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*Auditing for a Better Oregon*

November 18, 2002

Stan Bunn, State Superintendent of Public Instruction  
Oregon Department of Education  
255 Capitol Street NE  
Salem, Oregon 97310-0203

Dear Mr. Bunn:

This letter presents the results of our review of the administrative and custodial trust funds administered by the Oregon Department of Education (department). The purpose of this audit was to review and evaluate internal controls over the processing of Oregon School of the Blind (OSB) and Oregon School for the Deaf (OSD) trust fund transactions. During our audit we interviewed department staff, and reviewed department procedures, cash receipt and disbursement documentation, and petty cash reimbursement requests. We also performed independent counts of petty cash and selected change funds at each school. The audit was conducted in accordance with generally accepted government auditing standards.

As of March 28, 2002, the schools had a combined balance of approximately \$801,000 in their student and administrative trust accounts, of which approximately \$1,300 was in individual student trust accounts. During our audit period from April 1, 2001 to March 31, 2002, transactions flowing through the accounts totaled approximately \$252,000 in cash revenues and \$224,000 in cash expenditures. The majority of the trust funds are a variety of administrative trust accounts originating from donations, high school fund raising, and high school student businesses.

During our audit, we found that controls at both schools and at the department's central office need strengthening in order to reduce the risk of loss or theft. We found insufficient segregation of duties, inadequate physical controls over cash and cash documentation, unauthorized staff executing transactions, inappropriate commingling of designated and undesignated donations, and infrequent independent reviews of cash handling.

Strong controls not only protect the department by reducing the risk of loss or theft, they protect employees and students with cash handling duties from suspicion if a loss were to occur. Furthermore, commingling of designated and non-designated funds makes it difficult to ensure that donated funds are disbursed as requested. Transactions approved by unauthorized employees also may result in payments that are inappropriate or inconsistent with management's objectives.

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Management Letter No. 581-2002-11-01

We have summarized our conclusions in six sections:

- Cash Receipts and Designated Donations
- Petty Cash and Other Trust Fund Disbursements
- Student Work Experience Payments
- Change Funds and Fund-Raising Activities
- Central Administration
- Other Issues

## **Cash Receipts and Designated Donations**

Both schools and the department's central office receive checks in the mail for donations and for deposit into student trust accounts. During our audit we found weaknesses in cash receipt controls and non-compliance with *Oregon Revised Statutes* (ORS), the Oregon Accounting Manual (OAM), and certain department procedures.

Cash receipt controls that need strengthening can be grouped into five areas:

- *Segregation of Cash Handling Duties*
- *Physical Controls Over Cash and Cash Documentation*
- *Cash Receipt Documentation*
- *Independent Checks on Performance at OSB and OSD*
- *Designated Donation Tracking*

### ***Segregation of Cash Handling Duties***

- The OSB lacked segregation of cash handling duties. During our audit we found that OSB's Office Manager/Cashier:
  - Opened mail that included checks and prepared receipts.
  - Prepared student trust account disbursement requests and disbursed cash.
  - Provided manually prepared trust account balance information to students. The SFMA accounting records were not provided to students or parents. In addition, we found several instances in which the manual ledgers did not match the SFMA records.
  - The inventory and custody of receipt forms were not segregated from the cashiering function at either school.

### ***Physical Controls Over Cash and Cash Documentation***

- The OSB office manager/cashier held as much as \$300 in cash for a student without receipting it. OSB personnel told us that one parent brings cash in for a child without a student trust account. Since OSB did not have a trust account to receipt the funds into and did not prepare receipts, there was no record of the cash entrusted to OSB personnel.
- Checks received at OSB and OSD were not immediately restrictively endorsed. The department's central office staff used an electronic endorsement machine to endorse the checks. We found that personnel in the department's central mailroom did not immediately restrictively endorse checks. Department personnel told us that the reason checks were not immediately endorsed was to eliminate the need for multiple endorsement stamps or machines that might be used inappropriately.

- All receipts were not deposited daily or at least weekly. The department has not submitted documentation to the Secretary of State as required by statute regarding a valid business reason for depositing funds later than one day after receipt.
- OSB and OSD cash receipts were placed in a safe at the department's central office, that remains unlocked during the day, until deposit.

### ***Cash Receipt Documentation***

- OSB personnel discarded original receipts instead of providing them to depositors.
- At OSB unused and used receipt forms were kept in a vault, which was generally unlocked during the day.
- School personnel did not consistently submit voided original school receipts to central accounting.
- OSB personnel used an additional unofficial receipt book, originally set up for noncash donations, to prepare receipts for cash received for official OSB business and to record staff fund receipts. In addition, OSB personnel estimated the value of one noncash donation at \$250.00 and recorded it as a cash donation on an unofficial receipt.
- School personnel did not always prepare or date receipt forms the day cash or checks were received. In addition, the received date was not stamped on supporting documentation for cash receipts.

### ***Independent Checks on Performance at OSB and OSD***

Personnel separate from cashiering did not perform periodic inventories of prenumbered cash receipt forms. Personnel in the department's central business services office did not check that all consecutive receipts were accounted for, including original voided receipts.

### ***Designated Donation Tracking***

We found that designated funds were sometimes recorded in project files in SFMA along with nondesignated funds. The department's central office and the schools had limited internal procedures addressing the recording and monitoring of designated donations.

The OAM provides rules for attaining control over cash receipts. These rules require agencies to appropriately segregate cash handling duties, establish immediate control over cash receipts, maintain control over cash receipt forms, physically secure cash at all times, and perform independent checks on performance. Receipts also are required for all currency transactions, regardless of source. State law requires agencies to submit in writing to the Secretary of State, Audits Division, a valid business reason for depositing funds later than one day after receipt. Although the Department of Administrative Services (DAS) does not have specific guidance for designated donation tracking, state law requires that all private donations or contributions deposited into the State Treasurer be kept in a separate trust fund for the use and benefit for which the donation or contribution was made.

**We recommend** that the department follow all state laws and rules, and best practices regarding cash receipt controls and separation of designated donations. Specifically, we recommend:

- Student trust disbursements be prepared or approved by someone other than the OSB cashier.

- School personnel provide the SFMA trust account balance information to students and parents or guardians, other than the manual account balance information prepared by OSB's cashier.
- Both schools segregate the inventory and custody of receipt forms from the cashiering function.
- School personnel give original pre-numbered receipts to persons from whom cash is received, or other appropriate persons such as the staff person in charge of the administrative trust account. Receipts should be prepared and dated the same day cash or checks are received. The date received should also be placed on the supporting documentation.
- Immediately restrictively endorse all checks received at the schools and at the department's central mailroom.
- OSB personnel use the unofficial receipt book only for receipt of noncash donations.
- School personnel submit the original and duplicate copy of voided receipts, marked "void", to the department's central accounting office. The triplicate copy should be retained at the schools.
- The department submits in writing to the Secretary of State, Audits Division a valid business reason for depositing receipts beyond one business day after collection.
- The department keeps the central office safe locked.
- The department implement independent checks on receipts at both schools. For example, personnel other than the cashier should periodically verify the cash receipt book inventory against the actual forms on hand.
- The schools establish procedures to identify designated funds and create a system to keep them separate from non-designated funds.

## **Petty Cash and Other Trust Fund Disbursements**

Many trust fund disbursement transactions were processed through the schools' petty cash funds. For trust accounts, OSB manages \$600 and OSD \$750 of petty cash funds. During our review, we looked at all documentation for five student trust fund disbursements and six administrative trust fund disbursements made through petty cash. (Work experience disbursements out of petty cash are reported in the "Work Experience Payment" section below.) In addition, we performed a walkthrough to gain an understanding of two other trust fund disbursements processed outside of the petty cash process.

### ***Segregation of Duties for Petty Cash Handling***

The OSB Office Manager/Cashier was the petty cash custodian and:

- Received cash receipts for student trust accounts.
- Prepared student trust account petty cash disbursement requests, disbursed cash, and provided manually prepared trust account balance information to students. We were told

that manually calculated account balances were given to students because SFMA records were not current; however, OSB petty cash reimbursements were made only every two to three weeks. Thus, trust fund transactions made through petty cash were not recorded into SFMA in a timely manner.

### ***Physical Controls Over Petty Cash***

At OSB we found that:

- Petty cash overages were placed in an envelope held separately from petty cash. Shortages were compensated from the envelope of overages or from the office manager/cashier's personal funds.
- Petty cash was left unlocked and out on a back counter, while the responsible staff went to the front counter to assist auditors.

### ***Disbursement Documentation***

- At OSB, no documentation of petty cash counts or identified overages and shortages was kept.
- One of two OSB administrative trust cash advances reviewed did not indicate whether receipts submitted in excess of the advance were disbursed to the requestor. The cash advance form also did not have a field for the cashier's signature; however, the new form created March 2002 did.
- OSD student trust account withdrawal forms did not require a signature from the person disbursing funds to the student.
- Both schools' petty cash disbursement forms did not require non-numeric written dollar amounts.

### ***Lack of Proper Authorization***

Authorized persons at both schools did not always sign disbursements in accordance with school procedures. OSB procedures require that administrative trust fund disbursements be signed by the director. During our audit we found an example where the director did not sign an administrative trust fund disbursement. OSD procedures required two signatures for administrative and student trust fund disbursements. One of the persons signing was required to be a member of the Leadership Team. During our audit we found that disbursement requests were not always signed by two persons and not always signed by a member of the Leadership Team. In addition, we found an instance in which a student trust withdrawal form had an amount change that was not initialed by the student and authorized staff.

### ***Independent Checks On Performance at OSB and OSD***

- Personnel without cash handling duties did not make surprise counts of petty cash.
- During the OSB's petty cash custodian's vacations, there was no review of the custodian's performance. The custodian counted out a portion of petty cash for her backup to use while she was on vacation.
- Department personnel did not appear to compare the OSB petty cash disbursement spreadsheet used to make entries into SFMA to original disbursement documentation for a discrepancy we noted during our review.

The OAM requires segregation of petty cash handling duties, securing of cash at all times, and surprise counts of petty cash.

**We recommend** that the department follow all OAM requirements related to petty cash and cash disbursements. Specifically, we recommend:

- OSB has personnel other than the petty cash custodian prepare and approve student trust disbursements.
- OSB personnel prepare and submit petty cash reimbursement requests to the department's central office every two or three days.
- The department provide legal guardians and students account balances from SFMA records.
- OSB perform regular counts of petty cash and document results of the counts, including overages and shortages.
- OSB does not keep petty cash overages separate from petty cash and that school personnel not use personal funds to eliminate shortages.
- OSD ensure that student trust account withdrawal forms be signed by the person disbursing funds to students.
- Both schools change petty cash disbursement forms to require alphabetically and numerically written dollar amounts.
- An independent person periodically perform surprise counts of petty cash.
- OSB assign full petty cash responsibilities to other staff when petty cash custodians are on vacation.
- OSB spreadsheets, used for recording transactions into SFMA, are compared to original documentation by central accounting when discrepancies are found.

**We further recommend** that department and school management review authorized signature requirements and revise OSB and OSD procedures, if necessary.

## **Student Work Experience Payments**

Both schools offer work experience programs to students funded by administrative trust accounts. The supervising teacher or dorm supervisors usually have the authority to approve work experience payments to students. Work experience disbursement forms were used by the schools as instruments similar to checks, which could be submitted by students to the school's cashiers for immediate payment.

During our audit we found that:

- Disbursement forms were unnumbered and access to the forms was not restricted. We also found that the forms did not require nonnumeric written dollar amounts. Thus, opportunities existed to create false claims or change claim amounts by inserting a numerical character.
- The schools did not have procedures requiring reconciliation of amounts earned to amounts paid for work experience. Without reconciliation, the schools would not know if students received all compensation due them or if amounts paid agreed to records of amounts earned. During our interviews, we were told that students sometimes lose or misplace their disbursement forms and do not submit them for payment. OSB personnel told us that in comparing records of time worked to disbursements made for selected students, they found that approximately 80 percent of work experience disbursement forms were submitted for payment, leaving 20 percent unpaid. Reconciliations also would provide a means to detect false or altered claims.
- Students and persons disbursing funds did not always sign the disbursement forms. In our review of one petty cash reimbursement request for OSB, we found that 14 of the 28 disbursement forms were missing initials on the "Paid by" line and one form was not signed by the student to indicate receipt of funds. We also found that the OSD disbursement form did not have a "Paid by" line; thus, the persons paying the claims could not be identified.
- For OSB, disbursements may not be approved in accordance with the OSB Trust Accounts Program Guidelines. The Dorm Counselors or Teaching Assistants, who do not have authority under these guidelines, signed disbursement forms. The OSB office manager/cashier told us that she was not sure who was authorized to sign the disbursement form and was unaware of OSB's guidelines on authorized signers. Transactions approved by unauthorized employees may result in payments made that are inappropriate or inconsistent with management's objectives.

The schools use work experience disbursement forms as instruments similar to checks. The OAM requires that checks be prenumbered, physically secured, and completed to avoid insertion of additional dollar amounts. The OAM also requires cancellation of documents after payment and proper approval of all documents that support disbursements. The OAM considers reconciliations, by employees not responsible for disbursements, to be important independent checks on performance. OSB and OSD's Trust Accounts Program Guidelines set signature authorization.

**We recommend** that the department consider submitting records of work performed to central accounting for entry into student trust accounts. Students would then receive compensation for all work performed and could still gain access to the cash by requesting a disbursement from their trust account. This change also would eliminate the need for the work experience disbursement form and the reconciliation of work performed to disbursements made.

In contrast, if the department decides to retain their current system, **we recommend** that the department:

- Create a pre-numbered work experience disbursement form that is physically controlled similar to a check.

- Modify forms to require non-numeric written dollar amounts.
- Develop and communicate new procedures that require forms be signed by:
  - students to document receipt of cash,
  - school cashiers to document disbursement was made, and
  - management authorized to approve disbursements.
- Require department accounting personnel to review all forms submitted with petty cash reimbursement requests for appropriate signature.
- Reconcile records of work performed to disbursements paid. School personnel responsible for disbursing cash should not perform this reconciliation.

## **Change Funds and Fund-Raising Activities**

School staff request cash advances from the school's petty cash to establish change funds for a variety of student-run businesses, educational experiences, and fund-raising activities. As the activities received cash, the students or staff sponsor of the activities counted the cash receipts that exceed the established change fund and prepared a yellow slip, known as a "Cash Box Reconciliation", to document the currency denominations to be deposited. During our audit we reviewed four change funds: the OSD Deli, the OSB snack shop, the OSB classroom store, and the OSB Pepsi vending machine. We found that physical controls over change funds and cash documentation, and independent checks on performance need strengthening.

### ***Physical Controls Over Change Funds And Cash Documentation***

- Earnings generated in an OSB classroom store were commingled with the \$82.50 classroom change fund. The classroom store did not appear to send receipts to the department's central office for deposit. Cash disbursements were most likely made from cash receipts.
- During the period that OSB was managing the soda pop vending machines, we found that keys to the machines were not secured, and a dorm counselor took home approximately \$300 from the machines "to keep it safe."
- The OSD deli did not record cash receipt amounts in ink and did not follow statutes regarding frequency of deposits.
- The students or staff sponsor of the fundraising activities prepared the cash box reconciliation. When OSD's cashier prepared the total receipts for deposit, she did not provide the department's central office with the original cash box reconciliation that could be used for comparison to amounts deposited.
- OSB did not have written procedures, including specific cash procedures, in place for fundraising events. At OSD, the Haunted House was the only fundraising event that had specific written procedures.

### ***Independent Checks On Performance***

- An independent person made no surprise counts of change funds.

- The department's central accounting did not have a list of all change cash funds on hand at OSB and OSD.

The OAM lists fundamental rules for attaining control over cash receipts and the minimum internal controls over agency change funds that must be established. Included in these rules are requirements to segregate cash handling duties, establish immediate control over cash receipts, physically secure cash at all times, maintain a record of all change cash funds, and perform surprise counts of change funds.

The department's Administrative Bulletin 6.7 requires written procedures, including specific cash procedures, be in place for fundraising events.

**We recommend** that the department follow all state rules related to change funds. Specifically, we recommend that the department:

- Perform surprise counts of change funds.
- Secure all cash in a safe or locking cabinet and limit access to keys or combinations.
- Record cash receipt amounts in ink.
- Follow statutes regarding frequency of deposits.
- Require that the cash box reconciliation yellow slip prepared for fundraising activities be completed, signed in ink, and forwarded to the department's central accounting office for comparison to deposited amounts.
- Assist schools in the development of written procedures, including specific cash procedures, for fundraising events.
- Maintain a list of all change funds in central accounting.

## **Central Administration**

### ***ADPICS Segregation of Duties***

The department's access controls to the Advanced Purchasing/Inventory System (ADPICS) were not appropriately segregated, which increases the opportunity for loss. During our audit, we learned that many department employees with approval authority for the direct purchase order screen also had add, modify, inquiry and delete capabilities. The Department of Administrative Services (DAS) set up standard ADPICS security user shells that segregate these duties, but the department requested that these shells be changed and relies upon manual controls instead. Department personnel told us that the procurement officer reviews and approves all printed purchase orders.

**We recommend** that the department reconsider the changes it has made to the standard ADPICS security user shells.

### ***Trust Fund Interest Earnings***

Interest earned on administrative trust funds was not appropriately allocated to designated donations as required by state law. With few exceptions, all treasury interest earned on the Trust Funds was allocated to a single project. This interest was then reallocated to projects based on need as determined by the schools' directors.

State law requires all private donations or contributions deposited into the State Treasurer be kept in a separate trust fund for the use and benefit for which the donation or contribution was made and requires all interest, if any, earned by a trust fund to inure to the benefit of the trust fund.

**We recommend** that the schools provide central accounting with information on which projects contain designated donations and that central accounting allocates the appropriate interest to those projects. Since some projects contain both designated and non-designated funds, the department and the schools will need to determine if it is cost beneficial to set up projects specifically for designated funds, or allocate interest to the project based upon the entire balance, designated and non-designated included.

### ***Unlocked Safe***

The schools' cash receipts were kept at the department's central office in an unlocked safe until deposit. The safe was kept unlocked during the day. In addition to cash receipts, we found the safe included other items that could be susceptible to loss or theft. For example, titles to vehicles, the key to another safe, credit cards and building keys were sitting on the shelves.

**We recommend** that the department keep the safe locked during the day.

### ***Trust Fund Reconciliations***

Reconciliation of the SFMA trust fund balance to the Treasury Statement was not performed in a timely manner. In addition, central accounting may decide to discontinue reconciliation of the individual SFMA project accounts to the total SFMA trust fund balance. Reconciliations are important controls to timely detect errors or irregularities in cash and individual trust fund balances.

During our audit we found that as of July 10, 2002, the last reconciliation for the OSB's SFMA trust fund balance to the Treasury Statement was for the month of March 2002. We also noted during our testing of balance transfers several coding error corrections between OSD and OSB project accounts indicating the need for the reconciliation of project accounts to the total trust fund balance.

We were told that reconciliation of the SFMA trust fund balance to the Treasury Statement was not timely because of the current hiring freeze and a vacated position. We also were told that central accounting did not consider the reconciliation of subsidiary SFMA project accounts to the SFMA trust fund balance to be a requirement under state rules. Although a previous employee had performed this reconciliation, we were told that because of the hiring freeze central accounting did not have the resources to continue the reconciliation.

The OAM requires reconciliation of cash accounts to Treasury Statements. Revenue controls stated in the OAM include reconciliation of subsidiary to control accounts. Reconciliations prepared timely are important controls in detecting errors or irregularities.

**We recommend** that central accounting prepare timely reconciliations of the SFMA trust fund balance to Treasury. We further recommend that central accounting continue to reconcile the subsidiary project account balances to the trust fund balance and retain a copy of the reconciliation.

## **Other Issues**

### ***Classification of Trust Funds***

Analysis of whether trust funds were properly classified was not within the scope of our audit. Department management expressed concern, however, that some activities may be inappropriately classified as trust funds. We briefly reviewed several of these activities and concur with department management that some transactions may be more appropriately recorded in other funds. For example, revenues earned from a sign language class were recorded in a trust account.

Department management explained that the OAM lacks guidance on trust fund activity classification. Some guidance can be obtained from Governmental Accounting and Financial Reporting Standards which state that fiduciary funds should be used “to report assets held in a trustee or agency capacity for others and therefore *cannot be used to support the government’s own programs (emphasis added).*”

**We recommend** that the department consult with DAS to determine if any accounts should be in a different classification.

### ***Oregon School for the Blind Budgeted Funds Petty Cash***

The amount held in OSB’s \$2,575 budgeted funds petty cash appears excessive. Reimbursement requests indicate approximately \$750 to \$1,750 remain in the fund at time of reimbursement.

The OAM requires periodic evaluation of the need and size of petty cash funds.

**We recommend** that the department consider reducing the amount held in OSB’s budgeted funds petty cash and periodically evaluate the need and size of each petty cash fund.

### ***Legislative Approval for Establishment of Petty Cash Funds***

The department was not able to provide auditors with documentation of the legislative approval required by the OAM for establishment of their petty cash funds.

**We recommend** that the department contact DAS and DOJ to determine appropriate measures to take.

### ***Senior Class Account Trust Funds***

Each class at OSD has a separate class account in the Trust Fund. The source of funds primarily comes from student dues, donations, and fundraisers. One activity paid for with the funds is the

Senior Class Trip. During our audit, the department notified auditors of a senior class fund accounting issue, involving a cash advance for the Senior Class Trip. The advance resulted in a distribution of approximately \$2,900 of fundraising and \$1,100 of class dues to nine students.

As a result of issues surrounding the large cash distribution to students, the department implemented written procedures limiting the amount of cash paid to any student to \$35.00. While this does set a control on the maximum amount of cash any student can receive it does not address the issue of how any remaining excess funds should be expended.

**We therefore recommend** that the department expand the new procedures to include preliminary budgeting for class needs and identification of uses for excess funds before fundraising activities commence. This would not only ensure that funds are used for purposes agreed to by the class, but would eliminate excess funds in the trust project account that are carried forward for many years after the class graduates.

Should you have any questions, please feel free to contact me at (503) 986-2255.

Sincerely,  
OREGON AUDITS DIVISION

Charles A. Hibner, CPA  
Deputy Director

CAH:bk

c: Jane Mulholland, Director, Oregon School for the Deaf  
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