

Internal Audit Report

**FINANCIAL AUDIT
HOWARD COUNTY
PUBLIC SCHOOL SYSTEM
MARCH 2017**

Office of the County Auditor





OFFICE OF THE COUNTY AUDITOR

Craig Glendenning, CPA
County Auditor

March 2017

The County Council of Howard County, Maryland

Pursuant to Council Resolution 88-2016, the County Auditor performed a financial audit of the Howard County Public School System.

As specified in the Resolution, the audit included:

- Special education services
- Health and Dental Fund
- Legal services

Our report is submitted herewith. We wish to express our gratitude to the staff of the Howard County Public School System for the cooperation and assistance extended to us during the course of this engagement.

A handwritten signature in blue ink, appearing to read "Craig Glendenning", is written over a horizontal line.

Craig Glendenning, CPA
County Auditor

Background, Scope and Process

In accordance with Council Resolution 88-2016, the County Auditor performed a financial audit of the Howard County Public School System (HCPSS). As specified in the Resolution, the audit included:

- Special education services
- Health and Dental Fund
- Legal services

The authority for the County Auditor to perform this type of audit is granted under the Annotated Code of Maryland Education Article Section 5-109 (d). Section 5-110 of the Code precludes the County Auditor from conducting performance audits of the schools to determine efficiency and effectiveness of programs and operations. As a result, the audit specifically examined transactions for propriety, support and proper classification. We did not evaluate whether the transaction should have been made or if it accomplished its intended purpose.

Our audit was not a financial audit performed in accordance with generally accepted government auditing standards (GAGAS) issued by the U.S. Government Accountability Office (GAO). GAGAS states that financial audits include 1) financial statement audits for the purpose of expressing an opinion on an entity's financial statements, 2) obtaining sufficient evidence to express an opinion on a single statement, elements, accounts or items of a financial statement, 3) issuing letters for underwriters or other certain parties, and 4) auditing compliance with applicable requirements related to one or more government programs. HCPSS contracts with an independent external firm for the purpose of expressing an opinion on its financial statements and auditing compliance with government programs.

As noted above, our audit was also not a performance audit. GAGAS defines a performance audit as an audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. These audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and to contribute to public accountability.

HCPSS financial statements for the year ended June 30, 2016 were audited by the accounting firm of CliftonLarsonAllen LLP. We requested access to their workpapers in order to avoid duplicating their work, but they were unresponsive.

For fiscal year 2016, HCPSS' general fund budget was approximately \$776.3 million, including approximately \$544.1 million (or 70 percent) from the County. Fiscal year 2016 general fund expenditures were approximately \$775.2 million. Expenditures in the areas that we audited were as follows:

Special Education	\$ 93,423,671	(approximately \$83 million was salaries & benefits)
Health and Dental Fund	\$ 133,604,349	
Legal Services	\$ 729,474	

Our financial audit included transactions processed by HCPSS in fiscal years 2015 and 2016. Financial information for each of the three areas reviewed is included in Exhibit A at the end of this report. The steps we performed included:

1. Ensuring detail records provided by HCPSS agreed to, or could be reconciled to, HCPSS audited financial statements;
2. Verifying that judgmentally selected detail transactions agreed to source documents (such as invoices) and were properly recorded in HCPSS financial records;
3. Tracing rates on supporting documents to approved contracts or purchase orders where applicable; and
4. Determining that goods or services for the selected transactions complied with the related contract or purchase order.

Findings

Special Education Services

We tested 34 fiscal year 2015 and 2016 expenditure transactions totaling \$1.1 million, and determined that the amounts recorded on the detail records agreed to the audited financial statements with only immaterial differences, and that the rates paid for services provided agreed to related contracts or purchase orders. We also found the following:

- Although all detail transactions agreed to supporting documentation, we noted HCPSS used the Instructional Textbooks and Supplies category to pay for a \$300,000 special education consulting contract. According to the Maryland State Department of Education's Financial Reporting Manual for Maryland Public Schools and the Chief of the Local Financial Reporting Office, contractual services costs for consultants cannot be charged to the Instructional Textbooks and Supplies category.

We recommend that HCPSS administration adhere to the Maryland State Department of Education's Financial Reporting Manual for proper classification of payments for services.

Superintendent's Response:

Management's procedures call for adherence to the Financial Reporting Manuals for Maryland Public Schools and management will continue to monitor compliance.

- Services provided under the consulting contract did not comply with the related contract. Although the special education consultant issued a 26 page "Highlights for Sharing" report in spring 2015 (the report did not include a specific issuance date), a final report had not been issued as of January 2017, almost two years later. The term of the contract ran from April to December 2014. In an e-mail dated January 24, 2017, HCPSS administration advised us that the report "...represented preliminary findings which are being vetted and validated systematically to ensure any actions taken do not have a detrimental impact on programming."

Although the Highlights report included recommendations to improve the delivery of special education services, the contract also included the following:

- The contractor is required to identify cost savings or cost avoidance with each of the recommendations. Our review of the draft report found that none of the proposed recommendations included potential cost savings or cost avoidance.

- A performance assurance provision states that contractor identified strategies will raise student achievement and generate annual savings of at least two times the contract's price. If the contractor does not meet these requirements, they agree to provide continued research at no cost for up to six additional months.

We recommend that HCPSS ensure the vendor complies with the provisions of the contract.

Superintendent's Response:

Management will continue to work with all vendors to successfully complete contracts that are underway.

Health and Dental Fund

We tested 10 operating revenue transactions (totaling \$8.0 million) and 30 operating expense transactions (totaling \$26.6 million) made in fiscal years 2015 and 2016 and determined that services provided complied with the related contracts or purchase orders. We also found the following:

- We identified a recordation issue with one transaction. In fiscal year 2015, \$1.45 million for the Workday Enterprise Cloud Application subscription fee was charged to the Fund. The HCPSS CFO subsequently approved transfers totaling \$745,000 to other cost centers (such as Human Resources), leaving a total of \$707,159 charged to the Fund. We requested support for the reasoning behind the Fund being assessed approximately 49% of the fee. We were advised that the Budget Manager who prepared the allocation was no longer with HCPSS and documentation of the allocation could not be located. In an e-mail dated January 5, 2017, HCPSS administration stated that the amount was based partly on available funds and the transferring of employee benefits administration from a third party to in-house using Workday. We noted that no similar charge was made to the Fund in fiscal year 2016.
- While one fiscal year 2016 payment totaling \$516,648 to the Department of Health and Human Services agreed to the source document, HCPSS did not pay the correct amount. Our review of the documents found that HCPSS made an error in calculating the payment due and underpaid the required amount due by \$103,488. This error understated expenses and overstated the year-end fund balance for fiscal year 2016. We brought this to the attention of HCPSS management who corrected the error and paid the additional amount due in November 2016.

We also noted that while amounts recorded on the detail records agreed to the audited financial statements, the fiscal year 2015 Comprehensive Annual Financial Report contained a \$2,000,000 typographical error in the supporting schedule of Fund activity. This error overstated the revenue from internal contributions to the Fund. Based on our review of the detail records, the financial statements accurately reflected the total revenue received by the Fund for the fiscal year and the Fund's year-end balance.

Observation:

Revenues have not kept pace with expenses. For example, from fiscal year 2014 to 2016, contributions from employees increased 4.6% and transfers from the General Fund (employer contributions) decreased 0.9%. However, expenses for health care and prescription claims increased 9.0% and 37.6%, respectively over the same period. According to the HCPSS fiscal year 2016 audited financial statements, the Fund had a deficit balance of \$16.5 million as of June 30, 2016. To address a similar Fund deficit, a neighboring school system obtained a one-time infusion to its Fund that did not impact maintenance of effort.

We recommend that HCPSS work with stakeholders to address the deficit in the Fund.

Superintendent's Response:

Management has a comprehensive cost containment program in place which includes routine RFP's to ensure the lowest costs each year. The most recent RFP's resulted in projected annual savings of \$9.1 million, more than \$4.2 million of which was achieved through negotiation of an earlier application of the new contract terms. Management continues to monitor the health program performance and implement industry best practices to contain costs in this area so that employee benefits can be sustained. Management welcomes opportunities to work with all stakeholders to make the school system's benefits for employees sustainable by restoring the fund balance and ensuring the ability to fund these benefits in the future.

Legal Services

Legal fees are not separately identified in the financial statements. As a result we did not reconcile the detail records we received from HCPSS to the financial statements.

Our test of 21 fiscal year 2016 expenditure transactions (totaling \$141,200) found that:

- All detail transactions agreed to supporting documentation. Transactions were properly recorded in the financial records.
- Rates paid for services provided agreed to related contracts or purchase orders in all material aspects.
- Services provided complied with the related contracts or purchase orders.

Exhibit A
Selected Financial Data

Table Special Education Expenditures Fiscal Years 2015 to 2016			
Program #	Program Name	FY 15	FY 16
3320	Countywide Services	\$ 9,267,119	\$ 9,160,354
3321	Special Education-School Based	47,405,737	48,013,105
3322	Cedar Lane	3,837,855	3,900,790
3323	Bridges	1,237,126	1,317,562
3324	Early Childhood	9,409,327	8,784,797
3325	Language and Hearing	9,422,929	9,517,962
3326	Special Education Summer Services	539,534	766,710
3328	Nonpublic Community Intervention	7,164,504	7,629,342
3330	Special Education Central Office	1,101,645	1,025,259
3390	Home and Hospital	758,208	733,336
	Other Special Education Expenditures	1,049,997	2,574,454
Total		\$ 91,193,981	\$ 93,423,671

Source: HCPSS General Ledger

“Other Special Education Expenditures” includes Psychological Services, Legal Fees and Internal Service Fund Charges

Table Legal Services Expenditures Fiscal Years 2015 to 2016			
Program #	Program Name	FY 15	FY 16
10104	Legal Services	\$ 554,498	\$ 478,877
19716	Workers Compensation	216,503	175,434
60104	Legal Services-Special Education	221,921	75,163
Total		\$ 992,922	\$ 729,474

Source: HCPSS General Ledger

Exhibit A
Selected Financial Data

Table Health and Dental Fund Revenues Fiscal Year 2014 to 2016				
Source	FY 14	FY 15	FY 16	% Change from FY 14 to FY 16
Employee Withholding	\$ 16,117,036	\$ 16,627,796	\$ 16,864,550	4.6%
Retiree Payments	4,826,278	5,008,063	6,169,210	27.8%
Transfer From General Fund	84,175,226	80,831,427	83,444,436	-0.9%
Transfer From Other Funds	4,383,635	4,267,067	3,164,009	-27.8%
Rebates	3,485,476	4,825,824	5,385,987	54.5%
Miscellaneous	412,711	682,549	462,992	7.8%
Total	\$ 113,400,362	\$ 112,242,726	\$ 115,491,184	1.8%

Source: HCPSS General Ledger

Table Health and Dental Fund Expenditures Fiscal Year 2014 to 2016				
	FY 14	FY 15	FY 16	% Change from FY 14 to FY 16
HCPSS Administrative Costs	\$ 1,667,569	\$ 1,608,179	\$ 1,863,375	11.7%
Health Care Claims	68,249,626	70,639,962	74,399,170	9.0%
Prescription Claims	27,840,500	32,403,388	38,297,453	37.6%
Dental Claims	4,499,122	4,637,764	4,867,295	8.2%
Vision Claims	498,753	474,806	546,841	9.6%
3rd Party Administrator	4,093,564	3,930,738	4,681,371	14.4%
Stop Loss	1,610,323	1,702,882	1,760,573	9.3%
Employee Non-Election Payments	3,801,381	3,826,893	3,783,671	-0.5%
Reserve Adjustment	(641,860)	1,061,315	921,415	N/A
Miscellaneous	1,294,850	3,397,251	2,483,185	91.8%
Total	\$ 112,913,828	\$ 123,683,178	\$ 133,604,349	18.3%

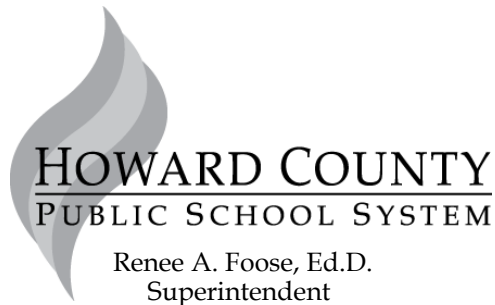
Source: HCPSS General Ledger

AUDIT TEAM

Edward L. Shulder, CPA
Deputy County Auditor

Lisa L. Geerman, CPA, CIA
Audit Manager

Stephen E. Peters, Jr., CPA
Audit Manager



March 8, 2017

Via Electronic Mail and US Mail

Mr. Craig Glendenning
County Auditor
Office of the County Auditor
Howard County Government
3430 Court House Drive
Ellicott City, Maryland 21042

Dear Mr. Glendenning,

Re: County Audit Report

Thank you for your audit report of the Howard County Public School (HCPSS). We appreciate the opportunity to gain your insight into the school system's financial management and internal control over financial reporting.

We agree with your comment that your audit was not a financial audit conducted in accordance with generally accepted government auditing standards. Those standards would have required that you opine on management's financial statements.

We do not agree with your comment that your audit was not a performance audit. Both the HCPSS CFO, Beverly Davis, and Internal Auditor, David Clark, believe that you performed a performance audit of financial matters. Maryland education law does not provide for you to conduct a performance audit. Nevertheless, we welcomed your audit in the spirit of cooperation with the county government and in the interest of transparency and good government oversight. Auditors provide value in that they always have suggestions for continuous improvement.

Your audit supports the invaluable work done by our external auditors, CliftonLarsonAllen (CLA) and supports CLA's opinions that the school system's financial statements are presented fairly presented in all material respects in accordance with generally accepted accounting principles, and CLA's conclusions that we have strong systems of internal control and that we comply in all material respects with applicable laws and regulations.

Your findings and recommendations are the type that financial auditors generally convey orally or in a management letter with the appropriate context regarding their significance. We believe additional context that was provided to your auditors would have been helpful in the final report. We believe your suggestions are constructive and HCPSS has made, or plans to make, the necessary adjustments to our accounting and other records to address the suggestions. The specific responses to your suggestions are summarized below.

Regarding the first special education services compliance recommendation, management's procedures call for adherence to the Financial Reporting Manuals for Maryland Public Schools and management will continue to monitor compliance. Regarding the second recommendation, management will continue to work with all vendors to successfully complete contracts that are underway.

With regard to the Health and Dental Fund, management has a comprehensive cost containment program in place which includes routine RFP's to ensure the lowest costs each year. The most recent RFP's resulted in projected annual savings of \$9.1 million, more than \$4.2 million of which was achieved through negotiation of an earlier application of the new contract terms. Management continues to monitor the health program performance and implement industry best practices to contain costs in this area so that employee benefits can be sustained. Management welcomes opportunities to work with all stakeholders to make the school system's benefits for employees sustainable by restoring the fund balance and ensuring the ability to fund these benefits in the future.

Again, thank you for your suggestions, and for your professional and constructive working approach with the school system's Budget and Finance Department staff.

Sincerely,

A handwritten signature in blue ink, appearing to read "Renee A. Foose". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Renee A. Foose, Ed.D.
Superintendent
Howard County Public School System