



Mary Taylor, CPA
Auditor of State

KENSTON LOCAL SCHOOL DISTRICT PERFORMANCE AUDIT

AUGUST 12, 2010



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Auditor of State

To the Residents and Board of Education of the Kenston Local School District:

On February 11, 2010, the Kenston Local School District (Kenston LSD or the District) engaged the Auditor of State's Office to conduct a performance audit of its internal controls over financial activities, focusing on the changes made by the District to its internal controls subsequent to the discovery of fraudulent acts. Accordingly, the performance audit reviewed policies, procedures and related controls over the bill payment and purchasing processes, as well as receipt processes external to the Treasurer's Office.

The performance audit contains recommendations which the District can consider to improve internal controls. While the recommendations contained in the audit report are resources intended to assist in identifying improvements, the District is encouraged to independently assess operations and develop additional alternatives.

An audit report has been prepared which includes the project history; a background of the District; the scope, objectives and methodology for the performance audit; the assessments that did not yield recommendations; and the recommendations. This report has been provided to the District and its contents discussed with the Superintendent, Treasurer and Board members. The District has been encouraged to use the results of the performance audit as a resource for improving overall operations.

Additional copies of this report can be requested by calling the Clerk of the Bureau's office at (614) 466-2310 or toll free at (800) 282-0370. This performance audit is also accessible online through the Auditor of State of Ohio website at <http://www.auditor.state.oh.us/> by choosing the "Audit Search" option.

Sincerely,

A handwritten signature in cursive script that reads "Mary Taylor".

Mary Taylor, CPA
Auditor of State

August 12, 2010

**Kenston Local School District
PERFORMANCE AUDIT**

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Project History

On February 11, 2010, the Kenston Local School District (Kenston LSD or the District) engaged the Auditor of State's Office (AOS) to conduct a performance audit of its internal controls over financial activities, focusing on the changes made by the District to its internal controls subsequent to the discovery of fraudulent acts. Accordingly, the performance audit reviewed policies, procedures and related controls over the bill payment and purchasing processes, as well as receipt processes outside of the Treasurer's Office.

Background

Kenston LSD is a public school district serving the Townships of Auburn and Bainbridge in Geauga County, and instructing students in preschool through the 12th grade. For the school year 2008-09, the District met all 30 performance indicators, received a score of 105.9 of 120 on the performance index, and achieved a rating of Excellent on the Ohio Department of Education (ODE) Report Card. The District has five buildings for educational purposes. According to ODE, the District had 201 full-time teachers and an enrollment of 3,140 students for school year 2008-09.

On July 6, 2009, the Treasurer of Kenston LSD discovered that an employee had been writing unauthorized checks to herself. Upon investigation, the Auditor of State determined that the amount of these fraudulent checks were \$134,855. On May 20, 2010, the former Assistant Treasurer of Kenston LSD received a two-year jail sentence. The Court also ordered restitution of \$137,355.98 from the former Assistant Treasurer. Due to the discovery of fraudulent acts in the procurement cycle, the District modified its procedures to help prevent the reoccurrence of similar acts in the future.

Audit Methodology and Scope

Performance audits are defined as engagements that provide assurance or conclusions based on evaluations of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. This performance audit was conducted in accordance with generally

accepted government auditing standards. Those standards require that AOS plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives.

Audit work was conducted between February 2010 and May 2010, and data was drawn from January, through April 2010. To complete this report, the auditors gathered data pertaining to Kenston LSD, conducted interviews with various individuals, and reviewed and assessed available information.

The performance audit process involved significant information sharing with the District, including preliminary drafts of findings and proposed recommendations related to the identified audit areas. Furthermore, periodic meetings were held throughout the engagement to inform the District of key issues affecting selected areas, and share proposed recommendations to improve or enhance operations. Throughout the audit process, input from the District was solicited and considered when assessing the selected areas and framing recommendations. Finally, the District provided verbal and written comments in response to various recommendations, which were taken into consideration during the reporting process. Where warranted, AOS modified the report based on Kenston LSD's comments.

Furthermore, external organizations and sources were used throughout the report to provide benchmarks, including the Government Finance Officers Finance Association of United States and Canada (GFOA), the Ohio Revised Code (ORC), the Ohio Administrative Code (OAC), and the Committee on Sponsoring Organizations of the Treadway Commission. The information used for comparison purposes was not tested for reliability, although the information was reviewed for reasonableness.

The Auditor of State and staff express appreciation to Kenston LSD for their cooperation and assistance throughout this audit.

Audit Objectives

The overall objective of this performance audit was to identify opportunities to improve internal controls by reviewing policies, procedures, and related controls over the procurement cycle. This review focused on the recent changes made by the District to improve these processes, and covered preventive and detective controls, such as segregation of duties, reconciliation procedures, and monitoring processes. Additionally, accounting for financial activity in certain high risk funds/activities was examined (e.g., student activity fund). The following audit objectives were used to conduct the performance audit of Kenston LSD:

- Do the District's current processes, and related formal policies and procedures instill an appropriate internal control structure for purchasing and bill payment?

- Do the District's current process, and related formal policies and procedures instill an appropriate internal control structure for the revenue collections outside of the Treasurer's Office?
- Has the District implemented effective modifications to its internal control structure after the discovery of the aforementioned fraudulent acts?

Assessments Not Yielding Recommendations

Certain assessments conducted in this performance audit did not yield recommendations. These assessments are described below.

On March 25, 2010, the Auditor of State released the Kenston LSD Financial Audit for the year ending June 30, 2009. The audit reported Finding Number: 2009- Kenston- 001 – Significant Deficiency, which described the internal control weaknesses of cash disbursements that allowed the theft to remain undetected for an extended period. This performance audit confirmed that the District implemented changes that strengthen its internal control structure and accordingly help reduce the risk of future fraudulent acts. As a result, these confirmations did not yield recommendations. Specifically, the confirmed improvements include the following:

- The District has separately assigned the following three duties to three different employees: preparing cash disbursements, posting expenditures to the accounting records, and reconciling bank accounts.
- Only the Treasurer receives the bank statements and has access to the Treasurer's signature plates.
- The District secures the supply of checks in a locked facility and their issuance is strictly controlled.
- The Treasurer approves manual checks.
- A person not responsible for handling or recording cash prepares bank account reconciliations.
- All reconciling items were examined and satisfactory explanations obtained for the nature of each reconciled item.
- The Treasurer reviews and approves monthly reconciliations.
- Journal entries affecting cash transactions are reviewed and analyzed for accuracy and appropriateness, and signed by the Treasurer.
- A person outside of the Treasurer's Office reconciles outstanding checks.
- A person outside of the Treasurer's Office prepares the checks for mailing, including matching the check register to the checks, but does not have access to the system or to blank checks.

Lunchroom receipts from the five cafeterias within the Kenston LSD represent approximately 14 percent of all receipts not collected in the Treasurer's Office. Procedures and practices for lunchroom receipts were observed and tests for deposit compliance were completed. These observations and tests yielded no written recommendations.

According to the Treasurer, the District provides the Ohio Ethics Law and related statutes to every employee and obtains a receipt from the employee. In addition, at the beginning of each year, employees acknowledge that they have received the Kenston LSD Fiscal Guidelines. The District also has available a detailed Student Activities Handbook, as required by policy, covering student activity funds and topics such as budgets, deposits, fundraising, and purchasing. The student activities file, maintained in the Treasurer's Office, documented that the spring baseball trip activity complied with the Student Activities Handbook, including signoffs by the advisors for the Fiscal Guidelines. As a result, this assessment yielded no recommendation.

The District has formal policies for the procurement process, including the requirement to use purchase orders and related approvals, and the use of competitive bids. With the exception of the two policies noted in **Recommendation 2**, the assessment of the formal policies did not yield a recommendation.

Recommendations

1. Review Bonds and Insurance

Given the fraud committed in the District, the Board of Education (the Board) should review the amounts and costs of the employee bonds and insurance. This would ensure that they align with the District's risk tolerance level.

Currently, the Board President and the Superintendent each provide a bond of \$50,000 to the District. The Treasurer provides a bond of \$100,000. Additionally, the District carries \$50,000 of dishonesty insurance on two payroll clerks and \$10,000 per employee. The District also carries a separate insurance policy of up to \$50,000 covering "employee dishonesty, computer fraud, forgery, and money in and out."¹ These instruments provide assurance, under certain circumstances, that Kenston LSD would be repaid up to the face amount of the bonds and insurance if an employee proved to be dishonest with the resources of the District. The bonds are for four-year terms while the insurance policies are annual.

According to *Strengthening Enterprise Risk Management for Strategic Advantage* (Committee of Sponsoring Organizations of the Treadway Commission, 2009), risk appetite is the amount or risk the organization is willing to take in pursuing the goals of the stakeholders. Organization boards and management must communicate to determine the amount of risk that is appropriate for the stakeholders. Because risks are constantly changing, management and the Board must be aware of these changes and take appropriate action to maintain risks at the appropriate level. Additionally, OAC 117.02 (A) and 117.02 (B) (4) state all public officials are responsible to design a system of internal control to provide reasonable assurance regarding safeguarding of assets in conjunction with effectiveness and efficiency of operations. Furthermore, according to *Governmental Accounting, Auditing, and Financial Reporting* (GFOA, 2005), "The cost of internal control, of course, should never exceed related benefits. Thus, a key limitation on internal control is that cost considerations will prevent management from ever installing a "perfect" system. Instead, management will deliberately and properly choose to run certain risks because the cost of preventing such risks cannot be justified."

At the beginning of this audit, the Treasurer indicated that the Board and management had not discussed the bonds since November 2008, when the last bond was acquired. The District can mitigate its risk by ensuring that the amounts of its bonds and insurance adhere to its risk tolerance level.

¹ Summary of Insurance 7/1/2009-7/1/2010 Kenston Local Schools

2. Comply with ORC and Board Policy, Clarify Payment and Pricing Policies, Obtain Discounts, and Avoid Potential for Penalties

Kenston LSD should use blanket and/or super purchase orders for the same items procured on a monthly basis to comply with fiscal officer certification requirements in ORC Section 5705.41(D), increase efficiency in the purchasing process and ensure purchase orders are issued prior to making purchases. Prior to approving purchases in excess of \$100,000, the District should obtain and review the antiterrorism certificates required by ORC Section 2909.33 and subsequently maintain them. Furthermore, the Board should clarify the prompt payment portion of its policy to ensure staff obtains available discounts and avoids penalties for late payments. Along with clarifying the policy, the District should allow for exceptions to its payment schedule in order to take advantage of payment discounts when available and avoid penalties for untimely payments. Alternatively, the District should consider decreasing the disbursement cycle time by increasing the number of times checks are written during the month. Finally, the Board should clarify the pricing policy for items under \$25,000 to require multiple quotes for other appropriate items. For example, the Board could establish an appropriate dollar threshold that triggers the requirement for multiple quotes and/or adjust the language in its current policy to actually require the Superintendent to determine the most appropriate methods and subsequently document the methods.

AOS conducted a sample test of 74 items related to 28 separate checks for compliance with the ORC, and District policies and procedures. Two of the 74 items did not meet ORC Section 5705.41(D). Specifically, the Treasurer did not certify the availability of funds prior to the commitment to purchase. As a result, the purchase order dates were 1 and 2 days after the invoice dates for these two items (two vendors). In addition, the purchase order date and invoice date were the same for 2 items related to 2 vendors.² For 9 different items comprising 3 different vendors, the payment date surpassed the due date, ranging from 6 to 45 days past the due date.³ Another vendor offered a discount related to 4 items if the payment was made within a certain timeframe. However, the District did not meet the timeframe requirement. Additionally, neither of the two major contracts (exceeded \$100,000) in the sample complied with the antiterrorism certificate requirement in ORC Section 2909.33. However, the District provided the certifications during the performance audit.

The District could use blanket or super purchase orders for vendors who supply goods or services on a monthly basis, as permitted by ORC Section 5705, to allow for compliance and

² The purchase order and invoice dates were the same for another item, which was an emergency. Additionally, the purchase order date was only one day prior to the invoice date for 13 items related to one vendor.

³ This excludes 3 items related to the Geauga County Educational Service Center in which the payment dates were 29, 35 and 38 days after the due dates because the invoice indicated that payment was due upon receipt. In addition, the payment date and due date were the same for 9 other items comprising 5 vendors, which includes 2 items related to 1 vendor for hotel expenses.

avoid the need to create and approve multiple purchase orders. These tools could have been used to ensure the purchase orders preceding the invoices for the abovementioned four items. By reviewing bills for available discounts and due dates and subsequently allowing for payment outside of the District's regular payment schedule (twice per month), or by altering the regular payment schedule to decrease the disbursement cycle time, the District could have been able to take the one vendor discount and pay the 3 vendors on a timelier basis. Furthermore, the Board's payment policy requires that the District promptly pay bills, but also ensure that due care is taken in reviewing the bills. The latter part of the policy can contribute to the abovementioned items being paid past the due dates. By clarifying the meaning of prompt payments, the Board would increase the potential of obtaining discounts and avoiding penalties for late payments.

Lastly, Board policy requires quotes for any item or group of items in a single transaction costing \$25,000 or more. Board policy also indicates that the Superintendent may determine the most appropriate method of obtaining prices for items under \$25,000. Based on the language in this policy, the Board does not actually require the Superintendent to determine the most appropriate methods or require staff to obtain multiple quotes for items under \$25,000. By comparison, the Akron City School District's purchasing policies require employees to obtain three price quotes on anything costing more than \$6,000. In addition, the Cincinnati City School District's purchasing policies require competitive bidding for supplies and materials costing more than \$500.

3. Eliminate Duplications of Effort and Increase Use of Detective Controls

The District should eliminate duplication of systems and efforts (i.e., cash receipting) in the system of student accounting by training employees to fully use ESIS. The District should also install detective controls for the system of student accounts, which can be aided by eliminating the aforementioned duplication.

The individuals in the different buildings of the District are using different and duplicate systems to account for the revenue collected outside of the Treasurer's Office. These revenues consist of students' financial transactions including student extracurricular activities as well as student fees. The utilization of ESIS ranges from almost complete utilization of the ESIS system and a separate backup system used by one individual to another employee using a separate system with little utilization of ESIS. In addition to the duplicate systems, the building personnel records cash receipts and the personnel in the Treasurer's Office records the same receipts. AOS performed a detective test of sixth grade history fees. This test could not be performed electronically due to the lack of uniform usage of ESIS, but was performed by utilizing several different sources of information. Although time consuming, this test confirmed the District's recorded amounts of sixth grade history fees.

OAC Section 117 requires an efficient and effective system of internal controls. This section also requires monitoring of the system of internal controls.

The varying levels of training and experience in the use of ESIS has caused the personnel to use separate and individual approaches to the student accounting, thus resulting in maintaining separate systems. Maintaining duplicate systems coupled with duplicating efforts by multiple staff recording receipts contributes to the District not implementing monitoring controls (detective controls), such as reconciling the student accounts to the billing, receipts, and bank deposits. The elimination of duplication would help the District find time to implement several detective controls without additional personnel costs.

District Response

The letter that follows is Kenton LSD's official response to the performance audit. Throughout the audit process, staff met with the District to ensure substantial agreement on the factual information presented in the report. When the District disagreed with information contained in the report and provided supporting documentation, revisions were made to the audit report.

It should be noted that the performance audit did not specifically recommend that the District obtain a higher limit of liability insurance coverage. Rather, the audit recommended that given the fraud committed in the District, the Board of Education should review the amounts and costs of the employee bonds and insurance. Based on the District's official response, the Board of Education reviewed the amounts and decided to increase the limit of the liability and dishonesty policy for theft.



KENSTON

S C H O O L S

Kenston Local Schools

17419 Snyder Road
Chagrin Falls, Ohio
44023-2730
Phone: (440) 543-9677
Fax: (440) 543-8634
www.kenstonlocal.com

Robert A. Lee, Ph.D.
Superintendent

Jack K. Thompson, Ed. D.
Assistant Superintendent

Linda M. Hein
Treasurer

July 21, 2010

Auditor of State
Mary Taylor, CPA
Performance Audit Section
88 Broad Street, 5th Floor
Columbus, OH 43215

The Honorable Ms. Taylor,

After uncovering the fraudulent activities of Geraldine Kanieski, Mrs. Hein, Treasurer, immediately implemented new preventative accounting measures, and a state audit was completed with assessments and recommended fraud prevention measures. To further pursue our diligence in this matter, the Kenston Board of Education unanimously approved a performance audit contract in February, 2010 with the Auditor of State's office. Over a five (5) month period, the Performance Audit Team reviewed the procedures put in place by the Treasurer's Office, as well as the recommended procedures developed from the regular audit. Lastly, they conducted their own specialized audit. The results of their audit were completed with a report to the Kenston Board of Education.

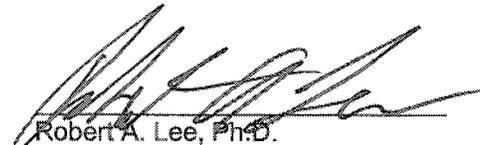
After taking our corrective measures and implementing all the recommendations of the regular audit, the Performance Audit identified additional measures. From the report and meeting, the following actions have been taken:

1. The Performance Audit recommended the Kenston Board of Education seek and obtain a higher limit of liability insurance coverage from \$50,000 to an amount that Kenston Board felt was sufficient to the district. At the June 21, 2010 Kenston Board of Education meeting, the board approved a new liability dishonesty policy for theft that increased our limits to \$250,000.
2. The Performance Audit recommended a written purchasing procedure to be put into place which established thresholds and the practice of seeking multiple vendors. Although there were processes in place, there was no written procedure. Since the audit report, the board added the written procedures to Board Policy Guideline 6320 – Purchases, that states all purchases \$6,000 or above, but less than \$25,000, must have at least three (3) price quotations. For purchases over \$25,000, board policies already exist that specify the purchasing process in accordance with Ohio Revised Code.
3. The Performance Audit recommended a revision of Policy #6470 regarding vendor payments. Since the audit report, the board amended the policy and guidelines to include criteria prioritizing when payment of claims can occur.
 - a. The primary consideration will be the accuracy of the invoice above all other due dates or discounts.
 - b. Once the primary consideration has been met, payments will be made within the next disbursement cycle.
 - c. Discounts will be taken if the approved payment falls within the next disbursement cycle.

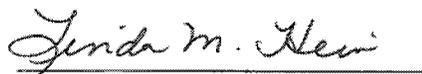
4. The Performance Audit recommends that the district utilize super blanket purchase orders. The superintendent and treasurer will recommend approval of super blanket purchase orders beginning with the first board meeting in July, 2010 and at subsequent meetings as needed.
5. The Performance Audit recommended that the district consider the timing issues involved with increasing disbursement cycles. The treasurer will review and implement the recommendation to increase the disbursement cycles as allowed.
6. The Performance Audit recommended that the district reduce duplication of receipt processing. The treasurer has begun the process of implementing the procedures recommended by the Performance Audit and will complete the training and changes by the end of the 2010-2011 school year. Steps have been taken to use the current student software (ESIS) as the primary fee collection software to ensure that each student's account is accurately updated. The treasurer will utilize both building and internal staff to comply with the recommended changes.

On behalf of the Kenston Board of Education, we would like to express our appreciation for the work performed by the Auditor of States Office, specifically, Mr. Jim Pyers. Through the process, we found them to be professional, thorough and efficient in developing best practices that could be easily implemented into our school district. The internal control process has been thoroughly evaluated and procedures put in place to safeguard our fiscal operations.

Sincerely,



Robert A. Lee, Ph.D.
Superintendent



Linda M. Hein
Treasurer



Anne Randall
Board President

RAL/ms



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Mary Taylor, CPA**

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88 E. Broad Street
Columbus, Ohio 43215
(800) 282-0370
www.auditor.state.oh.us**