REPORT TO THE

UTAH STATE BOARD OF EDUCATION

Report No. 2015-06

REVIEW OF USOE AND USOR YEAR-END FINANCIAL CLOSEOUT PROCESS

FISCAL YEAR 2014

January 15, 2015

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

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

Dear Board Members:

The fiscal year end closing process was identified by Internal Audit (IA) and prioritized by the Audit Committee in the annual audit plan for review. Additionally, with the implementation of GASB 65 and with the encouragement of State Finance, IA initiated a review of accounts receivable and unearned revenue in the Education fund at the end of fiscal year 2014.

Internal Accounting Financial Closeout Process

The current Internal Accounting reconciliation process at year-end includes running a BASE report to identify any programs and activities where expenditures exceed revenues or where revenues exceed expenditures for both USOE and USOR. As the financial closeout process is very time consuming, Internal Accounting has indicated that they currently do not have sufficient staff or time to dedicate to investigate and resolve all these differences during the closing period.

Therefore, if an over-expenditure is noted, an accounts receivable (AR) and revenue are recorded; if excess revenue is noted, the revenue is reduced and unearned revenue (UR) is recorded. In both cases, the use of these entries balances the revenue and expenditure accounts at year-end. In the new fiscal year, the balancing journal entries from the old fiscal year are reversed to reinstate the revenues and expenditures. Once financial closeout is complete and if time permits, Internal Accounting reviews the over-expenditures and excess revenues along with any subsequent transactions that were recorded and makes corrections as considered appropriate.

According to Internal Accounting, this practice has been the standard operating procedure for approximately the past 15 years. We noted some of the unreconciled accounts have been carried over since 2009. Internal Accounting indicated that these were in existence when the current staff took over the closing practice.

State Finance Financial Closeout Requirements

State Finance is tasked with producing the State's official financial statements each fiscal year, which are then audited by the Office of the State Auditor in accordance with Generally

Accepted Auditing Standards and *Government Accounting Standards,* to obtain reasonable assurance that they are not materially misstated.

All state agencies provide information which is included in the financial statements. To ensure the information provided is accurate and consistent, State Finance provides the following tools:

- Budget and Accounting Officers training
- Detailed Closing Instruction and Examples
- Training modules, including multiple modules for year-end closeout procedures

State Finance is also available to answer any questions that may arise during the closeout process.

According to the 'Detailed Closing Instructions and Examples' provided as part of the financial close process, State Finance requires state agencies "to ensure that revenue, receivables, and cash are recorded in the correct fiscal years." This requirement includes "review[ing] the validity of all receivables recorded in FINET [the state's official general ledger system]" and only recording revenue and receivables "when earned;" if not earned, revenue should be recorded as unearned revenue. The closing instructions also state that "agencies are responsible to maintain supporting documentation to justify cash, revenues, and receivables for audit purposes."

<u>Internal Audit Findings</u>

Internal Audit obtained the closing entries for state fiscal year 2014 related to the areas noted above. These entries included AR/revenue entries totaling $3,128,863.76 and UR/revenue entries totaling $3,425,046.56 for federal, state, and other activities. Internal Audit attempted to reconcile the year-end revenues and expenditures and any other associated line items. The findings resulting from the review are included in the Findings and Recommendations section of this report. Responses provided by the Internal Accounting section at the USOE are included after findings 1-3.

After discussing the findings with State Finance, USOE management requested a client adjustment to the year-end financial statements to reduce both unearned revenue and accounts receivable by $1,952,999. This change was made to ensure the Comprehensive Annual Financial Report (CAFR) of the State of Utah was fairly stated for the Education Fund. While this change ensured that the accounts receivable and deferred revenue numbers reported in the fiscal year 2014 CAFR were materially correct, it did not correct the underlying issues in the activities and programs in BASE or FINET. Please see further discussion of these issues in the 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,

Natalie Grange CPA, CFE
Internal Audit Director, Utah State Office of Education

FINDINGS AND RECOMMENDATIONS

I. INSUFFICIENT INTERNAL CONTROLS AND INSUFFICIENT DOCUMENTATION

In identifying the year-end closeout transactions to review, Internal Audit noted that the documentation for the accounts receivable, deferred revenue, and revenue transactions was prepared by the USOE Financial Manager. The journal entries were entered into FINET by one of the Budget and Accounting Officers that is supervised by the Financial Manager. It does not appear that anyone, aside from the Financial Manager, reviewed or approved the year-end closing journal entries. Material year-end closing transactions should be reviewed for accuracy, compliance with GAAP and State Finance Policy, and approved by someone with sufficient knowledge and authority to ensure these transactions are appropriate and represent the financial activity of the USOE and the USOR accurately.

The documentation for these closing transactions included a spreadsheet listing the account coding and amounts for each line item. However, there was no supporting documentation or schedules from the accounting system to corroborate or support the amounts on the spreadsheet. Based on our discussion with USOE Internal Accounting, the amounts came from a report from the BASE system that was only available on the date it was generated. Internal Accounting did not keep a copy of that report; therefore, Internal Audit cannot verify the accuracy or completeness of the amounts included on the transaction list nor verify that all programs and accounts were included.

Recommendations:
We recommend management and the USOE Internal Accounting section:

- Establish policies, procedures, and internal controls over year-end closing transactions to ensure appropriate separation of duties and internal controls in the preparation and approval of transactions.
- Maintain adequate documentation for all transactions to ensure appropriate evidence is available for audit verification purposes.

II. INTERNAL CONTROL WEAKNESSES AND MISSTATEMENTS RELATED TO YEAR-END GRANT RECONCILIATIONS AND FINANCIAL REPORTING

Internal Audit selected several year-end closeout transactions to review. This review was very high level in order to determine estimates of valid and invalid entries. IA did not perform detailed testwork and investigation of each transaction. During our review, we noted several issues as documented below. We have divided the issues noted into two sections: those pertaining to AR/revenue transactions and those pertaining to UR/revenue transactions.

A. Accounts Receivable (Asset)/ Revenue Transactions

Year-end journal entries RE4004E*69 and RE4004E*74 – RE4004E*76 were booked to record both receivables and revenue for accounts or activities where expenditures exceeded revenues at year-end. We reviewed these journal entries for propriety with the State Finance "Detailed Closing Instructions and Examples" and for accuracy. We noted various accounts receivable transitions that appear to be valid and recorded appropriately. These valid transactions totaled $546,706 and represent 17% of the total year-end AR transactions posted. We also noted many receivable transactions that did not appear valid or that need further investigation. These transactions total $2,582,158 and represent 83% of the total $3,128,863 in year-end AR transactions posted. The table below summarizes issues by funding sources and issue. See additional explanation below.

Invalid		**Funding Source**		
Issue	**Federal**	**State**	**Other**	**Total**
Expired Grant/Old Activity	531,779.71	958,458.59	-	1,490,238.30
Errors, Oversights, etc.	185,549.22	271,359.28	5,851.77	462,760.27
Writeoff Issues (not AR)		629,159.84		629,159.84
Total	**717,328.93**	**1,858,977.71**	**5,851.77**	**2,582,158.41**
% of Combined Total	**57%**	**100%**	**59%**	**83%**
Valid				
Errors, Oversights, etc.	542,612.09		2,685.88	545,297.97
No Issues			1,407.38	1,407.38
Total	**542,612.09**	**-**	**4,093.26**	**546,705.35**
% of Combined Total	**43%**	**0%**	**41%**	**17%**
Combined Total	**1,259,941.02**	**1,858,977.71**	**9,945.03**	**3,128,863.76**

As noted in the table above, we noted issues pertaining to the following:

1. Expired Federal Grant Period – We noted several receivables associated with federal grant periods that are closed. This means that no additional revenue may be requested from the federal government and no further cash will be received. Because these grants are closed, the funding is no longer available to cover expenditures and the expenditures will have to be covered with unrestricted state funds, unless revenues were requested during the grant period that can be matched against the expenditures. This determination should have been made in the year the grant activity occurred.
2. Old Activities – We noted several receivable line items related to the Minimum School Program where the activity is from several years previous (e.g. 2009, 2010) and the same AR/revenue year-end entry has been recorded and reversed each year. These balances have been carried forward for several years instead of matching the revenue with appropriate expenditures in the year the activity occurred. It is particularly concerning that these entries have been made for several years without resolution of the issues through the closing review and approval process. There do not appear to be sufficient internal controls in place to ensure that these types of reconciliation issues are resolved.

3. Miscoding, Errors, Oversights, etc. – We noted several receivable line items in federal, state and other activities that appear invalid. These issues include recording expenditures and revenues for one program in different activities or other codes so it is difficult to match and recognize them appropriately, duplicate entries, incorrect reversal of year-end accrual entries, inappropriate program coding, draws recorded to the wrong grant year, and other various errors in financial reporting. We also noted some valid items that had these issues.
4. Write-off Issues – We noted several revenue line items related to state activities that appeared to write-off old receivables; however, a subsequent related transaction (IDT*204) was also booked which appeared to book an additional revenue and cash. It does not appear appropriate to increase revenue and it is unclear if the cash transferred was from an allowable source (i.e. restricted or unrestricted, as appropriate). This has the effect of potentially overstating revenue.

B. Unearned Revenue (Liability)/Revenue Transactions

Year-end journal entries JVYE4004UR*1 – JVYE4004EUR*8 were booked to record both UR and negative revenue for accounts or activities where revenues exceeded expenditures at year-end. We reviewed these journal entries for propriety with the State Finance "Detailed Closing Instructions and Examples" and for accuracy.

We noted various unearned revenue transitions that appeared to be valid and recorded appropriately. These valid transactions totaled $623,828 or 18% of the total year-end UR transactions posted. We also noted several UR transactions that did not appear valid or that needed further investigation. See the schedule below. These transactions totaled $2,801.218, or 82% of the total $3,425,047 booked to UR at year-end. The table below summarizes issues by funding sources and issue.

Invalid

		Funding Source		
Issue	**Federal**	**State**	**Other**	**Total**
Expired Grant/Old Activity	103,883.72	91,604.05	300,123.58	495,611.35
Advance Draw	175,570.04			175,570.04
Should be Fund Balance		414,876.68	580,618.51	995,495.19
Errors, Oversights, etc	336,116.48	566,829.32	225,452.67	1,128,398.47
Immaterial*	1,131.40		5,011.69	6,143.09
Total	**616,701.64**	**1,073,310.05**	**1,111,206.45**	**2,801,218.14**
% of Combined Total	**59%**	**100%**	**85%**	**82%**

*Immaterial items were not reviewed.

Valid

Advance Draw	327,417.00			327,417.00
No Issues	105,438.80		190,972.62	296,411.42
Total	**432,855.80**	**-**	**190,972.62**	**623,828.42**
% of Combined Total	**41%**	**0%**	**15%**	**18%**

Combined Total	**1,049,557.44**	**1,073,310.05**	**1,302,179.07**	**3,425,046.56**

1. Expired Federal Grant Period – We noted several UR transactions where the federal grant is closed. Grant revenue from previous years should have been matched with expenditures within the period of availability of the grant. Because these grants are closed and the period of availability has ended, the USOE needs to determine whether expenditures occurred in the proper year to match these revenues. If it is determined these funds were requested from the federal programs without valid expenditures, these funds should be returned to the Federal Government with interest.
2. Old Activities – We noted several UR transaction items related to state or other funding sources, where the activity is from several years previous (e.g. 2006, 2007) and the same revenue/UR year-end entry has been recorded and reversed each year. These balances have been carried forward for several years instead of matching the revenue with appropriate expenditures in the year the activity occurred. It is particularly concerning that these entries have been made for several years without resolution of the issues through the closing review and approval process. There do not appear to be sufficient internal controls in place to ensure that these types of reconciliation issues are resolved.
3. Advance Draw – We noted several UR line items where it appears that requests for federal grant funds were made in advance of expenditures. Based on auditor knowledge of the grants at USOR and USOE, all grants are reimbursement basis grants. Therefore, drawing funds in advance is not allowable under the State cash management agreement. Grants should be reconciled in the year revenues and expenditures occur. If funds were drawn in advance of expenditures, interest should be calculated and paid to the Federal Government for any funds drawn in advance. If expenditures were not incurred in the proper period, funds should be returned to the Federal Government, with interest, or subsequent draws should be reduced.
4. Fund Balance – We noted several UR line items related to state or other funding sources, where the revenue does not appear to have been recognized due to the revenue and expenditures being coded to different activity codes. If revenues and expenditures are not matched, the final impact results in an inaccurate fund balance.
5. Errors, Oversights, etc. – We noted several unearned revenue line items in federal, state and other activities that appear invalid. These issues include recording expenditures and revenues for one program in different activities or other codes so it is difficult to match and recognize them appropriately, duplicate entries, incorrect reversal of year-end accrual entries, inappropriate program coding, draws recorded to the wrong grant year, and other various errors in financial reporting. We also noted some valid items that had these issues.

Summary

Each of the journal entries reviewed recorded accounts receivables and revenues to zero out activities with expenditures in excess of associated revenues or recorded unearned revenues

and negative revenues to zero out activities with revenues in excess of expenditures. The aim of these entries was to net the activities to zero and enable the agency to close its books.
The practice of booking AR and revenues or UR and negative revenue to zero out accounts so the agency can close does not appear to be in compliance with Generally Accepted Accounting Principles (GAAP) or with State Finance policies. While these transactions mostly net out in the State's CAFR, the transactions cause the current year revenue activity to be understated and the assets and liabilities to be overstated in the CAFR. Had this issue remained uncorrected, the CAFR would have been materially misstated. Although Internal Audit does not issue audit opinions, this type of finding would have been considered a material weakness over financial reporting if issued by an independent auditor.

Based on our high level review, it appears that the AR/revenue transactions booked to zero out activities and programs at the end of fiscal year 2014 resulted in an overstatement of assets totaling $1,952,999 in the Education Fund. The UR/revenue transactions booked resulted in an overstatement of liabilities totaling $2,801,218 in the Education Fund. USOE management proposed the following Client Adjustment journal entry to ensure the fiscal year 2014 State CAFR was fairly stated in all material respects for the Education Fund:

Account	**BS Account**	**Debit**	**Credit**
Unearned Revenue	6500	$1,952,999	
Accounts Receivable	1005		$717,328.93
Accounts Receivable	1000		$1,235,669.64

While this journal entry does not reverse all invalid UR entries, the remainder of the balance of invalid UR is considered immaterial to the Education Fund and was not booked. The revenue and negative revenue side of these journal entries essentially net out and only resulted in an immaterial understatement of the actual revenue activity in the current year.

This adjustment ensured that the AR and UR numbers reported in the fiscal year 2014 CAFR were materially correct and fairly stated; however, it did not correct the underlying issues in the activity and program codes in BASE or FINET. The Internal Accounting section will need to perform a detailed analysis of the activity and program codes in BASE and determine the proper disposition of each of these items. The agency did not have sufficient time or personnel to conduct this analysis prior to the agency close out date or completion of the CAFR.

Internal Accounting staff indicated that oftentimes revenues and expenditures for various programs and activities are not tracked in the same programs or activity codes. Especially in the current year, the expenditure activity and revenue activity need to be matched as part of the close. Some of the transactions we reviewed appear to support Internal Accounting's assertions that current year activities just need to be matched. However, in other cases (as noted above), we found activities from prior fiscal years where the same closing entries were booked and reversed for as many as five fiscal years.

Recommendations:
We recommend that management and the USOE Internal Accounting section establish policies, procedures, and internal controls over the financial closeout process to ensure appropriate financial reporting and grant management. Management and Internal Accounting should consider including policies, procedures, and controls that address and ensure the following:

1) Maintenance of adequate documentation for all transactions. The documentation should include enough detail to show the source of all amounts included and appropriate approval.
2) Implementation of a review and approval process to ensure the all recorded year-end receivables and unearned revenue are in compliance with State Finance's requirements and GAAP.
3) Implementation of a process for regular (at least quarterly) reconciliations of grant revenues to grant expenditures, including policies and procedures to account for any adjustments that occur subsequent to the regular draw process, any funds that appear to be drawn in advance of expenditures, and any circumstances that result in a reversal of a draw with a corresponding refund.
4) Implementation of sufficient internal controls to ensure appropriate review of all year-end transactions to minimize coding and other errors or oversights.
5) Implementation of a review and approval process for all write-offs or transfers.

Additionally, we recommend that the agency review and resolve all of the outstanding unreconciled balances prior to year-end close for fiscal year 2015. Over expenditures must be recognized and unrestricted state funds used to cover the over expenditures. Revenues in excess of expenditures should be closed to the proper activities and any excess funds should be properly recorded and returned to the Federal Government, if applicable. We recommend that USOE management oversee this process and approve the resolution of all of these accounts. We further recommend that State Finance be consulted on the proper way to book or record these entries to ensure no further implications to the State's financial statements.

III. INTERNAL CONTROL WEAKNESSES RELATED TO THE PREPARATION OF THE USOE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

We noted three federal grants that were not included in the State's Schedule of Expenditures of Federal Awards (SEFA) and do not appear to follow the grant notification and approval process. These grants are managed by the Teaching and Learning section and come from the National Security Agency (NSA). The grant awards for all three grants total approximately $357,550 and has been managed by the Teaching and Learning section for at least three years. The receivables booked to cover the expenditures made were valid because funds had been requested from the NSA before year-end due to notices received from the NSA for the State to draw funds before they expired.

Recommendation:
We recommend that Internal Accounting section conduct a review of federal programs in each section to ensure that all policies and procedures (including legislative approval and appropriation processes) are followed. Additionally, we recommend that internal controls be implemented to ensure that the USOE SEFA accurately reflects all federal programs managed by the USOE.

IV. <u>USOE Internal Accounting Response</u>

The Internal Accounting Section (IAS) agrees with the recommendations to establish controls over year-end closing transactions. Specifically, IAS will review and the approval will be done by someone other than the person tasked with the responsibility to research and create closing transactions for fiscal year-end. For fiscal year ending June 30, 2014, the closing package was due to State Finance on August 1st. The USOE\USOR closing package was submitted in accordance with this deadline. IAS has been in negotiations with State Finance to have additional time to submit the closing package in order to correct any issues which might arise. Each year, IAS in conjunction with USOE management creates a fiscal year closing calendar based upon State Finance rules. For instance, they would only allow us to pay old year invoices up through July 18, 2014. Also in mid-July, the last payroll posts to the system. With these transactions posting, IAS only had about eight working days to complete the closing package. In recent negotiations with State Finance, they will now allow USOE\USOR to submit the closing package with a staggered deadline. This means if the closing package for fiscal year ending June 30, 2015 is due August 3, 2015, IAS can submit the line items when they are complete. For instance if the only line item completed by August 3rd is the Charter School section, we will submit it that day and then continue to work on the other line items and submit an amended closing package which will be more accurate. State Finance has to close out all state agencies and then compile the CAFR. They will work on the smaller agencies while the USOE\USOR and other large agencies have some additional weeks to close their books. They issue the CAFR sometime around the first of November. A review of the closing package prior to submission to State Finance could be done by the IA staff after IAS completes it if the IA staff thinks this would be necessary.

IAS has reviewed the receivables and the unearned revenue adjustments made in the fiscal year end 2014 transactions. IAS is currently working to correct those which are invalid. Some of them have already been corrected. IAS will continue to work through these transactions to clear them by May 31, 2015. This will allow IAS to submit the fiscal year ending June 30, 2015 closing package without prior year issues.

Recommendations:

1. IAS agrees there should be maintenance of adequate documentation for all transactions. When closing out the fiscal year each day, the Financial Manager runs a

report in BASE which is approximately 1100 pages. He will make Year End adjustments in FINET that day then repeat the process for 10 days. Printing out, reviewing and saving 11,000 pages of a budget report will be too cumbersome. Instead of printing the entire report on a daily basis, he will save the 1100 pages into a PDF and also try to print out the applicable pages he uses to calculate each adjustment.

2. IAS will establish procedures for year-end receivables and unearned revenue to make sure they are in compliance State Finance's requirements and generally accepted accounting principles.
3. IAS doesn't have sufficient manpower to reconcile all grants on a quarterly basis. IAS has implemented a policy to reconcile grants when they are closing. Reconciling these closing grants occurs between September and January and is labor intensive. This process was implemented two years ago. IAS proposes hiring an additional Financial Manger I (the total cost per year would be between $90,000 and $100,000) *in order to accomplish this recommendation. The funding for this position could come from rent savings or other sources for the first year then come from the Indirect Cost Pool thereafter.
4. IAS works to ensure all transactions are properly coded. Errors do occur but IAS will strategize how to best minimize and possibly eliminate coding errors.
5. IAS developed and implemented an approval process for all transfers of funds prior to the 2014 fiscal year. IAS only approves Journal Entries in BASE or Journal Vouchers, IETs, IDTs, ITIs and ITAs in FINET with section approval. The section approval can come from the section accountant, the section director or someone designated by the section director. Write-offs will use the same approval process.