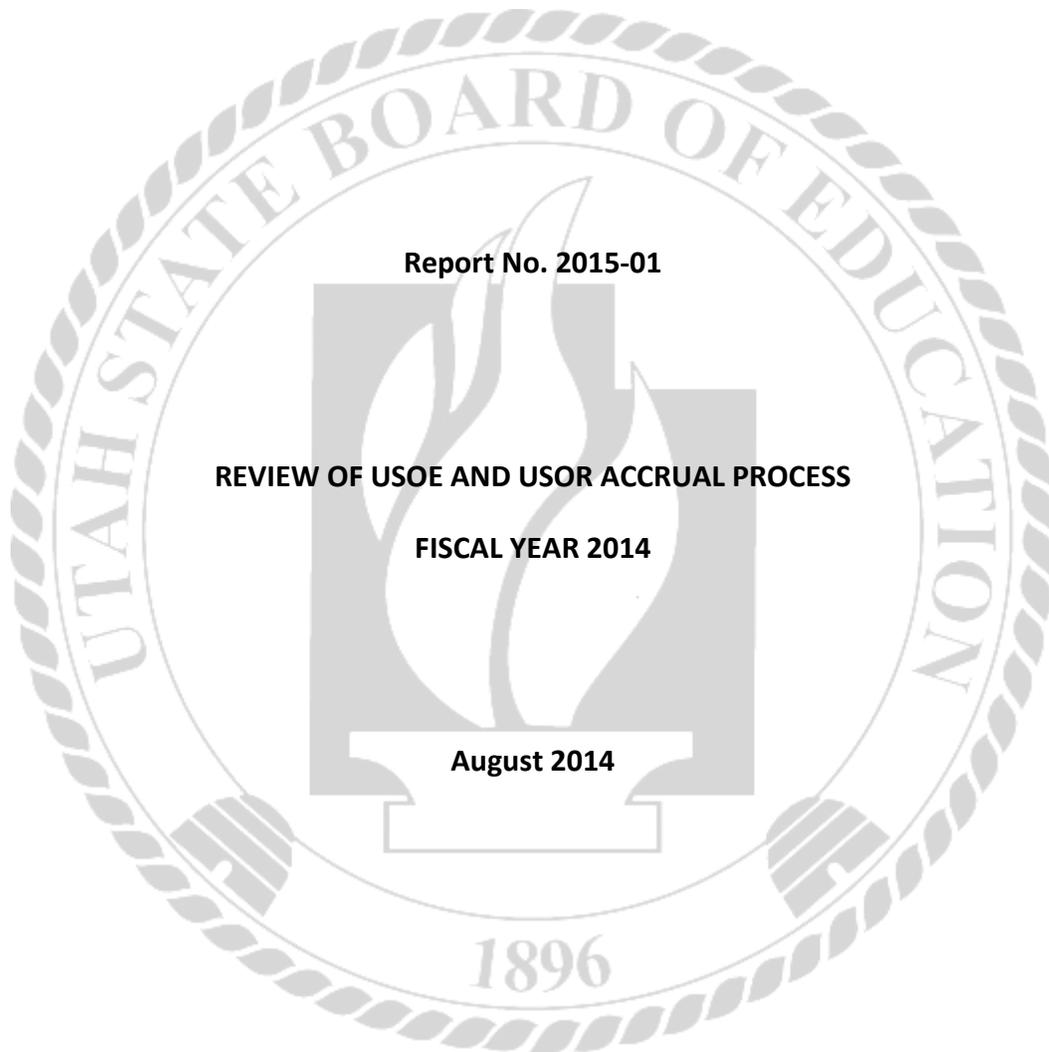


**REPORT TO THE
UTAH STATE BOARD OF EDUCATION**



**Audit performed by:
Utah State Board of Education's Internal Auditors and
Utah State Office of Rehabilitation Internal Auditor**

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Report 2015-01

August 8, 2014

Utah State Board of Education
250 East 500 South
Salt Lake City, Utah 84114

Dear Board Members:

State agencies are required each fiscal year, as part of the financial close process, to determine the proper amount of any accruals that should be booked in the state's financial system for proper reporting in the state's comprehensive annual financial report (CAFR). State Finance accounting policy 0700.00 defines proper revenue recognition criteria for the state and establishes guidelines for these accruals. Accruals, which are estimates, are adjustments for 1) revenues that have been earned but are not yet recorded, and 2) expenses that have been incurred but are not yet recorded. The accruals need to be added via adjusting entries so that the financial statements are fairly stated. State Finance policy indicates that federal revenues are considered "available" if monies are received or expected to be received within 12 months of the fiscal year end.

In the case of the Utah State Office of Education (USOE), an accrual is booked that estimates the amount of expenditures incurred by LEAs for federal grants in the old fiscal year that were not submitted to the USOE for recording and reimbursement until the new fiscal year. This results in both an accounts payable/expenditure and an accounts receivable/revenue accrual which is booked in the education fund at year end by State Finance. This accrual also complies with all recognition requirements outlined in Governmental Accounting Standards Board (GASB) 33.

The Utah State Office of Rehabilitation (USOR) does not currently book an accrual related to client services. However, it does appear that clients are incurring expenditures against federal grants in the old year, which are not submitted for payment or reimbursement until the new fiscal year.

As part of the annual audit plan, Internal Audit performed a review of the accrual process and calculation for USOE and USOR. Auditing standards require evaluation of the following pertaining to the determination and valuation of significant estimates and audit steps were performed as follows:

1. Evaluate policies, procedures, and internal controls over the determination and calculation of material estimates;
2. Identify the requirements of the applicable financial reporting framework;

3. Identify the transactions, events, and conditions that may give rise to the need for accounting estimates;
4. Outline the accounting estimation process and the data on which the estimate is based, including:
 - a. The method used to make the accounting estimate;
 - b. Relevant internal controls (see also 5. below);
 - c. Whether management has used a specialist;
 - d. The assumptions underlying the accounting estimate;
 - e. Whether there has been or ought to have been a change from the prior period in the method or assumptions used and why;
 - f. Whether and, if so, management has assessed the effect of estimation uncertainty (i.e. uncertainty surrounding the assumptions and factors used in the calculating an estimate).
5. Evaluate management's consideration of the experience and competence of those making the accounting estimates and internal controls related to:
 - a. The determination of the completeness, relevance, accuracy, of the data used to develop accounting estimates;
 - b. The review and approval of accounting estimates, including the assumptions or inputs used in their development, by appropriate levels of management, and when appropriate, those charged with governance;
 - c. The segregation of duties between those committing the entity to the underlying transactions and those responsible for making the accounting estimates.

USOE Accrual Calculation

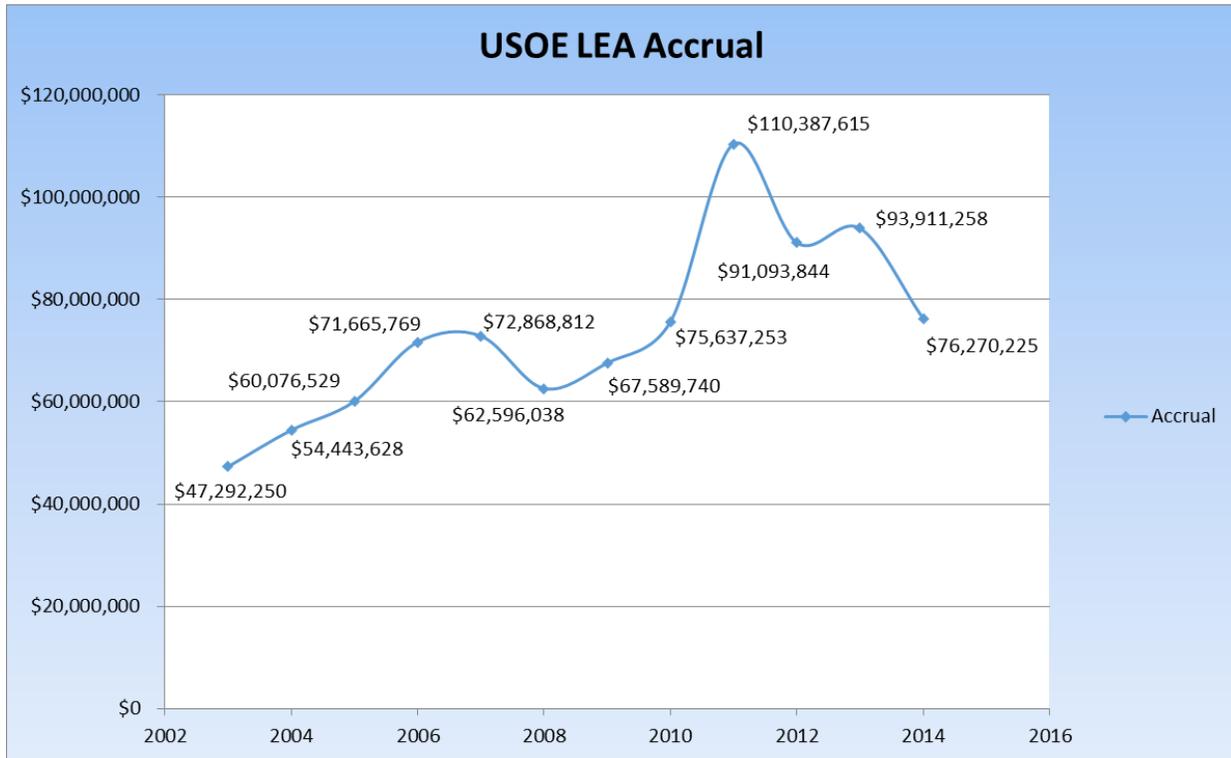
Each year, the USOE Internal Accounting division estimates an accrual for reimbursement requests from LEAs for federal funds in compliance with GASB 33. This estimate is calculated using data from the previous fiscal year's Annual Financial Reports (AFR) for each LEA. A percentage of total LEA federal receivables to total LEA federal revenues is calculated using this AFR data. The calculated percentage is then applied to total federal expenditures made by LEAs for the previous fiscal year. Expenditures are used because they are only booked in FINET when a draw request is processed and paid to LEAs. Prior year fiscal data is used because it is the most recent data point available.

We reviewed the accrual calculated by the USOE Internal Accounting division and calculated our own estimate of the accrual. With the exception of a data issue, identified in **Finding 2**, we did not note any other issues with the accrual calculation spreadsheet. The theory applied to the accrual calculation appeared consistent with prior years. An allowance for doubtful accounts is not considered necessary as collection of grant funds from the federal government is considered assured.

We expected the accrual estimate to decrease in fiscal year 2014 due to sequestration, which reduced federal funds by approximately 5%, the fact that many LEAs have fully implemented their new accounting systems and are submitting reimbursement requests in a timely manner,

and that all but two small ARRA grants have been fully expended and are no longer increasing Federal revenues in the State.

The accrual calculation for fiscal year 2014 is \$76,270,225, which is a decrease of \$17,641,033 from prior year. However, this decrease appears reasonable and is in line with pre-ARRA funding levels in 2009 and 2010 (see table below).



USOR Client Services Accrual Calculation

Presently, a fiscal year-end accrual is not calculated or submitted by USOR or the USOE Internal Accounting division. As required by State Finance policy, the USOE Internal Accounting division for USOR currently tracks accrual transactions manually on a spreadsheet beginning August 1 of each year. Payments processed prior to August 1 are booked into the old fiscal year, which would reduce the accrual calculation. This spreadsheet is provided to State Finance on a quarterly basis. There is an option to track accrual transactions electronically using a unique prefix in the transaction id field in FINET; however, the interface between IRIS, BASE, and FINET does not allow for use of this option.

We reviewed the accrual tracking spreadsheets maintained by the USOE Internal Accounting division for USOR and noted that there was no efficient way to determine the completeness and accuracy of the information on these spreadsheets. In order to determine the validity of the data on the spreadsheet, the data would need to be agreed to source documentation, or to a query of transactions in IRIS, the client payment system. Service dates would be required for each transaction to determine if each transaction should be included in a year-end accrual.

However, service dates are not formatted consistently in IRIS, and there is no effective way to query transactions by service date and pay date.

Furthermore, we reviewed a limited selection of detail transactions we noted one transaction with a new fiscal year service date that was included in the accrual data, which is considered an error. Because there is no established procedure on how this data is compiled, and no way to validate the completeness or accuracy of the data, we are unable to conclude if the data is reasonable and accurate enough to use in an accrual estimate. Therefore, per auditor judgment as we cannot rely on that information, we performed alternative procedures to determine an accrual estimate.

Alternative procedures included querying both the IRIS client service system and FINET general ledger systems, inquiring with relevant personnel, and applying knowledge of the current financial situation, payment processing procedures, and grant programs to determine an estimation of the possible amount of the accrual.

Based on these procedures, we feel the estimated accrual is likely in the range of \$2.5 million - \$3 million. The accrual for USOR client services is very likely to be immaterial to the Education Fund and actual data is not available to quantify or validate this estimate. As the risk to the CAFR is an overstatement of accounts receivable and revenue, we recommend that this estimate not be recorded in fiscal year 2014. See **Finding 3** below.

The findings resulting from the above procedures are included in the attached Findings and Recommendations section of this report.

This report is intended solely for the information and use of USOE, USOR, State Finance, the Office of the State Auditor, and the Utah State Board of Education and is not intended to be and should not be used by anyone other than these specified parties.

By its nature, this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not also various strengths and accomplishments. If you have any questions, please contact me at (801) 538-7813.

Sincerely,

A handwritten signature in black ink that reads "Natalie Grange". The signature is written in a cursive, flowing style.

Natalie Grange CPA, CFE
Internal Auditor, Utah State Office of Education

FINDINGS AND RECOMMENDATIONS

1. INSUFFICIENT POLICIES, PROCEDURES, AND INTERNAL CONTROLS OVER ACCRUALS

Per discussion with USOE Internal Accounting personnel and review of records related to accrual determinations, there are no written policies and procedures or defined internal controls over the accrual calculations at USOE and USOR. Lack of formal policies and procedures and established internal controls may result in errors in accrual estimates and thus, in financial reporting, in addition to noncompliance with financial reporting standards.

Recommendation:

We recommend USOE and USOR management and the USOE Internal Accounting division establish policies and procedures and internal controls to ensure significant estimates are appropriately determined, approved, and reported.

2. INSUFFICIENT INTERNAL CONTROLS OVER DATA COMPILED BY SCHOOL FINANCE

We reviewed the USOE accrual calculated by the USOE Internal Accounting division and noted that the federal accounts receivable numbers for fund 23 (Non K-12 Programs Fund) were incorrect for all LEAs. It appears that the summary spreadsheet prepared by School Finance and used by Internal Accounting in preparing the calculation had fiscal year 2012 data instead of fiscal year 2013 data. This error was not discovered by School Finance or by Internal Accounting staff prior to using the data. This data was also posted on the USOE's website. There does not appear to be a documented quality control or review process established by School Finance to ensure data errors do not exist prior to publishing data.

Recommendation:

We recommend that School Finance develop and implement a review process over AFR compilation data to ensure that it is complete and accurate prior to publishing the data online or releasing it for use to the USOE.

3. INSUFFICIENT INTERNAL CONTROLS OVER ACCRUAL CALCULATION FOR USOR

Presently, there is no efficient or effective method for tracking and reviewing accrual transactions for USOR client payments at year-end. The lack of these procedures resulted in a financial reporting misstatement, though most likely not material, in the Education Fund. The data collected in IRIS pertaining to dates of services for payments is not consistently formatted or recorded, and there do not appear to be review or quality control processes to ensure consistent and data entry. Furthermore; IRIS does not have the capability to query data by services dates for use in financial reports and other estimates. Presently the USOR is developing a new vocational rehabilitation client services system (AWARE) which is the primary source of data for client payments. We have been unable to ascertain how the data collection and summary process for use in accrual estimates has been addressed in the programming.

Recommendation:

Management and the USOE Internal Accounting division should establish policies, procedures, and internal controls to ensure that accurate data is collected and summarized for use in the calculation of the USOR client services accrual. Additionally, with the upcoming implementation of AWARE, management should determine if programming can be added to allow for efficient and effective tracking of accrual items that could also interface with FINET for electronic tracking of accrual items.