

**Examination of Certain Policies, Procedures, Controls, and
Financial Activity of the Shelby County School District**



ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS
www.auditor.ky.gov

209 ST. CLAIR STREET
FRANKFORT, KY 40601-1817
TELEPHONE (502) 564-5841
FACSIMILE (502) 564-2912

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ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

October 9, 2014

Allen Phillips, Board Chair
Shelby County School District
1155 West Main Street
P.O. Box 159
Shelbyville, Kentucky 40066-0159

RE: Examination of Certain Policies, Procedures, Controls, and Financial Activity of the Shelby County School District

Dear Chair Phillips:

We have completed our Examination of Certain Policies, Procedures, Controls, and Financial Activity of the Shelby County School District (District). This examination identifies 16 findings and offers several recommendations to strengthen the financial management and oversight of the District.

Examination findings report an apparent fraud totaling \$593,179.96 that occurred over a period of approximately seven years from March 15, 2007 through April 1, 2014. These findings identify serious concerns regarding a lack of appropriate policies and controls related to fiscal management and oversight. Due to the nature of certain findings discussed within this report, we are referring these issues to the Office of the Commonwealth's Attorney, 53rd Judicial District, and the Kentucky State Police.

In performing this examination, we requested and examined certain financial and system administration records maintained by the District for the period January 2007 through June 2014, unless otherwise noted. Information provided included District personnel and payroll records, travel reimbursement expenses, several internally generated payroll reports, vendor payment reports, other various financial reports, District policies and procedures, system user access rights, and other documentation when available. The audit team conducted interviews with the District Superintendent, District Director of Finance and other Finance Department staff, Payroll and Personnel Department Staff, and others to obtain further information related to general District financial policies, controls, procedures, and oversight practices.

209 ST. CLAIR STREET
FRANKFORT, KY 40601-1817

TELEPHONE 502.564.5841
FACSIMILE 502.564.2912
WWW.AUDITOR.KY.GOV

AN EQUAL OPPORTUNITY EMPLOYER M/F/D

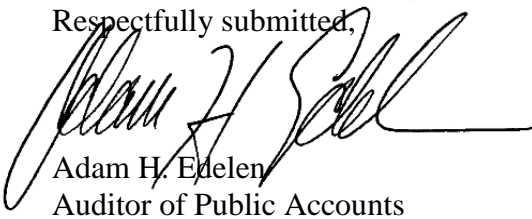


Chair Phillips
October 9, 2014
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The purpose of this examination was not to provide an opinion on the District's financial statements, but to address specific issues brought to the attention of this office and to ensure strong policies, controls, and procedures are in place in processing financial activity.

The Auditor of Public Accounts requests a report from the District on the implementation of the examination recommendations within (60) days of the completion of the final report. If you wish to discuss this report further, please contact me or Brian Lykins, Executive Director of the Office of Technology and Special Audits.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Adam H. Edelen", with a long horizontal flourish extending to the right.

Adam H. Edelen
Auditor of Public Accounts



Examination of Certain Policies, Procedures, Controls, and Financial Activity of the Shelby County School District

Impetus and Objectives

The Shelby County School District (District) Superintendent requested the Kentucky Auditor of Public Accounts (APA) to perform a special examination related to a potential payroll fraud totaling \$593,179.96 that was discovered by District staff. The Superintendent requested the APA review District records to ensure that the amount of the suspected fraud was limited to the amount already discovered. The Superintendent also requested that the APA review payroll and accounting system internal controls and processes to make recommendations to strengthen controls and to reduce future fraud risk at the District.

To accomplish the examination, the APA developed the following procedures to review the identified areas of concern:

- Confirm the \$593,179.96 in apparent payroll fraud discovered by District personnel;
- Review payroll data and records to determine whether any further potential fraud could be detected;
- Review payroll control and oversight processes used by District; and
- Review certain information technology user controls and access rights for the District's accounting system, Municipal Information System (MUNIS).

The general examination period was January 2007 through June 2014, unless otherwise stated. This time period was determined based on the period that the suspected payroll fraud had occurred; however, certain data for earlier time periods was reviewed when available to examine whether the apparent payroll fraud had occurred prior to January 2007. Upon examination, auditors did not identify additional apparently fraudulent activity.

Details of the Apparent Fraud

District personnel initially detected a suspected payroll fraud on April 2, 2014 and reported it to the Kentucky State Police on April 4, 2014, once a preliminary District review of payroll records confirmed the initial suspicions. The apparent fraud was facilitated by using

the former Payroll Manager's user access to the payroll system. A flowchart of the apparently fraudulent activities is located at Exhibit 1.

The Payroll Manager was initially suspended with pay from her position on April 10, 2014, and later resigned on April 28, 2014. Records indicate that from March 15, 2007 through April 1, 2014, the former Payroll Manager's user access was used to direct \$593,179.96 of District funds into personal bank accounts using the name and personnel data of a former District employee. This former employee worked at the District as a teacher until her retirement at the end of the 2002 school year, and later as a substitute teacher until the end of the 2006 calendar year.

As was typical District protocol, once a final W-2 form for 2006 was issued for the former employee's work as a substitute teacher, the employee's personnel record was moved from the Live to Terminated area within the MUNIS payroll system. The Live and Terminated areas refer to two separate sets of data. Former employees' personnel records are moved from Live to Terminated areas so historical and current employment records can be maintained separately.

The apparent fraud is suspected to have started in the March 15, 2007 payroll when the former Payroll Manager's user account was used to move the former substitute teacher's personnel information from Terminated back to Live in the payroll system. While the former substitute teacher's employment record was in the Live area, she continued to be listed as an inactive employee. This is typically the status of current substitute teachers or an employee who no longer works for the District but has not yet been issued a final W-2. Moving the employee record from Terminated to Live was able to be completed without the review, approval, or knowledge of another District staff member because the former Payroll Manager's user account was granted superuser rights within the payroll system. These rights gave this user account the ability to add or delete an employee or change the employment status within payroll.

It appears the former Payroll Manager's user account was used to change the former substitute teacher from inactive to active status. In addition, using the former Payroll Manager's user account, the bank account number on file for the former substitute teacher was changed to other personal bank account numbers. For most of the apparently fraudulent transactions, direct deposit payroll payments were split between two separate bank accounts.

The daily rate of pay input for the former substitute teacher using the former Payroll Manager's user account varied from \$133 to as much as \$352 per day, which exceeds the normal rate of pay for District substitute teachers. Days reportedly worked for the pay period were then entered into the payroll system. Typically, the number of days entered for this apparently fraudulent activity exceeded the possible number of days that could be worked in a single pay period, ranging from eight days to as many as 52 days.

The Cover Up

To conceal this apparently fraudulent activity, a variety of steps had to be completed. Since deductions for taxes would result in a W-2 being issued to the actual former substitute teacher and deductions for retirement would generate a retirement earnings report, these deductions had to be manually removed. In addition, a quarterly report containing all employees paid by the District must be generated for the federal government. To ensure that this report would not identify that the former substitute teacher was paid and also had no deductions, actions were initiated within the system, using the former Payroll Manager's user account, to make it appear the former substitute was never paid. This was done by voiding the payroll payment to the former substitute teacher after the payment was made by the bank.

Findings and Recommendations

Finding 1: The District did not implement proper segregation of duties contributing to \$593,179.96 in payments made to a "ghost" employee over a seven year period.

The District did not implement proper segregation of duties between the employees responsible for the entry and maintenance of personnel information and those employees responsible for the payroll processing and payment. District Personnel Department employees and the former Payroll Manager had the ability to add new employees, as well as move an employee's record between the Live and Terminated areas within the payroll system without the approval or knowledge of any other District employee. This lack of segregation of duties goes against all basic best practices

recommended for the oversight and control of both personnel and payroll activities. By not implementing these controls, an apparent fraud of \$593,179.96 was able to occur over a seven-year period.

Recommendations: We recommend the District remove personnel related menu access within MUNIS for all District Payroll Department employees. This includes the ability to add, delete, or otherwise change the employment status of employees. All additions, deletions, or other changes to the employment status of District staff should only be conducted by employees within the District's Personnel Department. Written procedures should be developed to ensure changes to employment status are communicated between the two departments consistently and timely. These written procedures should establish specific criteria and timeframes for when changes to employment status are to be carried out. We also recommend all employee demographic information be updated by Personnel Department employees. A document, such as a PCS form, showing the employee's request to change their bank accounts should be maintained. In addition, we recommend changes to information made by employees through the Employee Self Service (ESS) function be reviewed and approved by Personnel Department employees. We further recommend the District establish a written process requiring a person in a supervisory position, independent of the personnel process, to generate reports available within MUNIS that will allow a review of the changes that are made to personnel information. This process should be performed on a monthly basis, at a minimum.

Finding 2: The District did not ensure employee record updates were consistent, timely, or reviewed, which provided an opportunity for the apparent fraud.

District system access rights were comingled among Personnel and Payroll staff allowing users in both departments to add new employees to the Live area, to change employment status between active and inactive, and to move employees between Live and Terminated. Given that both Personnel and Payroll Department staff were granted the ability to make these changes, confusion existed regarding which department is ultimately responsible to perform these actions and are to ensure that all changes are authorized, appropriate, complete, and processed in a timely manner.

Recommendations: We recommend the ability to add employees to the Live area, to change employment status between active and inactive, and to move employees between the Live and Terminated areas be restricted to the Personnel staff. Currently, the Personnel Department has four staff, which should allow sufficient resources to exclusively perform these tasks. This control would allow a separation of this

process from the Payroll function, which would then focus on ensuring that all current District employees are established with proper pay rates based on job position and tenure. Regarding the process for changing employees from active to inactive status, we recommend Personnel Department staff formally document terminations, resignations, decisions not to return to work, and retirements on a PCS form and provide these forms to the Payroll section as close to the termination date as possible in order for any final payout to the employee to be issued. Once Payroll has processed any necessary final payout for the individual, we recommend the PCS form be returned to the Personnel Department for the individual's status to be changed to inactive. The timing of this process is critical to ensure that inactive employees are properly classified prior to the next payroll process. We recommend a formal, written process document be created to explicitly identify the responsibilities of the Personnel and Payroll departments. We also recommend that the District review all substitute personnel on an annual basis. Any staff identified as not performing substitute duties for the upcoming school year should be changed to inactive status. The process for the establishment and removal of substitute staff should be documented in writing and consistently followed. We recommend that the Personnel Department staff perform a review of all inactive staff within the Live area annually in February after W-2 forms have been issued to staff for the previous year. Any individuals identified as no longer being employed by the District and have not worked during the calendar year should be moved to the Terminated area. In addition, we recommend the District develop written documentation for the process to complete this review and movement of inactive staff to the Terminated area. Further, we recommend that the District begin using the hire, inactive, and terminated dates within the employee record to reflect the current employment status of employees. To that end, the District should develop a procedure to use these fields of information to ensure that the individuals are consistently and appropriately updated in the system to reflect changes in the employment status of all staff. Finally, we recommend the Personnel Department act as the final repository of all PCS forms. These forms should be retained per the District's retention schedule and be readily available for either internal management review or audit purposes.

Finding 3: The District did not segregate the duties between payroll maintenance, final review, and the approval process, which increased the risk of potential fraud.

The former Payroll Manager was given complete control over the maintenance of payroll records, review of payroll accuracy, and approval of final payroll

payments without a secondary review by another District employee. As the manager over the District's payroll process, the former Payroll Manager was responsible for maintaining the payroll system and ensuring that it was operating timely and accurately. While this is expected of a payroll manager, the District allowed the former Payroll Manager to be the only staff member to have final review over the payroll files prior to being sent to the bank for payment. In addition, it was the former Payroll Manager's responsibility to send the payroll file to the bank and authorize payroll payments from District accounts. This is considered "one of the biggest security lapses" of payroll best practices and can allow fraudulent activities to occur, such as apparently fraudulent payments that went undetected by the District over a seven-year period.

Recommendations: We recommend that the District establish a process to create a separate review and approval of the payroll process. We recommend that the Director of Finance, or other qualified executive management staff, review and compare the preliminary and final payroll proofs to determine if any changes have been made. Also, we recommend changes be investigated for necessity and validity. We further recommend the Director of Finance, or other qualified executive management staff, review the final payroll proof for potential errors or questionable payments, including excessive pay rates, number of hours worked, and employees not actively working at the District. We finally recommend the Director of Finance, or other qualified executive management staff, also review the Payroll Earnings Distribution Report to further identify potential anomalies within the payroll.

Finding 4: The District did not develop a formal written process to ensure only substitutes who worked for the District were paid during the school year.

Discussions with District officials revealed a formal written process was not developed to ensure only active substitutes were paid during the school year. According to the Personnel Director, substitutes are determined at the beginning of the school year and entered into the substitute placement and absence management software application by District Personnel Department staff. However, Payroll Department staff also have the access to enter substitutes into this application. Once the hours worked by a substitute are entered into the substitute placement and absence management application, the application automatically populates the hours and pay rate within the MUNIS payroll system. Though this is the typical process followed by the District to account for and pay substitute employees, Payroll staff can bypass the substitute placement and absence management software application and instead manually enter and initiate

payment of substitutes directly from MUNIS. As discussed in the Introduction and Background of this report, the former Payroll Manager's system user account was used to change an inactive substitute teacher record to perpetrate an apparent fraud diverting \$593,179.96 to personal bank accounts during the period of March 15, 2007 through April 15, 2014.

Recommendations: We recommend the District develop and adhere to a written process explaining how the District will authorize, account for, and pay substitute employees. The Personnel Department staff should be responsible for entering substitutes at the beginning of each school year into the substitute placement and absence management software application. We recommend any substitutes hired after the start of the school year have sufficient documentation to demonstrate management's approval prior to being entered into the substitute placement and absence management software application. Further, we recommend the Personnel Department staff change the status of all substitutes under contract for the current year to an active status. Any substitutes who were not offered or executed a contract for the current year should be changed to an inactive status. Once the substitute's W-2 is issued, the employee record should be moved to Terminated. In addition, we recommend payroll hours for all substitutes primarily be supported by information from the substitute placement and absence management application. Manual payroll entries into MUNIS for substitutes who are not within the substitute placement and absence management application should not be allowed unless appropriate documented authorization is granted by management for special circumstances. Finally, we recommend the District consider requiring each school or facility submit a substitute log or form to the central office to support work hours claimed by substitutes. If this information is available, Payroll Department staff can use it to validate substitute hours for each pay period.

Finding 5: The District did not use available controls within MUNIS to prevent removing an essential step of the payroll process.

The District provided the former Payroll Manager and others access to MUNIS that allowed the elimination of a step in the payroll process that automatically posts payroll payments or voided payroll activity to the District general ledger. By eliminating this step, transaction activity from voided payrolls, which included apparently fraudulent payments made using the name and personnel information of a former substitute teacher, were not recorded to the general ledger within MUNIS. At the time of the apparently fraudulent activity, the general ledger was the primary source of information the District used to reconcile

payroll payments reported by MUNIS to the District bank statements. The administrative features in MUNIS provided the functionality for the District to have eliminated or restricted the former Payroll Manager's access to the MUNIS menu containing the selection of payroll steps that must be performed to complete the payroll process. However, the District did not adequately restrict the availability of this menu. By allowing the former Payroll Manager to have access to this menu, the District provided the opportunity to circumvent the primary method used by the District to monitor its payroll activity through the general ledger report.

Recommendations: We also recommend the District ensure the payroll steps required by management are established in the system and develop written procedures that specify all payroll steps to be included with each type of payroll. The procedures should also identify the request and approval process for making changes to the required payroll steps. District executive management should periodically review the payroll steps established in MUNIS to ensure they are in compliance with the written procedures. We recommend the District restrict menu access within MUNIS to prevent Payroll Department staff from making any changes to payroll steps determined to be necessary by District management as specified in the written procedures. Such changes should only be performed by the Director of Finance, or other qualified executive management, who should document the required steps performed to complete payroll and the purpose of any necessary changes made to these steps. We recommend the District enable the alert system within MUNIS to notify the Director of Finance, or other qualified executive management, when a payroll process has begun and when payroll steps are completed.

Finding 6: The District did not develop or implement a system access control policy, increasing the risk of unauthorized or inappropriate activity.

The District did not develop or implement adequate logical security controls governing user access to MUNIS. Therefore, it was not possible for auditors to ensure that all users were authorized and granted appropriate access to MUNIS. While written procedures are not currently in place for administrative staff to follow when granting, changing, and terminating user access, an informal process was used to grant system access. It should be noted that the Director of Finance was initially responsible for establishing user access; however, this job duty was delegated to the Finance Coordinator in 2012.

Recommendations: We recommend the District develop a written policy to ensure staff obtains appropriate access to MUNIS. As part of this policy,

the Personnel Department should consider developing and completing a form to substantiate the permissions and roles granted within MUNIS. This form, or other comparable communication, should be submitted and approved by the individual's supervisor. In addition, we recommend an employee be formally designated as the primary person responsible to provide employees with appropriate system access and that a backup also be designated to perform this function when necessary. We recommend these employees receive training to ensure they have a clear understanding of how to effectively and efficiently perform this function. District management should perform, at a minimum, an annual review to ensure users are still employed and require access to MUNIS. Actions taken to change access levels should be thoroughly documented. All documentation supporting the user's access should be maintained for audit purposes.

Finding 7: The risk of inappropriate activity increased due to the District failing to limit or monitor MUNIS user access.

District employees were granted excessive MUNIS access, including continued access after terminating employment, due to District administrators not consistently establishing minimal necessary access rights or monitoring a user's need for continued access. The District is responsible for establishing access roles within MUNIS and for monitoring the appropriate level of user access. MUNIS security features allow access roles to be customized by each district based on specific needs. This customization can be established at a granular level that will allow a user to view specific system process menus and to execute specific transactions.

Recommendations: We recommend the District first perform an in-depth review of all access rights established within MUNIS, inclusive of the attributes, menus, and transactions that can be accessed or used by an individual granted these rights. Controls over user access should be strengthened to deny all user rights except those specifically necessary to perform job duties. Once the access rights have been reviewed and appropriately modified, the District should create a matrix of access rights to ensure accurate and consistent rights are established for individual users in functional areas, including but not limited to FRYSC coordinator, principal, and secretary. Using the matrix of baseline access rights and the results of the access role review, we recommend District staff review each existing user account and related access to determine whether the roles provided are appropriate based on the employee's job duties. Additional information and discussions from other district staff may be required to ensure only necessary rights are provided. Additionally, we recommend the district disable the functional area

accounts. New accounts should be created for each individual user based on the matrix of baseline access rights, which will be uniquely attributed to the individual. This process will allow more accurate tracking of actions performed within the system by these individuals. Finally, going forward, we recommend as employees no longer require access to MUNIS these rights be disabled in both the MUNIS Cloud Administration and the MUNIS application as soon as notice is provided. We recommend the termination of a user's access be included in an employee exit checklist to ensure access is revoked. The person who revoked the access should initial the form indicating that the action was completed.

Finding 8: The District did not use payroll reporting and monitoring functions that could assist in detecting potential fraud.

District executive management did not use various reports available in MUNIS to monitor and review payroll processes and activity. The District only relied on the payroll totals reported in the general ledger to reconcile to monthly bank statements. As seen in Finding 5, the totals reported in the general ledger were able to be manipulated by removing steps from the payroll process. District executive management could have routinely used a variety of other existing MUNIS reports that, upon review, could have identified the apparently fraudulent payroll activities discovered at the District. The MUNIS vendor, as well as the Kentucky Association of School Business Officials (KASBO) offered multiple training opportunities that presented these various reports and methods for reconciling payroll.

Recommendations: We recommend the District continue to generate the Check Register and the Employee Deduction Register for use in the payroll reconciliation process. Since up-to-date banking information is available to the District through an online bank portal, this could be a process completed after each payroll or performed on a monthly basis for the two payrolls completed during that time period. We recommend the District develop a payroll review process that incorporates the Payroll Audit Report, Clerk Report, and Global Audit inquiry to monitor changes and activities within the payroll process. This review should be carried out by an employee that is not directly involved in regular daily updates and changes to personnel or payroll information. We recommend any questions resulting from performing the reconciliation process, including changing payroll process steps or questionable changes to an employee's payroll record, should be fully investigated and documented in a timely manner. We further recommend that a primary and backup employee be

sufficiently trained to generate and use all of these reports to perform a thorough reconciliation process.

Finding 9: The void payroll process was not consistently followed by staff to ensure recovered funds were properly recorded.

During the review of District payroll disbursements recorded in the general ledger for the period of July 1, 2006 through June 30, 2014, voided payroll disbursements were identified, some of which did not follow the void payroll process. A void transaction is initiated to document when a payroll disbursement was voided and funds were recovered and re-deposited by the District. Therefore, voided transactions are recorded as a negative dollar amount and the status for the original payroll disbursement will be changed to void. During the examination period, in addition to the apparently fraudulent transactions identified, auditors found two instances where the funds from voided payments were not recorded in the general ledger as recovered. These two voided payments, totaling \$1,557.88, were issued to the same employee. According to the District, this individual left the employment of the District, but continued to be identified, in error, as active in the payroll system during the next two pay periods; therefore, payroll payments continued to be made to this employee. These two transactions were not included in the routine reports that identify void transactions created within the system. District staff was able to find a record of these payments being re-deposited into the District's bank account; however, the payments were not voided through the void payroll process.

Recommendations: We recommend the District create a written procedure to explicitly itemize the steps to be taken to void a payroll payment within MUNIS. In addition, we recommend the Director of Finance, or other qualified executive management, routinely review all void payroll transactions within MUNIS to ensure the process is followed consistently and the voids are appropriate, authorized, and documented. Finally, documentation should be maintained to support all void actions taken and should be readily available for internal management review and audit purposes.

Finding 10: The central level substitute teacher budget was exceeded four times without sufficient review and understanding of the cause.

For FY 2008 through FY 2014, a District budget line-item for substitute teachers was exceeded four of the seven years. This was the budget line-item used to make the apparently fraudulent payments to personal bank accounts using the payroll information of a former substitute teacher. While District executive management stated they evaluate the causes for exceeding this budget line-item, the research appears to

primarily be anecdotal in nature rather than a detailed data-driven review. This made the budgetary review for this particular line-item insufficient to detect that a substitute teacher was paid for more work days than scheduled school days in each of those years.

Recommendations: We recommend the District perform a thorough data oriented review when the central level substitute teacher budget is exceeded. This review should include the pay rate of the substitute and the number of days worked by school and individual. We also recommend the District perform a thorough review of the payments made from any other budget line-items that are allowed to regularly exceed budgeted amounts due to the unexpected nature of their costs.

Finding 11: The District did not ensure all Payroll staff received sufficient training to complete the payroll process.

The former Payroll Manager appears to be the only District employee to have received sufficient training to complete all aspects of the payroll process. This gave the former Payroll Manager extensive knowledge of the complete payroll process and led the District to exclusively rely on her to process payroll. The reliance placed on the former Payroll Manager provided her with an excessive amount of leverage with her supervisors. It also placed the District at risk of significant payroll errors not being detected and the possibility that a payroll process could not be completed without the assistance of the former Payroll Manager. Based on information provided by District financial staff and internal District personnel documents, executive management should have realized the risk to the payroll process and ensured that proper training was being provided.

Recommendations: We recommend the District ensure all appropriate financial staff be fully trained in the completion of the payroll process. This should include at least two payroll employees that are proficient with the payroll system and interact with it on a routine basis. We also recommend that the Director of Finance, or other qualified executive management, receive sufficient training on the payroll system to act as a backup. In addition to acting as a backup, this will provide a member of executive management with a deeper understanding of the security, processing, reporting, and oversight procedures that should be established for payroll.

Finding 12: The District did not maintain work-related emails as required by the Kentucky Department of Library and Archives.

Due to the allegations of apparent fraud facilitated using the former Payroll Manager's system user account, auditors made a request to the District for

access to this former employee's work email account. District management stated several years of emails for all staff were retained. However, the District was only able to successfully recover the last two months of the former Payroll Manager's emails. Based on auditor's review of the email retention settings, the District is not in compliance for any employees with the Kentucky Department of Library and Archives' (KDLA) retention schedule, specifically Series L5304. This schedule requires school districts to retain routine correspondence, such as work-related emails, for two years.

Recommendations: We recommend the District work with their technology staff to establish a retention policy for all employees' email in compliance with KDLA retention schedule requirements. Further, we recommend management communicate the KDLA retention schedule to all staff and provide guidelines to ensure adherence. The retention policy established by the District should be monitored on a regular basis and updated as needed.

Finding 13: District staff did not consistently maintain garnishment statements as required by the Kentucky Department of Library and Archives.

According to the record retention schedule established for school districts by the KDLA, individual payroll documents, including garnishment statements, are to be maintained for three years after employment termination or three years after the statement is superseded. Garnishments are a legally binding, required transfer of earned income to a creditor. For the period of July 1, 2006 through June 30, 2014, garnishment statements were not available to support all garnishment deductions for two individuals whose net pay amount was zero for one or more pay periods. In both instances, the required retention period, after which the statements could be destroyed, had not expired.

Recommendations: We recommend written procedures be developed to define the method to establish garnishments within MUNIS. In addition, we recommend the process address ensuring that garnishment amounts and priorities are applied legally and timely and that appropriate documentation is maintained according to retention requirements. We recommend the Payroll Manager, or other designated staff, review garnishments for accuracy and appropriate authority. Further, garnishment statements should be consistently maintained, at a minimum, for the three-year period either after termination of employment or is superseded as required by the retention schedule established for school districts by KDLA.

Finding 14: The District did not properly distribute retirement refunds to appropriate staff.

A District payroll issued on November 15, 2013, was specifically discussed by District staff during the examination entrance conference because of the unique purpose of this payroll and the manner in which it was processed. According to the Director of Finance, the payroll was created to redistribute a \$77,000 refund from CERS to certain substitute teachers. This refund resulted from retirement payments submitted to CERS for substitute teachers during the 2011-2012 school year who, by the end of the year, did not work sufficient time at the District to receive a year of retirement service time. Therefore, these payments made to CERS throughout the year were refunded to the District for redistribution to the affected employees. Because a payment of \$2,482.01 within this payroll was identified as part of the apparent fraud accomplished using the former Payroll Manager's user account, the District performed additional research to determine whether all eligible employees received the appropriate refund. By the end of examination fieldwork, District staff were able to identify 15 individuals who did not receive their refunds, which totaled \$2,187.14.

Recommendations: We recommend the District ensure that all outstanding refunds are issued to the appropriate staff and the single refund issued in error is recovered. Further, as noted in Finding 8, we recommend the District improve monitoring the overall Payroll process. In this particular case, the Director of Finance, or other qualified executive management, should review any refunds issued to the District to ensure all appropriate actions are taken and documentation is maintained. We recommend all documentation be retained in accordance with the District's record retention schedule and be readily available for internal management or audit review purposes.

Finding 15: The District uses the same series of identification numbers for employees and vendors, which could cause confusion when included in the same report.

During the review of MUNIS fiscal year reports of all payroll disbursements issued for the period July 1, 2007 through June 30, 2014, we found 49 instances where the same identification number was assigned by the District to both an employee and a payroll vendor. Discussion of this situation with the MUNIS vendor determined that there are three unique sets of identification numbers within the MUNIS system. The only time a situation involving identification numbers would potentially cause concern or confusion is when more than one type of identification number is included in a single report. If vendors of different types are included in a single report, it may appear that there is a

duplicate identification number on the report; however, the appropriate names for each will be provided on the report.

Recommendations: We recommend District management review the situation regarding the use of identification numbers and determine whether it is beneficial, within the current system configurations, to create unique numbering sequences for Employees, Payroll Vendors, and Accounts Payable Vendors. The change to unique identification numbers would ensure that there was no confusion when generating reports that may contain two or more of these types of vendors.

Finding 16: Certain MUNIS reports did not properly reflect payroll activity.

Although not related to the apparent payroll fraud, review of MUNIS reports provided by the District during our examination of an apparent payroll fraud revealed several issues that are being directed to KDE in a formal audit finding for FY 2014 since they are responsible for MUNIS reporting and vendor performance. The District was provided this information to assist in generating reports moving forward. Our review of the Detail Check History report in MUNIS for the period July 1, 2006 through January 31, 2010, revealed nearly all payroll payments showed an amount of zero. However, a review of transactions within MUNIS found dollar amounts identified as being issued to each employee's direct deposit account. Discussion with the MUNIS vendor determined a programming change was made in January 2010 that affected how the net pay amount was calculated. However, this change did not retroactively correct the net pay amount. A review of the All Checks report in MUNIS revealed that for the period July 1, 2006 through January 31, 2010, the majority of payroll payments were identified as voided with a payment amount of zero. This situation was corrected in MUNIS version 10.5, which Kentucky school districts will start migrating to by the end of calendar year 2014.

Recommendations: We recommend the District work with KDE, as well as the MUNIS vendor, to ensure all reports discussed in this finding accurately reflect District payroll and personnel data. Further, we recommend the District ensure any reporting issues identified going forward are formally reported to KDE and the MUNIS vendor to ensure the issues are resolved in a timely manner.

Chapter 1

Introduction and Background

Impetus and Objectives

The Shelby County School District (District) Superintendent requested the Kentucky Auditor of Public Accounts (APA) to perform a special examination related to a potential payroll fraud totaling \$593,179.96 that was discovered by District staff. The Superintendent requested the APA review District records to ensure that the amount of the suspected fraud was limited to the amount already discovered. The Superintendent also requested that the APA review payroll and accounting system internal controls and processes to make recommendations to strengthen controls and to reduce future fraud risk at the District.

To accomplish the examination, the APA developed the following procedures to review the identified areas of concern:

- Confirm the \$593,179.96 in apparent payroll fraud discovered by District personnel;
- Review payroll data and records to determine whether any further potential fraud could be detected;
- Review payroll control and oversight processes used by District; and
- Review certain information technology user controls and access rights for the District's accounting system, Municipal Information System (MUNIS).

The general examination period was January 2007 through June 2014, unless otherwise stated. This time period was determined based on the period that the suspected payroll fraud had occurred; however, certain data for earlier time periods was reviewed when available to examine whether the apparent payroll fraud had occurred prior to January 2007. Upon examination, auditors did not identify additional apparently fraudulent activity.

Details of the Apparent Fraud

District personnel initially detected a suspected payroll fraud on April 2, 2014 and reported it to the Kentucky State Police on April 4, 2014, once a preliminary District review of payroll records confirmed the initial suspicions. The apparent fraud was facilitated by using the former Payroll Manager's user access to the payroll system. A flowchart of the apparently fraudulent activities is located at Exhibit 1.

The Payroll Manager was initially suspended with pay from her position on April 10, 2014, and later resigned on April 28, 2014. Records indicate that from March 15, 2007 through April 1, 2014, the former Payroll Manager's user access was used to direct \$593,179.96 of District funds into personal bank accounts using the name and personnel data of a former District employee. This former employee worked at the District as a teacher until her retirement at the end of the 2002 school year, and later as a substitute teacher until the end of the 2006 calendar year.

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As was typical District protocol, once a final W-2 form for 2006 was issued for the former employee's work as a substitute teacher, the employee's personnel record was moved from the Live to Terminated area within the MUNIS payroll system. The Live and Terminated areas refer to two separate sets of data. Former employees' personnel records are moved from Live to Terminated areas so historical and current employment records can be maintained separately.

The apparent fraud is suspected to have started in the March 15, 2007 payroll when the former Payroll Manager's user account was used to move the former substitute teacher's personnel information from Terminated back to Live in the payroll system. While the former substitute teacher's employment record was in the Live area, she continued to be listed as an inactive employee. This is typically the status of current substitute teachers or an employee who no longer works for the District but has not yet been issued a final W-2. Moving the employee record from Terminated to Live was able to be completed without the review, approval, or knowledge of another District staff member because the former Payroll Manager's user account was granted superuser rights within the payroll system. These rights gave this user account the ability to add or delete an employee or change the employment status within payroll.

At the beginning of the payroll process, a preliminary proof of the payroll is printed and reviewed for accuracy and any necessary updates. As an inactive employee, the former substitute teacher would not be included in the preliminary payroll proof. During the review of the preliminary proof, the Payroll Assistant and two clerks review payments for classified District employees. Any errors or changes are noted by the clerks and changed in the payroll system. The preliminary proof was then forwarded to the former Payroll Manager for review of certified employees and to make any additional changes. At this time, it appears the former Payroll Manager's user account was used to change the former substitute teacher from inactive to active status. In addition, using the former Payroll Manager's user account, the bank account number on file for the former substitute teacher was changed to other personal bank account numbers. For most of the apparently fraudulent transactions, direct deposit payroll payments were split between two separate bank accounts.

The former Payroll Manager's user account was then used to enter a daily rate of pay for the former substitute teacher. Retired long-term teachers, such as the former substitute teacher, receive the highest pay rate. However, the rates input using the former Payroll Manager's user account varied from \$133 to as much as \$352 per day for the former substitute, which exceeds the normal rate of pay for District substitute teachers. Days reportedly worked for the pay period were then entered into the payroll system. Typically, the number of days entered for this apparently fraudulent activity exceeded the possible number of days that could be worked in a single pay period, ranging from eight days to as many as 52 days. The number of work days reported was attributed to multiple District schools, which made the number of excessive days reportedly worked less obvious.

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The pay information for the former substitute teacher was added to the payroll prior to printing the final proof, which was the last step in the review process. It was the responsibility of the former Payroll Manager to print the final payroll proof, which is bound and retained by the District as documentation of the payroll process. However, before the final payroll proof was bound, the printed page containing the former substitute teacher's name was replaced with the page from the preliminary payroll proof printed before the former substitute was added to the payroll. By substituting this page, no record of the payment to the former substitute teacher was provided in the printed report. Interestingly, the two proofs were printed on different printers with different paper types, leading to the added page being a brighter white with a glossier texture than the other proof report pages.

With the former substitute teacher added to the payroll, the total employee payroll amount was now higher than the amount originally reflected in the preliminary proof. While differences between the preliminary and final payroll proofs could potentially occur due to necessary changes made during the process, District financial staff stated that the two proofs were never compared or reviewed so that differences, legitimate or not, could be investigated and approved. Staff further stated that the preliminary proof was shredded once the payroll process was complete. No electronic copies of the preliminary or final payroll proofs could be located by District staff.

Since the District requires direct deposit of payroll for all employees, payroll data was transmitted electronically by the former Payroll Manager to the bank for payment. It was the responsibility of the former Payroll Manager to transmit this file and authorize payment by the bank. Once payments were disbursed by the bank, the former Payroll Manager's user account was then used to change the former substitute teacher's bank account back to the original bank account number on file. It was also used to change the former substitute teacher's employee record back to inactive status. It appears for the first several years of this activity, the former substitute teacher was transferred back to Terminated in the payroll system between each payroll run. This step appears to have been eliminated in November 2012 when the former substitute teacher continued to be designated as Live in the payroll system and was only shifted between active and inactive status.

The Cover Up

To conceal this apparently fraudulent activity, a variety of steps had to be completed. Since deductions for taxes would result in a W-2 being issued to the actual former substitute teacher and deductions for retirement would generate a retirement earnings report, these deductions had to be manually removed. In addition, a quarterly report containing all employees paid by the District must be generated for the federal government. To ensure that this report would not identify that the former substitute teacher was paid and also had no deductions, actions were initiated within the system, using the former Payroll Manager's user account, to make it appear the former substitute was never paid. This was done by voiding the payroll payment to the former substitute teacher after the payment was made by the bank.

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Voiding a payroll for an individual would normally result in an update to the District's general ledger. This would reduce the payroll amount and cause the general ledger to no longer agree to bank statements. This would have been a red flag for anyone reconciling the general ledger to the bank statements, which was done by the District on a monthly basis by the Director of Finance. Due to the former Payroll Manager's superuser access, it was possible to avoid posting to the general ledger by eliminating a typically required step within the payroll system. By eliminating this step, the payment would appear to be voided in the system without posting the amount to the general ledger. Since the supervisory review of the payroll process was only of the general ledger, it allowed the voids to go unnoticed.

In what appears to be a further effort to conceal the apparently fraudulent activities, payroll records were purged from the system. This eliminates the ability to recreate a particular payroll, but it does not delete the historical data that can be retrieved and reviewed through various reporting capabilities within the MUNIS payroll function. The overall purpose of purging the records is unclear since other reports could be generated to view the payment history.

Retirement Adjustments

Of the \$593,179.96 diverted to personal bank accounts, \$2,482.01 was processed on November 15, 2013 in a different manner than the apparently fraudulent activity previously described. This was the remaining balance from a \$77,000 refund from the County Employees Retirement System (CERS) due to an overpayment made by the District related to certain substitute teachers.

Findings and Recommendations

Finding 1: The District did not implement proper segregation of duties contributing to \$593,179.96 in payments made to a “ghost” employee over a seven year period.

The District did not implement proper segregation of duties between the employees responsible for the entry and maintenance of personnel information and those employees responsible for the payroll processing and payment. District Personnel Department employees and the former Payroll Manager had the ability to add new employees, as well as move an employee’s record between the Live and Terminated areas within the payroll system without the approval or knowledge of any other District employee. This lack of segregation of duties goes against all basic best practices recommended for the oversight and control of both personnel and payroll activities. By not implementing these controls, an apparent fraud of \$593,179.96 was able to occur over a seven-year period.

Addition/Deletion of Employees

A common payroll fraud scheme involves the use of a “ghost” employee created by someone with the access to enter or change personnel information. A “ghost” employee is an employee that does not exist except within the personnel and payroll system. In this instance, the “ghost” employee was a former District substitute teacher that was no longer employed by the District.

To prevent fraud involving “ghost” employees, controls should be implemented to ensure that segregation of duties exist between the staff members responsible for entry and maintenance of personnel data and those responsible for payroll processing. Certain Payroll Department employees had payroll superuser system access, which allowed these employees to add, delete, or change employees’ information. In addition, payroll employees were also routinely requested to perform these functions, which should be the responsibility of the Personnel Department. This access allowed the former substitute teacher’s employment record to be routinely moved in the system between Terminated and Live without approval or notification to another District staff member. The former substitute teacher had not been employed by the District for a year prior to the beginning of the apparent fraud.

According to the Director of Finance, in July 2013, the District started requiring that only staff within the Personnel Department create new employees within the Live area or move employee records between Live and Terminated. While this could have assisted in providing appropriate segregation of duties, the system access rights of the Payroll Department employees were never changed to restrict this access and these actions continued to be performed. District staff stated this access was occasionally needed in order to expedite the process if a Personnel Department employee was not available.

Findings and Recommendations

Changing Employee Information

In addition to having the ability to add employees or change their employment status within the payroll system, the Payroll Department staff had the ability to change any and all demographic information associated with the employee. Demographic information not only includes such things as the name, age, and address of an employee, but also includes the bank account designated by an employee for payroll direct deposit. While the District practice required that changes to an employee's bank account information be accompanied by a Personnel Consideration Sheet (PCS), the Payroll Department staff had sufficient system access to make such changes without the approval or knowledge of any other District employee. This and the lack of oversight of the payroll process allowed the former substitute teacher's designated bank account to be changed from the one on file to a new personal bank account without detection. The bank account number was also able to be changed back to the original designated account between payrolls seemingly to conceal the apparently fraudulent activity.

Had Payroll Department staff not been provided the user access to move the former substitute teacher from Terminated to Live, this apparent fraud would not have been possible. The District currently has sufficient Personnel Department staff to segregate these duties from the Payroll Department. By assigning one department this duty, it will separate the personnel and payroll functions, significantly strengthening internal controls.

Similarly, strong internal controls require the entry and maintenance of personnel demographic information to be performed by separate parties not associated with the payroll process. This function could also be carried out by the District Personnel Department.

Recommendations

We recommend the District remove personnel related menu access within MUNIS for all District Payroll Department employees. This includes the ability to add, delete, or otherwise change the employment status of employees. All additions, deletions, or other changes to the employment status of District staff should only be conducted by employees within the District's Personnel Department. Written procedures should be developed to ensure changes to employment status are communicated between the two departments consistently and timely. These written procedures should establish specific criteria and timeframes for when changes to employment status are to be carried out.

We also recommend all employee demographic information be updated by Personnel Department employees. A document, such as a PCS form, showing the employee's request to change their bank accounts should be maintained. In addition, we recommend changes to information made by employees through the Employee Self Service (ESS) function be reviewed and approved by Personnel Department employees.

Findings and Recommendations

We further recommend the District establish a written process requiring a person in a supervisory position, independent of the personnel process, to generate reports available within MUNIS that will allow a review of the changes that are made to personnel information. This process should be performed on a monthly basis, at a minimum.

Finding 2: The District did not ensure employee record updates were consistent, timely, or reviewed, which provided an opportunity for the apparent fraud.

District system access rights were comingled among Personnel and Payroll staff allowing users in both departments to add new employees to the Live area, to change employment status between active and inactive, and to move employees between Live and Terminated. Given that both Personnel and Payroll Department staff were granted the ability to make these changes, confusion existed regarding which department is ultimately responsible to perform these actions and are to ensure that all changes are authorized, appropriate, complete, and processed in a timely manner.

The presence, accuracy, and completeness of employee records are necessary to support payroll expenditures for the District. Additions, changes, and removals of employee records should be based on properly authorized personnel actions. Further, all documentation should be retained to validate personnel actions and payroll expenditures.

As discussed in Finding 1, the District provided the former Payroll Manager's user account, as well as others, with sufficient access rights to move an inactive former substitute teacher's employment record from Terminated to Live within MUNIS. This individual's record was able to be changed from an inactive to active status, which allowed apparently fraudulent payments to be made through the payroll process. Further, bank account information for this individual's employee record was changed, using the former Payroll Manager's system user account, to divert these funds to a personal bank account. No controls or procedures were in place to review these types of changes to employee records, which could have identified these changes as a concern that warranted further scrutiny.

During our review of MUNIS payroll data, we found several instances, in addition to the apparently fraudulent payroll transactions, where employee records appeared incomplete or changes were made without proper approval or support. Specifically,

- The review of additions to employee records made for the period January 1, 2013 through April 15, 2014 found two instances where the employee record for an individual did not reflect the most recent employment information. There were also three instances where the former Payroll Manager's system user account was used to move staff from Terminated to Live without apparent cause or support. Further review of transactions related to these individuals did not identify any additional suspicious financial activity.

Findings and Recommendations

- The review of payroll payments for the period July 1, 2007 through June 30, 2014 found:
 - An employee resigned and was given a final payout on January 2, 2013; however, the individual was not removed from payroll in a timely fashion. The error was caught after the February 15, 2013 payroll payments were issued. These inappropriately issued payments were voided and the money was transferred back from the individual's account.
 - An employee resigned in September 2013, but notice was not given to Payroll until December 15, 2013. Therefore, the individual was not removed from payroll in a timely fashion. The payroll payments issued in error were voided and the money was transferred back from the individual's account and then a final payout for this individual was processed.
 - An employee did not return to work, but remained active in the payroll system during the next two pay periods, which allowed payroll payments to be processed. The District originally stated that these payments were voided and the funds were recovered. Though the payments were recovered, the District staff did not take appropriate action to ensure these payments were recorded in the payroll system. Discussion of the proper processing and documentation of voided disbursements are further addressed in Finding 9.
- The review of the employee records within the Live area of the payroll system found:
 - Of the 490 inactive employees within the Live area, 455, or 92.9 percent, have an inactive and/or termination date that is earlier than January 1, 2014. According to District personnel, inactive employees are maintained in the Live area until W-2's for their last work year are processed. Auditors expected these individuals to have been moved to the Terminated area after the W-2 processing for the calendar year 2013. However, District management stated that they also retain substitutes in inactive status until they have actively worked. Additionally, employees that retire and could potentially be rehired are also retained in the Live area. This prevents staff from having to manually switch the employee between the two areas. According to the District's Director of Finance, 301 different substitutes worked at the District during the 2013-2014 school year. Therefore, if all 301 substitutes were within the population of 490 inactive staff in the Live area, there were still 189, or 38.6 percent, of the individuals listed as inactive that should be moved to the Terminated area.

Findings and Recommendations

- 19 employees were identified as active and had a hire date after the recorded inactive/termination date. The existence of these conflicting dates within the same employee record could cause confusion when determining the accurate population of current staff. According to the District, MUNIS does not require the hire, inactivation, and termination dates be populated on the employee's record. MUNIS only requires the individual to be in active status when the payroll is processed for the individual to be paid. This situation was confirmed with the MUNIS vendor. Furthermore, the District was not instructed by KDE to update or remove these dates when a change in employment occurs.
- Four active employees were identified with no hire dates recorded in the employee record. We determined that these individuals received payroll payments during the period of FY 2007 through 2014 and the District confirmed that these individuals are current board members or paraprofessional coaches. However, without a hire date, the information within the system cannot be used to validate the appropriateness of payments to these individuals.

Recommendations We recommend the ability to add employees to the Live area, to change employment status between active and inactive, and to move employees between the Live and Terminated areas be restricted to the Personnel staff. Currently, the Personnel Department has four staff, which should allow sufficient resources to exclusively perform these tasks. This control would allow a separation of this process from the Payroll function, which would then focus on ensuring that all current District employees are established with proper pay rates based on job position and tenure.

Regarding the process for changing employees from active to inactive status, we recommend Personnel Department staff formally document terminations, resignations, decisions not to return to work, and retirements on a PCS form and provide these forms to the Payroll section as close to the termination date as possible in order for any final payout to the employee to be issued. Once Payroll has processed any necessary final payout for the individual, we recommend the PCS form be returned to the Personnel Department for the individual's status to be changed to inactive. The timing of this process is critical to ensure that inactive employees are properly classified prior to the next payroll process. We recommend a formal, written process document be created to explicitly identify the responsibilities of the Personnel and Payroll departments.

We also recommend that the District review all substitute personnel on an annual basis. Any staff identified as not performing substitute duties for the upcoming school year should be changed to inactive status. The process for the establishment and removal of substitute staff should be documented in writing and consistently followed.

Findings and Recommendations

We recommend that the Personnel Department staff perform a review of all inactive staff within the Live area annually in February after W-2 forms have been issued to staff for the previous year. Any individuals identified as no longer being employed by the District and have not worked during the calendar year should be moved to the Terminated area. In addition, we recommend the District develop written documentation for the process to complete this review and movement of inactive staff to the Terminated area.

Further, we recommend that the District begin using the hire, inactive, and terminated dates within the employee record to reflect the current employment status of employees. To that end, the District should develop a procedure to use these fields of information to ensure that the individuals are consistently and appropriately updated in the system to reflect changes in the employment status of all staff.

Finally, we recommend the Personnel Department act as the final repository of all PCS forms. These forms should be retained per the District's retention schedule and be readily available for either internal management review or audit purposes.

Finding 3: The District did not segregate the duties between payroll maintenance, final review, and the approval process, which increased the risk of potential fraud.

The former Payroll Manager was given complete control over the maintenance of payroll records, review of payroll accuracy, and approval of final payroll payments without a secondary review by another District employee. As the manager over the District's payroll process, the former Payroll Manager was responsible for maintaining the payroll system and ensuring that it was operating timely and accurately. While this is expected of a payroll manager, the District allowed the former Payroll Manager to be the only staff member to have final review over the payroll files prior to being sent to the bank for payment. In addition, it was the former Payroll Manager's responsibility to send the payroll file to the bank and authorize payroll payments from District accounts. This is considered "one of the biggest security lapses" of payroll best practices and can allow fraudulent activities to occur, such as apparently fraudulent payments that went undetected by the District over a seven-year period.

Payroll Proofs

Prior to the payment of each payroll, a preliminary payroll proof is printed for review to determine if any corrections are required. This preliminary proof was printed by the former Payroll Manager then the proof reports for classified employees were distributed to the Payroll Assistant and two other clerks. The Payroll Assistant and the two clerks were responsible for reviewing the report for classified employees. Classified employees include food service workers, secretarial staff, custodians, and any other positions that do not require a certification for their employment.

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The former Payroll Manager was responsible for reviewing the payroll proof reports for all certified staff, such as teachers, principals, and substitute teachers. While changes or corrections noted by the Payroll Assistant and the two clerks for classified staff were reported to the former Payroll Manager for review, no similar review process occurred for changes made by the former Payroll Manager.

Once all changes noted during the preliminary payroll proof process were made in the payroll system, a final payroll proof was printed by the former Payroll Manager. The final proof is intended to serve as the record of all payroll payments made during a particular payroll period and is maintained in the District records. According to District financial staff, the former Payroll Manager was the only District staff to review the final payroll proof. Accordingly, there was no secondary comparison or review of the preliminary proof and the final proof to identify changes made to the payroll or a scan of the final proof for accuracy.

It was during the period between the preliminary payroll proof and the final proof that a former substitute teacher was manually added to the payroll. Since no secondary reviews were conducted by other District employees of certified staff changes or the final payroll proof, this addition went undetected.

Auditor's review of the final proofs for the examination period found that the report page containing the payment made to the former substitute teacher was removed. This page was replaced with the same page number from the preliminary proof that did not show the payment because the substitute teacher information was added after the preliminary proof. Had the final proof been printed by an employee performing a secondary review, the report pages could not have been manipulated and the excessive number of days and pay rate reported for the former substitute teacher should have been identified. The former substitute was typically paid more than most District employees and at times exceeded the amount paid to the highest paid District employees. See Exhibit 2 for a listing of all payments made using the information of the former substitute teacher.

Authorizing Payment

In addition to making unmonitored changes to the payroll data and performing the sole final review of the payroll file, the former Payroll Manager was also responsible for sending the payroll file to the bank and authorizing the bank to distribute payroll to employees. Best practices dictate that there should be a segregation of duties for these responsibilities. As an example, training materials produced by the MUNIS vendor states,

One of the biggest security lapses that can exist within your payroll process is to allow the person(s) who maintains the data used to create the checks to actually have access to the Check Print and Direct Deposit File transmission process.

Findings and Recommendations

Separate review and approval steps must be carried out by different staff between creating and transmitting the payroll file to the bank. The control over the disbursement of payroll should typically be performed by executive management, such as the Director of Finance.

Recommendations We recommend that the District establish a process to create a separate review and approval of the payroll process. We recommend that the Director of Finance, or other qualified executive management staff, review and compare the preliminary and final payroll proofs to determine if any changes have been made. Also, we recommend changes be investigated for necessity and validity.

We further recommend the Director of Finance, or other qualified executive management staff, review the final payroll proof for potential errors or questionable payments, including excessive pay rates, number of hours worked, and employees not actively working at the District.

We finally recommend the Director of Finance, or other qualified executive management staff, also review the Payroll Earnings Distribution Report to further identify potential anomalies within the payroll.

Finding 4: The District did not develop a formal written process to ensure only substitutes who worked for the District were paid during the school year.

Discussions with District officials revealed a formal written process was not developed to ensure only active substitutes were paid during the school year. According to the Personnel Director, substitutes are determined at the beginning of the school year and entered into the substitute placement and absence management software application by District Personnel Department staff. However, Payroll Department staff also have the access to enter substitutes into this application. Once the hours worked by a substitute are entered into the substitute placement and absence management application, the application automatically populates the hours and pay rate within the MUNIS payroll system.

Though this is the typical process followed by the District to account for and pay substitute employees, Payroll staff can bypass the substitute placement and absence management software application and instead manually enter and initiate payment of substitutes directly from MUNIS. As discussed in the Introduction and Background of this report, the former Payroll Manager's system user account was used to change an inactive substitute teacher record to perpetrate an apparent fraud diverting \$593,179.96 to personal bank accounts during the period of March 15, 2007 through April 15, 2014.

As further noted in Finding 2, the District maintains a significant number of inactive substitutes on their employee listing in the Live area of MUNIS longer than reasonable. Employee's status along with hire, inactive, and termination dates being inconsistently recorded and the blurring of Payroll and Personnel Department staff responsibilities for the maintenance of employee records led to 455 individuals being reported as inactive in the Live area with either an inactive or terminated date prior to January 2014. This situation creates the opportunity for inactive staff to be inappropriately paid during the school year.

Findings and Recommendations

Recommendations We recommend the District develop and adhere to a written process explaining how the District will authorize, account for, and pay substitute employees. The Personnel Department staff should be responsible for entering substitutes at the beginning of each school year into the substitute placement and absence management software application. We recommend any substitutes hired after the start of the school year have sufficient documentation to demonstrate management’s approval prior to being entered into the substitute placement and absence management software application. Further, we recommend the Personnel Department staff change the status of all substitutes under contract for the current year to an active status. Any substitutes who were not offered or executed a contract for the current year should be changed to an inactive status. Once the substitute’s W-2 is issued, the employee record should be moved to Terminated.

In addition, we recommend payroll hours for all substitutes primarily be supported by information from the substitute placement and absence management application. Manual payroll entries into MUNIS for substitutes who are not within the substitute placement and absence management application should not be allowed unless appropriate documented authorization is granted by management for special circumstances. Finally, we recommend the District consider requiring each school or facility submit a substitute log or form to the central office to support work hours claimed by substitutes. If this information is available, Payroll Department staff can use it to validate substitute hours for each pay period.

Finding 5: The District did not use available controls within MUNIS to prevent removing an essential step of the payroll process.

The District provided the former Payroll Manager and others access to MUNIS that allowed the elimination of a step in the payroll process that automatically posts payroll payments or voided payroll activity to the District general ledger. By eliminating this step, transaction activity from voided payrolls, which included apparently fraudulent payments made using the name and personnel information of a former substitute teacher, were not recorded to the general ledger within MUNIS. At the time of the apparently fraudulent activity, the general ledger was the primary source of information the District used to reconcile payroll payments reported by MUNIS to the District bank statements. The administrative features in MUNIS provided the functionality for the District to have eliminated or restricted the former Payroll Manager’s access to the MUNIS menu containing the selection of payroll steps that must be performed to complete the payroll process. However, the District did not adequately restrict the availability of this menu. By allowing the former Payroll Manager to have access to this menu, the District provided the opportunity to circumvent the primary method used by the District to monitor its payroll activity through the general ledger report.

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Removing Steps from the Payroll Process

To conceal apparently fraudulent payroll activities, it had to seem as though the payroll payments to the former substitute teacher never occurred. This was accomplished by performing a void of the payroll transaction only for the payment made to the former substitute teacher once the payroll process was complete and after the payments were made by the bank. Given that voiding payroll transactions related to the apparent fraud does not redeposit funds into the District's bank account, it was necessary to remove the payroll step that would post transactions to the general ledger. Had these transactions posted, it would have caused a noticeable imbalance when reconciling District bank account statements to the general ledger. Concealing this apparently fraudulent activity was accomplished by removing the step within the MUNIS payroll system that would automatically post a voided transaction to the general ledger.

As previously stated, the District could have limited access rights so that the menu allowing changes to payroll process steps was not available to a user. However, District officials acknowledged that these restrictions were not used and certain employees were able to alter payroll process steps. District financial officials further stated they were never aware that the former Payroll Manager and other payroll superusers had the authority to make such changes to the payroll process. Based on these additional statements, it appears management assumed that payroll processes were established by MUNIS and that important functions, such as posting to the general ledger, could not be turned off, altered, or eliminated except by District employees with higher level administrator rights.

The general ledger provides significant information to be used as an important financial tool for monitoring both payroll and other District financial information. The overall responsibility for ensuring completeness, accuracy, and timeliness of accounting processes that could affect the general ledger resides with a primary financial officer, such as the Director of Finance. Further, due to the importance of the payroll process, it is necessary to ensure that the expected and essential steps to complete the payroll process is documented by District executive management in written procedures. This provides a single point of reference and guidance for payroll employees and management providing oversight.

Using Alerts

Another capability within the MUNIS payroll function is the opportunity to establish alerts notifying designated management, such as the Director of Finance, when a payroll started, when each payroll step is completed, and when the payroll process ends. Access to this function is controlled by the system administrator and could not be turned off by the staff member performing the payroll processes. Such alerts would have notified the Director of Finance when a new void payroll process began and identify activity that could warrant further review.

Findings and Recommendations

Recommendations We also recommend the District ensure the payroll steps required by management are established in the system and develop written procedures that specify all payroll steps to be included with each type of payroll. The procedures should also identify the request and approval process for making changes to the required payroll steps. District executive management should periodically review the payroll steps established in MUNIS to ensure they are in compliance with the written procedures.

We recommend the District restrict menu access within MUNIS to prevent Payroll Department staff from making any changes to payroll steps determined to be necessary by District management as specified in the written procedures. Such changes should only be performed by the Director of Finance, or other qualified executive management, who should document the required steps performed to complete payroll and the purpose of any necessary changes made to these steps.

We recommend the District enable the alert system within MUNIS to notify the Director of Finance, or other qualified executive management, when a payroll process has begun and when payroll steps are completed.

Finding 6: The District did not develop or implement a system access control policy, increasing the risk of unauthorized or inappropriate activity.

The District did not develop or implement adequate logical security controls governing user access to MUNIS. Therefore, it was not possible for auditors to ensure that all users were authorized and granted appropriate access to MUNIS.

While written procedures are not currently in place for administrative staff to follow when granting, changing, and terminating user access, an informal process was used to grant system access. It should be noted that the Director of Finance was initially responsible for establishing user access; however, this job duty was delegated to the Finance Coordinator in 2012. Both individuals have System Administrator rights within MUNIS, which allows them to grant, change, or delete user access.

To establish a user's system access rights, the Finance Coordinator receives a PCS form from the Personnel Department showing newly hired staff. The Finance Coordinator is generally aware of new staff job duties; however, if any questions arise, this individual works in conjunction with the Director of Finance to ensure the necessary access is granted. Based on the Finance Coordinator's understanding of the job duties for this new staff person, a new user record may be created within MUNIS. Access is typically granted based on the individual's job position. This process allows the Finance Coordinator to copy the access rights from another employee in a similar position to the new employee's user account. There is no review process in place at the central District office or individual schools to ensure this access is appropriate. Further, no supporting documentation for user access additions, changes, or deletions is maintained.

As is discussed in Finding 7, testing also revealed numerous district employees were granted excessive access to MUNIS.

Findings and Recommendations

Failures to adequately document, implement, and communicate security policies and procedures could lead to a lack of understanding by management and users. This lack of understanding could potentially result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system functionality or resources. Additionally, it increases the likelihood of unauthorized or inaccurate data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources.

Allowing users the ability to access information without proper authorization may subject the processing of data to errors and/or omissions and may compromise the integrity of data processed through the system.

Recommendations We recommend the District develop a written policy to ensure staff obtains appropriate access to MUNIS. As part of this policy, the Personnel Department should consider developing and completing a form to substantiate the permissions and roles granted within MUNIS. This form, or other comparable communication, should be submitted and approved by the individual's supervisor.

In addition, we recommend an employee be formally designated as the primary person responsible to provide employees with appropriate system access and that a backup also be designated to perform this function when necessary. We recommend these employees receive training to ensure they have a clear understanding of how to effectively and efficiently perform this function.

District management should perform, at a minimum, an annual review to ensure users are still employed and require access to MUNIS. Actions taken to change access levels should be thoroughly documented. All documentation supporting the user's access should be maintained for audit purposes.

Finding 7: The risk of inappropriate activity increased due to the District failing to limit or monitor MUNIS user access.

District employees were granted excessive MUNIS access, including continued access after terminating employment, due to District administrators not consistently establishing minimal necessary access rights or monitoring a user's need for continued access. The District is responsible for establishing access roles within MUNIS and for monitoring the appropriate level of user access. MUNIS security features allow access roles to be customized by each district based on specific needs. This customization can be established at a granular level that will allow a user to view specific system process menus and to execute specific transactions.

Two layers of access are required for a user to work within the MUNIS application. First, an individual must be established as a user within the MUNIS Cloud Administration application. To be able to open the MUNIS application, the user must have a valid and enabled MUNIS Cloud Administration account. Once within the MUNIS application, application level security access rights are established that grant access to system transactions, menu, and data. The application level security access rights can be seen within the user attributes listing. To use these application level security access rights, the user account must also be enabled within the MUNIS application.

The District established two individuals as MUNIS system administrators, who have the responsibility to establish user rights throughout the MUNIS system. At the beginning of our examination, District management thought these two individuals were the only users with the ability to make changes to user account access rights within MUNIS. It was found that they were the only individuals with administrator rights to the MUNIS Cloud Administration application. However, a review of the user attributes listing within the MUNIS application for all District users determined that there were five additional users who, during the period under review, had administrator rights with the necessary menu access to perform changes to roles of existing users. These access rights were provided as part of customized roles established for these individuals. Therefore, for user accounts established within the MUNIS Cloud Administration application, these individuals would have had sufficient rights to make changes to the access granted to active MUNIS users.

In addition, the District had established four individuals as Payroll superusers, which granted unrestricted access to all functionality within the payroll programs. These individuals included the previous and current Payroll Managers, the Director of Finance, and the Finance Coordinator. The former Payroll Manager's access was confirmed to be disabled on April 10, 2014 within the MUNIS Cloud Administration application; therefore, at the time of our review, this account could not be used to access MUNIS. In addition to the four Payroll employees designated as superusers, a review of the user attributes listing revealed two additional users within the Personnel area that were granted Payroll superuser access. As these individuals are within the Personnel section, this access is considered excessive and unnecessary given their job duties.

A review of the MUNIS Cloud Administration application identified that of the 94 accounts established within the application:

- Two users resigned on August 9, 2012, and May 21, 2013, and continued to have enabled MUNIS access as of June 18, 2014. One of these individuals was also identified when reviewing the user attributes listing.

Findings and Recommendations

- Thirty-three accounts were established for specific functional areas (Family Resource and Youth Services Center (FRYSC) Coordinator, Principal, and Secretary) at individual schools/facilities. However, as no documentation is currently maintained for the access granted to individuals, internal controls are weakened because user activity cannot be easily attributed to a specific individual. For all but one account discussed below, the accounts were assigned to the individual staff person at each facility who was in the functional position. According to the Director of Finance, there is a high likelihood that some of these positions would be filled by a different employee from one year to the next. Further review of these accounts established for a functional area found the following:
 - Fifteen accounts did not have information about the current user of the account within the Accounts Detail section of the MUNIS user attributes. Although this section is for informational purposes only, the lack of current information draws into question the consistent monitoring of access rights by the MUNIS administrators. Specifically, we noted:
 - Eight accounts did not identify an assigned user.
 - Seven accounts had information related to an individual who no longer worked for the District.
 - One account is currently used as a group account, which means that more than one individual can use the account and actions cannot be attributed to a specific user.

The review of the user attributes listing also revealed:

- Six users either no longer worked for the District or no longer required access to MUNIS.
 - Three of these accounts were identified as disabled within the MUNIS Cloud Administration application; therefore, these accounts could not be used to access MUNIS. However, the access rights within the MUNIS application were still identified as enabled. Therefore, should their accounts be returned to enabled status in the MUNIS Cloud Administration application, the account would be granted all previous access rights. It was noted that these individuals are no longer with the District and, therefore, should no longer have access to the application.

Findings and Recommendations

- Two accounts were identified as enabled within the MUNIS Cloud Administration application; however, the accounts had no access rights established within the MUNIS application. Although these accounts had no access rights within the application, because they were established within the MUNIS Cloud Administration application, any individual with administrative access within the MUNIS application could establish access roles for these individuals. The District administrators stated that these individual did not require access to MUNIS; one of the accounts was related to an individual who was no longer employed by the District and one was a system account that was no longer being used.
- One account was identified as being enabled within the MUNIS Cloud Administration application; however, the account's access within the MUNIS application was shown as disabled. The District administrator identified this account as being disabled within MUNIS approximately 2.5 years before. They were not aware that the account was established within the MUNIS Cloud Administration application, or that it was designed as being enabled. As previously noted, any individual with administrative access within the MUNIS application could change the access rights for this individual, since they exist in the MUNIS Cloud Administration application.
- Two users within the Payroll area were granted access to Accounts Payable in addition to Payroll, which creates a lack of a segregation of duties weakening internal controls over financial activity.

Recommendations We recommend the District first perform an in-depth review of all access rights established within MUNIS, inclusive of the attributes, menus, and transactions that can be accessed or used by an individual granted these rights. Controls over user access should be strengthened to deny all user rights except those specifically necessary to perform job duties. Once the access rights have been reviewed and appropriately modified, the District should create a matrix of access rights to ensure accurate and consistent rights are established for individual users in functional areas, including but not limited to FRYSC coordinator, principal, and secretary.

Using the matrix of baseline access rights and the results of the access role review, we recommend District staff review each existing user account and related access to determine whether the roles provided are appropriate based on the employee's job duties. Additional information and discussions from other district staff may be required to ensure only necessary rights are provided.

Additionally, we recommend the district disable the functional area accounts. New accounts should be created for each individual user based on the matrix of baseline access rights, which will be uniquely attributed to the individual. This process will allow more accurate tracking of actions performed within the system by these individuals.

Findings and Recommendations

Finally, going forward, we recommend as employees no longer require access to MUNIS these rights be disabled in both the MUNIS Cloud Administration and the MUNIS application as soon as notice is provided. We recommend the termination of a user's access be included in an employee exit checklist to ensure access is revoked. The person who revoked the access should initial the form indicating that the action was completed.

Finding 8: The District did not use payroll reporting and monitoring functions that could assist in detecting potential fraud.

District executive management did not use various reports available in MUNIS to monitor and review payroll processes and activity. The District only relied on the payroll totals reported in the general ledger to reconcile to monthly bank statements. As seen in Finding 5, the totals reported in the general ledger were able to be manipulated by removing steps from the payroll process. District executive management could have routinely used a variety of other existing MUNIS reports that, upon review, could have identified the apparently fraudulent payroll activities discovered at the District. The MUNIS vendor, as well as the Kentucky Association of School Business Officials (KASBO) offered multiple training opportunities that presented these various reports and methods for reconciling payroll.

Based on interviews with current District financial staff, monitoring the accuracy and completeness of the payroll process was primarily the duty of the former Payroll Manager. This includes reviewing the payroll functions she personally performed. According to the District's Director of Finance, the former Payroll Manager's direct supervisor, he scrutinized the first four payrolls of each school year, with the primary focus on ensuring that employees' salaries correctly matched the District's Board-approved salary schedules. However, it appears the daily pay rate entered into the Payroll system for substitute teachers was not part of this review process.

Further payroll monitoring by the District's Director of Finance consisted of reviewing handwritten notes on a report identifying total payroll disbursed and periodically using a MUNIS general ledger report. The amounts identified on these reports were then compared to the monthly bank statements. These monitoring and oversight activities were insufficient to detect the apparent payroll fraud, especially given the significant control and system access given to the former Payroll Manager.

Available Reports

The former Payroll Manager was given the authority to:

- make any and all changes to an individual's personnel information and employment status;
- establish or change employee pay rates;
- void payroll payment transactions;
- change required steps to process payroll; and
- authorize the bank to make payroll distributions to employees.

Findings and Recommendations

The former Payroll Manager could perform all of this activity without review or approval from a supervisor during the payroll process. Though an employee may be given excessive control, potential fraudulent payroll activities could be identified by generating and reviewing certain MUNIS payroll reports.

The District completed a monthly reconciliation between payroll and District bank statements using the general ledger report from MUNIS. However, the process could be strengthened by using other financial reports that are not impacted by changing payroll process steps. At least one training session, presented at a KASBO conference, suggests using the combination of the Check Register and the Employee Deduction Register reports to perform the monthly bank reconciliation. The Check Register identifies the net amount paid into employees' primary bank accounts. The Employee Deduction Register reports any deductions employees have voluntarily requested be taken from their pay to be deposited in a secondary bank account. By adding these two report totals, a reviewer can then compare this amount to both the general ledger and the amount reported by the bank. If the three totals do not agree, further review of individual payroll payments would be required.

Additional training materials provided by the MUNIS vendor indicate there are numerous optional reports available in the Payroll system that can be generated to review specific payroll activities. These include:

- Payroll Audit Report – There are a variety of tables available through this report that contain all records involved with adding, updating, or deleting an employee within payroll. This could have identified that an additional employee was being added to the payroll just before the final payroll proof was being generated.
- Clerk Report – This is an optional report within the payroll proof. This report would identify changes made to an employee's pay or deductions, such as occurred in the apparently fraudulent transactions of a substitute teacher's payroll record changed to ensure no payroll and retirement deductions were made.
- Global Audit Inquiry – This is an option within the Payroll Administration menu that automatically stores the start and end dates for any of the payroll steps being completed. This would have identified the void payrolls that were being initiated on a regular basis. A reviewer could also use this report to determine that the payroll step to post payroll voids to the general ledger were not completed.

The Director of Finance has stated that the District has now incorporated, subsequent to the apparent fraud, the use of the Check Register and Employee Deduction Register into the payroll review process. By also expanding the payroll review process to adopt the use of the additional reports suggested in the MUNIS vendor training, the District will further strengthen payroll controls, giving employees a greater chance of detecting irregularities and potential fraud.

Findings and Recommendations

Recommendations We recommend the District continue to generate the Check Register and the Employee Deduction Register for use in the payroll reconciliation process. Since up-to-date banking information is available to the District through an online bank portal, this could be a process completed after each payroll or performed on a monthly basis for the two payrolls completed during that time period.

We recommend the District develop a payroll review process that incorporates the Payroll Audit Report, Clerk Report, and Global Audit inquiry to monitor changes and activities within the payroll process. This review should be carried out by an employee that is not directly involved in regular daily updates and changes to personnel or payroll information. We recommend any questions resulting from performing the reconciliation process, including changing payroll process steps or questionable changes to an employee's payroll record, should be fully investigated and documented in a timely manner. We further recommend that a primary and backup employee be sufficiently trained to generate and use all of these reports to perform a thorough reconciliation process.

Finding 9: The void payroll process was not consistently followed by staff to ensure recovered funds were properly recorded.

During the review of District payroll disbursements recorded in the general ledger for the period of July 1, 2006 through June 30, 2014, voided payroll disbursements were identified, some of which did not follow the void payroll process. A void transaction is initiated to document when a payroll disbursement was voided and funds were recovered and re-deposited by the District. Therefore, voided transactions are recorded as a negative dollar amount and the status for the original payroll disbursement will be changed to void.

During the examination period, in addition to the apparently fraudulent transactions identified, auditors found two instances where the funds from voided payments were not recorded in the general ledger as recovered. These two voided payments, totaling \$1,557.88, were issued to the same employee. According to the District, this individual left the employment of the District, but continued to be identified, in error, as active in the payroll system during the next two pay periods; therefore, payroll payments continued to be made to this employee. These two transactions were not included in the routine reports that identify void transactions created within the system. District staff was able to find a record of these payments being re-deposited into the District's bank account; however, the payments were not voided through the void payroll process.

Discussion with the current Payroll Manager revealed that the proper process for voiding a payroll payment is to follow the void payroll process; however, MUNIS would also allow a user with certain system access to the payroll payment information to manually change the status. The process of manually changing the payment status does not reverse the original payroll transactions and record the recovery of funds in the general ledger. Further, if funds were recovered and re-deposited to the District's bank account, the general ledger would have overstated expenditures and understated cash because of not following the proper process to record transaction activity.

Findings and Recommendations

As discussed in the Introduction and Background of this report, the void payroll process was used to conceal the apparently fraudulent payroll disbursements issued using a former substitute teacher's payroll record. The bank account number for this individual's employee record was changed to divert funds to other personal bank accounts. When the void payroll process was initiated, multiple process steps were removed including one requiring the transactions to post to the general ledger. Since the void payroll transactions were not posted to the general ledger, this allowed the general ledger to accurately reflect expenditures made and remain in balance with the District bank account statements.

Recommendations We recommend the District create a written procedure to explicitly itemize the steps to be taken to void a payroll payment within MUNIS. In addition, we recommend the Director of Finance, or other qualified executive management, routinely review all void payroll transactions within MUNIS to ensure the process is followed consistently and the voids are appropriate, authorized, and documented. Finally, documentation should be maintained to support all void actions taken and should be readily available for internal management review and audit purposes.

Finding 10: The central level substitute teacher budget was exceeded four times without sufficient review and understanding of the cause.

For FY 2008 through FY 2014, a District budget line-item for substitute teachers was exceeded four of the seven years. This was the budget line-item used to make the apparently fraudulent payments to personal bank accounts using the payroll information of a former substitute teacher. While District executive management stated they evaluate the causes for exceeding this budget line-item, the research appears to primarily be anecdotal in nature rather than a detailed data-driven review. This made the budgetary review for this particular line-item insufficient to detect that a substitute teacher was paid for more work days than scheduled school days in each of those years.

According to the Director of Finance, the District substitute teacher budget is a central level budget line-item. Since it is a central level budget line-item, it does not impact the budgets of individual schools where substitute teachers are working. The amount budgeted is established based on historical budgets and any known substitute needs for the upcoming school year. The Director of Finance stated that this budget line-item is very difficult to determine due to the unpredictable reasons for teacher absences. Therefore, it may be reasonable that the substitute teacher budget is exceeded. While this may be reasonable, it does not excuse District executive management from performing a more substantive review when budget line-items with unpredictable expenses are exceeded.

Table 1 contains the central level substitute teacher budget for FY 2008 through FY 2014 and the actual annual expenses charged. The difference between budgeted and actual expenditures for each year is also provided to identify those years where the budget was exceeded.

Chapter 2
Findings and Recommendations

Table 1: District Level Substitute Teacher Budget-to-Actual FY 2008 – FY 2014

Fiscal Year	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Budget	\$818,667	\$830,797	\$887,500	\$712,336	\$841,502	\$923,330	\$807,500
Actual	\$708,932	\$846,472	\$832,439	\$879,995	\$924,605	\$1,007,193	\$763,719
Difference	\$109,735	(\$15,675)	\$55,061	(\$167,659)	(\$83,103)	(\$83,863)	\$43,781

Source: APA based on budget information provided by the District.

As seen in Table 1, the FY 2011 budget was exceeded by \$167,659, or 23.5 percent, which is a significant portion of a budget line-item. FY 2012 and FY 2013 were exceeded by a lower margin, but still a sufficient amount to warrant a review, with differences of \$83,103, or 9.9 percent, in FY 2012 and \$83,863, or 9.1 percent, in FY 2013. FY 2009 was exceeded by only \$15,675, or approximately 1.9 percent.

The District Director of Finance has stated that when this budget line-item is exceeded, a determination is made whether specific issues caused greater than expected costs, such as unexpected maternity leave or long-term illness. It does not appear that actual substitute days or the amounts paid to substitutes were reviewed. Instead, general assumptions were apparently made based on anecdotal evidence. The variable nature of expenditures related to the substitute budget and the minimal review process were seemingly exploited to initiate an apparent fraud.

Based on data provided by the District, auditors calculated the total number of days supposedly worked by the former substitute teacher. The days worked are identified in Table 2, along with the associated annual amounts paid in the name of the former substitute teacher.

Table 2: Number of Work Days and Amount Paid in the name of Former Substitute Teacher by Fiscal Year

Fiscal Year	FY08	FY09	FY10	FY11	FY12	FY13	FY14*
Total Days	338	274	230	218	370	316	244
Total Paid	\$86,751.66	\$82,078.65	\$71,688.64	\$67,441.69	\$106,436.68	\$87,627.28	\$62,900.00

Source: APA based on detailed check history report provided by the District.

* Activity only occurred for a partial fiscal year through April 2014.

As seen in Table 2, the number of work days reported for the former substitute annually far exceeds the number of typical instructional school days, which rarely exceed 170. In comparison, the former substitute teacher was reported to have worked no less than 218 school days in a one-year period for each of the seven years in which the apparently fraudulent activity is known to have occurred. In addition, the resulting total annual payments made to the former substitute teacher exceeded the salaries of the majority of full-time District staff. If District executive management had conducted a more in-depth review during the years that the budget line-item was exceeded, the excessive number of days and pay to a substitute teacher should have been detected.

Findings and Recommendations

Recommendations We recommend the District perform a thorough data oriented review when the central level substitute teacher budget is exceeded. This review should include the pay rate of the substitute and the number of days worked by school and individual. We also recommend the District perform a thorough review of the payments made from any other budget line-items that are allowed to regularly exceed budgeted amounts due to the unexpected nature of their costs.

Finding 11: The District did not ensure all Payroll staff received sufficient training to complete the payroll process.

The former Payroll Manager appears to be the only District employee to have received sufficient training to complete all aspects of the payroll process. This gave the former Payroll Manager extensive knowledge of the complete payroll process and led the District to exclusively rely on her to process payroll. The reliance placed on the former Payroll Manager provided her with an excessive amount of leverage with her supervisors. It also placed the District at risk of significant payroll errors not being detected and the possibility that a payroll process could not be completed without the assistance of the former Payroll Manager. Based on information provided by District financial staff and internal District personnel documents, executive management should have realized the risk to the payroll process and ensured that proper training was being provided.

According to District financial staff, when the former Payroll Manager resigned on April 28, 2014, the Payroll Assistant had exceptional difficulty, having had limited prior experience, in completing the payroll process. This was due to a lack of on-the-job training provided to the Payroll Assistant by the former Payroll Manager. According to the Director of Finance, executive management directed the former Payroll Manager to provide training to the Payroll Assistant as a backup in the event the former Payroll Manager could not perform her regular duties. However, according to the Payroll Assistant, sufficient training to understand the complete payroll process was not provided.

Personnel Evaluation Reports for the former Payroll Manager document Excellent and Good ratings were given for cross-training the Payroll Assistant for the payroll backup role. Based on comments from the employee that was supposedly being trained, limited training was provided; therefore, it appears these high evaluation ratings were not merited. The former Payroll Manager's supervisors should have ensured that training was being provided by speaking with the Payroll Assistant and testing her proficiency. In addition, lack of the Payroll Assistant's training should have been recognized when the former Payroll Manager abruptly left her position for several days during the 2011 to 2012 school year. According to the Payroll Assistant, the uncertainty of being able to complete the payroll without the former Payroll Manager was discussed by District management.

Findings and Recommendations

Due to the District's reliance on this employee to complete the payroll process, personnel issues such as not providing sufficient training and abruptly walking off the job for several days may not have been addressed. Despite these actions, she continued to receive praise on her Personnel Evaluation Reports, particularly for her proficiency, knowledge, and experience with the payroll system. It appears the former Payroll Manager's ability to complete the District payroll provided leverage with supervisors.

Recommendations We recommend the District ensure all appropriate financial staff be fully trained in the completion of the payroll process. This should include at least two payroll employees that are proficient with the payroll system and interact with it on a routine basis. We also recommend that the Director of Finance, or other qualified executive management, receive sufficient training on the payroll system to act as a backup. In addition to acting as a backup, this will provide a member of executive management with a deeper understanding of the security, processing, reporting, and oversight procedures that should be established for payroll.

Finding 12: The District did not maintain work-related emails as required by the Kentucky Department of Library and Archives.

Due to the allegations of apparent fraud facilitated using the former Payroll Manager's system user account, auditors made a request to the District for access to this former employee's work email account. District management stated several years of emails for all staff were retained. However, the District was only able to successfully recover the last two months of the former Payroll Manager's emails. Based on auditor's review of the email retention settings, the District is not in compliance for any employees with the Kentucky Department of Library and Archives' (KDLA) retention schedule, specifically Series L5304. This schedule requires school districts to retain routine correspondence, such as work-related emails, for two years.

Since the District was unable to recover emails from either the software application vendor's archives or the former Payroll Manager's computer, it appears this individual deleted older work-related email, which is in violation with the KDLA policy.

KDE requires each public school district in the Commonwealth use a specific email software application. Emails are stored in default folders until action is taken by the user to delete or archive emails. However, the application is not configured by default to automatically archive older emails. The District is responsible for establishing a retention policy for all employees' email.

Recommendations We recommend the District work with their technology staff to establish a retention policy for all employees' email in compliance with KDLA retention schedule requirements. Further, we recommend management communicate the KDLA retention schedule to all staff and provide guidelines to ensure adherence. The retention policy established by the District should be monitored on a regular basis and updated as needed.

Findings and Recommendations

Finding 13:
District staff did not consistently maintain garnishment statements as required by the Kentucky Department of Library and Archives.

According to the record retention schedule established for school districts by the KDLA, individual payroll documents, including garnishment statements, are to be maintained for three years after employment termination or three years after the statement is superseded. Garnishments are a legally binding, required transfer of earned income to a creditor. For the period of July 1, 2006 through June 30, 2014, garnishment statements were not available to support all garnishment deductions for two individuals whose net pay amount was zero for one or more pay periods. In both instances, the required retention period, after which the statements could be destroyed, had not expired. Therefore, documentation was not available for auditors to validate the garnishments paid during these periods.

Further, a review identified incorrect garnishment amounts were applied to the pay of one of these individuals. Originally, the full amount of the garnishment could not be applied because it was more than the employee's net pay. However, after the employee's gross income increased, the full amount of the garnishment was not reinstated for approximately six months. During this six month period, an additional \$314.86 should have been collected and issued to the appropriate state agency due the garnishment.

Recommendations

We recommend written procedures be developed to define the method to establish garnishments within MUNIS. In addition, we recommend the process address ensuring that garnishment amounts and priorities are applied legally and timely and that appropriate documentation is maintained according to retention requirements.

We recommend the Payroll Manager, or other designated staff, review garnishments for accuracy and appropriate authority. Further, garnishment statements should be consistently maintained, at a minimum, for the three-year period either after termination of employment or is superseded as required by the retention schedule established for school districts by KDLA.

Finding 14: The District did not properly distribute retirement refunds to appropriate staff.

A District payroll issued on November 15, 2013, was specifically discussed by District staff during the examination entrance conference because of the unique purpose of this payroll and the manner in which it was processed. According to the Director of Finance, the payroll was created to redistribute a \$77,000 refund from CERS to certain substitute teachers. This refund resulted from retirement payments submitted to CERS for substitute teachers during the 2011-2012 school year who, by the end of the year, did not work sufficient time at the District to receive a year of retirement service time. Therefore, these payments made to CERS throughout the year were refunded to the District for redistribution to the affected employees.

Findings and Recommendations

Because a payment of \$2,482.01 within this payroll was identified as part of the apparent fraud accomplished using the former Payroll Manager's user account, the District performed additional research to determine whether all eligible employees received the appropriate refund. By the end of examination fieldwork, District staff were able to identify 15 individuals who did not receive their refunds, which totaled \$2,187.14. It was noted that 13 of these individuals were no longer employed by the District. Staff had to contact each of these individuals to determine their current demographic information. The District plans to distribute refunds to these employees once all necessary information is available.

Further, one individual who received a refund was not eligible for the refund. This individual was provided a refund in the amount of \$104.84. This refund appeared to have been issued in error by the former Payroll Manager. The District is working to contact the individual to recover the funds received in error.

Recommendations We recommend the District ensure that all outstanding refunds are issued to the appropriate staff and the single refund issued in error is recovered. Further, as noted in Finding 8, we recommend the District improve monitoring the overall Payroll process. In this particular case, the Director of Finance, or other qualified executive management, should review any refunds issued to the District to ensure all appropriate actions are taken and documentation is maintained. We recommend all documentation be retained in accordance with the District's record retention schedule and be readily available for internal management or audit review purposes.

Finding 15: The District uses the same series of identification numbers for employees and vendors, which could cause confusion when included in the same report.

During the review of MUNIS fiscal year reports of all payroll disbursements issued for the period July 1, 2007 through June 30, 2014, we found 49 instances where the same identification number was assigned by the District to both an employee and a payroll vendor. Discussion of this situation with the MUNIS vendor determined that there are three unique sets of identification numbers within the MUNIS system: Employees, Payroll Vendors, and Accounts Payable Vendors. An Employee or Accounts Payable Vendor may be established with an identification number that is six characters in length. A Payroll Vendor may be established with an identification number between 00001 and 32767. These series of identification numbers are maintained separately within the system; therefore, there should be no issues of crossover or confusion when processing or reporting a transaction. The only time a situation involving identification numbers would potentially cause concern or confusion is when more than one type of identification number is included in a single report. If vendors of different types are included in a single report, it may appear that there is a duplicate identification number on the report; however, the appropriate names for each will be provided on the report.

Findings and Recommendations

Since the system allows employees and vendors to potentially have the same identification number and this information is maintained separately within the system, this is not consider an exception. However, we are reporting this issue to the district for management consideration.

Recommendations We recommend District management review the situation regarding the use of identification numbers and determine whether it is beneficial, within the current system configurations, to create unique numbering sequences for Employees, Payroll Vendors, and Accounts Payable Vendors. The change to unique identification numbers would ensure that there was no confusion when generating reports that may contain two or more of these types of vendors.

Finding 16:
Certain MUNIS
reports did not
properly reflect
payroll activity.

Although not related to the apparent payroll fraud, review of MUNIS reports provided by the District during our examination of an apparent payroll fraud revealed several issues that are being directed to KDE in a formal audit finding for FY 2014 since they are responsible for MUNIS reporting and vendor performance. The District was provided this information to assist in generating reports moving forward.

Our review of the Detail Check History report in MUNIS for the period July 1, 2006 through January 31, 2010, revealed nearly all payroll payments showed an amount of zero. However, a review of transactions within MUNIS found dollar amounts identified as being issued to each employee's direct deposit account. Discussion with the MUNIS vendor determined a programming change was made in January 2010 that affected how the net pay amount was calculated. However, this change did not retroactively correct the net pay amount. Therefore, historical reports generated from MUNIS, for the period prior to the January 2010 programming change, do not accurately reflect the net pay amount.

A review of the All Checks report in MUNIS revealed that for the period July 1, 2006 through January 31, 2010, the majority of payroll payments were identified as voided with a payment amount of zero. During discussions with the MUNIS vendor, it was determined there was a programming change related to the status field in 2009. In addition, within the same report for the FY 2007 through FY 2014 period, auditors found that for any payment having a net pay amount of zero, the status of the payment was identified as a void. Discussions with the current District Payroll Manager revealed that since payments having a net zero pay amount are not printed or processed, MUNIS gives these payments a status of void. Therefore, the All Checks report does not reflect an accurate status for all net zero payments. This situation was corrected in MUNIS version 10.5, which Kentucky school districts will start migrating to by the end of calendar year 2014.

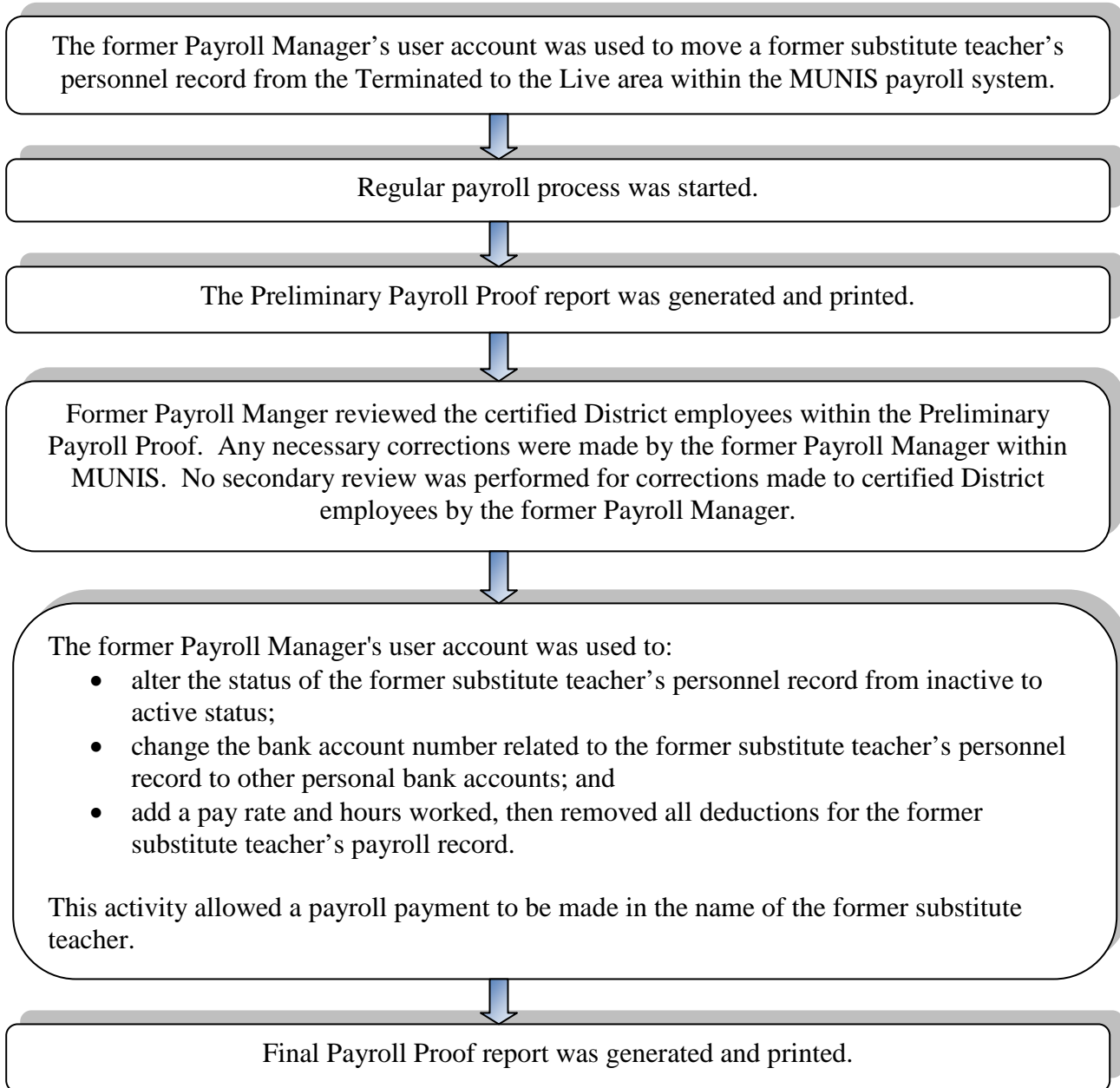
For this same report for the FY 2007 through FY 2014 period, auditors also found an instance where the vendor name was incorrectly populated. The All Checks report showed one payment in the amount of \$119,951.60 as being issued to a District employee. However, discussions with District officials, as well as the review of the master records in MUNIS, confirmed that this payment was issued to the Kentucky Department of Revenue (KDOR) for state taxes for the pay period. The current District Payroll Manager stated that the original process used to pay taxes each pay period was to process one lump sum payment to the various vendors for state taxes, federal taxes, etc. As recommended by another Payroll Manager from a different school district, in order to differentiate and specifically account for the different types of taxes paid, a new vendor account was created for KDOR. After changing the vendor code and running the payroll, processing issues occurred. This resulted in the Payroll Manager reverting back to the original KDOR payroll vendor number. The new payroll vendor number created for KDOR was subsequently deleted. MUNIS has not been configured to populate in the report a blank name or the original vendor name, if it has been deleted from the system. Therefore, when MUNIS could not identify the vendor name, given that it was deleted, the system populated the vendor name from the previous record's information in the report, which happened to be a District employee. This situation was discussed with the MUNIS vendor during the examination.

Finally, auditors learned that the District implemented the ESS within MUNIS so employees could manage changes to demographic information such as home address, bank account number, withholdings, etc. Once a change is made within ESS, the District Payroll Manager is notified. After the change is approved by the District Payroll Manager, a program is executed to update the production version of MUNIS. The current Payroll Manager informed auditors that based on her review of the employee's master records, while the requested change made by the employee is updated in MUNIS, the date of the change is not recorded. Therefore, the Payroll Manager must manually update the date field in MUNIS.

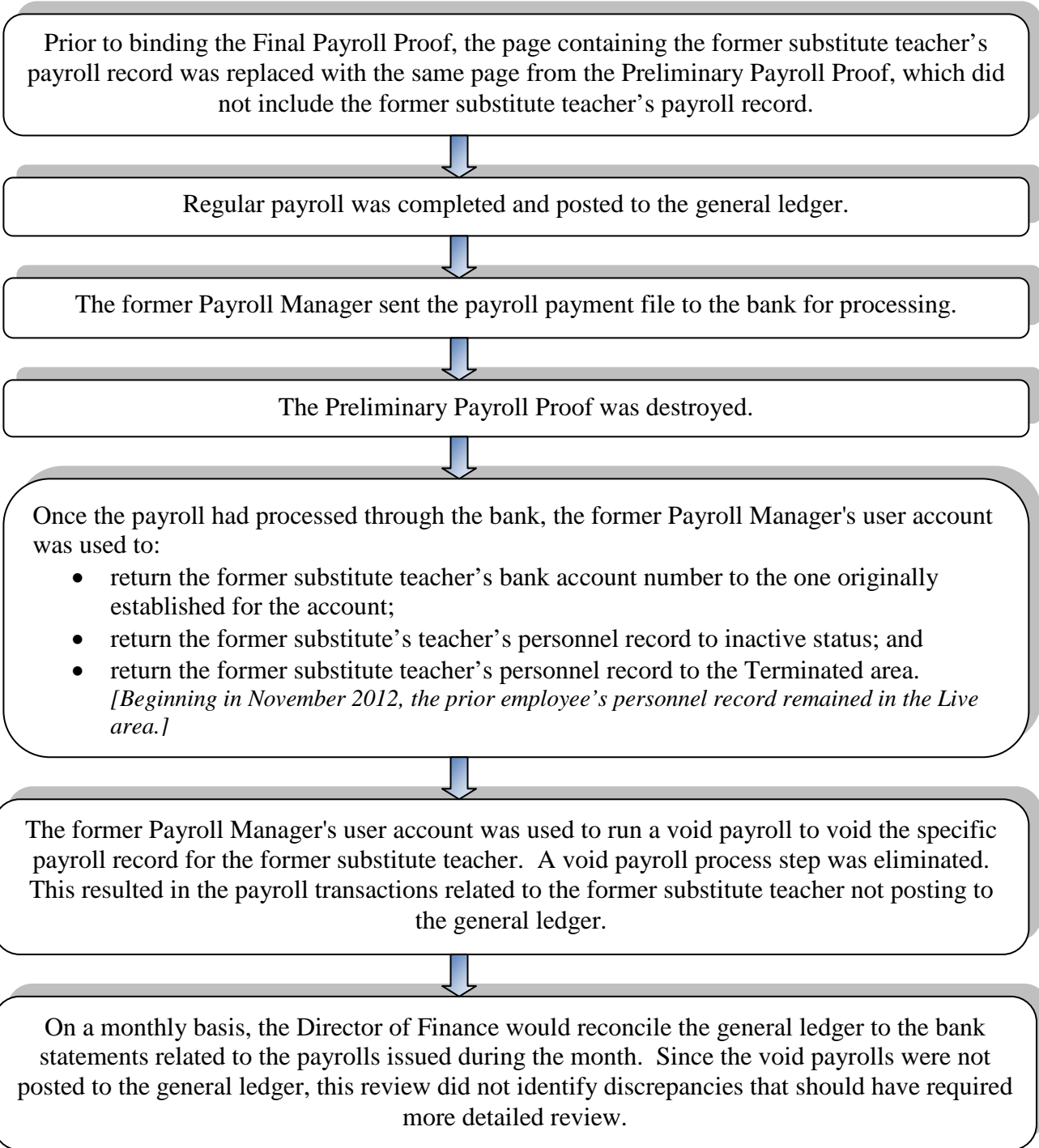
Recommendations We recommend the District work with KDE, as well as the MUNIS vendor, to ensure all reports discussed in this finding accurately reflect District payroll and personnel data. Further, we recommend the District ensure any reporting issues identified going forward are formally reported to KDE and the MUNIS vendor to ensure the issues are resolved in a timely manner.

EXHIBITS

How did it happen?



How was it hidden?



Schedule of Apparently Fraudulent Payments from March 15, 2007 through April 1, 2014

Exhibit 2

Date	Total Paid	Days Paid	Rate Paid
03/15/07	\$3,050.10	10.00	305.01
03/30/07	\$5,185.17	17.00	305.01
05/01/07	\$5,337.68	17.50	305.01
06/01/07	\$6,100.20	20.00	305.01
06/15/07	\$6,100.20	20.00	305.01
08/15/07	\$5,320.00	40.00	133.00
08/31/07	\$1,330.00	10.00	133.00
09/14/07	\$6,100.20	20.00	305.01
10/01/07	\$6,100.20	20.00	305.01
10/15/07	\$6,100.20	20.00	305.01
11/01/07	\$6,100.00	20.00	305.00
11/15/07	\$6,100.20	20.00	305.01
12/14/07	\$9,150.30	30.00	305.01
01/15/08	\$6,100.20	20.00	305.01
02/01/08	\$6,100.20	20.00	305.01
02/29/08	\$4,880.16	16.00	305.01
04/01/08	\$6,100.00	20.00	305.00
05/15/08	\$5,185.00	17.00	305.00
05/30/08	\$5,985.00	45.00	133.00
06/13/08	\$6,100.00	20.00	305.00
09/15/08	\$6,110.40	20.00	305.52
10/01/08	\$6,082.00	20.00	304.10
10/31/08	\$6,903.00	20.00	345.15
11/14/08	\$3,364.35	11.00	305.85
12/01/08	\$1,995.00	15.00	133.00
01/02/09	\$6,110.20	20.00	305.51
01/15/09	\$2,442.80	8.00	305.35
01/30/09	\$6,111.00	20.00	305.55
02/13/09	\$4,890.40	16.00	305.65
03/13/09	\$6,305.00	20.00	315.25
04/01/09	\$7,628.75	25.00	305.15
05/01/09	\$5,804.69	19.00	305.51
05/15/09	\$4,277.28	14.00	305.52
06/01/09	\$4,888.32	16.00	305.52
06/15/09	\$4,888.32	16.00	305.52
06/30/09	\$4,277.14	14.00	305.51
09/15/09	\$6,511.20	20.00	325.56
10/15/09	\$7,155.50	22.00	325.25
10/30/09	\$6,115.60	20.00	305.78
12/01/09	\$7,026.96	24.00	292.79
01/04/10	\$7,943.52	26.00	305.52
02/16/10	\$5,498.10	18.00	305.45
03/01/10	\$5,193.84	17.00	305.52
03/15/10	\$6,110.00	20.00	305.50

**Schedule of Apparently Fraudulent Payments from March 15, 2007
through April 1, 2014**

Exhibit 2

Date	Total Paid	Days Paid	Rate Paid
04/01/10	\$6,110.40	20.00	305.52
05/14/10	\$7,332.48	24.00	305.52
06/30/10	\$6,691.04	19.00	352.16
09/01/10	\$6,111.20	20.00	305.56
10/01/10	\$6,336.36	18.00	352.02
11/01/10	\$6,110.40	20.00	305.52
11/15/10	\$6,110.40	20.00	305.52
12/15/10	\$3,971.20	13.00	305.48
02/01/11	\$6,416.76	21.00	305.56
02/15/11	\$7,332.48	24.00	305.52
04/29/11	\$9,165.60	30.00	305.52
05/13/11	\$8,249.04	27.00	305.52
06/15/11	\$7,638.25	25.00	305.53
09/01/11	\$5,840.00	40.00	146.00
09/15/11	\$6,181.20	30.00	206.04
09/30/11	\$7,055.00	20.00	352.75
10/14/11	\$8,554.76	28.00	305.53
11/15/11	\$8,554.56	28.00	305.52
12/01/11	\$7,056.60	20.00	352.83
12/15/11	\$7,638.00	25.00	305.52
01/13/12	\$4,864.40	16.00	304.03
02/01/12	\$6,697.88	19.00	352.52
03/30/12	\$6,110.40	20.00	305.52
04/13/12	\$7,331.88	24.00	305.50
05/01/12	\$9,165.60	30.00	305.52
06/01/12	\$9,165.60	30.00	305.52
06/15/12	\$12,220.80	40.00	305.52
08/31/12	\$6,916.00	52.00	133.00
09/14/12	\$7,026.96	23.00	305.52
10/01/12	\$8,249.04	27.00	305.52
10/15/12	\$6,415.92	21.00	305.52
11/30/12	\$5,553.36	18.00	308.52
12/14/12	\$5,499.36	18.00	305.52
01/15/13	\$8,554.56	28.00	305.52
02/01/13	\$6,721.44	22.00	305.52
03/01/13	\$7,026.96	23.00	305.52
03/15/13	\$8,249.04	27.00	305.52
05/01/13	\$8,249.04	27.00	305.52
05/15/13	\$9,165.60	30.00	305.52
09/13/13	\$6,480.00	27.00	240.00
10/15/13	\$8,580.00	33.00	260.00
11/01/13	\$5,200.00	20.00	260.00
11/15/13	\$2,482.01*		
12/13/13	\$8,320.00	32.00	260.00

**Schedule of Apparently Fraudulent Payments from March 15, 2007
through April 1, 2014**

Exhibit 2

Date	Total Paid	Days Paid	Rate Paid
01/02/14	\$6,240.00	24.00	260.00
01/15/14	\$6,240.00	24.00	260.00
01/31/14	\$6,240.00	24.00	260.00
03/14/14	\$7,020.00	27.00	260.00
04/01/14	\$8,580.00	33.00	260.00

Total **\$593,179.96**

**Not Part of a regular payroll payment*

SHELBY COUNTY SCHOOL DISTRICT RESPONSE



October 7, 2014

Honorable Adam H. Edelen
Auditor of Public Accounts
209 St. Clair Street
Frankfort, Kentucky, 40601

Re: Draft Report of Examination of Certain Policies, Procedures, Controls and Financial Activity of the Shelby County Public School District

Dear Mr. Edelen,

On behalf of the Shelby County Public Schools Board of Education, please accept this letter in response to your draft report of the Examination of Certain Policies, Procedures, Controls and Financial Activity of the Shelby County Public School District.

Following the discovery of fraudulent action on April, 2, 2014, the Shelby County Board of Education immediately reported the matter to the Kentucky State Police and the Commissioner of Education. Subsequently, I enlisted the expertise of your office to provide an independent review of our accounting procedures related to allegations of fraud committed by the district's former payroll manager over a period of several years. The report sets forth various findings and recommendations for improvement in the fiscal management of the district, particularly in the governance of payroll functions. The findings and the recommendations will be carefully reviewed by members of the Board, the superintendent and staff following the public release of the full report. The recommendations will provide guidance as we seek to maximize the efficiency of our operations.

We will draft a full response to each finding in your examination. The response will be provided to your office and to the public within 60 days of receiving the final report.

We express our appreciation to you and your staff for the professional manner in which your examination was conducted during the past three months.

Sincerely,



James Neihof
Superintendent

James Neihof, Superintendent
1155 Main Street
Shelbyville, KY 40065
Phone: 502-633-2375
Fax: 502-633-1988
www.shelby.kyschools.us