



STATE OF ILLINOIS
**OFFICE OF THE
AUDITOR GENERAL**

William G. Holland, Auditor General

SUMMARY REPORT DIGEST

REGIONAL OFFICE OF EDUCATION #25
HAMILTON AND JEFFERSON COUNTIES

FINANCIAL AUDIT

For the Year Ended: June 30, 2012

Release Date: August 21, 2013

Summary of Findings:

Total this audit:	10
Total last audit:	14
Repeated from last audit:	4

SYNOPSIS

For the fiscal year ended June 30, 2012, **auditors disclaimed an opinion** of the financial statements of the Regional Office of Education #25. The Regional Office did not have sufficient internal controls over the processing of most accounting transactions. Specifically, auditors concluded that the Regional Office of Education #25:

- did not have sufficient internal controls over the financial reporting process;
- did not have adequate review of journal entries;
- had a cash account not recorded on the books;
- did not have adequate internal controls over:
 - cash;
 - payroll;
 - grant compliance;
 - cash disbursements; and
- had excess working cash in an internal service fund.

{ Revenues and expenditures are summarized on the reverse page. }

REGIONAL OFFICE OF EDUCATION #25
HAMILTON AND JEFFERSON COUNTIES

FINANCIAL AUDIT
For The Year Ended June 30, 2012

	FY 2012	FY 2011
TOTAL REVENUES	\$2,244,769	\$3,908,655
Local Sources	\$734,613	\$872,941
% of Total Revenues	32.73%	22.33%
State Sources	\$1,361,647	\$2,604,288
% of Total Revenues	60.66%	66.63%
Federal Sources	\$148,509	\$431,426
% of Total Revenues	6.62%	11.04%
TOTAL EXPENDITURES	\$2,246,106	\$4,043,895
Salaries and Benefits	\$1,553,993	\$2,644,457
% of Total Expenditures	69.19%	65.39%
Purchased Services	\$554,178	\$1,031,894
% of Total Expenditures	24.67%	25.52%
All Other Expenditures	\$137,935	\$367,544
% of Total Expenditures	6.14%	9.09%
TOTAL NET ASSETS	\$693,267	\$694,604
INVESTMENT IN CAPITAL ASSETS	\$734,439 ¹	\$778,929 ¹
¹ Capital asset amounts are not net of related debt which is associated with assets of the Hamilton-Jefferson Educational Services Cooperative. Percentages may not add due to rounding.		

REGIONAL SUPERINTENDENT
During Audit Period: Honorable Ron Daniels Currently: Honorable Ron Daniels

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

CONTROLS OVER FINANCIAL STATEMENT PREPARATION

The Regional Office of Education #25 did not have sufficient internal controls over the financial reporting process.

The Regional Office of Education #25 is required to maintain a system of controls over the preparation of financial statements in accordance with generally accepted accounting principles (GAAP). Regional Office internal controls over GAAP financial reporting should include adequately trained personnel with the knowledge and expertise to prepare and/or thoroughly review GAAP based financial statements to ensure that they are free of material misstatements and include all disclosures as required by the Governmental Accounting Standards Board (GASB).

For the fiscal year ended June 30, 2012, auditors disclaimed an opinion of the financial statements of the Regional Office of Education #25. The Regional Office did not have sufficient internal controls over the processing of most accounting transactions. There were inadequate controls over the preparation/review of GAAP based financial statements. During the normal course of performing their assigned functions or duties, management may fail to prevent or detect financial statement and disclosure errors and omissions. Auditors, in their review of the Regional Office's accounting records, noted the following:

- The Regional Office did not have adequate controls over the maintenance of complete records of cash by fund, accounts receivable, capital assets, accounts payable, or deferred revenue.
- The Regional Office did not have adequate controls in place to ensure that all assets and revenues were properly recorded in the general ledger. (See Findings 12-03, 12-04, and 12-07)
- The Regional Office did not have adequate controls in place to ensure that all transactions were properly authorized, recorded in the proper period, and correctly allocated between funds. (See Findings 12-02, 12-05, 12-06, 12-07, and 12-08)

According to Regional Office officials, for the fiscal year ended June 30, 2012, the Regional Office of Education #25 had all new management and accounting personnel and was unfamiliar with Regional Office policies, procedures and necessary internal controls over the financial reporting process. (Finding 12-01, pages 12-13) **This finding was first reported in 2007.**

The auditors recommended that, as a part of its internal control over the preparation of financial statements, including disclosures, the Regional Office of Education #25 should implement comprehensive preparation and/or review procedures to ensure the financial statements, including disclosures, are complete and accurate. Such procedures should be performed by a properly trained individual(s) possessing a thorough understanding of applicable generally accepted accounting principles, GASB pronouncements, and knowledge of the Regional Office of Education's activities and operations.

Additionally, the Regional Office of Education #25 should design and implement a system of processes and controls that will ensure complete records are maintained, all assets and revenues are recorded in the general ledger, and all transactions are properly authorized, recorded in the proper period, and correctly allocated between funds.

The Regional Office of Education #25 responded that it understands the nature of this finding and realizes that this circumstance is not unusual in an organization of this size. The transition to the office without any prior knowledge of the office practices and a part-time bookkeeper for half of the year led to several mistakes. The Regional Office stated that now that a full time trained bookkeeper has been hired, the ROE is implementing procedures and controls that ensure all records are maintained and all assets and revenues are recorded in the general ledger, which includes all transactions, deposits, expenses, assets and liabilities. (For previous Regional Office response, see Digest Footnote #1.)

INADEQUATE REVIEW OF JOURNAL ENTRIES

The Regional Office of Education #25 did not have adequate review of journal entries.

The Regional Office of Education #25 is responsible for establishing and maintaining an internal control system over journal entries to prevent errors or fraud. In addition, adequate controls over compliance with laws, regulations, and grant agreements require supervisory review of expenditures charged to grant programs.

During review of journal entries, auditors noted it was the Regional Office's policy to document journal entries with support from the general ledger, a "snapshot" of the journal entry printed from the accounting system and a journal entry report listing all journal entries made during the fiscal year, all or part of which would contain approval by the Regional Superintendent. The Regional Office of Education #25 made 242 journal entries during the fiscal year ended June 30, 2012. In 18 of the 242 (7%) journal entries made, there was no supporting documentation other than the journal entry listing and approval by the Regional Superintendent was not documented.

Auditors also noted that two journal entry numbers within the sequence of journal entries posted through the year ended June 30, 2012 were not included on the journal entry report listing. The bookkeeper indicated that she probably entered the journal entry incorrectly and subsequently deleted them.

In addition, during testing of 32 individual journal entries, the following exceptions were noted:

- In 12 of the 32 (38%) journal entries tested, while the Regional Superintendent signed off on the journal entry “snapshot,” there was no documentation to support the purpose of the journal entry.
- In 13 of the 32 (41%) journal entries tested, the purpose of the journal entry appeared to be to shift expenditures to match grants. (See Finding 12-06)

According to Regional Office officials, during the fiscal year ended June 30, 2012 the Regional Office bookkeeper was new and they indicated adequate training was not available and that many journal entries were needed to correct previous miscoded transactions. (Finding 12-02, pages 14-15)

The auditors recommended that the Regional Superintendent should review and approve all journal entries along with supporting documentation prior to the entries being posted to the accounting records. In addition, the Regional Office should seek training opportunities for the bookkeeper.

The Regional Office of Education #25 responded that the Regional Superintendent or Assistant Regional Superintendent now reviews and approves all journal entries along with the supporting documentation. The Regional Office noted that after the initial transition year, journal entries were minimal. The bookkeeper will also continue to attend needed training opportunities to follow proper accounting procedures.

CASH ACCOUNT NOT RECORDED ON THE BOOKS

Good business practices and sound internal controls require that accounting records accurately and completely record all assets and transactions of the entity. The Regional Office opened a new bank account on February 15, 2012 to segregate the funds received and paid for its University Classes fund. The bookkeeper did not enter the new bank account into the accounting system. In order to transfer the amounts received from July 1, 2011 to February 15, 2012, the Regional Office prepared checks made out to the new bank account totaling \$57,130. Instead of recording these checks as a transfer to another bank account within the general ledger, the Regional Office recorded the checks as a reduction of revenue.

The Regional Office of Education #25 had a cash account not recorded on the books.

In addition, from February 15, 2012 through June 30, 2012, all receipts and disbursements related to the University Classes fund were deposited and paid from the new bank account and were not entered into the general ledger.

Assets were understated by approximately \$60,000, revenues were understated by approximately \$131,000, and expenditures were understated by approximately \$71,000. Failure to record bank accounts in the general ledger results in inaccurate financial reporting and increases the risk of misappropriation of assets. According to the Regional Office of Education #25 officials, the bookkeeper believed that more than one bank account could not be entered into the general ledger. (Finding 12-03, page 16)

The auditors recommended that the Regional Office of Education #25 should ensure all bank accounts and related activity are recorded in the general ledger.

The Regional Office of Education #25 responded that it separated obligated funds into separate bank accounts so that cash balances would not appear inflated. The ROE stated that it is working with support from the financial account system company and has moved all bank accounts and related activity into the general ledger.

INADEQUATE CONTROLS OVER CASH

The Regional Office of Education #25 is responsible for the safeguarding of assets and maintaining an adequate system of internal controls over accounting transactions to prevent error or fraud. In addition, bank reconciliations should be performed on a regular basis and all differences between the bank balance and the general ledger balance should be investigated and resolved.

The Regional Office of Education #25 did not have adequate internal controls over cash.

During the audit of the Regional Office of Education #25, auditors noted the following deficiencies related to its internal control over cash:

- The Regional Office of Education did not have an accurate general ledger cash balance for their pooled cash account or an accurate bank reconciliation as of June 30, 2012. The Regional Superintendent did not review and approve bank reconciliations prepared by the bookkeeper.
- While it is the policy of the Regional Office that disbursement checks contain dual signatures, the following issues prevent this from being an adequate control:

1. There are four authorized signatures on the bank account. One of the authorized signers maintains the books, prepares disbursements and reconciles the bank statements.
 2. The Regional Office maintains a stamp of the Regional Superintendent's signature. This stamp is in the custody of another authorized signer on the account and was not kept in a locked location.
- Auditors noted that after Regional Office employees left for the day, petty cash and undeposited funds were left in a file cabinet in the bookkeeper's office. While the drawer was locked, the key was kept next to the file cabinet and accessible by anyone with access to the Regional Office.
 - The Regional Office of Education implemented the use of bank debit cards during the fiscal year. The holders of the debit cards are able to use the debit cards anywhere they are accepted. Because cash is immediately removed from the Regional Office bank account in debit card purchases, these transactions are not subject to the Regional Office internal control procedures and unauthorized purchases could be made without recourse by the Regional Office.
 - During disbursement testing selection, auditors noted that checks numbered 52000 through 54000 were unaccounted for. Upon inquiry of the missing two thousand (2000) checks, no steps had been taken by the Regional Office to determine the reason for the unaccounted for checks. The bookkeeper believed they may have not been sent from the check printer.

According to Regional Office of Education #25 officials, they believed that by having dual signatures on their checks they were implementing a better internal control system than that which a single authorized check system provides. They did not consider the lack of segregation of duties or the signature stamp as weaknesses in the control. The Regional Office indicated that the use of debit cards made purchasing items for the programs it administers easier and did not consider that the cards could be misused. The bookkeeper indicated that she could not get cash to balance and could not figure out how to remove old voided checks from the accounting system. (Finding 12-04, pages 17-19)

The auditors recommended that the Regional Office of Education #25 should implement proper controls for the safeguarding of assets and maintain an adequate system of internal controls over accounting transactions to prevent error or fraud.

The Regional Office of Education #25 responded that the Regional Superintendent or Assistant Regional Superintendent now reviews and signs off on all monthly bank reconciliations. Bank reconciliations are prepared monthly using the STI module by the bookkeeper and signed off by the Regional Superintendent or Assistant Regional Superintendent. The Regional Office stated that tighter controls have also been implanted in the office to increase internal control over cash: all petty cash and undeposited funds are locked in the Bookkeeper's office with the key located elsewhere in the building. The Bookkeeper has been removed as a signer on all bank accounts and the ROE has stopped using the debit cards and implemented the use of US Bank credit cards. The signature stamp is locked up in the Bookkeeper's office and she has been removed as a signer on all bank accounts. The signature stamp is not used for check signing purposes anyway. The Bookkeeper confirmed, with the company that printed the office checks, that a sequence of checks was inadvertently missed. The ROE will ensure that the next order is verified and all blank checks are locked up in a fireproof filing cabinet in the Bookkeeper's office.

INTERNAL CONTROLS OVER PAYROLL

The Regional Office of Education #25 did not have adequate internal controls over payroll.

The *Regional Office of Education (ROE) Accounting Manual* (Section XIV) general policies concerning payroll procedures states that a master record should be maintained on each employee or contractor for federal and State reporting purposes. The master payroll record should contain at least the following: employee name, social security number, address, date of hire, rate of pay, and terms of contract/agreement.

In addition, the *ROE Accounting Manual* (Section XIV) states all payroll costs should be supported by time and effort attendance records (prepared at least monthly and signed by the employee) that account for the total activity for which each employee is compensated. Only actual payroll costs supported by time sheets should be charged to each Source of Funds.

During the course of the audit, auditors noted that certain employees' assigned functions included tasks for various funds, but their salaries and benefits were not allocated those funds.

During review of payroll, auditors tested 25 employees and 40 individual payroll transactions covering 23 payroll periods, of which 18 periods contained direct deposit transactions, and the following exceptions were noted:

- In 1 of the 25 (4%) employees tested, two different employment contracts with the same date were

signed by the Regional Superintendent and maintained in the employee's personnel file.

- In 1 of the 25 (4%) employees tested, the pay rate schedule maintained by the bookkeeper differed from the contract by \$1,148.
- For 24 of the 25 (96%) employees tested, the reasonableness of the amount paid could not be determined because the ROE did not maintain a listing of job titles, descriptions of job duties and responsibilities and related pay scale.
- In 17 of the 40 (43%) individual payroll transactions tested, required time and effort sheets were not maintained.
- In 7 of the 25 (28%) employees tested, the employee paychecks did not agree with the pay schedule maintained by the bookkeeper.
- In 8 of the 25 (32%) employees tested, the amount paid to the employee differed from the approved contract amount.
- In 6 of the 23 (26%) payroll periods tested, an approved payroll register was not maintained.
- In all 18 of the direct deposit payroll transactions tested, a preliminary direct deposit draft was not approved by either the Regional Superintendent or the Assistant Regional Superintendent.
- In all 18 of the direct deposit transactions tested, a final direct deposit transmittal was not approved by either the Regional Superintendent or Assistant Regional Superintendent.

The Regional Office did not document when terms or pay amount changes were made to employee contracts or update the pay schedules to reflect those changes. The bookkeeper indicated that she sometimes forgot to print the payroll registers and/or the direct deposit drafts and transmittals. In addition, the Regional Office was not aware that time and effort sheets were required to support payroll costs across funds. The Regional Office did not maintain a listing with job titles or description of duties and responsibilities that would help ensure salaries were allocated accurately across funds. (Finding 12-05, pages 20-22)

The auditors recommended that the Regional Office of Education #25 should implement proper controls over payroll, including properly documenting any changes to salary, job

title and/or job duties and responsibilities. Each change should be clearly described and approved by the Regional Superintendent on an employee contract and updated on the bookkeeper's pay schedule.

Auditors also recommended that time and effort sheets should be completed and maintained and the Regional Superintendent should approve payroll only once proper fund allocation has been determined. The Regional Superintendent should also review and approve direct deposit confirmation reports to ensure that accurate payroll has been disbursed.

The Regional Office of Education #25 responded that during the transition year many adjustments were made to match payroll to the actual funds available to the Regional Office. The ROE noted that it was extremely difficult to determine how much salary could be assigned to different funds when income from different programs was not known. An office policy manual with job titles, duties and responsibilities is being developed. The Regional Office stated that the Regional Superintendent is in the process of implementing proper controls over payroll and any payroll changes that occur during the fiscal year. Time and effort sheets have been implemented with certain staff, along with yearly days worked calendars. The ROE noted that the Regional Superintendent or Assistant Regional Superintendent currently checks and signs off on the payroll register report, direct deposit report and the transmittal confirmation from the bank for the direct deposits. The Regional Office also stated that salaries have been adjusted during the FY 13 year to better match available funding. Job titles, descriptions and responsibilities should all be completed by the end of the fiscal year.

INTERNAL CONTROL OVER GRANT COMPLIANCE

The Regional Office of Education #25 did not have adequate internal control over grant compliance.

As a recipient of federal, State, and local funds from various grantor agencies, the Regional Office must incorporate certain procedures into their operations in order to comply with the grant agreements with these entities. The Regional Office is responsible for establishing and maintaining an internal control system over receipts and disbursements sufficient to complete accurate and timely quarterly expenditure reports required for grants administered by the Illinois State Board of Education.

In addition, grant agreements require the Regional Office to report actual expenditures incurred rather than reporting expenditures based on the amount budgeted in the grant agreement. The Regional Office is required to spend funding in accordance with budgets submitted to grantors.

During the course of the audit, auditors noted the following related to the controls over grant compliance:

- The final expenditure report for the Regional Safe Schools grant was submitted to the Illinois State Board of Education 38 days late.
- Expenditure reports were not consistent with the Regional Office's general ledger for the Truants Alternative and Optional Education grant, the Regional Safe Schools grant, and the ROE/ISC Operations Grant. The expenditure documentation was inadequate to support the amounts reported to granting agencies.
- The Regional Office did not document the time and effort of employees that work for or are paid from multiple grants (Finding 12-05) so that salary can be allocated to the grants based on actual costs.
- Multiple journal entries were made to "match grant final expenditures," to "balance of grant," "to tie out to grant," and other similar descriptions. According to the bookkeeper, these reclassified expenditures could have been used by any program or grant and were not necessarily incurred by the fund being charged.

The Regional Office did not have adequate internal control procedures in place to ensure that accurate expenditure reports were transmitted and that they were properly supported by actual general ledger activity.

Additionally, the Regional Superintendent stated that for the first two quarters, expenditure reports were submitted as an estimate based on grant budgets and expenditures were later reclassified through journal entries to match previously submitted expenditure reports and not necessarily to match actual expenditures incurred by those grants. (Findings 12-06, pages 23-24)

The auditors recommended that the Regional Office of Education #25 should implement adequate internal controls to ensure that timely expenditure reports are supported by appropriate documentation and expenditures are recorded within the applicable general ledger fund at the time of the expenditure. The employee responsible for submitting expenditure reports should use expenditures from the general ledger after all adjustments have been made when completing the expenditure report. In addition, the Regional Office should formally document time and effort spent on each grant for employees paid from multiple grant sources and allocate actual costs to each grant accordingly.

The Regional Office of Education #25 responded that time and effort sheets are now kept for employees in each grant. Again,

determining the amount of salary to be allocated from each grant was very difficult to determine during the first year in office. The Regional Office stated that it is correcting the recording and processing of grant expenditures in a timely matter. The ROE noted that the Regional Safe Schools expenditure reports have all been filed properly this year and time and effort sheets are now being used to document time spent working for different funding sources.

INTERNAL CONTROLS OVER CASH DISBURSEMENTS

The Regional Office of Education #25 did not have adequate internal controls over cash disbursements.

The Regional Office of Education (ROE) Accounting Manual (Foreword) establishes that the Regional Superintendent of Schools is responsible for establishing and maintaining an internal control system that provides reasonable assurance about the reliability of its GAAP financial statements, operational compliance with legal and contractual provisions, safeguarding of assets, and effectiveness and efficiency of ROE operations.

Regional Office of Education #25 policies and procedures indicate that all cash disbursements, other than those for payment on regular monthly utilities, would be initiated through the preparation of a purchase order. The purchase order would be later matched to the invoice and then subsequently entered into the general ledger for payment.

Pursuant to Regional Office policies and procedures, the bookkeeper receives all invoices for coding to the appropriate general ledger account. The bookkeeper lacked personal knowledge of where the items were being used and coded the invoices using one of two methods. One, she coded it as it had been coded in prior years, or two, if it was an expenditure allowable by a grant, she would charge a grant that had money left in its budget, regardless of where the expenditure was actually incurred.

Auditors selected 60 individual cash disbursements, 20 debit card, and 9 credit card transactions and noted the following exceptions:

- In 1 of the 60 (2%) cash disbursements tested the check amount was greater than the invoice amount and there was no documentation to support the difference.
- In 1 of the 60 (2%) cash disbursements tested, there was no supporting documentation for the payment.
- In 10 of the 60 (17%) disbursements tested, no purchase order was prepared.

- In 1 of the 20 (5%) debit card disbursements tested, supporting documentation could not be located.

Further, during review of capital assets, auditors noted that the Regional Office inadvertently paid two invoices totaling approximately \$16,000 that should have been paid by Rend Lake Regional Delivery System. (Finding 12-08, pages 26-27)

The auditors recommended that the Regional Office of Education #25's management should ensure the Regional Office designs and implements an adequate system of internal controls over cash disbursements to prevent errors and fraud. All disbursements made by the Regional Office should be supported by sufficient documentation and should be recorded in the correct fund.

The Regional Office of Education #25 responded that the Regional Superintendent will implement closer control over the cash disbursements made and documentation provided by the bookkeeper to ensure adequate procedures are followed and that expenses are recorded in the correct fund.

EXCESS WORKING CASH IN INTERNAL SERVICE FUND

Internal Service Funds are used to account for the Regional Office of Education #25's administrative services, which are provided to many of the Regional Office's funds. Revenue is generated through charges to other funds using inter-fund billings. Regulations set forth by *OMB Circular A-87 (Revised 5/10/04)* require charges by an internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve. In addition, the full recovery of costs is allowable. A working capital reserve of up to 60 days cash expenses for normal operating purposes is considered reasonable. A working capital reserve exceeding 60 days may be maintained for exceptional cases; however, it requires approval of the cognizant Federal agency.

The Regional Office of Education #25 had excess working cash in internal service fund.

Over the last two years, average annual expenses within the Workers' Compensation Fund and Unemployment Fund, both Internal Service Funds, were \$45,233 and \$7,716, respectively. Workers' Compensation Fund cash at June 30, 2012 totaled \$70,106, representing approximately 566 days of average expenses. Unemployment Fund cash at June 30, 2012 totaled \$6,702, representing approximately 317 days of average expenses.

The Regional Office of Education #25's prior years' indirect cost rates were too high, as the calculations included funding for future expenditures. (Finding 12-09, pages 28-29) **This finding was first reported in 2009.**

The auditors recommended that the Regional Office of Education #25 should examine and adjust the indirect cost rate as needed and provide credits to the individual programs overcharged in prior years.

The Regional Office of Education #25 responded that the Regional Superintendent agrees with this finding that indirect costs are too high and is working to make adjustments accordingly. The ROE stated that it will credit individual accounts and transfer some of the excess for other liabilities. Since the fund balance is extremely large and with a reduced number of employees, during the next fiscal year, the ROE will allocate zero indirect costs to individual accounts. (For previous Regional Office response, see Digest Footnote #2.)

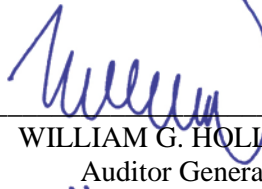
OTHER FINDINGS

The report contained two additional findings. These findings included:

- internal controls over revenues (Finding 12-07, page 25); and
- internal controls over distributive funds (Finding 12-10, pages 30-31).

AUDITORS' OPINION

As noted in Finding 12-01 (see page iii of the digest), our auditors disclaimed an opinion on the Regional Office of Education #25's financial statements as of June 30, 2012.



WILLIAM G. HOLLAND
Auditor General

WGH:KJM

AUDITORS ASSIGNED: West & Company, LLC were our special assistant auditors.

DIGEST FOOTNOTES

#1: CONTROLS OVER FINANCIAL STATEMENT PREPARATION — Previous Regional Office Response

In its prior response in 2011, the Regional Office of Education #25 responded that the current administration has hired a bookkeeper with a Masters in Business Management and 20 years of background in school accounting and GAAP financial reporting. The ROE has implemented procedures to ensure internal control.

#2: EXCESS WORKING CASH IN INTERNAL SERVICE FUND — Previous Regional Office Response

In its prior response in 2011, the Regional Office of Education #25 responded that the current administration is in the process of implementing procedures to examine and adjust the indirect cost rate as needed and provide credits to the individual programs overcharged in prior years.