

INVESTIGATIVE AUDIT REPORT

ETOWAH CITY SCHOOL
ETOWAH CITY SCHOOL SYSTEM
JULY 1, 2006, THROUGH JUNE 30, 2007



State of Tennessee



**Comptroller of the Treasury
Department of Audit
Division of Municipal Audit**



STATE OF TENNESSEE

John G. Morgan
Comptroller

C O M P T R O L L E R O F T H E T R E A S U R Y

STATE CAPITOL

NASHVILLE, TENNESSEE 37243-0260

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May 15, 2008

Director of Schools and Members of the
Board of Education
Etowah City School System
858 Eighth Street
Etowah, TN 37331

Director of Schools and Board Members:

Presented herewith is the report on our investigative audit of selected records of the activity funds of Etowah City School, and selected records of the Etowah City School System. This investigative audit focused on the period July 1, 2006, through June 30, 2007. However, this scope was expanded if warranted.

Section 49-2-110, *Tennessee Code Annotated*, provides for student activity funds and establishes responsibility for those funds. This section requires local school systems to adopt the *Internal School Uniform Accounting Policy Manual* (prepared and approved as set forth in this code), and to maintain all activity fund books and records in accordance with the requirements of the manual. The purpose of our audit was to determine the extent of the school's compliance with certain laws and regulations, including those in this manual.

The findings and recommendations in this report present those conditions that we believe warrant the attention of the school's officials and other responsible individuals. As a result, the responses to each of the findings and recommendations are included in the report.

Director of Schools and Members of the
Board of Education
Etowah City School System
May 15, 2008

Copies of this report are being forwarded to Governor Phil Bredesen, the State Attorney General, the District Attorney General, certain state legislators, and various other interested parties. A copy is available for public inspection in our office.

Very truly yours,

A handwritten signature in black ink that reads "John G. Morgan". The signature is written in a cursive style with a long horizontal flourish at the end.

John G. Morgan
Comptroller of the Treasury



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF MUNICIPAL AUDIT

John G. Morgan
Comptroller of the Treasury

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Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

May 15, 2008

Mr. John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, TN 37243

Dear Mr. Morgan:

As part of our ongoing process of examining the records of the activity and cafeteria funds of schools, we have completed our investigative audit of selected records of the activity funds of Etowah City School, and selected records of the Etowah City School System. This investigative audit focused on the period July 1, 2006, through June 30, 2007. However, this scope was expanded if warranted.

Section 49-2-110, *Tennessee Code Annotated*, provides for student activity funds and establishes responsibility for those funds. The board of education is responsible for providing reasonable regulations, standards and procedures, and adopting an activity fund accounting manual. The director of schools is responsible for ensuring that laws and rules of the state and of the board of education are faithfully executed. The principal's responsibilities include accounting for the safekeeping and handling of money collected for and raised by student activities and school services and events. During the scope of this audit, state law specifically excludes funds raised by parent-teacher and parent-student support type organizations from accounting and recordkeeping requirements. Therefore, these funds were not included in our audit.

Student activity funds must be accounted for according to the *Internal School Uniform Accounting Policy Manual*. This manual was prepared by the Tennessee Department of Education and approved by the Comptroller of the Treasury and the Commissioner of Finance and Administration, in accordance with Section 49-2-110, *Tennessee Code Annotated*. The purpose of our audit was to determine the extent of the school's compliance with certain laws and regulations, including those in this manual.

Mr. John G. Morgan
Comptroller of the Treasury
May 15, 2008

Our investigative audit resulted in findings and recommendations related to the following:

1. Failure to establish and follow policies regarding credit cards
2. Inadequate procedures and documentation related to purchases of gift cards
3. Inadequate supporting documentation
4. Purchase authorization not correctly documented for all required purchases
5. Discrepancies between check payees recorded in the school system's computerized accounting system and payees noted on actual transacted checks
6. Dot matrix printer used by school to print checks could not be properly scanned
7. Inadequate separation of duties.

Because state law assigns specific responsibilities for school activity funds to the members of the board of education, the director of schools, and the principal, they were asked to respond to each finding. When appropriate, other responsible individuals were also asked to respond. The responses are included in this report.

If after reviewing the report you should have any questions, I will be happy to provide any additional information which you may request.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis F. Dycus". The signature is fluid and cursive, with a large initial "D" and "F".

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

**INVESTIGATIVE AUDIT OF SELECTED RECORDS
OF THE ETOWAH CITY SCHOOL
ETOWAH CITY SCHOOL SYSTEM
FOR THE PERIOD JULY 1, 2006, THROUGH JUNE 30, 2007**

FINDINGS AND RECOMMENDATIONS

1. **FINDING: Failure to establish and follow policies regarding credit cards**

School system administrators failed to establish policies related to credit cards issued in the school system's name. We noted numerous deficiencies in internal controls and procedures related to school system credit cards:

- a) The finance director apparently obtained credit cards in the school's name at her discretion, without any required approval or authorization by the director of schools, the school principal, or other administrators.
- b) The finance director was the only authorized signature on at least one school credit card. As a result, other administrators did not have access to account information.
- c) The finance director was unable to provide auditors with complete information related to school credit cards, and the number of cards provided to the school.
- d) Although some credit cards, such as the Wal-Mart cards, were provided to other school employees to make purchases, the finance director did not maintain any logs to show to whom the cards were issued and when they were returned.
- e) The finance director was unable to provide complete records of credit card charges. She stated that she physically cut the statements so that applicable charges could be filed with other invoices from corresponding accounts. Auditors were unable to locate many of the credit card statements' pieces or related charge slips and invoices, in the school records provided by the finance director. (To obtain a comprehensive record of charges, credit card statements were requested and obtained from applicable credit card companies.)
- f) School records did not include adequate supporting documentation for many credit card purchases. As a result, documentation was insufficient to determine if the school system or school received the benefit of some purchases. Refer to Finding 2 and Finding 3 for additional information and recommendations related to inadequate supporting documentation.
- g) The school received premium rewards from at least two of the credit card companies as incentives for use. These rewards, redeemed by the finance director, apparently

included restaurant gift cards, fuel cards, food items, etc. The finance director stated that a former administrator had given her permission to keep the cards for her personal use at school-related conferences. She later stated that some of the premium rewards had also been given to a consultant and used to purchase office gifts.

State law sets forth the powers and duties of the local board of education, which include developing policies as needed to manage and control schools under its jurisdiction, including policies concerning the supervision and administration of internal school funds.

RECOMMENDATION:

To ensure that all purchases are authorized and appropriate and benefit the school system and/or school, administrators should establish a policy related to credit cards obtained in the school's or system's name. The policy should address authorization required to obtain cards, authorized limits, authorized users of each card, documentation of use requirements, etc. Administrators should also ensure that the policy addresses the disposition of incentive rewards and is consistent with the City of Etowah's Ethics Policy. In all instances, school and/or school system administrators should ensure that the finance director obtains and files adequate supporting documentation for all disbursements.

MANAGEMENT'S RESPONSE:

Director of Schools and Members of the School Board:

We concur with the findings of the audit. We are in the process of developing policies concerning the use of credit cards in our system, in accordance with our own policies, the policies of the City of Etowah and state law. The director of schools is in the process of issuing a directive concerning the number of credit cards, the use of such cards, and the accounting for purchases made thereon.

Finance Director:

I do not concur with the findings of a and b. The superintendent at that time, Dr. Larry Beckley, directed the finance director to obtain the credit card in her name. I concur with all other findings and have already taken steps to correct e and f.

Principal:

I concur with the findings of the audit.

2. **FINDING: Inadequate procedures and documentation related to purchases of gift cards**

The finance director failed to establish adequate procedures or to obtain and file adequate documentation related to gift cards purchased with school system and school money. From November 2005 through June 2007, gift cards totaling approximately \$4,000 were purchased by the school/school system. The director of schools stated that earlier in the 2007 school year, he instructed the finance director not to purchase additional gift cards. However, school records indicated that between January 1, 2007, and June 30, 2007, the finance director purchased cards totaling over \$2,000. The finance director told auditors that she purchased gift cards totaling over \$1,400 from Wal-Mart in June 2007 in order to indicate in school records that money related to the homeless grant had been expended so that the school would not lose the money. She stated that she gave three of the gift cards totaling \$665.03 to the school employee responsible for administering this money. According to the finance director, she used the remainder of the eight \$100 gift cards to purchase items related to the homeless grant.

We noted the following deficiencies in documentation related to gift cards:

- School records did not include any documentation as to the disposition of some of the gift cards. The finance director stated she gave some cards as gifts to various employees, such as “Teacher of the Year,” and others to teachers who were retiring. However, the finance director maintained no written documentation indicating who received these cards as gifts.
- The finance director did not require employees to sign indicating they were provided gift cards in order to make school purchases, and did not ensure that these employees remitted documentation showing how the cards were expended, or that cards with unused balances were returned.
- The finance director retained eight \$100 Wal-Mart gift cards at the end of the 2007 school year purchased with homeless grant funds. Although the finance director provided auditors with an invoice from Wal-Mart, showing the purchase of 35mm cameras, headphones, various software packages, etc., the invoice apparently had been cut, and did not include a date, total, store location, or payment method. In addition, two items on the invoice, showing the purchase of spaghetti, were marked out with no explanation.

Etowah City School Policy Code 485 requires all payments to be supported by invoices and vouchers properly certified and approved with respect to materials or services received or expenses incurred. The *Internal School Uniform Accounting Policy Manual*, pages 5-13–15, set forth purchasing procedures, which include maintaining adequate supporting documentation for all disbursements.

RECOMMENDATION:

To help ensure and provide evidence that each disbursement was for a valid school purpose, school system and school administrators should ensure that if gift card purchases are allowed to continue, the finance director adequately controls the cards, and requires and maintains adequate documentation of disposition in the school's files.

MANAGEMENT'S RESPONSE:

Director of Schools and Members of the School Board:

We concur with the findings of the audit. The director of schools is in the process of issuing a directive that no gift cards will be purchased without the prior approval of the director of schools or his designee.

Finance Director:

I concur with the findings of the audit.

Principal:

I concur with the findings of the audit.

3. **FINDING: Inadequate supporting documentation**

The school's files did not include adequate supporting documentation for some disbursements. We noted the following deficiencies:

- a) We were unable to locate any invoices or other supporting documentation in school records for some disbursements.
- b) Some disbursements were supported by monthly statements only.
- c) Checks were signed without review of adequate supporting documentation.
- d) Although many disbursements had invoices, invoices were not signed to indicate the school actually received the goods or services.
- e) For numerous purchases for meals, candy, medications, gift cards, supplies, etc., the purpose was not indicated. Therefore, documentation was insufficient to determine if the school or school system actually received the benefit of these purchases.
- f) The finance director was unable to provide complete records of credit card charges. As noted previously, she stated that she physically cut the statements so that

applicable charges could be filed with other invoices from corresponding accounts. Auditors were unable to locate many of the credit card statements' pieces or related charge slips and invoices, in the school records provided by the finance director.

Etowah City School Policy Code 485 requires all payments to be supported by invoices and vouchers properly certified and approved with respect to materials or services received or expenses incurred. The *Internal School Uniform Accounting Policy Manual*, pages 5-13–15, set forth purchasing procedures, which include maintaining adequate supporting documentation for all disbursements. Section 6-3 of the manual states that “Before signing checks, each signatory should review adequate supporting documentation (such as vendor invoices, purchase authorizations, etc.).”

RECOMMENDATION:

To help ensure and provide evidence that each disbursement was for a valid school purpose, school system and school administrators should ensure that adequate documentation is maintained in the school’s files. Check signers should review adequate supporting documentation as necessary prior to signing checks.

MANAGEMENT’S RESPONSE:

Director of Schools and Members of the School Board:

We concur with the findings of the audit. The director of schools is in the process of issuing a directive that proper documentation must be made and maintained that support all purchases, and that such documentation be reviewed before checks are signed.

Finance Director:

I concur with the findings of the audit. But, as previously stated, there were invoices and documentation missing that were there before.

Principal:

I concur with the findings of the audit.

4. **FINDING: Purchase authorization not correctly documented for all required purchases**

School administrators failed to ensure that the finance director and other school employees obtained required authorization prior to making purchases. Both the school principal and director of schools acknowledged that the finance director provided the purchase requisitions/authorizations for their signature concurrently when she provided the related check, rather than prior to the actual order or purchase of goods and services.

Etowah City School Policy Code 482 states that for a requisition to be appropriate, it must contain the necessary specified information and "... (4) have the approval of the Superintendent (or the Administrator designated with this responsibility)." Related to internal school funds, the *Internal School Uniform Accounting Policy Manual*, page 5-12, states:

A purchase authorization is a prior written authorization by the principal, or designee, approving the purchase of goods and services. A prenumbered purchase authorization is required for each purchase of goods and/or services of \$100 or more except for emergency repairs or purchases, reimbursements from restricted accounts not sponsored by the principal, and purchases of goods and services made under contract. . . . the principal should not authorize payment in any amount for purchases that: are not appropriate; or are to be paid out of accounts that do not have sufficient balances.

Pages 5-12–14 of the manual set forth detailed procedures for the use and retention of school purchase requisitions/authorizations/orders.

RECOMMENDATION:

To better control expenditures and help prevent deficit fund or account balances, school personnel should correctly and consistently use and file a purchase requisition/purchase order for each applicable order of goods and services. The requisitions should be signed as authorized by the appropriate administrators prior to the related purchase.

MANAGEMENT’S RESPONSE:

Director of Schools and Members of the School Board:

We concur with the findings of this audit. The director of schools is in the process of issuing a directive that all future purchases in excess of \$100 must be supported by a purchase order/purchase requisition signed by the appropriate administrators prior to the related purchase. In accordance with state law, all purchases of \$10,000 or more must be approved by the Etowah City School Board before such purchase is made.

Finance Director:

I concur with the findings of the audit.

Principal:

I concur with the findings of the audit.

5. **FINDING:** **Discrepancies between check payees recorded in the school system's computerized accounting system and payees noted on actual transacted checks**

We noted several discrepancies between the payees noted on checks per the check register and the actual payees shown on canceled checks. Review of the imaged checks indicated that the payees noted on the related checks had been altered after being printed. According to the finance director, in some instances, mistakes on posted and printed checks were corrected manually, rather than the appropriate adjusting journal entry being made in the computerized accounting system. She stated that appropriate handwritten notes were supposed to be made in the accounting records after they were printed. We were unable to determine if the alterations were made before or after the checks were signed as approved by applicable administrators. In addition, because many imaged checks were not legible, as noted in Finding 6, we were unable to determine the extent of this deficiency.

Section 49-2-301, *Tennessee Code Annotated*, sets forth the responsibilities of the director of schools which include:

(D) Keep in electronic disks and in well bound books, furnished by the board and arranged according to the regulations prescribed by the commissioner of education, a detailed and accurate account of all receipts and disbursement of the public school funds;...

RECOMMENDATION:

To ensure that the school system's books and records are correct and can be relied on as an accurate record of financial transactions, school administrators should ensure that the finance director follows proper procedures when correcting errors or making other adjustments. These procedures should include a requirement that all corrections, even those made manually and are well documented, are properly reflected in the school's computerized accounting system.

MANAGEMENT'S RESPONSE:

Director of Schools and Members of the School Board:

We concur with the findings of the audit. The director of schools is in the process of issuing a directive that errors on checks will be corrected by voiding that check and issuing a new check in place thereof.

Finance Director:

I concur with the findings of the audit and have already taken steps to correct.

Principal:

I concur with the findings of the audit.

6. **FINDING: Dot matrix printer used by school to print checks could not be properly scanned**

In at least three school system bank accounts, bank records showed that from July 2006 through July 2007, the date, payee, and school-entered amount on at least 603 imaged checks (over 31%) were unreadable because the checks printed on the printer used by the finance director apparently could not be properly scanned by the bank. As a result, canceled checks could not be reviewed to determine if payees and dates agreed with payees and dates noted in the system's accounting records. As noted in Finding 5, we noted discrepancies between the payee noted in the computerized accounting records and the payee noted on the actual check.

Section 49-2-301, *Tennessee Code Annotated*, sets forth the responsibilities of the director of schools which include:

(D) Keep in electronic disks and in well bound books, furnished by the board and arranged according to the regulations prescribed by the commissioner of education, a detailed and accurate account of all receipts and disbursement of the public school funds;...

RECOMMENDATION:

To provide adequate documentation that disbursements are appropriate and benefit the school, school system administrators should ensure that check images received from the bank are clearly legible.

MANAGEMENT'S RESPONSE:

Director of Schools and Members of the School Board:

We concur with the findings of the audit. New printing equipment and software have been purchased in order that checks images received from the banks will be clearly legible.

Finance Director:

I concur with the findings of the audit and this is ready to be installed.

Principal:

I concur with the findings of the audit.

7. **FINDING: Inadequate separation of duties**

School system administrators failed to separate incompatible financial duties in the system. The finance director received and counted some collections; prepared bank deposits; maintained and updated the school system's accounting records; initiated and authorized most purchases; requested and prepared checks; signed some checks; and reconciled the school system and school's bank statements.

Page 4-6 of the *Internal School Uniform Accounting Policy Manual*, states:

To the extent possible, the following duties should not be performed by the same individual: receiving cash, making bank deposits, maintaining the accounting records and reconciling bank accounts.... Bank reconciliations should be prepared and reviewed at least monthly by someone who is independent of the receiving and recording functions.

RECOMMENDATION:

To help ensure that all collections are deposited into the school's account, disbursements are appropriate, and errors or irregularities are detected promptly, the principal should require an adequate system of internal controls so that no employee has control over a complete transaction.

MANAGEMENT'S RESPONSE:

Director of Schools and Members of the School Board:

We concur with the findings of the audit that certain incompatible financial duties are currently in our system; however, we do not concur with the finding that, concerning activity funds, our cash collections, preparation for bank deposits, and person making deposits is incompatible.

Finance Director:

I do not concur with the finding concerning the activity fund. The only time the finance director counted any money was when Mrs. Parrott and Mrs. Cathey were absent. Bank reconciliations before 07-08 were always reconciled by two people. In 07-08, David Wilkinson helped about half the time. I concur with any other findings of the audit.

Principal:

I concur with certain findings of the audit; however, I do not concur with the finding that, concerning activity funds, cash collections, bank deposits, and persons making deposits is incompatible.