The District may consider working with the accounting software provider to optimize the system so that receipts and disbursements can be recorded against the proper cash and investment account on the balance sheet.

A review of the master vendor file should be performed for completeness and to identify any vendors that are no longer utilized by the District. Vendors no longer utilized by the District should be inactivated from the system and any vendors that are utilized by the District and do not have complete information should be corrected within the software.

ANALYSIS OF CAPITAL ASSETS FUNDS:

The District's Superintendent and interim Business Manager expressed concern regarding the current balance in the Capital Project Fund.

Baker Tilly reviewed the following items to determine if the balance in the Capital Project Fund appeared reasonable as of April 21, 2010:

- The District's fiscal year 2008 audited financial statements
- The District's fiscal year 2009 audited financial statements
- The District's internal accounting reports for the Capital Projects Fund for fiscal year 2008, 2009, and 2010
- The closing memo's associated with the 2008 and 2009 Bond issuances for the Capital Project Fund
- Reports provided by Tom Carrano with IHC Construction Company regarding project expenses and unpaid items
- Reviewed payments made in fiscal year 2010 to vendors regarding the Asbestos Abatement Project and VOIP Project

During the review of the previously mentioned items, it was noted that there were several timing variances between the District's internal accounting records, the District's audit reports, and the schedules prepared by IHC. After adjusting for the timing variances in each report, a reconciliation was performed by reviewing the expenditures paid per the District's audited financial statements and expenditures recorded through April of fiscal year 2010 to the IHC reports.

During the reconciliation, it was noted that the IHC reports did not include the expenditures associated with the bond issuance. This is an incorrect assumption as the District incurred approx. \$292,000 in costs to issue the bonds that funded the Capital Project Fund. It was also noted that the IHC schedule included expenditures that had not yet been paid by the District as of April 2010. After further review of this schedule with Tom Carrano at IHC it was noted that approx. \$1,080,000 of expenditures were pending relating to unprocessed invoices and retainage across several projects. This schedule was also incorrect regarding the actual amounts paid by the District through April 2010 for the Asbestos Abatement and VOIP Project.

ANALYSIS OF CAPITAL ASSETS FUNDS (continued):

After adjusting for all of the timing variances between the District's records and the report prepared by IHC the following reconciliation was prepared and is as follows:

IHC Construction Schedule Reconciliation to District internal Cash Basis Records through April 2010		
Total Expenditures per IHC construction schedule	24,406,147.00	
Abatement cost variance –	(107,897.00)	
VOIP cost variance -	(116,369.00)	
Open Invoices per IHC	(705,722.00)	
Retainage Payable per IHC	<u>(373,816.00)</u>	
Adjusted Construction Schedule Payments through - 4/21/2010		23,102,343.00
Total Capital Project Fund Exp. - paid through 4/21/2010		<u>23,113,258.99</u>
Unreconciled difference		<u><u>(10,915.99)</u></u>

Based upon the above reconciliation between the District's internal records and the report provided by IHC Construction Company LLC it appears that the records can be tied out to each other within approximately \$11,000.

ANALYSIS OF CAPITAL ASSETS FUNDS (continued):

A further analysis was performed based upon the remaining balance in the Capital Project Fund as of April 2010 in the District's internal records and the remaining open invoices and retainage payable per IHC Construction Company LLC and is as follows:

Capital Project Fund Analysis 7/1/08 through 4/21/10 - Cash Basis		
Total Bond Proceeds-Net of Issuance Costs	24,693,480.00	
Total Interest Revenue	300,379.67	
Total Expenditures - paid through 4/21/2010	<u>(23,113,258.99)</u>	
Remaining Balance Capital Project Fund		1,880,600.68
Cash and Invest. balance per Balance Sheet - 4/21/2010		<u>1,880,599.81</u>
Difference		<u><u>0.87</u></u>
Cash and Invest. per Balance Sheet - 4/21/2010	1,880,599.81	
Pending Billings - Per Tom Carrano at IHC - 4/21/2010	(1,079,538.00)	
VOIP - Pending	(116,369.00)	
Credits due from IHC	<u>50,000.00</u>	
Estimated ending balance Capital Project Fund		<u><u>734,692.81</u></u>

Based upon the analysis it appears that the District's estimated ending balance in the Capital Project Fund will be approximately \$735,000 once all invoices and retainage is closed out by IHC Construction Company LLC.