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Members of the Board and Management
Jefferson County Board of Education
Louisville, Kentucky

In planning and performing our audit of the financial statements of the Jefferson County Board of Education (the "Board") as of and for the year ended June 30, 2012 in accordance with auditing standards generally accepted in the United States of America, we considered the Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control. Accordingly, we do not express an opinion on the effectiveness of the Board's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, there can be no such assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Board's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider items 2012-1 and 2012-2, noted in the following pages, to be significant deficiencies. Other matters discussed on the following pages are opportunities for strengthening internal control over financial reporting and operating efficiency.

The Board's written responses to the comments identified during our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, the members of the Board, and others within the District, and the Kentucky Department of Education, and is not intended to be and should not be used by anyone other than these specified parties. We appreciate the opportunity to serve the Board and are available at your convenience to answer questions or assist in the implementation of these suggestions.

Strothman & Company PSC

Louisville, Kentucky
November 1, 2012

I. Accounts Payable

Item 2012-1 – Segregation of Duties

Condition & Criteria: There are accounts payable clerks that have the ability to set up and edit vendor information, including EFT information, as well as process invoices.

Cause: There are no controls in place that allow for proper segregation of duties.

Effect: Clerks could potentially enter fraudulent invoices for payment.

Recommendation: We recommend that segregation of duties be implemented as much as administratively possible. When not possible we recommend an alternate review, such as a vendor audit, be performed.

Management's Response: During the year, we removed the vendor maintenance functions from all clerks except the clerk responsible for the vendor file. We have substantially reduced the invoice processing from this clerk, but we have been unable to completely remove this task without causing the position to be less than a full-time position. We continue to perform additional reviews of the invoices processed by this clerk and of vendor file changes.

II. Financial Reporting

Item 2012-2 – Proper Inclusion of Component Units

Condition & Criteria: Management believes the Jefferson County Public Education Foundation to be a component unit and it is not included in the Board's financial statements.

Cause: The information necessary to properly include the Foundation has not been available by the date needed for inclusion.

Effect: This component unit is not included in the Board financial statements

Recommendation: We recommend that management engage and complete in a timely manner the audit of the component unit so that it can be properly included in the financial statements.

Management's Response: We have tried to get the audited financial statements of the Jefferson County Public Education Foundation by the deadline for inclusion in our financial statements for a number of years. We will continue to ask for them, but they are a separate entity with their own audit schedules.

III. Payroll

Item 2012-3 – Terminated Employees not Reported in Board Minutes

Condition & Criteria: Board policies require all terminated employees to be included in Board minutes.

Cause: Seven of twenty-five terminated employees selected for testing were not noted as terminated in the Board minutes.

Effect: Board policy was not followed.

Recommendation: We recommend that management emphasize to all employees the importance of following Board policies.

Management's Response: Our current procedure for preparing the Board report depends on compiling data from hard copy Personnel Action Forms. This procedure has exposed us to the risk of printer and print set-up issues, which we had numerous times during the 2011-2012 year, the year of our conversion to Munis. We have worked through many of the printing issues but are still confronted with an inefficient process. We are reviewing the feasibility of converting this to an electronic form with hard copy review.

Item 2012-4 – Terminated Employees' Termination Date not Reported Correctly in Board Minutes

Condition & Criteria: Board policies require termination dates for all terminated employees to be included in Board minutes.

Cause: Two of twenty-five terminated employees selected for testing were not noted as terminated in the Board minutes.

Effect: Board policy was not followed.

Recommendation: We recommend that personnel in Human Resources ensure termination dates are reported correctly in Board Minutes.

Management's Response: This error was due to differences between the date fields in our old payroll system and our new payroll system. We have reviewed these fields with staff and corrected the errors.

Item 2012-5 – Notice of Change Document not Included in Personnel File

Condition & Criteria: It was noted during the audit that required documentation related to a terminated employee was not included in the personnel file.

Cause: Four of twenty-five terminated employees selected for testing did not have the required "Notice of Change" document included in their personnel file.

Effect: Board policy was not followed for those items required in an employee's personnel file.

Recommendation: We recommend that personnel in Human Resources ensure a "Notice of Change" document for terminated employees is included in the personnel file.

Management's Response: We have worked through many printing issues during our year of Munis conversion. These systems are now functional.

Item 2012-6 – Ensure Personal Days for Retirees are Paid Out and at the Correct Rate

Condition & Criteria: It was noted during the audit that one retiree did not receive payout for personal days upon retirement and one retiree was paid out at the incorrect rate.

Cause: One of twenty-five terminated employees selected for testing did not have the correct rate from MUNIS.

Effect: Board policy was not followed.

Recommendation: We recommend that Payroll personnel ensure personal days are paid out for all retirees and correct rates are utilized in the calculation.

Management's Response: We have reviewed required procedures with the staff and have put additional controls in place to minimize the risk of missing payments such as these in the future.

Item 2012-7 – New Hires not Reported in Board Minutes

Condition & Criteria: Board policies require all new hires to be included in Board Minutes.

Cause: Two of twenty-five new hires selected for testing were not disclosed as new hires in the Board Minutes.

Effect: Board policy was not followed.

Recommendation: We recommend that Human Resources personnel ensure that new hires are properly included in Board Minutes and the importance of following board policies.

Management's Response: We have experienced many printing problems during our year of Munis conversion, but these have been overcome. We continue to strive for ways to eliminate errors and refine our processes toward greater efficiency.

IV. Other Items

Item 2012-8 – Collection of Tax Revenues

Condition & Criteria: Per KRS 160.500 - .510, the Sheriff or other property tax collector is not to deduct his fees from the taxes collected. Currently, the Sheriff is deducting his fee prior to remitting funds to the Board.

Cause: Tax revenues are remitted daily by the Sheriff as a convenience to the Board. The fees are only required to be remitted monthly. Because the taxes are remitted on a daily basis the Sheriff withholds his fee from the remittance.

Effect: Non-compliance with Kentucky Revised Statues.

Recommendation: We recommend the Board assess the potential consequences of this transaction in comparison to the benefits.

Management's Response: We certainly agree that all laws must be followed precisely. However, the law also allows the Sheriff to hold tax revenues and only remit to us monthly, exacerbating our cash flows requirements and causing lost interest revenue. We will work to get the law changed or explore other ways to meet the letter of the law.

Item 2012–9 – Purchases Should not Be Made for Student Incentives for Perfect Attendance

Condition & Criteria: Redbook policies created by the Kentucky Department of Education prohibit the purchase of student incentives for perfect attendance purposes.

Cause: It was noted during our school visits that some schools are making purchases for student incentives for perfect attendance.

Effect: Redbook policy was not followed.

Recommendation: We recommend that management review and ensure that Redbook policies relating to student incentives are being properly followed.

Management's Response: We will remind schools of this law during training sessions.

Item 2012–10 – Additional Compensation Provided to Employees

Condition & Criteria: General Fund monies were utilized to purchase gifts cards for staff appreciation and attendance incentives which could be considered additional compensation.

Cause: It was noted during our testing at one school that gifts cards were purchased from General Fund monies for Board employees.

Effect: Internal Revenue Service ("IRS") regulations may require such gifts to employees to be reported on their W-2's.

Recommendation: We recommend awarding of gift cards to employees not be allowed since it could affect contractual pay scales of Board employees.

Management's Response: In August 2012, we issued new Spending Guidelines which specifically prohibit gift cards. Additionally, we will be monitoring to ensure these Guidelines are followed.

Item 2012–11 – Violation of Meals and Refreshments Guidelines

Condition & Criteria: The Meals and Refreshments Guidelines of the Board specify that meals are allowable under the General Fund if incorporated into a daylong meeting without a lunch break. A listing of those in attendance along with an agenda indicating no break for lunch must be kept as support for food purchases.

Cause: During our testing, we noted several purchases for food items for staff meetings without the proper documentation that these disbursements were for daylong meetings without a break for lunch.

Effect: Board policy is not being followed.

Recommendation: Board should establish procedures to review disbursements to determine only allowable costs are incurred and are for an educational purpose.

Management's Response: In August 2012, we issued new Meals & Refreshments Guidelines which prohibit any meals or refreshments for staff meetings or activities. We will be monitoring to ensure these Guidelines are followed.

Item 2012–12 – Insufficient Controls Resulted in Questionable Purchases

Condition & Criteria: Current procedures do not require approval of increases to blanket purchase orders and review of supporting documentation to verify items purchased were for their original stated purpose on the original blanket purchase order.

Cause: During our testing, blanket purchase orders were created in various amounts for food, supplies, and miscellaneous teaching non-bid items from both Target and Kroger. Increases to the purchase orders would be made throughout the year as the amounts expended would exceed the amount originally requested. Questionable purchases were noted including gift cards, Apple IPods, Sony PlayStations and DVD's, which were given as prizes and incentives to students.

Effect: Insufficient controls, combined with the inherent risk of abuse associated with blanket purchase orders, weakened the Board's ability to ensure that funds were being properly controlled and expended.

Recommendation: Board should review the need for blanket purchase orders. If blanket purchase orders are deemed necessary, there needs to be a process in place to review any request for increases in purchase orders. There also needs to be a formal process in place to ensure that items purchased utilizing purchase orders are being used for their stated purpose and not left to the discretion of the Administrators/Principals at the individual schools.

Management's Response: The new Spending Guidelines and Meals & Refreshments Guidelines have eliminated the use of many blanket purchase orders. Routine expenses such as utilities are the only blanket purchase orders that may be increased other than minimal amounts for items like shipping costs. Increases to other blanket purchase orders may only be done by creating a new purchase order.

Additional controls are now in place to ensure that invoices paid against purchase orders are appropriate and align to the purpose of the purchase order. Abuse of the purchase order system will result in disciplinary reviews of the staff.

V. <u>Internal Audit</u>

Item 2012–13 - Internal Audit Report Process

Condition & Criteria: It was noted that formal reports by Internal Audit were not always being prepared or sent to the appropriate management personnel.

Cause: Instances where a formal report or memo was not provided occurred.

Effect: Uncertainty of the scope of the audit or review and the conclusion by Internal Audit could lead to inappropriate or incomplete action being taken by management personnel.

Recommendation: In all cases where a special audit or review is conducted by Internal Audit staff a formal report should be completed. These reports should have the following characteristics:

- Same format and structure
- Address all necessary areas including school or department, issue investigated, work performed, conclusion, and recommendations
- Signed by preparer and reviewer
- Maintained in an organized electronic or manual filing system
- Should note whether a follow up by Internal Audit is necessary
- Listing of those the report is provided to
- All correspondence and support should be filed with the report

The follow-up process should be documented and included with the Special Audit/Review file.

Management's Response: We will collaborate with JCPS administration to determine the optimum special project reporting classifications, formats, protocols, and resolution.

Item 2012–14 – Internal Audit Internal Control Testing

Condition & Criteria: It was noted during our review of Internal Audit's internal control testing workpapers that various internal control attributes marked as tested were either not tested or not properly documented.

Cause: Instances of improperly documented workpapers occurred.

Effect: Workpapers that did not properly document the work performed required additional work and follow up by the external auditor.

Recommendation: We recommend that Internal Audit workpapers be properly reviewed by another Internal Audit staff member to ensure that workpapers are complete and accurate before providing workpapers to external auditors for review.

Management's Response: We will continue to strive to maintain and improve the quality of audit workpaper documentation, regardless of work volumes and time constraints.

Item 2012–15 – Audit Plan for Internal Audit Department should be Developed

Condition & Criteria: It was noted that Internal Audit does not have a formal Audit Plan.

Cause: Management and other responsible users of Internal Audit projects do not request an annual audit plan be prepared and submitted for prior review and approval.

Effect: Improper usage of Internal Audit Department dilutes its' effectiveness.

Recommendation: We recommend that Internal Audit perform a risk assessment and develop an audit plan for each fiscal year based on the assessment. At the end of each fiscal year, the Director of Internal Audit should report to the Board the projects that were completed during the fiscal year, projects scheduled but not completed due to various circumstances and the plan for the upcoming fiscal year. This plan should include:

- Audits of the School Activity Funds for the 155 schools within the District
- Operational reviews of internal processes throughout the District
- Control Testing of Cash Receipts, Cash Disbursements, Payroll, Fixed Assets, Terminations, New Hires and Transfers which are external audit requirements

Management's Response: We will formally consolidate our annual Internal Audit plans in a single audit plan document.

VI. <u>Technology</u>

Item 2012-16 – Technology Planning and Strategy

Condition & Criteria: The Board has a number of issues to resolve in the near future including:

- Active directory self-management
- Munis cloud
- Network devices out of warranty
- Internet connectivity and bandwidth requirements
- Desktop refresh in schools

Cause: The current Board Technology Plan is dependent upon the Kentucky Department of Education ("KDE") Kentucky Education Technology System plan for approval and implementation. Communication between the Board and KDE regarding these matters has been problematic in the past, and several of the technology items in this letter are pending resolution of a KDE project.

Effect: Board administration has taken steps to work with KDE, however, the risks associated with not finding an appropriate solution to these issues remain, and include inability to provide adequate, reliable, and secure technology services to students, teachers, staff, and other stakeholders.

Recommendation: Coordination and planning between the Board and KDE needs to be prioritized to complete these needed projects timely.

Management's Response: We are reviewing all technology needs, costs, and timelines and will present this strategy in the near future.

Item 2012-17 – Network Devices

Condition & Criteria: The Board has a network with a large number of switches and devices to manage connectivity to the Internet as well as connectivity between the Kentucky Department of Education, Board Administration, and the schools. The equipment currently in place is either not under warranty or is at/or approaching vendor end-of-life warranty, and is no longer going to be supported with firmware updates and maintenance agreements.

Cause: The Board currently has no documented plan to replace these devices prior to the expiration of support.

Effect: Lack of support and firmware upgrades could result in downtime, data breaches, and failure to prevent attacks on the network.

Recommendation: We recommend the Board develop and implement a plan for replacement of network devices with equipment that is supported and will meet District needs.

Management's Response: Efforts are underway to replace the aging network (voice and data) infrastructure. The Kentucky Department of Education has a Request for Proposals to provide these assets. We have written these purchases into our 2012-2013 budget.

Item 2012-18 – Business Continuity Plan

Condition & Criteria: While the Board has made some arrangements for continuity of Munis and Infinite Campus processing in case of disaster, certain technology systems, including telephony, internet, and student information systems are not covered by a formal Business Continuity Plan.

Cause: A major disaster could cause loss of data and operational downtime.

Effect: If a major disaster occurs, the Board does not have a plan for how to continue business as usual.

Recommendation: The Board should consider the development of a comprehensive Business Continuity Plan for critical business functions. The Board should consider a formal Risk Assessment which will identify all critical systems and functions. The Business Continuity Plan will be driven from the results of the Risk Assessment. This plan should include not only MIS but also key accounting and business functions that are required to continue in operation.

Management's Response: In September 2012, we installed a new one megawatt generator to provide backup power to the entire VanHoose building which powers the Data Center and all district systems. At full building load and diesel, we can provide 72 hours of backup power. Our new uninterrupted power supply provides 25 minutes of interim power at full load, allowing plenty of time for the generator to power up, which has taken only one minute in our tests. After generator loss, the backup processes we have in place would carry the risk of up to one day's lost data before offsite processing can resume, though Munis can be operated from Maine and Infinite Campus can be operated from Minnesota.

Item 2012-19 – Domain Administrator Accounts

Condition & Criteria: The Board currently has several user accounts that have Domain Administrator privileges. These users use this account to sign onto their PC's to do their daily work.

Cause: This was apparently done to make it more convenient for administrators to sign in.

Effect: If a virus, spyware, or malware is installed on their PC, the infection could be spread across the entire network.

Recommendation: We recommend the Board to create a second account without Domain Administrator rights to be used to sign into the PC.

Management's Response: During the past year, we have cleansed the Global Access Catalog of excess service accounts and continue to clean up Active Directory

Item 2012-20 – Password Expiration

Condition & Criteria: The Board currently does not force user passwords to expire when logging into the Domain.

Cause: There is no policy in effect to enforce password changes.

Effect: Unauthorized users could gain access to the system.

Recommendation: We recommend that the Board establish a policy to require user passwords to expire.

Management's Response: We presently have permissions and centralized controls over all of the student documents and staff documents will be underway in 2013. We plan to create a password policy for staff, then students, in 2013 in conjunction with the new identity management software project.