EXAMINATION OF CERTAIN POLICIES, PROCEDURES, AND FINANCIAL ACTIVITY OF THE FAYETTE COUNTY PUBLIC SCHOOLS

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September 17, 2014

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The Auditor of Public Accounts (APA) has completed its examination of the Fayette County Public Schools (FCPS). This letter summarizes the procedures performed and communicates the results of those procedures.

Examination procedures included interviewing staff concerning FCPS's environment and operating activities; reviewing expenditure transactions associated with FCPS for the time period of July 1, 2009 through June 30, 2014; and reviewing certain additional financial activity related to FCPS's budgeting activities for fiscal years 2011 through 2014.

The purpose of this examination was not to provide an opinion on the financial statements, but to ensure appropriate processes are in place to provide strong oversight of financial activity of FCPS and to review specific issues brought to the attention of this office.

Detailed findings and recommendations based on our examination are presented in this report to assist all parties involved for improving procedures and internal controls. Overall, these findings identify serious concerns with regards to lack of appropriate policies and procedures related to fiscal management, and a lack of proper oversight and communication conducive for effective governance.

If you have any questions or wish to discuss this report further, contact me or Libby Carlin, Assistant Auditor of Public Accounts.

Sincerely,

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Executive Summary
September 17, 2014

Examination of the Fayette County Public Schools

Examination Objectives

On May 29, 2014, we notified the Fayette County Public Schools (FCPS) that a special examination would be conducted in order to address areas of concern and allegations that the APA had received. The Auditor of Public Accounts (APA) also received a formal request from the Superintendent to perform a review of the allegations. The purpose of the APA examination was to determine if FCPS funds are administered in a manner to ensure FCPS objectives are met and accountability and transparency exist. The examination was not to perform a financial statement audit of FCPS.

FCPS Background

Mission Statement: FCPS states its mission is to create a collaborative community that ensures all students achieve at high levels and graduate prepared to excel in a global society.

FCPS is Kentucky's second largest school district. The district serves over 40,000 K-12, Preschool, and other students in the Lexington metropolitan area. 2,896 full time teachers serve in the district along with 2,531 student support and administrative staff.

Organizational Structure

The current management structure in the district central office (IAKSS) consists of three leadership levels: the Superintendent, four Chief Officers, and a Cabinet comprised of various department Directors which report to the Chief Officers. The Department of Financial Services and the Department of Budget and Staffing Services are two departments frequently referenced in this report.

The Department of Financial Services consists of a Director, three Associate Directors (Finance and Accounting, Tax and Accounting, Benefits and Insurance), and 31 staff members per the most recent organizational chart. This department is responsible for managing accounts payable and receivable, tax collection, payroll, grants, and insurance in the district.

The Department of Budget and Staffing Services consists of a Director and three staff members. Its primary function is the preparation of the district's budget and ensuring that staffing allocations are aligned with Board of Education policies.

Both Departments report to the Chief Operating Officer who also oversees transportation, construction, technology, and other functions in the district.

Financial Highlights

For fiscal year 2013, revenues in the General Fund were \$360,673,939 while expenditures were \$384,486,949. This resulted in a General Fund deficit of \$23,813,010. The district had a General Fund deficit in 2011 and 2012 as well. Expenditures have steadily increased during the period covered by our examination; significantly outpacing revenues.

Findings and Recommendations

Finding 1: Weaknesses In Budget And Financial Management Processes Led To Significant Errors In The District's Working Budgets

Prior to the current administration, district leadership had determined to intentionally spend down the district's general fund balance. Allegations expressed a fiscal year 2012 journal entry was not known in time to be taken into account in building the 2011-2012 Working Budget, which accelerated the district's spend down plan. The failure to take into account the journal entry resulted in an erroneous 2011-2012 budget that overstated available revenues. This was due to a poor budget process and ineffective communication between the Department of Financial Services and the Department of Budget and Staffing Services. As expenditures exceeded revenues, the district was forced to release general funds from escrow accounts at year end in order to meet their obligations. This exacerbated the intentional spend down and depleted the general fund balance. Budgeted expenditures still exceeded budgeted revenues for the 2013-2014 Working Budget but the expenditure total was 'plugged' in order to make the budget balance. This resulted in an intentionally misrepresented budget being adopted by the Board and submitted to the Kentucky Department of Education. These issues led to a weakened financial position culminating in the request for a 19 million reduction in the 2014-2015 budget. Auditors identified additional issues such as mathematical errors in the 2014-2015 Tentative Budget and releases of funds from escrow without the necessary Board action.

Recommendation: We recommend FCPS extensively evaluate the budget process from a personnel, structural, policy and procedural perspective in order to develop a process more conducive to strategically managing district resources in an effective and efficient manner.

Finding 2: The FCPS Working Environment Is Not Conducive to Efficient And Effective Operations

The working relationship between the Director of Budget and Staffing Services and the Director of Financial Services is toxic based on interviews with staff and district leadership. This has led to mistrust, antagonism, and ineffective communication. In addition, the auditors noted staff concerns with the working environment within the Department of Financial Services. Employees fear retaliation if they voice their concerns with activities in the Department of Financial Services. Staff related a meeting in which they felt threatened based on their status in the Department of Financial Services. Staff also expressed concerns about hiring practices in the Department of Financial Services.

Recommendation: We recommend FCPS take steps to attain a healthy working relationship between the two Directors as well as ensuring the 'tone at the top' in FCPS Departments contributes to a positive work and control environment.

Finding 3: Administrative And Management Salary Increases Outpace Other District Employees, Some Without Appropriate Transparency

Changes to the Hay Grade Schedule, a salary additive reserved for administrators based on responsibility level, were not transparently reported to the Board. The top Hay Grade level increased from 14 ($36,726) to 20 ($63,299). In addition, raises for the highest paid IAKSS employees in the district outpaced percentage increases approved, on average, for teachers.

Recommendation: We recommend FCPS staff properly communicate changes to the Salary Schedule to the Board. Also, a consistent methodology for determining which positions receive what level of Hay Grade should be established.

<u>Finding 4</u>: FCPS Circumvented District Controls And Did Not Follow Procurement Guidelines
In order to pay a vendor, a company owned by a personal friend of the FCPS Superintendent, a budget transfer was made which did not comply with district policy. The policy was subsequently changed in order to allow more transfers. Although the auditors did not note any apparent conflicts of interest, favoritism may have been shown to this vendor in that adopted procurement policies were not followed.

Recommendation: We recommend FCPS reinstate a budget transfer policy and in all cases follow proper procurement guidelines.

<u>Finding 5</u>: The Mary K. Stoner Trust Fund Is Not Being Used In Accordance With Its Charter
This trust fund, intended for the "enhancement and enrichment of the educational program", is being used for travel loans to IAKSS staff. Auditors found serious control deficiencies in the process for repaying the loans including employees foregoing mileage reimbursements, foregoing per diem amounts, and transfers from other district trust funds. Auditors also noted that the Department of Financial Services, which holds three of the five seats on the Trust Fund Committee, was disproportionately benefiting from the Mary K. Stoner Trust Fund.

Recommendation: We recommend FCPS strengthen controls over the repayment of loans and ensuring that loans are issued for reasons compliant with the fund's charter.

<u>Finding 6</u>: Travel And Professional Development In The Department of Financial Services is Excessive And Often Unnecessary

Numerous issues related to professional development in the Department of Financial Services were noted. Despite multiple staff members attending the same conferences, the requests to the Board for travel were split across several Board meetings. Auditors also questioned costs incurred by the District for Department of Financial Services employees who stayed extra nights at conferences when other FCPS employees returned earlier. Control deficiencies were also noted for how travel is approved for certain staff members. The equitability of IAKSS employees having certification costs covered by the district while teachers do not was also questioned.

Recommendation: We recommend FCPS review its professional development policies and procedures to strengthen controls over travel approval, transparency, excessiveness, and applicability to the district in an effort to protect district funds.

<u>Finding 7</u>: Conflicts of Interest
Vendors are providing perks to district personnel which could compromise the procurement process. The Department of Financial Services is also paying for ten memberships to a civic organization. The Director of Financial Services serves as Treasurer for the parent entity of the organization in question.

Recommendation: We recommend FCPS thoroughly review its business practices, vendor relationships, ethics policies, and procurement activity for possible conflicts of interest.

<u>Finding 8</u>: Monthly Financial Reports To The Board Lack Significant Information
The Board relies on monthly reports from district personnel in order to remain apprised of the financial standing of FCPS. The information provided was insufficient to clearly communicate the district's rapidly changing financial position. Metrics used in the reports did not highlight the shrinking fund balance or emphasize the fact that expenditures were consistently outpacing revenues.

Recommendation: We recommend FCPS reevaluate the methodology of the monthly financial reports to the Board in order to better capture and relate the actual financial position of FCPS.

<u>Finding 9</u>: Accounting Weaknesses Within the Department of Financial Services

Control weaknesses in the Department of Financial Services included the Director of Financial Services' wife handling a significant piece of the receipt process, circumvention of the budget process through canceled purchase orders, vendor creation, and questionable expenditures including the continuation of an insurance policy despite landmark legislative changes on the national level.

Recommendation: We recommend FCPS strengthen controls related to nepotism, encumbering of funds, vendor creation, and the cost effectiveness of expenditures.

<u>Finding 10</u>: The Current FCPS Internal Audit Structure Needs Improvement

Employees do not have an avenue through which to anonymously express concerns with FCPS activities. In addition, the current structure does not provide adequate opportunities to discuss the scope, nature, or results of internal audits. The absence of an Audit Committee devoted to audit related matters inhibits FCPS's ability to assess the results of internal and external audits.

Recommendation: We recommend FCPS establish a formal Audit Committee consisting of the Superintendent and members of the Board which is exclusively focused on audit related issues. We also recommend the establishment of a system in which employees can report suspected instances of fraud, waste, and abuse for review by the Audit Committee.

Conclusion

The findings indicate chronic mismanagement of the district's budget and finances that have contributed to financial instability. Errors and misrepresentations in the budget process over several years weakened the district's ability to address budget imbalances in the current year. Additional weaknesses were noted in the budget and finance area that identify opportunities to strengthen the district's financial position were missed or overlooked.

Background

Impetus And Objectives Of The Examination

On May 29, 2014, the Auditor of Public Accounts (APA) notified the Fayette County Public Schools (FCPS) that a special examination would be conducted in order to address areas of concern and allegations that the APA had received. The APA also received a formal request from the Superintendent to perform a review of the allegations. Upon consideration of the risk factors identified, the APA determined an examination was warranted to address significant concerns surrounding FCPS. Based on allegations noted, the examination focused on several key areas related to the district's fiscal management, including budgetary and accounting practices.

The purpose of this examination was not to perform a financial statement audit of FCPS, but instead to determine whether funds are administered in a way to ensure FCPS objectives are met, and that the proper level of accountability and transparency exists for activities funded with taxpayer dollars. In order to meet this objective, the examination focused on reviewing transactions, policies, procedures, and other documentation to determine if FCPS funds were appropriately expended and reported.

Scope And Methodology

The scope of the FCPS examination was a review of transactions and activities primarily from July 1, 2009 through June 30, 2014, although the review of certain activities expanded beyond this time period when the circumstances warranted additional consideration. To address the examination objectives, the APA conducted numerous interviews with FCPS employees, Board members and others with direct knowledge of FCPS requirements and administration. In addition, auditors reviewed and analyzed financial documents, reports, contracts, and minutes from FCPS Board meetings.

FCPS Structure And Mission

FCPS is Kentucky's second largest school district. The district serves over 40,000 K-12, Preschool, and other students in the Lexington metropolitan area. The district is served by 2,896 full time teachers, along with 2,531 student support and administrative staff.

The current management structure of the central office (IAKSS) in the district consists of three leadership levels: the Superintendent, four Chief Officers, and a Cabinet comprised of various department Directors which report to the Chief Officers. The Department of Financial Services and the Department of Budget and Staffing Services are two departments frequently referenced in this report.

Background

The Department of Financial Services consists of a Director, three Associate Directors (Finance and Accounting, Tax and Accounting, Benefits and Insurance), and 31 staff members per the most recent organizational chart. This department is responsible for managing accounts payable and receivable, tax collection, payroll, grants, and insurance in the district.

The Department of Budget and Staffing Services consists of a Director and three staff members. Its primary function is the preparation of the district's budget and ensuring that staffing allocations are aligned with Board of Education policies.

Both Departments report to the Chief Operating Officer who also oversees transportation, construction, technology, and other functions in the district.

Findings and Recommendations

Finding 1: Weaknesses In Budget And Financial Management Processes Led To Significant Errors In The District's Working Budgets

In May 2014, the Director of Budget and Staffing Services submitted a memo to the Fayette County Board of Education, Auditor of Public Accounts, and Office of Education Accountability identifying what was believed to be an untimely journal entry in fiscal year 2012 impacting the budget of Fayette County Public Schools (FCPS). The memo indicated the improper timing of this journal entry in 2012 ultimately resulted in a shortfall in the current FCPS budget, in which approximately $19 million in budget cuts were proposed for the 2014-2015 school year.

The journal entry in question committed district funds to an escrow account for future use. On May 23, 2011, the FCPS Board of Education approved the commitment. The impact of this journal entry moved $20 million from the Unassigned Fund Balance, which is the balance in the financial statements available for spending, to a category titled Committed Fund Balances, which is a classification of fund balance that is identified by management and approved by the Board for specific purposes. The purposes identified by FCPS related to these committed funds were:

- Future Construction Projects - $8,000,000
- Future Instructional Program Expansion - $3,000,000
- Anticipated Future Increases in Insurance/Energy Cost - $2,000,000
- Anticipated Future Increases in Employer Retirement Match - $4,000,000
- Anticipated Future Mid-Year Funding Reductions - $3,000,000

Analysis of journal entry activity indicates that the funds committed by the Board on May 23, 2011 were moved into committed accounts on September 1, 2011 - prior to the December 6, 2011 date alleged. Although the journal entry was made several months after the Board's approval, it was completed by the FCPS Department of Financial Services within the adjustment period for the purpose of financial statement preparation as adjustments to financial statement fund balances may be made any time before the annual audit is completed. While the adjustments were made prior to the finalization of the financial statements, Kentucky Department of Education (KDE) best practices indicate these adjustments should be made prior to the July 25th submission date for the district's unaudited Annual Financial Report (AFR) to KDE.

Although the timing of the journal entry in relation to financial statement reporting was not a concern, auditors also assessed the budgetary implications associated with the September journal entry as well as whether the purposes of the commitment were valid. As such, auditors reviewed the budget process for FCPS budgets and supporting documentation for budget years 2011-2012 through 2014-2015.

Findings and Recommendations

Several deficiencies were noted in the budget process beginning with the lack of sufficient detail in the current FCPS Board policies and procedures. Key elements of the budget process are not defined in a manner which would provide the most effective and efficient methods of constructing an annual budget. In addition, no internal policies and procedures are in place for activities performed by the Department of Budget and Staffing Services. These procedural weaknesses led to erroneous working budgets and spending policies that were implemented without complete awareness of how specific errors impacted the district's budget.

Erroneous 2011-2012 Budget

Review of supporting documentation for the 2011-2012 Working Budget indicates it was adopted with a Beginning Balance that was incorrectly inflated by the $20 million committed by the Board in May 2011. The Beginning Balance is comprised of funding from various sources, including any carry forward from the previous year derived from residual Unassigned Fund Balance. For use in building the 2011-2012 Working Budget, the amount of residual Unassigned Fund Balance was derived from the district's unaudited AFR balance sheet that is prepared each year for submission to KDE by July 25th. The unaudited AFR is prepared by the Department of Financial Services. The Unassigned Fund Balance on this report was misleading because the commitments approved in May had not yet been recorded in the accounting records by the Department of Financial Services. Thus the Beginning Balance for the purposes of the working budget was inflated.

When the commitments were recorded in the accounting system on September 1, 2011, the Beginning Balance was not adjusted in the working budget to reflect the decrease in available revenues. Table 1 below presents the 2011-2012 Working Budget as adopted by the Board and also a presentation of what the working budget should have reflected if the commitment had been taken into account. As a result, it appears the working budget indicated more funds were available for spending during the budget year than actually would have been available had the error in the Beginning Balance been identified. Policies did not exist to require the budget or financial staff to provide the Board information reflecting the impact of Board decisions, such as following-up with the Board to show how the May 2011 commitment approval was reflected in the accounting records or how it impacted the working budget. Additional weaknesses related to information provided to the Board are addressed in Finding 8.

Findings and Recommendations

Table 1 - 2011-2012 Working Budget

	Before 9/1/2011 Journal Entry		After 9/1/2011 Journal Entry (Auditor Calculation)	
Estimated Receipts				
Beginning Cash Balance in General Fund		$ 60,016,633		$ 40,016,633
Estimated Tax Receipts	198,293,773		198,293,773	
Additional General Fund Receipts	85,293,554		85,293,554	
Total Other Receipts and Cash Balances	104,414,461		104,414,461	
Total All Estimated Receipts		388,001,787		388,001,787
Grand Total Estimated Receipts Plus Beginning General Fund Cash Balance		448,018,420		428,018,420
Fund 1 Total Estimated General Fund Expenditures		343,603,960		343,603,960
Total Estimated Expenditures (Funds 2, 51, 310, & 320)		104,414,460		104,414,460
Grand Total Estimated Expenditures		448,018,420		448,018,420
Revenues in Excess of (Less Than) Expenditures		$ -		$ (20,000,000)

Source: FCPS 2011-2012 Working Budget

In the initial allegation provided to auditors, there was concern regarding a December 2011 journal entry, indicating it is the first time the commitments approved by the Board in May 2011 were recorded. As described above, the September journal entry actually recorded the commitments, but auditors also reviewed the December 2011 journal entry and its impact on the budget and financial reporting. As part of the annual year-end close process, the Director of Financial Services prepares accounting entries to close out the fiscal year. This closing entry rolls forward accounts, and establishes the beginning fund balance for the new fiscal year. During this closing process, the Director made an error by rolling forward a beginning balance of $57,329,933 in November 2011, which did not take into account the commitments established by the September 2011 transaction. Upon inquiry, district personnel indicated the December 2011 entry was needed in order to correct the Unassigned Fund Balance account as a result of the error made in November as the $20 million in committed funds was inadvertently included in Beginning Balance in the accounting records, as well as the 2011-2012 Working Budget. Auditors were able to confirm this response through chronological journal entry analysis and supporting documentation. However, as stated above, the budget was not adjusted for this reduction of the Beginning Balance. The impact of this entry is evidenced as part of the Monthly Financial Reports presented to the Board, which is presented in Appendix A. As shown, the Beginning Balance reflected in the accounting records decreases from $58,052,100.31 in October 2011 to $37,329,932.57 in November 2011 for a change of $20,722,167.74. The entry impacted the November 2011 report because although posted in December, its effective date was November 2011.

It is important to note that in many districts, the same employee is responsible for both the financial accounting entries and budget process. Larger and more complex districts have the ability to separate these functions, but when performing entries of this magnitude and complexity, communication between finance and budget departments is vital. All parties must be fully aware of the effect an entry will have on the position of both the financial statements and budget. However, policies did not exist to clearly identify the need for shared communication and/or reconciliations between the pertinent records. Also, as described in further detail in Finding 2, the working relationship between the Directors of the FCPS Department of Financial Services and the Department of Budget and Staffing Services had deteriorated and all relevant information was not being shared between the two departments. In addition, interviews also indicated the Director of Budget and Staffing Services is excluded from the FCPS central office management group, known as the "Cabinet". This group is primarily comprised of the Superintendent, Chief Officers, and central office directors. The Cabinet plays a major role in the operations of the district. Having access to the information from the meetings would be vital to the success of the director responsible for budgeting district resources, and should also help communicate the impact certain decisions have on the budget. In this instance, the lack of communication within the district's central office led to a reduction in revenue which was not properly accounted for in its budget. This resulted in an unbalanced budget in which expenditures exceeded revenues, although the Working Budget utilized erroneously reflected a balanced budget.

Another element that exacerbated the impact of the 2011-2012 errors related to a management decision regarding what the district management believed to be an excessive fund balance. Interviews and documentation obtained substantiated that FCPS officials had made a strategic decision to spend down the district's fund balance, which had grown to over $80 million. The rationale communicated by district management for this strategy was that a higher amount of district resources needed to be invested in students. Typically, the resulting budget deficit caused by the errors in the working budget noted above should have drawn heavy scrutiny from district leadership in order to pinpoint the reason for the excessive expenditures. But, because of the decision to spend down some of the fund balance, officials were not overly concerned that expenditures exceeded revenues as it met their expectation in regard to their plan. Thus, errors in the 2011-2012 Working Budget were not detected given that excess expenditures over revenues were anticipated. Even though the district already had a plan to spend down the fund balance, the errors in the working budget accelerated the spend-down faster than planned.

Interviews conducted with FCPS personnel, as well as documentation provided to the auditors, indicates the Chief Operating Officer (COO) and Director of Financial Services were advised by the Director of Budget and

Staffing Services in July 2012 concerning the flawed 2011-2012 budget and its effect on the district. In response, a temporary measure was taken to increase Beginning Balance by releasing $13 million in funding from the escrow account held for committed funds. In an email submitted with the allegations provided to the APA, in relation to the release of funds, the Director of Financial Services stated, "No one in cabinet had a clue about what I was talking about because I was very vague," while the Director of Budget and Staffing Services said, "We have no choice but to ask for the release of the escrows back into the General Fund." No further response, including a reassessment of district expenditures and impact on the 2012-2013 Working Budget in development at that time, appears to have occurred. Based on this information, it is not clear whether the Superintendent or Board were made aware of the errors and resulting impact on the district.

The Director of Budget and Staffing Services continued to inquire as to whether the Superintendent had been made aware of the situation. In October 2012, she requested to meet with the Superintendent and relayed that the 2011-2012 Working Budget had contained errors. When questioned about this meeting, the Superintendent stated that he felt the journal entry did not have a budgetary impact and the strategic spend-down continued during school year 2012-2013, depleting the fund balance. Table 2 below reflects the change in fund balance presented in the district's audited financial statements between FY 2010 and FY 2013.

Table 2 - FCPS Year - End Fund Balance

FY 2010	FY 2011	FY 2012	FY 2013
$ 83,348,088	$ 78,233,587	$ 60,221,834	$ 36,447,545

Source: 2010-2013 FCPS Audited Financial Statements

Misrepresented 2013-2014 Budget

Interviews with district personnel indicated there was an identified need for a reduction in expenditures for the 2013-2014 budget cycle. However, budgeted expenditures were not adequately reduced to balance the budget. Disturbingly, district personnel identified that this fact was concealed from the Board by intentionally misrepresenting the total General Fund expenditures in the 2013-2014 Working Budget. The amount reported in the working budget as Total Expenditures for the General Fund was $346,878,675. However, when manually added, the individual expenditure line items actually total to $368,379,092, or $21,500,417 more than the amount represented as Total Expenditures for the General Fund. Table 3 below presents the 2013-2014 Working Budget as presented to the Board for approval. As can be seen, this plug figure distorted the expenditures budgeted for the district and resulted in inaccurate information being presented to the Board for approval. Thus, the budget that was adopted and submitted to the

Kentucky Department of Education was not balanced. The adoption of an unbalanced budget further accelerated the spend down of the fund balance, leading to further financial instability within the district through unanticipated reductions in fund balance.

2014-2015 Budget Weaknesses

Due to these prior budget issues, auditors also reviewed the 2014-2015 Tentative Budget adopted by the Board. This review revealed several discrepancies. Auditors identified a mathematical error in the calculation of Instructional Expenditures. Total Instructional Expenditures, in the 2013-2014 Working Budget column, are presented as $185,934,971; however, the correct total of Instructional Expenditures is $185,929,762, for a discrepancy of $5,209. In addition to the mathematical error, it was noted that prior year budget amounts presented for comparison purposes do not agree with the amounts presented on the 2013-2014 Working Budget adopted by the Board as presented in Table 3 below.

Table 3 - 2013-2014 FCPS Working Budget

	2013-2014 Working Budget as Adopted		2013-2014 Working Budget Comparison presented in 2014-2015 Tentative Budget
Total Instruction	$ 190,725,991		$ 185,934,971
Total Student Support Services	18,476,429		18,160,053
Total Instructional Staff Support Services	15,843,992		15,450,232
Total District Administrative Support Servcies	5,591,177		5,841,994
Total School Administrative Support Services	20,612,267		18,501,121
Total Business Support Services	26,170,221		19,829,944
Total Plant Operation & Maintenance	43,043,786		39,036,955
Total Student Transportation	20,498,700		20,605,758
Total Debt Service	1,698,786		1,698,786
Total Fund Transfers	3,767,743		1,410,969
Contingency	21,950,000		21,950,000
Total Expenditures	$ 346,878,675	*	$ 348,420,783

*Misrepresentation identified - correct total is $368,379,092

Source: 2013-2014 FCPS Working Budget and 2014-2015 FCPS Tentative Budget

Auditors recognize the intentional spend down of a large General Fund balance may have been prudent in the circumstances, and understand the strategy to do so is a management decision outside the scope of this examination. However, poor financial management, weak policies, and failed communications in the implementation of the fund balance spend down, as well as other issues discussed within this finding, culminated in a weakened financial position for the district. This weakened position reduces the district's budgetary flexibility, leading to the need for significant budget cuts and other budget balancing strategies to stabilize the financial position of the district.

Use Of Committed Fund Balances

The Governmental Accounting Standards Board (GASB) promulgates financial reporting requirements for governmental entities, including FCPS. GASB Statement No. 54 - Fund Balance Reporting and Governmental Fund Type Definitions (GASB 54) stipulates "Amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority should be reported as committed fund balance." Auditors noted the purposes for commitments outlined in Board-approved motions as detailed above did not appear to be related to specific purposes, but instead were general categories of spending. Therefore, the commitments did not contain sufficient detail as to the intended future use of funds committed to the escrow account. Allegations received during the examination suggested that district management requested the Board's approval for these commitments in order to conceal the true amount of fund balance that was unassigned, or available for spending.

During the examination, auditors inquired as to the reason for the district's methodology for committing fund balances, and comments suggested that this methodology began many years ago to avoid reporting a large amount of fund balance available for spending, which may trigger unwelcomed attention from legislators or others.

In assessing whether the commitments appeared to be reasonable, auditors noted that during the fiscal year district management requested the Board's authorization to release funds from the committed escrow account into an unassigned (spendable) account. Releasing funds from the committed escrow account removed the purpose restriction established by the Board, and made the funds available for spending for any purpose. This methodology in effect sets aside funds for the use of district management to spend as it wishes during the year, which impairs both transparency and accountability.

Escrow Account Related To Board-Approved Commitments

Auditors performed a reconciliation of the committed/escrow account activity to Board motions for commitments or releases of any escrowed funds. During this reconciliation, auditors identified a $3,000,000 release from the escrow account during fiscal year 2013 which was not supported by an agenda item or Board approved motion for release. GASB 54 states, "Those committed amounts cannot be used for any other purpose unless the government removes or changes the specified use by taking the same type of action (for example, legislation, resolution, ordinance) it employed to previously commit those amounts." Since these funds were originally committed by motion of the Board, a Board motion is needed to release the funds from escrow.

Recommendations

We recommend the following:

- Extensively evaluate the budget process from a personnel, structural, policy and procedural perspective in order to develop a process more conducive to strategically managing district resources in an effective and efficient manner. This should include ensuring all directors receive information necessary for the successful completion of their job functions and are responsible for providing information pertinent to the functions of other departments.
- Develop controls to ensure all parties with decision making authority for the district, including the Superintendent, Board, and Kentucky Department of Education, are presented complete and accurate information in order to make informed decisions about the most effective and efficient use of district funds.
- All releases from escrow, and consequential de-commitment of funds, should be authorized by the Board in accordance with GASB Statement 54.

Finding 2: The FCPS Working Environment Is Not Conducive To Efficient And Effective Operations

The original allegations provided to the APA included what appeared to be hostile emails between FCPS central office employees. Because of budgetary weaknesses identified, auditors conducted interviews and reviewed additional documentation to determine whether the work environment at FCPS central office is conducive for appropriate cooperation between the budget and finance functions. Auditors interviewed several employees to inquire about the working relationship between the budget and finance departments. Interviews revealed the working relationship appears to be toxic and not conducive for proper fiscal management. The auditors reviewed additional email exchanges between the directors of the two departments and the COO in addition to those included in the allegations. The correspondence indicates well-established antagonism on both sides.

Unproductive Relationship Between Budget And Finance Functions

FCPS's Superintendent has been aware of the environment and indicated that it has worsened over the last several years. Staff revealed that the rivalry between the two departments, and the resulting lack of cooperation, even predated the two current directors. Based on the documentation reviewed the relationship became especially strained as the spend down of the district's fund balance described in Finding 1 began.

Upon consideration of the structure of the budget and finance functions, it appears many issues stem from departmental roles in the current process. Currently, the Department of Budget and Staffing Services is responsible for adjusting, creating, and balancing the budget. To be effective, this requires extensive consultation with the Department of Financial Services, especially in regards to determining the beginning fund balance available for the next year's budget. A primary contention of the Department of Budget and Staffing Services is the availability of forecast amounts from the Department of Financial Services so that the budget can be completed in a timely manner. The Department of Financial Services indicates a desire to have the information as accurately presented as possible. The Director of Financial Services also expressed concern over the methodology of the budget process in emails to the Superintendent and the COO.

The interaction between the two department directors became dysfunctional enough in 2012 for the Director of Budget and Staffing Services to email the COO, “One of these days Financial Services or Human Resources is going to withhold information trying to make themselves look superior that will be serious enough to get Board or public attention and I don’t want nor do I plan to be the scape goat…” At that time the Director of Budget and Staffing Services believed that information was being withheld intentionally by the Department of Financial Services to the detriment of the budget process. The Director of Financial Services indicated that the information provided is sufficient in terms of revenue and expenditure projections to satisfy his department’s minimal role in the budget process. However, because the department is responsible for providing accurate fund balance projections for budgeting purposes, its role in the process is anything but minimal.

Also, based on interviews and consideration of the negative impact on the poor work environment, it appears that mistrust and questions of each other’s professional competency significantly contributed to the confusion over the impact of the commitment journal entry described in Finding 1. As the fiscal situation grew dire for FCPS from 2011 to 2014, the Director of Budget and Staffing Services indicated she was convinced that she was being unfairly blamed for the need for budget cuts. As long as this environment exists, so will the risk of significant financial and budget errors.

Fear Of Retaliation And Intimidation within The Department Of Financial Services

Interviews with FCPS employees revealed an environment within the Department of Financial Services in which perceived intimidation has led to poor morale and a fear of retaliation. Many employees refused to speak with auditors on FCPS property and stated their concerns in meetings outside of the district office. Recurring themes in interviews with staff included allegations of intimidating management tactics and authoritarian control.

One recurring example provided in interviews was of a department meeting in which the employees were separated into three groups based on whether the Director of Financial Services “hired them,” “inherited them,” or “transferred them into the department.” He allegedly stated that if employees weren’t a good fit in the department, everyone was replaceable regardless of tenure. The message many took from this was a warning to not question any activities and that the Director of Financial Services was building the department around personal connections at the expense of transfers and established employees. Other interviewees stated that they were reminded by the Director that “what happens in financial services stays in financial services.” Many took this as a warning not to take any concerns outside of the department or above the Director level. Employees felt they had no recourse in the district to address their concerns based on these meetings.

When asked, the Director of Financial Services acknowledged the meeting had occurred, but that it was in response to customer service issues the department was facing. Confidential information was being shared with employees outside of the department and this was causing problems. He stated that no threat to any employees was intended and that the separation into groups was to remind everyone, regardless of employment history, that they were all one family.

Favoritism In Hiring Process

As noted above, concerns suggested the Director of Financial Services was building the department around personal connections at the expense of others. Auditors reviewed documentation related to the December 2013 filling of a vacant position within the Department of Financial Services. Inquiries and evidence indicate that interviews were conducted by a panel of staff that did not include the Director of Financial Services, and this panel made a recommendation for an applicant to fill the vacancy. Based on interviews with staff, the candidate recommended by the panel was changed at the direction of the Director of Financial Services. Staff indicated the Director stated he had contacted the initial choice and that person turned down the offer for compensation reasons. However, auditors interviewed the allegedly recommended candidate, and the individual stated they were never contacted regarding a job offer for the FCPS position. The eventual hire was a personal friend of the Director of Financial Services.

Auditors inquired directly with the Director of Financial Services, who stated he was not involved in the interview process and that the December 2013 hire was the recommended choice for the position. He stated he knew the individual personally, but reiterated he had nothing to do with the selection. He indicated that some of the staff confusion may have been the result of another position filled in July 2014 for which an offer was turned down because of compensation. However, a review of Personnel Action Forms confirmed the position in question was related to the December 2013 hire.

Irrelevant Training Perks

During our interviews auditors learned that certain employees in the Department of Financial Services attended trainings around the country, even though their duties were at best remotely relevant to the subject matter. Employees indicated this led to increased resentment in the department. Also, it is unclear why FCPS management would authorize expenditures related to out-of-state travel for employees that were not in the position to utilize the training. Training and professional development concerns are further described in Finding 6.

Overall, the working environment depicted in internal correspondence and during interviews is counterproductive and does not allow for the open communication and teamwork necessary to effectively manage the district's finances. By alienating a significant portion of the staff, information is restricted and the fear of retaliation is ever present, both of which foster a negative environment.

Recommendations

We recommend the following:

- The Superintendent and COO take steps to attain a healthy working relationship between the budget and finance functions, which includes the implementation of sound policies and procedures that dictate proper accountability, transparency, and accuracy for both budget and finance functions. To meet these objectives, FCPS management should consider the need to restructure the organization in a manner that mitigates or eliminates the inherent risks associated with the current climate.
- District leadership stress the significant role of the 'tone at the top' in maintaining a positive work and control environment within the Department of Financial Services and Department of Budget and Staffing Services.
- Human Resources should review recent hires in the Financial Services Department to ensure all relevant laws and policies are being adhered to throughout the hiring process.
- Procedures should be implemented for the approval of all out-of-state training, ensuring that only relevant employees attend.

Finding 3: Administrative And Management Salary Increases Outpace Other District Employees, Some Without Appropriate Transparency

During the examination, auditors reviewed FCPS salaries for fiscal years 2010 through 2014. The examination of FCPS salaries included the use of Board-approved Salary Schedules, Administrative Hay Grade Schedules, employee Personnel Action Forms (PAF), and job descriptions that included duties, responsibilities, and educational requirements. The review of this information identified concerns in how the district presented salaries to the Board for approval and also related to the disparity between raises given to employees. In addition, FCPS contracted with a consultant in May 2013 to complete a compensation and classification study of classified personnel (non-exempt) classifications, compensation, and supplemental or extra duty compensation for certified and classified personnel.

Results Of Salary And Classification Consulting Report

As noted above, FCPS contracted with a consultant for a salary and classification study in May 2013. Despite the contract terms estimating the study would be completed in four months, the report remains in draft form. Retaining this document in draft format restricts transparency and accountability since the report may contain information pertinent to the Board during its salary approval process. Based on interviews with Board members, some members thought the draft study was being withheld from them.

A draft report dated March 26, 2014, was provided to auditors. That document will be referenced throughout this finding.

Expansion And Misuse Of Hay Grade Additive Salary Adjustments

For school year 2013-2014 the Administrative Hay Grade Schedule was updated by FCPS management to expand the previous maximum pay grade of 14, with an administrative additive of $36,726, to a maximum pay grade of 20, with an administrative additive of $63,299, as presented in Appendix B. The Hay Additives are an element of district administrative employees' compensation intended to reflect the level of responsibility and relative value to the district.

Every year the Board must approve any changes made to Salary Schedules, including the Hay Grade Schedule since it increases an employee's salary. During the approval process, any significant changes to the schedules are typically identified in a cover letter by district management and attached to the proposed Salary Schedules for the Board's consideration. Also, changes are identified in red text in the body of the schedule. However, this significant change in the Hay Grade Schedule was not addressed on the cover letter issued to the Board or within the body of the Schedule.

The determination of a position's Hay Grade level is currently at the discretion of the Superintendent per discussions with Human Resources staff. Although the auditors reviewed a schedule which showed job titles and their corresponding Hay Additive, district staff indicated it was subject to change at any time. One concern noted during the examination was that the timing of the changes in the Hay Grade Schedule directly corresponded to increases for newly created positions or promotions by the Superintendent. An email dated May 3, 2013, provided to auditors in the allegations, shows the Superintendent requested the Director of Budget and Staffing Services elevate the COO to a Grade 15 from a Grade 12. Another email in the conversation, dated two months prior to the Chief Academic Officer's (CAO) start date, also mentions the incoming hire by name and states, "[the COO] and [the CAO] both hold superintendent certification and I want to be sure this is reflected in [the COO's] compensation."

The newly hired CAO was assured there would be no reduction in pay received in their former position as a Superintendent in another district if they accepted the position at FCPS. Documentation provided to the auditors indicated that the COO position currently receives a Hay Grade Additive of 17 ($48,872) while the CAO position receives a Hay Grade Additive of 18 ($53,277). For the COO, this is a total increase in Hay Grade compensation of $20,938 (from Grade 12 to 17) from the 2012-2013 salary schedule to the 2014-2015 salary schedule. Advocating budget cuts while adjusting the Hay Grade Schedule to provide raises to upper management was a source of frustration among many people auditors spoke with in the district.

IAKSS Compensation

Further review of FCPS salaries revealed that 36 employees for It's About Kids Support Services (IAKSS) are receiving annual compensation over $100,000. The list of employees receiving compensation over $100,000 includes the highest executive and administrative positions in the district such as the Superintendent and the four Chief Officers. However, it also includes employees listed as Directors, Associate Directors, Analysts, Coordinators, Managers, and other central office positions. A full list of IAKSS employees receiving an annual salary at or above $100,000 is presented at Appendix C.

To further analyze this information, auditors reviewed raises over the past several years provided to IAKSS staff who earned an annual salary above $100,000 as of FY 2014. Based on that review, data indicates that raises for these administrative and upper management employees outpaced those approved by the Board for teachers between 2010 and 2014. For this population of employees, the total compensation per position increased by an average of 24.73% from 2010 levels to 2014 levels. Three newly created positions, the Chief Academic Officer ($165,246), Chief Administrative Officer ($116,458), and an Exceptional Child Coordinator ($104,634) were not factored into the calculations. By reviewing the salary schedules for fiscal years 2010 through 2014, the average annual raise for teachers was 2.47%, or a total of 9.88% over the four year period. For the 2013-2014 and 2014-2015 schedules, teachers have only been approved for a 1% raise. However, the teacher percentage does not consider supplemental pay or other possible increases to compensation. Appendix C presents the salary information between 2010 and 2014 for those IAKSS employees who earned more than $100,000 as of 2014.

The information above, especially in light of information contained within the draft consultant report, indicates additional cause for concern that FCPS policies and practices create an environment that permits disparity by over-compensating certain administrative positions without equitable consideration of school level employees. This disparity also indicates FCPS may be missing opportunities to match its educational and administrative priorities with its spending practices.

Recommendations

We recommend the following:

- FCPS management direct its consultant to finalize the salary and classification report, currently in draft form. The final report should be provided to the Board for consideration during its salary approval process and for determining possible reforms to the salary schedule and the district's compensation methodology.
- All salary schedule adjustments, including Hay and supplemental increases, should be properly communicated to the Board for approval. The Board must have accurate information upon which to base its decisions.

- A consistent methodology for determining which employees receive a Hay Grade Additive, and to what level they are entitled, should be established through the creation of a formal policy. The district should consider not only the credentials held by individuals when applying Hay Grade Additives, but also the duties the employee performs for the district in relation to those credentials. The justification for all salary adjustments should be documented in the employee's personnel file.

Finding 4: FCPS Circumvented District Controls And Did Not Follow Procurement Guidelines

In the initial allegation provided to the APA, the complainant identified what was believed to be inappropriate budget transfers as one of the allegations of misconduct within the FCPS system. The allegation indicated the budget transfers were performed in order to facilitate payment of invoices to a northern-Kentucky based company which offers career and college preparation services. Also, information provided stated these transfers violated Board policy, which required that transfers in excess of $50,000 must be approved by the Board. Board policy was subsequently revised to eliminate the requirement for Board approval of transfers in excess of $50,000.

Board Policy And Budget Transfers

Auditors reviewed Board Policy 04.1 - Budget Planning and Adoption, and the amendment to this policy adopted during the July 22, 2013 FCPS Board meeting. Auditors confirmed the subsection "Budget Transfer Authority," which limited the Superintendent's authority to transfer dollar amounts within state defined expenditure codes to sums not exceeding $50,000 per fiscal year, was removed by the amendment approved in July 2013. Auditors also obtained correspondence indicating the Board policy amendment and budget transfers were requested to accommodate the payment of large invoices (including an invoice for the vendor's services) from the discretionary funds available to the Superintendent's office.

Analysis of budget entries and documentation provided evidence that budget transfers exceeding the $50,000 threshold were performed to facilitate two equal payments of $75,000 to the vendor. The first budget transfer completed on June 26, 2013 violated the Board policy in effect on that date. However, due to the amendment in Board policy described above, the second transfer completed on May 2, 2014, did not appear to violate the amended Board policy.

Procurement Process

In addition to the review of budget transfers associated with payments made to the vendor, auditors reviewed procurement documentation for the vendor services. This review identified several violations in the procurement process.

Procurement documentation identified the vendor as a sole source vendor, which requires written justification regarding why the procurement of the services should not be competitive. However, evidence confirmed there was no written determination identifying the vendor as a sole source vendor as of the date of the first vendor payment. The written determination for the vendor services provided to auditors is dated May 1, 2014, and only applies to the second payment of $75,000 made on May 22, 2014. KRS 45A.380 states, "A local public agency may contract or purchase through noncompetitive negotiation only when a written determination is made that competition is not feasible."

Additionally, interviews with district personnel questioned the validity of the claim that the vendor is the sole source of the services provided. District personnel expressed concerns for the need of the vendor's services as they may not be substantially different from college preparation services already available to students through the district. It was also suggested, if services beyond the current offerings to students were deemed necessary, other vendors with services comparable to the vendor may be available.

A second violation of Board policy noted by auditors was the lack of a formal contract. Upon request, district personnel were unable to provide the written contract between FCPS and the Vendor. Board policy 01.11 states, "Any proposed contracts for more than $20,000 shall be submitted to the Board for approval and shall be accompanied by figures showing the estimated cost of the project to the district." Invoice and payment documentation indicate the district expended $150,000 for the vendor's services; however, no approval of a formal contract is present in Board minutes. Further, correspondence revealed discrepancies in Board member knowledge of the vendor and its actual services including scope, timing, and fees. Emails indicated that, due to the fact that the services performed for the district by the vendor were considered a "pilot program," no formal contract existed or was necessary and one would only be necessary if FCPS wished to continue receiving services from the vendor beyond the "pilot program." However, exceptions of this nature were not found in written FCPS policies.

Auditors were provided a copy of an "Executive Summary" which is serving as the contract between the two parties. Several deficiencies were noted in the adequacy of this summary. In addition to the lack of basic contract elements including the signatures of both parties and the date of execution, the terms in the summary are vague and project deliverables lack sufficient detail. In order to facilitate proper evaluation of vendor performance, all contracts should contain precise terms, objectives, and criteria for evaluation.

Additionally, during interviews as well as through additional complaints received by the APA, auditors became aware that the FCPS Superintendent is a close personal friend with the vendor Founder and CEO. Auditors did not identify this relationship as a conflict of interest because it was not determined that the Superintendent received benefits from his relationship with the vendor's CEO; however, concerns are that this relationship may have played a role in the procurement process as some favoritism appears to have been shown as the district did not follow appropriate procurement policies. Another issue district personnel expressed was pressure to exaggerate the effectiveness of vendor because of the Superintendent's relationship with the CEO.

In addition to invoice payments of $150,000, FCPS has expended approximately $37,600 in stipends to teachers for training related to the vendor's services, bringing the total amount of district funds expended in relation to the vendor to at least $187,600.

Recommendations

We recommend the following:

- FCPS reinstate a budget transfer policy with an appropriate threshold to ensure any revisions to the annually adopted budget are appropriately reviewed and approved by the Board
- FCPS Follow proper procurement guidelines for the solicitation of all services performed for FCPS
- FCPS assess the benefit of continued vendor services and whether duplicate work is already being performed.

Finding 5: The Mary K. Stoner Trust Fund Is Not Being Used In Accordance With Its Charter

During interviews with FCPS staff, auditors were told of payments made to employees from a trust fund administered by the district. Documentation was requested to review the trust fund activity and auditors confirmed that disbursements to staff were occurring. Auditors also requested information on the establishment and restrictions of the trust fund as well as the policies and procedures governing the administration of the fund.

The Mary K. Stoner Trust Fund (Stoner Fund) was established in the will and testament of Mary K. Stoner, a resident of Lexington and former teacher in the district. The Stoner Fund was intended to be used by the Board for the "enhancement and enrichment of the educational program." Based on the terms of the trust, the district could utilize the interest earned from the trust and up to 10% of the principal each year for this objective. As of June 30, 2014, the fund's balance was over $1.1 million dollars.

The district did not provide any established policies and procedures for administering the Stoner Fund. However, district personnel indicated it has been used for a variety of expenses. These included educational loans to staff, loans to prevent financial hardship while traveling for professional development, and loans to obtain certifications. Allegations indicated that the Director of Financial Services had sole discretion over the Fund. In order to verify this, auditors inquired about whether a committee was involved in the decisions regarding the fund. The Director of Financial Services indicated that a committee was in place, but only minutes from the June 2014 meeting were provided.

Loan Processing And Repayment

Auditors examined a sample of disbursements from the Stoner Fund and noted the following concerns:

- During 2011, an employee processed their own loan in the accounting system.
- Also during 2011, an employee was permitted to repay their loans by foregoing mileage reimbursements unrelated to the professional development for which the loan was provided.
- One employee repaid their loan with a per diem reimbursement that was calculated in error, including reimbursement for time after the conference had already ended.
- Loan forgiveness occurred without established policies or procedures. Transfers were made into the Stoner Fund from another trust fund for the forgiven loans, potentially bypassing the intended purpose of the other trust fund.

Employees processing their own loans in the accounting system is a serious fraud risk. This practice provides the employee an opportunity to make inaccurate or fraudulent adjustments to the loan amounts, or even to provide themselves with unauthorized loans.

Also, repaying loans by foregoing mileage reimbursements is a fraud risk, primarily due to the format and procedures used for mileage reimbursements in FCPS. The individual mileage lines do not require an explanation of the business purpose per trip. Without a description of or reason for the mileage it is difficult for a supervisor to verify the information presented by the employee. Therefore, employees may have an incentive to submit travel reimbursement requests for travel that did not occur in order to repay loans.

Another method for the repayment of Stoner Loans is the submission of travel vouchers on which employees request reimbursement for per diem meal allotments, parking fees, taxi fees, and other costs incurred while traveling. Rather than being reimbursed for the travel costs, the reimbursement amount goes against their Stoner Fund loan. In such an arrangement, it is vital that only allowable travel costs are claimed. In one instance, a portion of an employee’s Stoner Fund loan was repaid with per diem allotments for a Saturday when the conference ended at noon on Friday. Therefore, expenses associated with Saturday should have been identified as personal in nature, but instead the employee was given credit for this time and the amount was applied against the loan. This methodology also increases the risk of abuse.

Auditors also inquired about transactions indicating repayments to the Trust fund for $17,139 in 2009. We were informed the current Director of Financial Services was not responsible for overseeing the fund during this period and instead it was administered by a former Associate Director in the Department of Financial Services. District personnel indicated these repayments to the Stoner Fund were drawn from another trust fund, the N. Isabel Schmidt Fund (Schmidt Fund), to satisfy the outstanding debt of those who had received education loans.

The previous Director of Financial Services allowed the loans to be forgiven if the employee remained with FCPS for three years, and therefore repayment was made to the Stoner Fund by the Schmidt Fund when loan forgiveness occurred. When inquiring about the large transfers in 2009, the auditors were provided work papers from the then and current external audit firm. These documents revealed only one known instance of an employee personally repaying an education loan. In all other cases, the Schmidt Fund was used to forgive employee loans and replenish the Stoner Fund.

In the establishing document of the Schmidt Fund, specific eligibility requirements were provided. By first receiving money through the Stoner Fund, these Schmidt eligibility requirements could be bypassed. The recipient must have a financial need or be disabled in addition to meeting one of the following criteria:

1. Must presently be a certificated [*sic*] employee of the Fayette County Public School System.

2. Must be a retired certificated [*sic*] employee of the Fayette County Public School System
3. May be a teacher/administrator who is on leave from the Fayette County Public School System
4. May be a teacher/administrator who has resigned from the school system because of mental/physical conditions

Other lump sum travel repayments occurred in 2009. Two of the most significant were for $18,415 and $24,778. These transactions were outside of the district's record retention period, which prevented the auditors from confirming the nature, reason, or appropriateness of the travel. Based on inquiry, these loans were for grant related training.

Despite the repayments from the Schmidt Fund identified, excessive loan disbursements caused the Stoner Fund balance to decline. Noting this problem, the current Director of Financial Services reduced the frequency of loans from the Stoner Fund. However, if the district continues to utilize the Stoner Fund as loans for staff and can justify that those loans meet the requirements of the trust, those loans should only be approved for amounts expected to be incurred while traveling on a specific trip. Subsequently, the loans should be repaid immediately following the trip from reimbursement proceeds for that travel.

Stoner Fund Loans Provided Primarily To Financial Services Staff

Another concern noted during the review of the Stoner Fund activity is that a significant portion of loans were being made to staff of the Department of Financial Services. Other loans were made to other central office and school level personnel, but it did not appear that the availability of funds to provide loans to assist with educational purposes was actively communicated to school level employees. Based on the trust documentation, this appears to be inconsistent with the intent of the benefactor, who was a former teacher in the district. As noted above, the trust was established for "the enhancement and enrichment of the educational program."

Providing loans primarily to Financial Services staff, even though they may be for travel advancements for training, is a questionable practice. When the use of these funds was discussed with the Director of Financial Services, he indicated the intent of the fund was for educational training, but acknowledged that the availability of these loans has not been publicized to school level employees. He indicated this is because it would be difficult to do so because of the number of teachers and others who might want their Masters degrees and other education covered. Given that the Department of Financial Services holds three out of the five trust fund committee seats, it gives the appearance that they may be utilizing funds primarily for the benefit of those working in their department, to the exclusion of others.

Recommendations

We recommend the following:

- The implementation of policies and procedures to ensure that disbursements from the Stoner Trust Fund are for the "enhancement and enrichment of the educational program" of the district as established in the fund's charter. This should include policies that impact employees district wide, and does not limit usage to only one group of employees. This fund appears to provide a great mechanism for incentivizing employees, but proper criteria must be established and evaluated.
- At least one Board member join the Trust Fund Committee so that those charged with governance are aware of trust fund activity and involved in the oversight of the funds.
- Policies and procedures reflecting the charters of other various trust funds be put in place to avoid noncompliance with trust fund requirements.
- Loan repayments should be made by receiving funds directly from the loan recipient and not through a methodology of withholding per diems. Not only should this make the loan activity easier to track, but the process will be more transparent and less risky. A timeframe should be established for the repayment of loans, such as within a certain number of days after the related travel occurs.

Finding 6: Travel And Professional Development In The Department Of Financial Services Is Excessive And Often Unnecessary

During our examination, discussions with staff indicated that excessive and unnecessary travel was occurring within the Department of Financial Services. To substantiate this allegation, procurement card expenditures, which are the primary method used to finance travel, were reviewed to assess the nature and volume of travel within the department. A similar concern has been noted in a different FCPS department in the past. FCPS updated its Professional Leave and Travel Policies in April 2013 when conference and travel spending for the FCPS Department of Special Education was reported by the press as waste, abuse, and a potential conflict of interest.

Inconsistent Accounting For Travel-Related Transactions

In analyzing data from 2010 to 2014, auditors found that procurement card expenditures for travel, training, and reference books totaled $115,212 for the Department of Financial Services. This amount does not include per diem or other ancillary charges that are included on travel vouchers submitted for reimbursement. Although these charges would likely add a substantial amount to the department's total travel expenditures, information was not readily available to efficiently review the total cost because of the district's coding methodology. For example, one purchase order reviewed listed 'Travel' as the description in the financial accounting system, MUNIS, but was coded as in an expenditure code for 'Other Rental'. Therefore, transactions were not consistently coded to a travel category, making the total difficult to identify. Rather than attempting to verify every suspected instance of travel over a four year period and reconcile it to the corresponding procurement card charge, the auditors used the procurement card total as a conservative estimate for the purposes of this examination. The analysis of conferences and trips attended by the FCPS Department of Financial Services revealed multiple instances of noncompliance with professional leave and travel policies, a lack of transparent reporting, and unnecessary travel.

Unnecessary And Excessive Conference Travel

To obtain approval to travel, employees are required to submit a Request for Professional Leave Form. The form provides an estimate of charges, per employee, for attending conferences or other trainings. However, the examination identified some FCPS Department of Financial Services staff failed to submit this form and are not complying with Board policy. Furthermore, when requests for professional development come before the Board, they do not include an estimated cost of each trip. By not consistently submitting the Request for Professional Leave Form to supervisors or the total estimated cost of travel to the Board, employees are not providing those charged with governance information needed to make sound decisions concerning district funds.

Also, auditors noted instances in which requests for approval were submitted for the same conference for different employees across multiple Board meetings. Without submitting requests for all employees attending the same conference at one time, the process loses the intended transparency and indicates a possible intent to conceal unnecessary or excessive travel. In one example, for a conference scheduled in April 2011, a total of 10 staff members were approved for the related Professional Leave by the Board in various meetings from December 2010 through March 2011. Three employees were approved in December, four in January, one in February, and two in March. By spreading the requests over several months, it would be difficult for the Board to recognize the total number of attendees. This greatly increases the risk of unnecessary travel and weakens the Board's ability to question the need for so many employees to attend one conference.

Employees Staying Extra Nights At District's Expense

During our review of travel expenditures, we noted four conferences at which the Department of Financial Services staff stayed an extra night beyond the last day of the conference, while other FCPS conference attendees left the final day of the conference. Per review of procurement card and travel voucher information for a 2011 conference in Nashville, the total cost to the district was $15,904. Of this amount, we questioned $1,244 since it pertained to costs incurred for Friday evening and Saturday when the conference ended at noon on Friday. A 2011 conference in Las Vegas cost the district $7,801 with five attendees. $420 was incurred after the conference ended on Saturday at noon. Also, for a 2012 conference in Dallas, the total cost to the district was $21,624 for 12 attendees. The final session ended at noon on Friday. Charges were incurred for Friday evening and Saturday totaling $1,360.

A 2014 conference to San Antonio cost the district $13,108 with six attendees; $1,131 of which was questioned because it was incurred for time after the conference ended on a Wednesday at noon.

When we questioned this, district personnel stated that the approval to stay an extra night is determined on a case by case basis. Table 4 below illustrates the questioned costs and conference dates.

Table 4- Questioned Travel Costs - Extended Stays Beyond End of Conference

Conference Date	Location	Attendees	Total Costs	Questioned Costs
April 26 - 29, 2011	Nashville, TN	9	$ 15,904	$ 1,244
October 5 - 8, 2011	Las Vegas, NV	5	7,801	420
April 10 - 13, 2012	Dallas, TX	12	21,624	1,360
April 13 - 16, 2014	San Antonio, TX	6	13,108	1,131
			$ 58,437	**$ 4,155**

Source: FCPS conference agendas, procurement expenditures, and travel reimbursements

Travel Approval Exceptions Creates A Risk Of Excessive Expenditures

Under current Professional Leave policy, all professional leave must have prior approval from the Board. The policy, however, allows for several exceptions. One exception is for operational/business meetings that require an overnight stay to conduct district business or represent the district. These types of meetings must be approved by the Superintendent or his designee only and do not require Board approval. District personnel indicated that the Superintendent's designee is considered the cabinet level Directors or Chiefs even when it is their own travel, which allows these individuals to bypass Board authorization for their travel. By removing the Board and Superintendent from the approval process, the risk of waste increases.

Three out of the ten trips examined by auditors were designated as official district business, but the justification provided does not clearly demonstrate how the trips directly benefited the district. These trips were for two attendees each to Miami, FL, Biloxi, MS, and San Antonio, TX, with costs to the district of $7,299, $3,021, and $5,424, respectively. The trip to Biloxi included an explanation that the cost would be zero for FCPS because the attendee was getting reimbursed for fees related to the trip as a conference speaker. However, only $613 was received to cover the costs. When questioned, district personnel said they would no longer attend such conferences after not receiving full reimbursement.

Excessive District-Paid Certifications And Other Professional Development

In addition to travel, auditors were informed that some central office employees were pursuing their Superintendent Certification. The auditors inquired whether the district paid for college courses to meet the superintendent certification requirements. FCPS provided a list of 22 current employees district-wide with Superintendent Certifications.

However, the district indicated that it was impossible to determine who was currently pursuing the certificate and whether the district paid for any of those costs.

Auditors then consulted with FCPS Human Resources and learned the district does not pay for college classes, although the Director of Financial Services informed the auditors that the cost of obtaining his superintendent certification was paid with district professional development funds. Subsequent to this inquiry, auditors were informed that the Director of Financial Services is refunding the full amount to avoid potential inconsistencies since other employees may have paid out of pocket. Because of the lack of documentation maintained by the district, auditors could not ascertain the amounts being paid on behalf of employees for certifications.

The lack of tracking district-paid benefits is a serious weakness. Certain benefits, including education benefits, may impose tax requirements on the recipient. Also, there is a concern that professional development funds and other funds could be misused for personal expenditures not approved by management or the Board. Auditors cannot determine whether the Director of Financial Services planned to repay funds to the district for costs associated with obtaining his Superintendent Certification prior to the examination, or why the district agreed to pay those costs initially.

In addition to the concerns related to Superintendent Certifications, auditors noted a very high number of FCPS central office employees have received the Gatton School's Certified School Financial Officer (CSFO) and Certified School Financial Manager (CSFM) certifications. Per information identified in the district's financial statements, six staff members have the CSFO certification and 11 have the CSFM certification. The Gatton School program is a curriculum built for school finance officers, and includes courses related to school financial management and budgeting. The current cost to obtain the CSFM certification covered by the district is $2,925 per employee.

Based on the APA's statewide finance officer survey conducted earlier this year, many districts indicated they did not have the funds to retain certification for their CFO, let alone provide funds to obtain initial certification for the majority of the financial staff. The APA has strongly supported improving the skill sets of school district finance departments, but in this case the necessity and reasonableness of such a high number of employees receiving these certifications is questionable. Based on the review of the salary schedule and compensation data, the CSFO qualifies employees for a $2,000 per year bonus. This creates a concern that the only reason employees are obtaining the certification is to obtain the salary adjustment, and ultimately that the district is paying for individuals to attain credentials and then rewarding them for attaining them.

Auditors learned that teachers are also eligible for a $2,000 annual bonus if they maintain National Board Certification. However, the district does not cover any fees necessary to pursue this certification. The disparity of IAKSS employees having their various certifications paid for by the district while teachers do not is questionable.

Although the certifications noted above may be personally beneficial to the careers of the individuals attaining them, the district should only pay for such certifications when they are necessary and reasonable for the performance of the employee's job duties. Also, the district should enter into agreements with individuals that have had paid benefits of this nature requiring full or partial repayment of the costs if the employee leaves the district within a specific timeframe.

Recommendations

We recommend the following:

- All personnel should submit the Request for Professional Leave Form to the appropriate management and to the Board for approval to ensure compliance with FCPS Policy.
- All trip requests should be appropriately approved by the Board prior to the dates of travel to ensure compliance with FCPS Policy. This includes that the approval for all anticipated attendees for a trip should be requested at the same time to ensure transparency and to avoid excessive and unnecessary travel. If the list of attendees needs to be adjusted after the Board's initial approval, the Board should be provided with an amended list of attendees that identifies previously approved attendees, as well as the new attendees.
- In addition to relaying anticipated attendees per conference, the Board should also be made aware of the anticipated cost of the travel as part of the approval process. Funds are encumbered months in advance related to travel so this information is readily available.
- All official district business trips should be approved by the appropriate management and contain support detailing how the trip benefits the district to ensure compliance with FCPS Policy.
- All personnel should submit the appropriate supporting documentation when requesting travel reimbursements to ensure compliance with FCPS Policy.
- All personnel should be informed of any updates to the FCPS Professional Leave and Travel Policy.
- Any travel costs incurred beyond the duration of the conference or training should only be allowable under extraordinary circumstances, such as the inability to find return flights on certain dates.

- The district should only pay for professional certifications for employees when the certification is necessary and reasonable for their position. Furthermore, the district should not pay for certifications unless an agreement is in place to contractually, under penalty of repayment, retain the employee for a reasonable period after attaining the certification.
- Department of Financial Services staff, whenever possible, should achieve continuing professional education through cost effective means. When out-of-state travel is necessary, procedures should be implemented to limit the total number of people attending to those employees directly impacted by the training. Information gathered during training can be shared with remaining staff at a later date.

Finding 7: Conflicts Of Interest

During the APA's 2013 examination of the FCPS Special Education Department, a finding was reported related to a conflict of interest within the department involving perks provided by a vendor, such as free lodging and an open bar. The APA recommended a revision of policies to more clearly define these types of potential conflicts of interest, and also additional training on the subject for employees. FCPS responded that training would be provided to clarify, identify, and avoid conflicts of interest in the future.

Conflicts Related To Vendors

Discussions with FCPS employees and payments identified during the current examination indicated additional conflicts of interest related to vendors at FCPS. In relation to one vendor, auditors became aware of several instances of FCPS employees taking advantage of perks available as a result of the district's relationship with a community bank. Each year the central office has a holiday luncheon in which a portion of the dinner is reimbursed by the bank. Also, several central office departments have utilized the bank's corporate box for baseball games. When contracting with a vendor, the primary consideration should be cost effectiveness and quality of service, uninfluenced by other factors such as perks. By engaging in these activities, the risk is greater that favoritism may be shown in the procurement process.

Also, while reviewing transactions, auditors noted district training agendas which acknowledged the contributions of vendors. It was identified that vendors provided gift certificates, cards, office supplies, and other prizes which were distributed during the trainings. While sponsorships for such items are preferable given that public funds should not be spent for unnecessary gifts and entertainment, the district should be careful in its solicitation for such sponsorships as not to create a risk or appearance of favor-trading with vendors.

Other Potential Conflicts

Another potential conflict of interest was identified by analyzing payments from the Department of Financial Services to a non-profit civic organization. The Director of Financial Services serves as the Treasurer for the parent entity of the organization in question. These payments were for annual memberships for FCPS staff, which is described in Finding 9. Auditors were unable to determine how the memberships were necessary to the educational mission of the district, especially given the appearance of a potential conflict with the Director of Financial Services acting as the organization's Treasurer. Auditors did not identify any policies clarifying the types of professional or civic memberships that could be paid by the district. The total amount of purchase orders paid by the Department of Financial Services to the non-profit during the period under review was $2,650.

Recommendations

We recommend the following:

- The district should thoroughly review its business practices, vendor relationships, ethics policies, and procurement activity for possible conflicts of interest. This review should result in changes to relevant district-wide policies and procedures.
- Educate all employees not only on the conflict of interest policies and regulations, but also on their role as stewards of taxpayer dollars and the importance of maintaining the integrity of the procurement process.
- All business dealings should be conducted at an arm's length, with even the appearance of conflicts of interests avoided.

Finding 8: Monthly Financial Reports To The Board Lack Significant Information

During the examination, some FCPS Board members expressed surprise at the amount of the budget cuts recommended by the Superintendent for the 2014-2015 budget. They felt, based on assurances by district personnel, that the financial position of the district was strong until nearly $19 million in cuts were proposed early in the 2014-2015 budget cycle. Auditors reviewed the district's financial statements, communications to the Board, and other documentation to determine whether red flags existed that should have been made known to the Board. This review indicated concerns with information provided to the Board, as well as with the Board's expectations regarding its role for financial oversight.

Inadequate Information Provided To The Board

The actual financial situation of the district, as reflected in the financial statements reviewed, identified rapidly accelerating expenditures that outpaced revenues and depleted fund balances. Based on a review of information reported to the Board and public, it does not appear that these troubling trends were adequately conveyed. The Board relies on monthly reports from the district Director of Financial Services and briefings on the annual financial statement audit in order to remain apprised of the district's financial standing. The Monthly Financial Report presents the following financial information:

1. General Fund balance at the beginning and end of the month;
2. Year-to-date revenues and expenditures; and

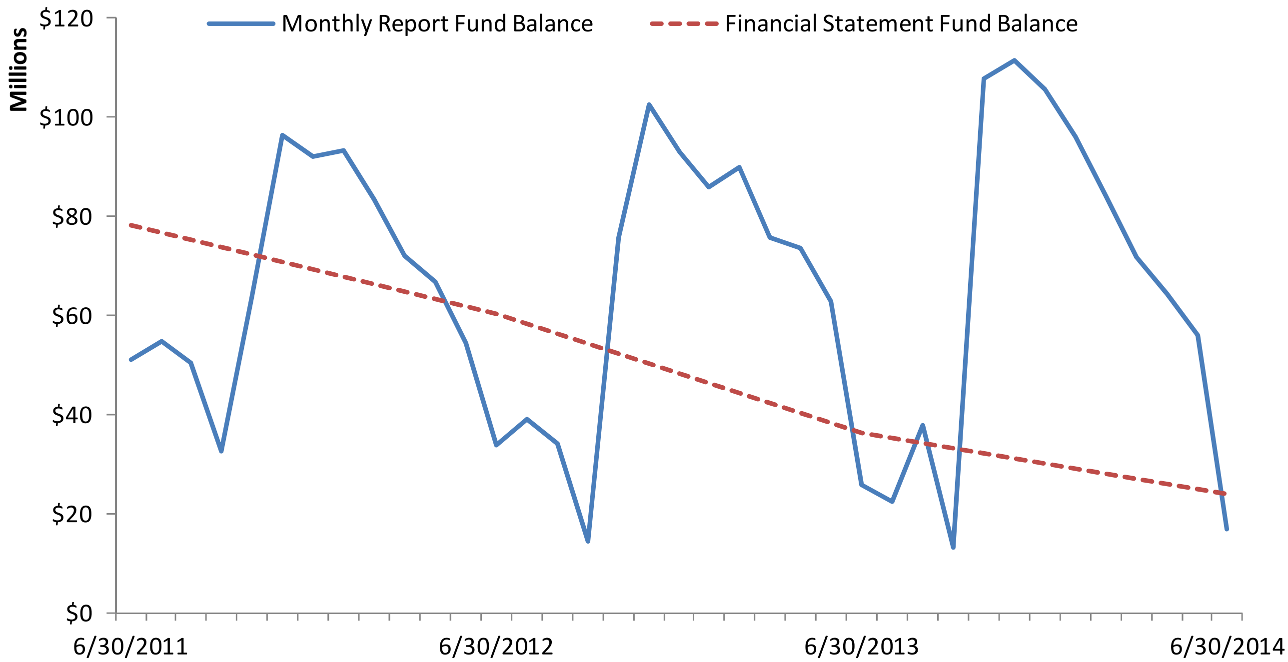
3. Revenue available for expenditures (beginning of the month fund balance with year-to-date revenues).

In addition to the above amounts, the Director of Financial Services attaches revenue support based on a spreadsheet designed by the Department of Financial Services using information they derive from the accounting system (MUNIS). A report directly from MUNIS is provided as support for the expenditures.

The auditors found this presentation to be ineffective at providing the necessary context by which Board members could judge the district's financial position. The summary information designed to convey financial activity has critical weaknesses. The reports presented are difficult to reconcile to supporting information. For example, the year-to-date revenues as presented by the Director of Financial Services do not reconcile to the supporting spreadsheet provided. More importantly, budget-to-actual comparisons are not emphasized, so it is difficult to derive how actual revenues and expenditures are performing in relation to the approved budget.

The fund balance presented for the General Fund in the Monthly Financial Report is particularly misleading because it fails to account for balances which are not available to spend such as the statutorily required contingency reserve. In effect, the fund balance presented is difficult to interpret and the fund balance available to spend is significantly lower than what is presented monthly. Additional contextual information is needed to assess the district's current and projected year-end financial position. Auditors performed a trend analysis of the information provided by the Director of Financial Services to the Board, and based on this analysis it would be difficult for the Board to readily identify the worsening financial situation of the Board. Table 5 below depicts fund balance information presented to the Board in the monthly Director of Financial Services' reports in contrast to the fund balance information presented in the district's annual financial statements. It is evident the information provided to the Board shows the fund balance fluctuations caused by day-to-day business decisions, but does not provide sufficient detail to enable the Board to see the declining trend in fund balance overall. Since only select information is presented throughout the year, and not tied to the actual financial position of the district, the true financial position is not reflected. In Table 5, auditors projected the 2014 financial statement fund balance based on historical data and the 2014 unaudited Annual Financial Report since the district's 2014 audited financial statements were not available as of the date of this report.

Table 5 - Fund Balance - Monthly Report in Contrast to the Financial Statements

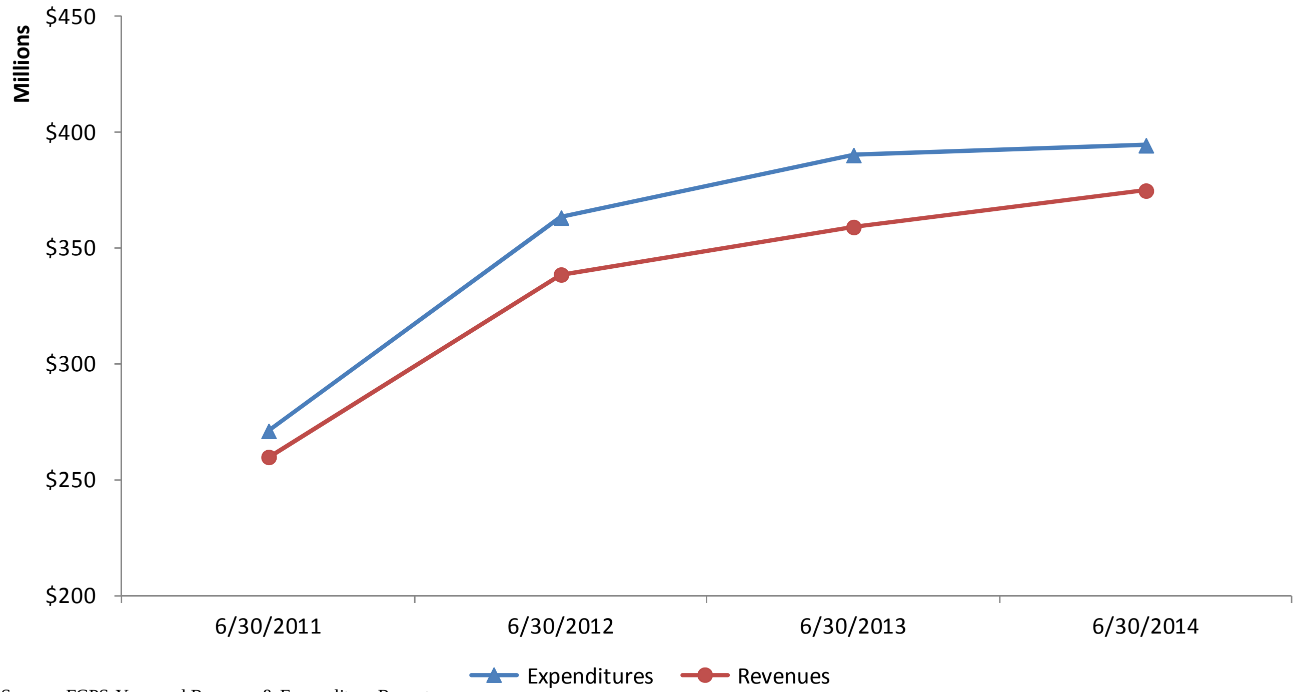


Source: FCPS Monthly Treasurer's Reports & 2011-2013 Audited Financial Statements

Internal communications reviewed during the examination identified financial maneuvers taken by the district, and indicated district management had an understanding of the worsening financial position despite the Board continually receiving positive reports. Specifically, documentation indicates that district leadership was aware that expenditures were consistently outpacing revenues and in part was included in management's plan to spend down the fund balance as described in Finding 1; however, monthly reports to the Board indicated there were no unexplained variances and the district was in sound financial condition. Further masking the situation is the fact that the General Fund was supplemented by multiple releases of funds being held in committed accounts, which removed the restrictions on those committed funds and made the funds available for spending. Consequently, no action was taken to reduce spending and the district fund balance declined. Table 6 below depicts the increase in expenditures and revenues between FY 2010 and FY 2014, which identifies the level of expenditures in excess of revenues. This is critical financial analysis the Board and public should have been provided as part of the monthly Director of Financial Services' reports.

Findings and Recommendations

Table 6 - Expenditures vs Revenues



Source: FCPS Year-end Revenue & Expenditure Reports

In addition to the Board, other district personnel received inaccurate information. Interviews with district personnel indicated budget amounts presented in the monthly financial reports cannot be used for budget-to-actual comparisons because of frequent adjustments by the Department of Budget and Staffing Services. Based on auditor review of documentation provided, budget adjustments are made throughout the year but most commonly at year end. In an interview with the Director of Budget and Staffing Services, auditors were told that year-end adjustments were made to the budget to avoid any significant variances which might lead to questions from the external auditor. By adjusting budget accounts after they have been approved and without approved budget amendments, the Board would never know of potentially material variances between actual operations and the approved budget, or have a firm basis for analyzing budgeted amounts for the following year's budget. Also, based on the Director of Budget and Staffing Services' response, it appears that the variances were intentionally concealed from external auditors making it difficult for auditors to perform appropriate procedures related to the district's budget-to-actual schedules.

Proper Board governance should include an understanding of the financial position of the entity throughout the year. This understanding should be facilitated by relevant, complete, and accurate financial reports, which include management's analysis of the information and response to significant fluctuations or variances. This would allow fiscal concerns indicated by the monthly financial report to be addressed, to the extent possible, well in advance of year-end.

Findings and Recommendations

Board Oversight

During the examination, inquiries were made with Board members regarding its oversight of the budget process. These inquiries resulted in concerns regarding appropriate governance when some Board members indicated that in regards to the budget, they have trusted the Superintendent to manage the budget, and due to his financial background increased oversight was unnecessary. This generates several concerns, most notably that it appears that some Board members may not understand their function, and that trust in an individual cannot replace proper oversight. Also, the primary responsibility for the budget and finances of the district currently falls to the Director of Budget and Staffing Services and Director of Financial Services. Weaknesses identified in this finding and elsewhere in this report identify the need for improved oversight over the budget and finance process.

Recommendations

We recommend the following:

- The monthly reporting process, including the structure of the Monthly Financial Report, be reevaluated. The goal of this evaluation should be to provide the Board with the relevant information it needs utilizing complete, accurate reports that have been properly reconciled to the financial records. Reconciling differences should be identified and explained. Expertise of both the Department of Financial Services and the Department of Budget and Staffing Services should be utilized in this process. By bringing those who supply, compile, and use the information together, the monthly reporting process will be improved.
- Monthly reporting to the Superintendent and Board include an analysis of the current financial position as well as year-end projections.
- A detailed budget review, including budget-to-actual reports, be prepared to provide the Superintendent, Board, and relevant personnel with sufficient information for decision making and for identifying corrective action when needed.
- Board members should ensure appropriate processes are in place to provide proper oversight of budget and finance matters. Whereas having a positive relationship with the district’s Superintendent is important for a well functioning district, that relationship should not keep Board members from performing their fiduciary responsibility to the district. Improved oversight will empower the Board by providing solid information for decision making and evaluation purposes.

Finding 9: Accounting Weaknesses Within The Department Of Financial Services

In the initial allegations submitted to the APA, certain accounting practices of the Department of Financial Services were questioned. In order to assess these concerns, the auditors interviewed staff within the Department of Financial Services and reviewed a sample of transactions to test for deficiencies. The auditors noted several instances of waste and also deficiencies in internal controls.

Lapse In Internal Controls Involving The Director Of Financial Services And His Spouse

During interviews with central office staff, auditors were informed the district did not have a formal nepotism policy. FCPS is a large employer in the area which increases the potential for nepotism. Staff indicated that spouses worked in the central office and the district at large. Although the auditors recognized that some instances of family relationships among employees in school district may be unavoidable, auditors were concerned about one relationship due to its potential of posing a fraud risk to the district. A relationship identified by auditors was the Director of Financial Services and his wife, an employee in the Department of Financial Services. IAKSS staff stated that the Director of Financial Services' wife is responsible for collecting all the receipts accounted for by the Department of Financial Services. The Director of Financial Services' wife did not work directly for her spouse but instead reported to an Associate Director in the Department of Financial Services.

The wife's position in the Department of Financial Services was confirmed in an interview with the Director of Financial Services, who stated he was unaware of her role. Although her role raises a red flag as to why such a lapse in internal controls was permitted to exist, it is even more concerning that the Director of Financial Services indicated he was unaware of the role of a key employee within his department, especially one held by his spouse. The Director of Financial Services did state that since being made aware of his wife's role during the APA's examination, it was in the process of being changed.

Misuse Of Purchase Orders

Another weakness identified within the district relates to the use of purchase orders. Auditors noted that purchase orders for travel were created months ahead of when the expenditure was anticipated. District personnel indicated that this practice was due to budgetary reasons, in that amounts requested in the budget were not always approved. The purchase orders would be open at the end of the fiscal year, causing current year budgeted funds to be encumbered for use in the next budget cycle. By circumventing the budget control process, the Department of Financial Services is compromising the budget process by setting aside funds for use in the following year instead of using the next year's budgeted funds to cover the travel expense. This process decreases transparency because the actual amount of funds available for spending is under reported. Auditors were unable to thoroughly examine this concern because the Department of Financial Services does not maintain supporting documentation for canceled purchase orders.

Lack Of Proper Segregation Of Duties

During the examination, auditors also inquired about the vendor creation process. The Purchasing Department creates vendors in MUNIS for the district but the back-up is an Associate Director in Financial Services. This back-up designation in effect nullifies the segregation of duties related to vendor creation, giving the Department of Financial Services the ability to create and delete vendors as well as pay them. This lack of properly segregated duties creates a significant fraud risk, which is exacerbated by the position held by the spouse of the Director of Financial Services since she receives all of the department's receipts.

Necessity And Reasonableness Of Expenditures

Auditors questioned how several expenditures were necessary to the educational mission of the district. The district pays for 10 memberships to an affiliate of a non-profit civic organization. The Director of Financial Services is the treasurer of the parent organization of the nonprofit in question. The total payments to the organization for the period under the examination were $2,650, as described in Finding 7.

Also, auditors identified that the district pays for travel and materials related to interacting with business organizations around the country. The district has an initiative to increase the percentage of minority and women owned businesses with which the district does business. Although a worthy goal, it is unclear how incurring the cost of out-of-state travel and related materials is a necessary expense to meet this objective. We reviewed three such trips, one to Miami, FL (2010), one to Biloxi, MS (2011), and another to San Antonio, TX (2013), which cost the district a total of $15,744. The documentation for these trips did not justify the necessity of the trips for the benefit of FCPS.

Another allegation involved the district paying for a $290,000 insurance policy to cover the cost of uninsured student athletes in the district in case of injury. The recent passage of the Affordable Care Act (ACA) has greatly reduced the percentage of uninsured citizens in the Commonwealth. Parents of student athletes are required to pay a $25 fee for each child participating in order to offset this insurance cost to the district, even if they already have private insurance that covers the student athlete. Given the recent tax increase approved by the Board and other costs passed down to parents, any financial relief the district can provide to parents through the reduction of unnecessary expenditures is vital, especially when it is not clear as to whether the expense is necessary.

Recommendations

We recommend the following:

- The establishment of a nepotism policy for FCPS to mitigate the inherent risks of fraud or abuse, favoritism, and other personnel issues. Although family relationships may not be easily avoided, procedures should be implemented to avoid spouses having the ability to

supervise or direct the work of each other, at a minimum.
- Funds should only be encumbered when the anticipated expense is quantifiable and reasonably expected to be incurred. Funds should not be encumbered in order to circumvent the budget process.
- Canceled purchase orders should have the reason for cancelation noted in MUNIS.
- The Department of Financial Services should not have authority to create vendors in order to maintain a proper segregation of duties and reduce the risk of fraud.
- The Board should establish a policy regarding what professional and/or civic memberships, if any, can be paid with district funds.
- The Department of Financial Services should identify more cost effective strategies for achieving the district's goals of increasing the percentage of minority and women owned vendors doing business with the district.
- The district should reassess the relevance and coverage level of the current insurance policy for student athletes. The district may want to enlist the assistance of state agencies to determine the impact on ACA and other programs for providing appropriate insurance coverage for student athletes.

Finding 10: The Current FCPS Internal Audit Structure Needs Improvement

During the course of the examination, auditors interviewed several stakeholders who expressed concerns with district financial practices. Some interviewees, including Board members, were unaware of the district's internal audit function. Others indicated they were not safe from retaliation regardless of with whom they spoke. Because of these concerns, auditors also inquired about the presence of a fraud hotline or other mechanism to anonymously report issues. Currently, no such hotline is available for FCPS employees.

FCPS outsources its internal audit function to a public accounting firm. At present, the scopes of the internal audits are set by the Budget and Finance Committee. The results of these audits are communicated to a 14 member Budget and Finance Committee consisting of the Superintendent, Chief Academic Officer, Chief Operating Officer, two Board members, the Director of Financial Services, the Director of Budget and Staffing Services, and other staff. A variety of financial issues are discussed at these meetings with the focus more on district initiatives than internal audits. When Board members were asked about their knowledge of internal audit activity, some were unaware of the existence of an internal audit function. Because of the breadth of information on the Budget and Finance Committee agendas, insufficient time is being devoted specifically to internal audit concerns and it does not appear that the concerns are routinely reported to the Board.

For organizations the size of FCPS, an internal audit function is vital for deterring fraud and evaluating organizational processes. To maximize effectiveness, however, the internal auditors must be sufficiently independent to perform their duties. They must also have adequate access to those charged with governance. While outsourcing internal audit duties is not uncommon, the organization must put in place a process that protects the independence of the internal auditors. Because the internal auditors report directly to the Budget and Finance Committee instead of the entire Board, the current structure for FCPS is not conducive to achieving this independence.

Because all Board members are not present on the Budget and Finance Committee, those charged with governance of the district are not appropriately involved in the internal audit process. Since those charged with governance are ultimately responsible for the direction of the district, it is imperative that they are made aware of any issues raised by the internal auditors.

Meeting minutes of the September 2012 Budget and Finance Committee indicate that the internal auditors should consult the Director of Financial Services and "agree on the finished product before coming to the committee." While a certain degree of consultation between the Department of Financial Services and the internal auditors during audit procedures is to be expected, consulting on the finished report might limit or distort important information needed by the Board and Superintendent.

Government Auditing Standards provide guidance for achieving internal auditor independence when employing internal auditors. Those standards indicate that internal auditors who work under the direction of the audited entity's management are considered independent for the purposes of reporting internally if the head of the audit organization meets all of the following criteria:

a. Is accountable to the head or deputy head of the government entity or to those charged with governance;
b. Reports the audit results both to the head or deputy head of the government entity and to those charged with governance;
c. Is located organizationally outside the staff or line management function of the unit under audit;
d. Has access to those charged with governance; and
e. Is sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal

Without a fraud hotline, and the expectation of anonymity and serious review by management, employees and others do not have a safe way to express concerns free of the fear of retaliation. This increases the risk that management and the Board will remain unaware of important issues impacting the district.

Recommendations

We recommend the following:

- The Board establish a formal Audit Committee consisting of at least the Superintendent and representatives of the Board. The Internal Auditors should report to this committee, and the committee should determine the scope of internal audit procedures based on external audit findings, hotline submissions, high risk areas, and any other relevant factors.
- The discussions of the Audit Committee should focus on audit related matters exclusively rather than other financial matters.
- The district should establish a system through which concerns of waste, fraud, and abuse can be anonymously reported. The established Audit Committee should be responsible for reviewing, discussing, and addressing anonymous concerns submitted by employees.
- The Audit Committee should report all internal audit conclusions, findings, and engagement results to the full Board.

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APPENDICES

Appendix A – Monthly Director of Financial Services' Report Presented To The FCPS Board

FAYETTE COUNTY BOARD OF EDUCATION
FINANCIAL SUPPORT SERVICES TREASURER'S REPORT
FOR THE MONTH ENDING OCTOBER 31, 2011
33% of the 2011-2012 FISCAL YEAR IS COMPLETE

GENERAL FUND 1 REPORT	WORKING BUDGET 11-12	TO DATE 09/30/2011	Available Budget Balance	% RECEIVED or expended
REVENUE				
Beginning Balance (un-audited)	$60,016,632.71	$58,052,100.31	($1,964,532.40)	
AD VALOREM TAXES	$143,018,137.00	$52,995,438.11	($90,022,698.89)	37.06%
UTILITY TAXES	$23,666,586.00	$4,112,717.69	($19,553,868.31)	17.38%
OCCUPATIONAL LIC TAXES	$29,610,228.00	$5,305,630.84	($24,304,597.16)	17.92%
REVENUE IN LIEU OF TAXES	$11,781.00	$0.00	($11,781.00)	0.00%
OMITTED TAXES & PENALTIES	$1,000,000.00	$0.00	($1,000,000.00)	0.00%
TUITION	$126,004.00	$7,875.00	($118,129.00)	6.25%
TELECOMMUNICATIONS	$998,822.00	$248,294.76	($750,527.24)	24.86%
INTEREST	$298,835.00	$38,355.27	($260,479.73)	12.83%
OTHER REVENUE LOCAL SRS	$3,305,500.54	$1,016,766.69	($2,288,733.85)	30.76%
SEEK REVENUE	$80,561,161.00	$26,377,164.00	($54,183,997.00)	32.74%
OTHER STATE FUNDING	$91,775.00	$0.00	($91,775.00)	0.00%
INTERFUND TRANSFERS (indirect cost)	$1,043,580.00	$166,794.49	($876,785.51)	15.98%
MEDICAID	$0.00	($3,938.80)	($3,938.80)	0.00%
SALE OF ASSETS	$0.00	$0.00	$0.00	0.00%
TOTAL OPERATING REVENUE (Unaudited)	$343,749,042.25	$148,317,198.36	($195,431,843.89)	43.15%

Source: October 2011 Monthly Treasurer Report

FAYETTE COUNTY BOARD OF EDUCATION
FINANCIAL SUPPORT SERVICES TREASURER'S REPORT
FOR THE MONTH ENDING NOVEMBER 30, 2011
41% of the 2011-2012 FISCAL YEAR IS COMPLETE

GENERAL FUND 1 REPORT	WORKING BUDGET 11-12	TO DATE 11/30/2011	Available Budget Balance	% RECEIVED or expended
REVENUE				
Beginning Balance (audited)	$60,016,632.71	$37,329,932.57	($22,686,700.14)	
AD VALOREM TAXES	$143,018,137.00	$114,476,396.36	($28,541,740.64)	80.04%
UTILITY TAXES	$23,666,586.00	$4,112,717.69	($19,553,868.31)	17.38%
OCCUPATIONAL LIC TAXES	$29,610,228.00	$7,115,127.94	($22,495,100.06)	24.03%
REVENUE IN LIEU OF TAXES	$11,781.00	$0.00	($11,781.00)	0.00%
OMITTED TAXES & PENALTIES	$1,000,000.00	$182,262.43	($817,737.57)	18.23%
TUITION	$126,004.00	$61,017.50	($64,986.50)	48.43%
TELECOMMUNICATIONS	$998,822.00	$413,824.60	($584,997.40)	41.43%
INTEREST	$298,835.00	$63,996.80	($234,838.20)	21.42%
OTHER REVENUE LOCAL SRS	$3,369,616.66	$1,399,911.23	($1,969,705.43)	41.55%
SEEK REVENUE	$80,561,161.00	$32,971,455.00	($47,589,706.00)	40.93%
OTHER STATE FUNDING	$91,775.00	$0.00	($91,775.00)	0.00%
INTERFUND TRANSFERS (indirect cost)	$1,043,580.00	$436,864.17	($606,715.83)	41.86%
MEDICAID	$0.00	($3,938.80)	($3,938.80)	0.00%
SALE OF ASSETS	$0.00	$0.00	$0.00	0.00%
	$0.00	$0.00	$0.00	0.00%
TOTAL OPERATING REVENUE (Unaudited)	$343,813,158.37	$198,559,567.49	($145,253,590.88)	57.75%

Source: November 2011 Monthly Treasurer Report

Appendix B - Memorandum Regarding Changes To The 2013-2014 Administrative Hay Schedule

It's about kids.
FAYETTE COUNTY PUBLIC SCHOOLS

Draft Working Document

May 3, 2013

TO: Ton Shelton
Superintendent

FROM: Julane Mullins
Director of Budget and Staffing

FOR: Board of Education

RE: 2013-2014 Salary Schedules

The various salary schedules for the employees of Fayette County Public Schools for the 2013-2014 school year are attached for your review. Each salary schedule reflects a 1% increase over the 2012-13 school year except for the supplemental duty salary schedules.

The electronic salary schedules attached are in mark-up version (with changes in red) so that the Board may see recommended changes for the 2013-2014 salary schedules easily.

The following is a summary of proposed changes:

- District Level Supplemental Duty – Page 10
  - Added an Academic Challenge Coordinator at the District Level to be paid for with 2020 allocation.
- Parameters for Stipend Pay – Page 17
  - Clarifying language related to less than 12 month administrators and stipend pay eligibility.
- FRYSC Salary Schedule – Page 21
  - Changed work calendar from 250 to 240 days.
- Classified Pay Increases for Education and Experience – Page 26-28
  - Clarifying language for experience credit for retirees.
  - Clarifying language for when pay increases will be granted for degrees, certification and licenses upgrades.

701 East Main Street, Lexington, Kentucky 40502 • Phone: 859.381.4100 • www.fcps.net

Appendix B - Memorandum Regarding Changes To The 2013-2014 Administrative Hay Schedule (Continued)

It's about kids.

FAYETTE COUNTY PUBLIC SCHOOLS

Draft Working Document

- Added additional certifications recognized for pay increases for Law Enforcement Personnel

The Tentative Budget scheduled to be approved on May 20, 2013, includes the 1.5% step up for experience and a 1% salary increase for both classified and certified employees.

If you have any questions, please let me know 381-4109.

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Appendix B - Memorandum Regarding Changes To The 2013-2014 Administrative Hay Schedule (Continued)

FAYETTE COUNTY PUBLIC SCHOOLS

ADMINISTRATIVE ADDITIVE SCHEDULE FOR ADMINISTRATIVE PERSONNEL

Approved: May 21, 2012 **Effective: July 1, 2012**

Pay Grade	Administrative Additive*
01	229
02	1,513
03	3,009
04	4,623
05	6,415
06	7,960
07	10,772
08	13,278
09	16,143
10	19,485
11	23,427
12	27,934
13	33,071
14	36,726

Effective with the 1990-91 school year, the following Longevity Increments* are incorporated into the administrative additive structure in recognition of years of experience in administrative service.

Administrative Service	Annual Amount
5 Years	$250
10 Years	$500
15 Years	$750
20 Years	$1,000
25 Years	$1,250

*Effective June 30, 2006, all components of administrative salaries, including base pay from the Teacher Salary Schedule, extended employment, Administrative Additive, and Longevity Increment will be subject to the same increases as those applied to the teacher salary schedule. Placement on the Teacher Salary Schedule based on rank and experience, extended employment, appropriate Administrative Additives, and Longevity Increments as listed in the tables above will be utilized as the starting salary for administrative and supervisory positions.

When adjusting employee additives up or down the hay and longevity schedules will be used as a baseline guide in determining the amount of the adjustment.

Appendix B - Memorandum Regarding Changes To The 2013-2014 Administrative Hay Schedule (Continued)

FAYETTE COUNTY PUBLIC SCHOOLS

ADMINISTRATIVE ADDITIVE SCHEDULE FOR ADMINISTRATIVE PERSONNEL

Approved: May 20, 2013 **Effective: July 1, 2013**

Pay Grade	Administrative Additive*
01	229
02	1,513
03	3,009
04	4,623
05	6,415
06	7,960
07	10,772
08	13,278
09	16,143
10	19,485
11	23,427
12	27,934
13	33,071
14	36,726
15	40,766
16	44,842
17	48,872
18	53,277
19	58,072
20	63,299

Effective with the 1990-91 school year, the following Longevity Increments* are incorporated into the administrative additive structure in recognition of years of experience in administrative service.

Administrative Service	Annual Amount
5 Years	$250
10 Years	$500
15 Years	$750
20 Years	$1,000
25 Years	$1,250

*Effective June 30, 2006, all components of administrative salaries, including base pay from the Teacher Salary Schedule, extended employment, Administrative Additive, and Longevity Increment will be subject to the same increases as those applied to the teacher salary schedule. Placement on the Teacher Salary Schedule based on rank and experience, extended employment, appropriate Administrative Additives, and Longevity Increments as listed in the tables above will be utilized as the starting salary for administrative and supervisory positions.

When adjusting employee additives up or down the hay and longevity schedules will be used as a baseline guide in determining the amount of the adjustment.

Source: FCPS 2013-2014 Salary Schedule presented to the Board.

Appendix C- IAKSS Staff Receiving A Salary Of More Than $100,000 Per Year As Of 2014

Title	F2010	F2011	F2012	F2013	F2014	Average Annual Raise	2010 to 2014 % Change
1 SCHOOL DISTRICT SUPERINTENDENT [2]	$ 232,338	$ 244,230	$ 329,300	$ 272,048	$ 278,273	6.21%	19.77%
2 CHIEF ACADEMIC OFFICER [1]	-	-	-	-	165,246		
3 CHIEF OPERATING OFFICER	120,392	127,394	144,859	142,179	156,206	6.89%	29.75%
4 DIR SCH IMPRVMENT & INNOVATION	106,554	114,076	121,219	128,307	129,775	5.08%	21.79%
5 DIR SCH IMPRVMENT & INNOVATION	107,124	113,643	120,937	128,019	129,300	4.84%	20.70%
6 DIR SCH IMPRVMENT & INNOVATION	106,414	112,979	120,725	124,816	129,144	4.97%	21.36%
7 DIR SCH IMPRVMENT & INNOVATION	103,152	110,293	117,559	127,561	129,055	5.80%	25.11%
8 DIR OF DISTRICT PERSONNEL-HR	100,446	109,249	116,900	124,094	125,501	5.76%	24.94%
9 CHIEF - COMM/SBDM/GOVT SUPT	89,370	96,840	105,174	111,886	124,797	8.72%	39.64%
10 DIRECTOR OF EXCEPTIONAL CHILD	101,349	108,229	115,631	122,607	123,833	5.17%	22.18%
11 DIR SCH IMPRVMENT & INNOVATION	98,658	105,172	109,135	115,214	121,158	5.28%	22.81%
12 MANAGER - FINANCIAL SYSTEMS	94,714	102,881	109,830	116,650	117,797	5.64%	24.37%
13 CHIEF ADMINISTRATION OFFICER [1]	-	-	-	-	116,458		
14 ASSOC DIR FED STATE MAGNET PRG	81,540	97,457	102,638	103,237	115,343	9.29%	41.46%
15 DIRECTOR - TECHNOLOGY	92,165	99,706	107,571	111,128	115,119	5.74%	24.91%
16 INSTRUCTIONAL COORDINATOR	92,718	99,223	106,673	113,919	115,054	5.58%	24.09%
17 INSTRUCTIONAL COORDINATOR	92,875	99,620	106,619	113,415	114,799	5.47%	23.61%
18 DIRECTOR OF PUPIL PERSONNEL	92,952	99,447	106,630	110,264	114,447	5.35%	23.12%
19 ATTENDANCE ANALYST	93,451	99,570	106,350	113,141	114,272	5.19%	22.28%
20 DIR CURRICULUM & ASSESSMENT	82,318	89,627	93,144	99,035	113,617	8.46%	38.02%
21 EXCEPTIONAL CHILD COORDINATOR [3]	88,365	94,483	57,271	106,288	113,111	14.89%	28.00%
22 INSTRUCTIONAL COORDINATOR	89,009	95,712	104,771	108,349	111,138	5.75%	24.86%
23 SUPV - SYSTEMS INTEGRATION	87,293	93,979	101,521	108,195	109,278	5.82%	25.19%
24 ASSOC DIR COM REL CUST SERV	86,610	97,828	101,082	107,921	109,001	6.01%	25.85%
25 OTHER CENTRAL OFFICE POSITIONS	87,397	95,369	100,498	104,215	108,395	5.55%	24.03%
26 SCHOOL PSYCHOLOGIST	88,640	95,546	101,758	105,230	107,754	5.03%	21.56%
27 ASSC DIR HR TCH LEAD EFFCTVNSS	87,730	96,073	99,759	105,253	107,736	5.30%	22.80%
28 EXCEPTIONAL CHILD COORDINATOR	85,182	95,700	99,190	105,052	107,610	6.09%	26.33%
29 DIRECTOR - BUDGET AND STAFFING	82,021	89,374	97,530	103,212	105,605	6.56%	28.75%
30 DIRECTOR - FINANCIAL SERVICES	90,622	95,929	99,662	102,868	105,163	3.80%	16.05%
31 ASSC DIR HR TCH LEAD EFFCTVNSS	86,951	95,084	100,896	107,246	104,752	4.86%	20.47%
32 EXCEPTIONAL CHILD COORDINATOR [1]	-	-	-	100,528	104,634	4.08%	
33 PAYROLL ACCOUNTING MANAGER	78,912	87,151	94,388	100,919	104,179	7.22%	32.02%
34 DIR SCH IMPRVMENT & INNOVATION	94,140	110,882	116,550	120,339	103,166	2.97%	9.59%
35 ASSOC DIRECTOR STDT SUPPORT	98,801	105,120	112,250	127,667	100,945	1.50%	2.17%
36 INSTRUCTIONAL SUPPORT SPEC	72,435	84,894	92,837	99,337	100,332	8.64%	38.51%
Total	**$ 3,192,638**	**$ 3,462,760**	**$ 3,720,857**	**$ 3,990,139**	**$ 4,351,993**		
						Average % Change Per Position	24.73%

1 *New Positions*

2 *In F2012, both the outgoing and incoming Superintendent received compensation.*

3 *In F2012, the outgoing employee did not work the entire year.*

Source: Salary Data Provided by FCPS

FAYETTE COUNTY PUBLIC SCHOOL'S MANAGEMENT RESPONSE

It's about kids.
FAYETTE COUNTY PUBLIC SCHOOLS

September 15, 2014

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

RE: Examination of Certain Policies, Procedures, and Financial Activity of the Fayette County Public Schools

Dear Mr. Edelen:

On behalf of the Fayette County Public Schools, I would like to express our appreciation to the Auditor of Public Accounts for accepting our invitation and completing an extensive review of our district's budgeting and finance processes.

First and foremost, I want to underscore the fact that the state auditor's office has confirmed there is no money missing in the Fayette County Public Schools and there is no evidence of criminal activity. It is vital for our community to hear that all public dollars are accounted for and that the allegations of improper journal entries causing a budget shortfall are not true.

That said, as Superintendent I know many tough decisions lie ahead. I am deeply troubled by many of the findings contained in the auditor's report and I assure our employees, families, and community-at-large that our leadership team will not allow adult issues at the district office to distract from our core mission of serving children.

Early in my tenure, I recognized that despite previous attempts to address the issues, significant areas of dysfunction resulting from a serious lack of communication and professionalism continued to exist between the Department of Budget and Staffing and the Department of Finance. Many of the findings and recommendations included in the Auditor of Public Accounts' examination are the very same action items our leadership team had already begun targeting.

In an effort to bring best practices and an outside perspective to the situation, we applied for and received a grant to streamline our budget and staffing practices and open up our budget processes to provide greater public involvement and transparency. Those efforts may have upset and threatened some employees who feared what change would mean to their positions.

The state auditor's recommendations highlight the fact that we must overhaul the operations of our budget and finance departments. We are committed to taking swift corrective action to restructure our approach to every aspect of financial accounting.

On Wednesday I will make public the immediate steps we will take to address the findings and recommendations in this report. We are compelled to strengthen, formalize, and communicate improved policies, procedures, practices and methodologies related to budgeting, internal auditing, salary determinations, travel, and procurement in order to shore up our budget, finance and accounting infrastructure.

While we are grateful for the constructive criticism and actionable recommendations, we must point out that we disagree with portions of some of the findings. The language in the report seemingly vilifies one employee while minimizing the impact of the mistakes of others. We also note possible misinterpretation and mischaracterization of certain events and actions, despite the fact that material evidence was provided to show otherwise.

Portions of this review amount to little more than "he-said-she-said." Throughout the report, allegations received from one party are outlined, with scant attention to documentation proving the allegations false. In many instances, there is no closure given to show whether the allegations were founded or not.

We also take issue with the language used in this report to characterize the financial stability of the Fayette County Public Schools. As we shared throughout the budget process last spring, our district had been relying on a healthy fund balance to weather the recession and, as the fund balance became depleted, we had to make budget reductions to reverse the trend and begin living within our means.

We completely agree with the auditor's findings that we must improve our budget and finance policies and management, and we concur that the relationship between the Department of Budget and Staffing and the Department of Finance was toxic. However, we vehemently disagree that the deficiencies in our system put the district's financial situation in jeopardy or impacted our ability to provide an excellent education for the students of our community.

We are committed to assimilating these recommendations to quickly adopt, review, and/or revise our policies and practices and to communicate clear compliance expectations across the district. These findings provide us with a platform from which we can move forward the efforts we began in 2013-14 to improve short- and long-range financial planning and reporting. We have already started the work of improving communications processes to better inform the board and the larger community about every aspect of financial planning and programming from budget development through the annual audit and beyond.

In the Fayette County Public Schools, every action we take and every decision we make must be centered on doing what is best for the students we serve. Accomplishing this mission will require a profound shift in the behaviors, habits and culture in our district's central office. We cannot and will not allow personality conflicts to keep us from doing what is right.

Robert Kennedy once noted, "Progress is a nice word. But change is its motivator. And change has its enemies." We know that our district must make substantive changes in order to respond to the shortcomings in current operations. We will need the commitment of our entire team, from the board room to the classroom, to embrace these changes and make progress.

Management Response to Finding 1:

When we first asked the Auditor of Public Accounts to come in and review the timing of the journal entry in question we were confident that there were no issues with the timing or accuracy of the action. We are thankful for the assurance from this report that there is no money missing and that the need to reduce our budget was not the result of an accounting error. We also appreciate the conclusion that "the timing of the journal entry in relation to financial statement reporting was not a concern."

Revamping the budgeting process and developing controls to include a strategic financial plan is already underway. We expect this to result in completely redesigned budgeting and financial accounting processes and the development of a sound and viable short- and long-range finance plan. Our work will also include communications efforts intended to help all stakeholders have a better picture of the district's budget, including a new, consumer-friendly format for our budget documents.

We feel compelled to note that our leadership team was actively trying to change current budgeting practices over the past year. This added scrutiny uncovered many of the same findings the auditor found in this review, including budget figures that were changed without board or superintendent knowledge, "plug figures" being used to make budgets appear to balance and improper financial reports being used in the development of the budget.

Language in the audit report widely blames "district personnel" for concealing information from the board by "intentionally misrepresenting the total General Fund expenditures in the 2013-14 Working Budget." We want to clarify that the superintendent, chief operating officer and finance director reported to auditors that they had uncovered these errors late in the spring of 2014 and were not involved in the decision to arbitrarily change numbers to make the budget appear balanced.

We agree that the deteriorating working relationships between the Department of Budget and Staffing and the Department of Financial Services and resulting lack of communication *exacerbated the situation, but we do want to note that in our existing organization there was a clear delineation of duties that segregated the budget and finance functions.*

In the findings, auditors note that the beginning balance figure used in the development of the 2011 working budget was taken from the AFR balance sheet, prepared each year by the finance department for the Kentucky Department of Education on July 25. They further note that best practice suggests adjustments like the one made by the finance director should be complete prior to that submission. We wish to point out that the best practice referred to was established in the fall of 2011 in relation to the adoption of new accounting procedures, after the report in question.

Effective working relationships are crucial in order for an organization to operate at maximum efficiency. Information must be shared fully and widely in order for everyone to have a full picture of the district's budget and finances to guide decision-making. Communication will be key in strengthening our processes and procedures.

We will work deliberately to complete our evaluation and redesign of district budgeting, finance and accounting processes. British scientist Mary Douglas noted, "If you want to change the culture, you will have to start by changing the organization." In that spirit we will take bold action.

Management Response to Finding 2:

In the Fayette County Public Schools, we strive to ensure we deliver superior customer service that values and respects everyone – every day and in every way. The basic tenets of value and respect are at the heart of our customer service initiative and it is troubling to concede that the environment in our district office between our budget and finance departments had devolved to a level that impacted working conditions and employee performance.

The findings and recommendations in this review will provide us with further leverage to completely reorganize and restructure our entire budget, staffing and finance system. We completely agree that the interpersonal relationships involved in this situation were toxic and must be addressed.

We must, however, correct the assertion that the fiscal situation in FCPS was ever "dire." It is true that we had made strategic spending decisions to reduce our fund balance and invest more money in our schools and classrooms. At no time has our district been unable to provide for the educational needs of our students. Even as our fund balance has grown smaller, it is still well above the state required 2 percent contingency and provides assurance of a strong financial position.

We understand that the auditors conducted extensive interviews during the review process and we are thankful for the time they took to conduct a thorough investigation. The allegations contained in this report are very troubling and our district will investigate each of them. It is of concern, however, that the allegations are outlined without a final conclusion about whether they were founded. To date, no complaints or grievances have ever been filed regarding the director of financial services. Leaders must at times make unpopular decisions and we question whether interviews were conducted only with one segment of employees, without providing an opportunity to counterbalance opinion or speculation.

As an organization, we are committed to developing a culture that encourages open dialogue, embraces differences, and enables employees and students to succeed. We will investigate all of the allegations and findings in this report and take appropriate action to correct any and all improprieties.

Management Response to Finding 3:

We agree with the recommendations of instituting clear procedures for changes to the salary schedule and setting explicit expectations about administrative additives. In addition to expediting the finalization of the classification and compensation study, we will recommend to the Board that we expand the compensation study to review and validate the administrative salary schedule as compared to comparable districts.

However, we disagree with the interpretation and innuendo in the rest of this finding and must note that the conclusions drawn are based on an inaccurate salary analysis and an incomplete understanding of the Fayette County Public Schools salary schedule.

Salaries in Fayette County are based upon education and experience. All certified and classified salaried employees are paid off of the base teacher pay scale. As employees earn additional years of service or educational credentials, they advance through the salary grid. The increase for each year of service varies from 1.5 percent to 6 percent, with an average annual increase of 2.4 percent. For every additional year an employee works for the school district, he or she automatically receives an average raise of roughly 2.4 percent, even if the school board does not approve a raise.

Incremental increases are also awarded to employees for earning advanced degrees. For example, a first-year teacher who holds a master's degree would earn 6 percent more than a first-year teacher with a bachelor's degree. The raise for certification beyond a master's degree is another 6 percent and a doctoral degree is an additional 6 percent.

When the school board approves a salary increase, the corresponding pay for each level of experience and education is raised by the percent approved. The actual resulting pay increase *then would be different for every employee depending on that employee's years of experience and educational attainment.*

For example, all employees in FCPS received the state-mandated 1percent salary increase this year. For a teacher with a master's degree moving up to 5 years of experience this year, the actual net increase would be 4 percent. For a teacher who just finished a master's degree moving up to 5 years of experience this year, the actual net increase would be 9.8 percent.

Auditors used the salaries of 36 district-level employees to conclude that central office administrators received exorbitant raises that outpaced other employees. Their reasoning is flawed because they did not consider why the salaries of the members of the group identified had changed, nor did they analyze the actual salaries earned by other employees to compare average percent change in pay for the rest of the district.

In several instances, auditors compared the salaries of different employees with the same title over the course of the five year period in question. Since salary is specific to the experience and education of the employee and not to the position, this is an invalid comparison. In one case, an employee's salary appeared to increase quickly, but it was because he had worked only a partial year the year prior. Other employees received pay increases because they changed jobs within the organization or completed advanced degrees that consequently led to increased pay.

Most disturbing is the mischaracterization of differential treatment between district office and school level employees. The audit is written in a way that minimizes the raises given to teachers in our school district, when in fact nothing could be further from the truth. Members of the Fayette County Board of Education have made a concerted effort to invest in boosting teacher salaries over the past decade. While employees in most school districts across Kentucky went for years without a salary increase, teacher salaries in Fayette County have risen dramatically. A starting teacher salary in FCPS was $30,000 in 2004. When compared with $41,186 in 2014, that represents a 37.3% increase.

Management Response to Finding 4:

We embrace the recommendations in this finding, and in response will shore up board policies related to budget transfers, examine and evaluate the benefit of existing vendor services and reinforce strict adherence to procurement guidelines.

We appreciate the auditor's confirmation that the referenced contract does not constitute a conflict of interest on the part of the superintendent. A preliminary assessment of the effectiveness of the services yielded positive feedback from participating schools and we dispute dissenting information presented in the report.

The need for transparency in fund transfers is evident, but we want to be clear that there was no intent to circumvent controls in this situation. In this case, the movement was between spending codes within the Superintendent's budget and did not represent a shift in budget priorities. Moving money from the superintendent's budget into another department would be a true budget transfer; spending from within the same department should not have warranted board approval. Nonetheless, we will comply with revised budgeting and procurement processes as recommended by the auditor's report and all contracts over $20,000 will be formalized and presented for Board approval.

Management Response to Finding 5:

We agree with the auditors that the district should examine the policies, procedures, accounting, governance and charters related to all of the trust funds under FCPS control. We agree that members of the Fayette County Board of Education should be added to each trust fund committee and that additional oversight is warranted and will investigate options to move fiscal agency for the trust to a more appropriate party. We also agree that information about these funds should be made widely available to everyone.

We do, however, want to point out that the auditors received documents showing that 30 employees had received loans totaling more than $140,000 from the Stoner Fund since 2007. Recipients included four employees who work in the Department of Financial Services, and their total loans amounted to $1,800, which draws into question the accuracy of the auditor's statement that a "significant portion of loans were being made to financial services staff."

Management Response to Finding 6:

Professional development for our teachers, administrators and operational staff is vital to ensure that our students have the benefit of the most current and cutting edge instructional practices and our district is managed efficiently and effectively. As laws change and technology advances, it is critical that our employees have current knowledge and skills.

We agree with the auditor that all professional travel must be reasonable, allowable and allocable. Substantive changes were made to the district's "Professional Leave and Travel Policy Handbook" in the spring of 2013 to strengthen our procedures and establish consistent guidelines. In light of some of the questions raised by the auditor's findings, we will again review our handbook to further improve our current practice. We will also look for ways to add additional safeguards and accountability and carefully review all related documentation in order to ensure that every IAKSS department fully complies with all board travel policies and procedures.

While we agree with the recommendations suggested in the audit, we want to note that many of the audit findings incorrectly target one department.

For instance, travel by 10 employees to the same conference in 2011 and by 12 employees to the same conference in 2012 was attributed to financial services. The timing of professional development requests to the board was questioned and an allegation was made that this was a deliberate attempt to hide information from the board. In fact, the employees attending these conferences were from three different departments and each department submitted its travel requests at different times.

Our current travel guidelines state that "occurrences of multiple employees attending the same activity (workshop, seminar) are discouraged unless it is necessary for efficiency and effectiveness to maximize training opportunities." We agree that this procedure could be strengthened by adding additional accountability steps or requiring approval of a written justification. In this case, the conference offers specific and concurrent "tracks" that are individualized according to work duties. Each individual in attendance received a unique set of trainings and workshops.

In another case, auditors question financial services employees staying over after a conference had ended. While it is completely appropriate to question such practices, auditors did not note that this is allowable under current travel guidelines if the conference ends later than the hotel check out time. To allege that one department is abusing travel when guidelines are being followed is unfair.

Another question raised by the auditors related to certifications earned at the Gatton College of Business and Economics. It is correct that the district has paid for multiple employees to take the certified school financial officer (CSFO) and the certified school financial manager (CSFM) training as part of their professional development. However, these employees are not solely from the department of financial services as the report alleges. Employees in the department of budget and staffing, department of human resources and department of technology have also completed these certifications at district expense.

The review goes on to suggest that the only reason people may have pursued these certifications is to receive the $2,000 benefit the district pays for this type of advanced credentials. However, of the six staff members with CSFO certification and the 11 with CSFM certification, only five receive the $2,000 additive, and again they represent four different departments.

The report goes on to compare the training being offered to IAKSS employees in contrast to the benefits given to school employees. We would like to note that in addition to the certifications mentioned in the review, our district also supports employee attendance at executive business management and leadership excellence offerings at the Gatton School. More than half of the 44 support employees who have earned those certifications work out in our schools.

We concur with the audit recommendation that we should develop a policy strictly identifying the type of certifications the district will pay for, but we reject the notion that we are not providing comparable opportunities for school level employees.

Management Response to Finding 7:

Above all, our public schools must earn and keep the community's trust. We concur with the recommendations and will launch a thorough review of our business practices, relationships with vendors and procurement activity to eschew any conflicts of interest.

We recognize the importance of adopting an appropriate policy to codify our commitment to being good stewards of taxpayer dollars and setting clear expectations for ethical conduct. We are in the process of developing an employee code of conduct with the help of UpSlope Solutions, and expect the new manual to be in place for the next school year. Rollout of the new code of conduct will include training for employees.

We are committed to ensuring that all FCPS schools and departments fully comply with Board conflict of interest policies and procedures. The auditor's review questioned benefits received from a community bank. It should be noted that documentation from the community bank showed that the benefit to each employee involved was less than the $25 gift threshold set in state law and Fayette County Board of Education policy.

Management Response to Finding 8:

An informed and engaged community is critical to ensuring the success of our students, schools and district. Our families, employees and board of education members must be equipped with the information they need to evaluate how we are stewarding the public's money.

As school leaders, we are excited and energized by the level of public engagement we saw in this year's budget development. We know it reflects the community's deep passion for education, and the partnership we can count on to help us do our jobs right.

My team and I are unwavering in that commitment, and to fostering the openness and responsiveness it takes to make it a reality. We agree that past budget communications, finance statements and monthly updates have been insufficient for effective school board oversight and public involvement and are already engaging in a process to improve communications related to budget and finance with the Board and the larger community.

Management Response to Finding 9:

We certainly agree with the need to develop formal policies regarding nepotism and allowable reasons to use district funds for professional memberships. We also welcome the suggested recommendations to strengthen our purchasing and accounting procedures.

At the same time, there are several insinuations in the findings that we must refute:

- *Related to questions of nepotism, the referenced finance director was promoted to his current position in 2006. At the time, both he and his wife were already employed in the finance department, but in different divisions with distinct reporting structures. Prior to applying for the director's position, the employee sought and received legal guidance from the district's legal counsel at the time. The board's attorney advised that the state nepotism statute was not applicable to his situation. Upon his promotion, an alternate reporting structure was developed by the attorney to be implemented in case of any personnel issues.*
- *Regarding the 10 memberships to the local civic organization, we would like to note that these memberships of just $50 each give our district employees access to training and professional opportunities at no additional cost. Members in the organization in turn provide mentoring and scholarships to FCPS students. Our travel handbook states that membership dues that lead to a reduced rate for training events are an allowable expense provided membership meets identified district needs and provides a reasonable educational/business benefit for the district.*
- *In reference to the auditor's opinion that travel related to increasing the participation of minority- and women-owned businesses was not justified, we would like to note that these expenses covered the attendance of FCPS representatives to the National Minority Supplier Development Conference. During these conferences, FCPS rents a booth in order to recruit, interact with and educate prospective vendors. As a result of such outreach and networking, FCPS experienced an unprecedented increase in our spending with minority- and women-owned businesses from $69,000 in 2010 to $954,000 in 2013 – a nearly 1,300 percent increase! We would also like to note that the audit review targeted only the trips involving one employee, but not other trips to the same conference in other years involving different employees.*
- *As for the provision of insurance for student athletes, it is certainly within the auditor's prerogative to raise questions of judgment regarding district spending decisions. We are very sensitive to and aware of this issue as it has been the topic of much discussion with families, school board members and athletic staff. We want to be certain that people understand the benefit of this insurance. It is accurate that since the Affordable Care Act the number of uninsured families in the Commonwealth has fallen drastically. However, this is secondary insurance. For a relatively minimal annual investment, families receive full reimbursement for any out-of-pocket costs related to a sports injury, including copays and coinsurance. Our sincere wish is that no student athlete ever need this*

coverage, but those who have been injured in the past have expressed gratitude for the additional financial assistance it provides.

Management Response to Finding 10:

Winning back the trust of our constituents will require swift and bold action. The very real questions, concerns and accusations that surfaced during our budget conversations last spring and continued throughout the audit process were voiced by people who care deeply about the future of FCPS and the services we provide to students. We do not doubt the sincerity with which these allegations were shared and we are sensitive to the fears expressed by those who spoke out.

We fully agree that we must strengthen our internal audit functions. We will immediately work to provide a way for people to report suspected waste, fraud or abuse that ensures anonymity and a thorough investigation. Our leadership team completed extensive research last spring on four nationally-benchmarked whistle blower/ fraud protection programs. We will select a vendor and implement these changes swiftly.

Changing the culture and climate in our district will require both structural and behavioral change. We are committed to creating an environment where people feel comfortable sharing concerns, suggestions and ideas, knowing that they will be embraced in the spirit of continuous improvement and shared accountability.

In conclusion, I want to again thank the Auditor of Public Accounts for first reassuring our community that there is no money missing and nothing illegal took place, and second, for helping lay the roadmap for the changes needed to overhaul our budget and finance operations.

There is nothing in this report that we cannot address and improve. Every business organization can find ways to work smarter and more efficiently. These report findings provide the leverage we need to make the immediate and substantive structural changes necessary to safeguard the fiscal future of our school district.

We will endeavor to rebuild trust and public confidence by doing what is best for kids, being responsible stewards of tax dollars and providing honest, proactive, consistent and responsive communication. Over the next 60 days, our top administrative priority will be to embrace these recommendations and to develop a comprehensive corrective action plan for the Board's consideration.

While the challenges ahead are considerable, we must not let these issues distract us from our core mission and daily work. My team and I are unwavering in our commitment to foster the openness, responsiveness and transparency it will take to establish a sound fiscal infrastructure to support our efforts toward creating a collaborative community that ensures all students achieve at high levels and graduate prepared to excel in a global society.

Sincerely,

Tom Shelton

Tom Shelton, Superintendent

AUDITOR'S REPLY TO FAYETTE COUNTY PUBLIC SCHOOLS MANAGEMENT RESPONSE

We have reviewed and considered all the information provided by FCPS in its response. FCPS management is inaccurate in its response statement that the need to reduce the district's budget was not the result of an accounting error. The examination found that the journal entry did have an impact on the FY 2011-2012 budget because the impact of the journal entry was not reflected in the working budget's beginning balance. Because of this error, the adopted working budget was not balanced because once the effect of the journal entry is taken into consideration the estimated expenditures exceeded the revenues.

Findings in the report are fact-based and objective, with no finding based solely on the allegations or interpretations of a single individual. If findings focused on one area or person more than another, it was because that is where the facts led. Auditors took into consideration all evidence provided, and derived conclusions based on the fact pattern evident in that information.

One troubling response by FCPS management related to Finding 1, states that "the superintendent, chief operating officer, and finance director reported to auditors that they had uncovered these errors late in the spring of 2014 and were not involved in the decision to arbitrarily change numbers to make the budget appear balanced". Auditors were provided evidence that the budget director informed management during the 2014-2015 budget preparation process that the 2013-2014 working budget did not balance and that the superintendent suggested she "fix the 12-13 actual to flow…" While these instructions could be open to interpretation, the management team has the collective responsibility to participate in the budget process, establishing policies and procedures to ensure that vital budget and financial information is complete, accurate, and transparent and provides proper oversight. It is a highly unusual and questionable practice for management to abdicate sole responsibility for the budget of such a large entity to a single person. However, FCPS's response seems to be indicating that is the case. It is concerning that those in the director's chain of command express a lack of responsibility for the procedural failures noted in the examination.

The salary analyses presented in Finding 3 are accurate based on information the district provided to auditors. The district informed auditors that the data requested to perform a more detailed analysis was unavailable. This limitation restricted the auditor's ability to look at a broad level of detail, and therefore audit procedures were performed for the population of employees specifically identified in the allegation regarding salary increases provided for the district's top administrative staff. The suggestion that the education and experience levels of administrators who are receiving sizeable percentage increases far exceed those of faculty is questionable without supporting documentation. The auditor's analysis was not a comprehensive salary study, but an analysis of whether percentage increases were equitable, transparent, and appropriately approved. In additions, auditors question the justification of higher percentage increases for administrators based on a higher number of work days. Auditors recognize that most faculty work a significant number of hours outside the scheduled school days. It is important to note that all of these concerns were examined in the context of allegations that employee raises are being given to select employees during a time when budget cuts are being mandated.

In Finding 9, auditors acknowledge that nepotism is sometimes unavoidable. However, the finding expresses concerns related to fraud risk and internal control weaknesses due to the director's statement that he is unaware of his spouse's role, which is a key financial services function.

Based on documentation and other information provided to auditors during the examination, this report fairly represents the deficiencies found during the examination period. While management expressed certain reservations, overall it appears that FCPS management accepts the majority of our recommendations. We encourage FCPS to work diligently to implement the report recommendations to ensure findings identified will not occur in the future.