

Financial Management Practices Audit Report

St. Mary's County Public Schools

September 2015



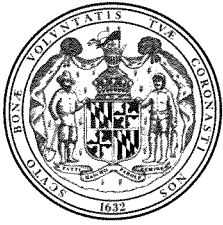
OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

For further information concerning this report contact:

**Department of Legislative Services
Office of Legislative Audits**
301 West Preston Street, Room 1202
Baltimore, Maryland 21201
Phone: 410-946-5900 · 301-970-5900
Toll Free in Maryland: 1-877-486-9964
Maryland Relay: 711
TTY: 410-946-5401 · 301-970-5401
E-mail: OLAWebmaster@ola.state.md.us
Website: www.ola.state.md.us

The Office of Legislative Audits operates a Fraud Hotline to report fraud, waste, or abuse involving State of Maryland government resources. Reports of fraud, waste, or abuse may be communicated anonymously by a toll-free call to 1-877-FRAUD-11, by mail to the Fraud Hotline, c/o Office of Legislative Audits, or through the Office's website.

The Department of Legislative Services does not discriminate on the basis of age, ancestry, color, creed, marital status, national origin, race, religion, gender, gender identity, sexual orientation, or disability in the admission or access to its programs, services, or activities. The Department's Information Officer has been designated to coordinate compliance with the nondiscrimination requirements contained in Section 35.107 of the Department of Justice Regulations. Requests for assistance should be directed to the Information Officer at 410-946-5400 or 410-970-5400.



DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

September 21, 2015

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
Delegate Craig J. Zucker, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We conducted an audit of the financial management practices of the St. Mary's County Public Schools (SMCPS) in accordance with the requirements of the State Government Article, Section 2-1220(e) of the Annotated Code of Maryland. The objectives of this audit were to evaluate whether SMCPS' procedures and controls were effective in accounting for and safeguarding its assets and whether its policies provided for the efficient use of financial resources.

Our audit disclosed that SMCPS needs to improve internal controls and accountability in a number of areas including procurement and disbursements, human resources and payroll processing, information systems, and food service collections. For example, SMCPS did not sufficiently ensure that the critical system capabilities assigned to employees were necessary, appropriate, or properly restricted. Due to the lack of proper procedures and controls in these areas, there was an increased risk of inappropriate transactions being processed without detection.

SMCPS also needs to improve processes and controls related to employee healthcare. SMCPS had not competitively bid its third party healthcare administrator contract or its health care stop-loss insurance contract since 2008. During fiscal year 2014, SMCPS paid \$1.6 million in administrative fees and \$1.2 million for stop-loss insurance. Also, SMCPS could not locate copies of all related contracts and did not ensure the accuracy of payments for employee healthcare claims. In fiscal year 2014, SMCPS healthcare expenditures (including fees and claims) totaled \$34.4 million.

SMCPS should also implement steps to improve cost-effectiveness and efficiency, especially as it relates to student transportation. For example, SMCPS did not perform a system-wide route analysis and ridership on routes we selected for testing was significantly lower than bus capacities, with some bus routes operating at less than 50 percent of desired capacity. In addition, SMCPS could not substantiate the reasonableness of its payments to bus contractors, which totaled \$12.6 million in fiscal year 2014. We estimated that for the 63 buses placed in service from July 2009 through December 2013, SMCPS will pay out approximately \$2.3 million more over the 12-year life of the buses because the rate established for a particular component was not based on market rates. SMCPS also paid bus contractors for fuel, but did not exclude federal excise taxes, which the contractors are exempt from paying and may claim as a credit on their income tax returns. For fiscal years 2010 through 2013, SMCPS fuel payments included \$479,000 related to these federal excise taxes.

An executive summary of our findings can be found on page 5 of this report. The SMCPS response to this audit is included as an Appendix to this report. We wish to acknowledge the cooperation extended to us during our audit by SMCPS.

Respectfully submitted,

A handwritten signature in black ink, reading "Tom J. Barnickel III", with a stylized flourish at the end.

Thomas J. Barnickel III, CPA
Legislative Auditor

Table of Contents

Executive Summary	5
Background Information	7
Statistical Overview	7
Oversight	7
External Audits	7
Status of Findings From Preceding Audit Report	8
Findings and Recommendations	9
Revenue and Billing Cycle	9
Federal Funds	9
Procurement and Disbursement Cycle	
* Finding 1 – SMCPs Did Not Adequately Restrict User’s Capabilities on Its Automated Procurement and Accounts Payable System	11
Finding 2 – Contracts Were Not Always Awarded Through Competitive Procurements and Contract Billings Were Not Always Properly Verified	12
Human Resources and Payroll	
* Finding 3 – HR and Payroll System User Capabilities Were Not Adequately Monitored and Restricted and Independent Documented Reviews of Transactions Were Not Performed	13
Inventory Control and Accountability	
* Finding 4 – SMCPs Equipment Policies Were Not Comprehensive and Proper Controls and Recordkeeping Were Not Established Over Sensitive Equipment Items	15

* Denotes item repeated in full or part from preceding audit report

Information Technology	
Finding 5 – Controls Over Accounts, Passwords, Database Access and Logging, and Security Monitoring Were Not Sufficient	17
Finding 6 – The SMCPs Computer Network Was Not Adequately Secured	18
Finding 7 – Workstations and Servers Were Not Sufficiently Protected Against Malware	19
Facilities Construction, Renovation, and Maintenance	20
Transportation Services	
Finding 8 – SMCPs Did Not Periodically Perform a System-Wide Analysis of Bus Routes and Related Bus Capacities to Maximize the Efficiency of Its Bus Routes	22
* Finding 9 – Certain SMCPs Payments to Bus Contractors Did Not Consider Market Conditions, Actual Costs, or Available Discounts	23
Finding 10 – Internal Controls Over Payments to Bus Contractors Were Not Adequate	25
Food Services	
* Finding 11 – Cash Receipt Duties Were Not Properly Segregated as Transactions Could Be Voided By Cashiers Without Independent Review or Approval	26
Finding 12 – SMCPs Did Not Perform Documented Independent Verifications of Validated Deposits	27
School Board Operations	28
Other Financial Controls	
Finding 13 – SMCPs Did Not Competitively Bid Healthcare Contracts For Administrative Services and Stop-Loss Coverage and Did Not Maintain Copies of the Annual Agreements	29
* Finding 14 – SMCPs Did Not Ensure the Propriety of Payments for Employee and Retiree Healthcare Costs	30
Audit Scope, Objectives, and Methodology	33
Agency Response	Appendix

* Denotes item repeated in full or part from preceding audit report

Executive Summary

Legislative Audit Report on the St. Mary's County Public Schools (SMCPS) September 2015

According to data compiled by the Maryland State Department of Education, SMCPS ranks 12th in student enrollment among the 24 public school systems in Maryland. In fiscal year 2014 SMCPS had a total full-time regular and special education pupil population of 17,841 students at its 27 schools. SMCPS' operating and capital expenditures totaled \$242 million in fiscal year 2014.

The Office of Legislative Audits has conducted its second audit of SMCPS' financial management practices. The results of the first audit were issued in a report dated April 9, 2009. Our current audit identified a number of opportunities for SMCPS to improve internal controls and to enhance policy direction.

SMCPS Needs To Improve Internal Controls and Accountability

SMCPS needs to improve internal controls in several financial areas. For example, we noted that SMCPS lacked an independent review and approval to ensure the propriety of vendor procurements and payments, personnel and payroll transactions, payments to bus contractors, and food service sales activity. SMCPS also needs to restrict user access capabilities to record critical transactions on its automated procurement and human resources and payroll systems. Additionally, SMCPS needs to implement adequate security measures and monitoring procedures to protect its network and related critical devices from security risks. Also, account and password controls to protect critical systems were not sufficient.

We also found that existing procurement policies were not consistently followed and certain contract payments were not sufficiently verified. Our test of 20 procurements totaling \$10.2 million disclosed various deficiencies in 11 of the procurements totaling \$4 million. For example, contracts with nine vendors for Special Education services were not competitively bid and were not approved by the Board as required by its policy.

SMCPS did not verify the propriety of payments to contractors for health care services, including claims, administrative fees, and stop-loss insurance. SMCPS is self-insured for employee medical benefits and uses a third-party administrator to process related claims. SMCPS reimbursed the administrator for claims paid upon request without sighting support for the amounts actually

paid. Payments to the administrator for health care services during fiscal year 2014 totaled \$34.4 million.

SMCPS Should Take Certain Steps to Improve Cost Effectiveness

SMCPS should take steps to ensure the efficiency of its bus operation, which transported over 17,900 students on approximately 200 buses, primarily operated by contractors. During fiscal year 2014, transportation costs totaled \$15.5 million, with \$12.6 million representing payments for contracted services. Specifically, SMCPS did not perform a system-wide route analysis to assist in planning efficient bus routes. Our analysis found that ridership was lower than SMCPS' desired bus capacity goals, with almost half the routes reviewed operating at less than 75 percent of the goal. Also, SMCPS should establish payment rates to bus contractors in a manner that ensures that the amounts are reasonable, by considering market conditions and actual costs. For example, we estimated potential cost savings of \$2.3 million over the estimated 12-year life of 63 buses owned by contractors if a particular payment component was based on market rates.

SMCPS Needs to Establish or Modify Certain Comprehensive Policies and Procedures

SMCPS needs to develop formal system-wide policies to control equipment, including physical inventory and recordkeeping requirements. In addition, SMCPS needs to reevaluate its policy of reimbursing bus contractors for federal excise taxes included with fuel purchases when paying contractors for fuel. According to federal law, the bus contractors are exempt from the federal excise tax and can recover the taxes paid when filing their federal income tax return. For fiscal years 2010 to 2013, SMCPS' fuel reimbursements to contractors included \$479,000 for the federal excise tax.

Background Information

Statistical Overview

According to student enrollment records compiled by the Maryland State Department of Education (MSDE), St. Mary's County Public Schools (SMCPS) ranks 12th in student enrollment among the 24 public school systems in Maryland. Fiscal year 2014 full-time student enrollment was 17,841 students. SMCPS has 27 schools, consisting of 17 elementary, 4 middle schools, 3 high schools and 3 other types of schools (including vocational, charter, and alternative).

According to SMCPS' audited financial statements, fiscal year 2014 revenues were \$234 million and expenditures were \$241.7 million. The largest expenditure category was salaries and wages, including benefits, which accounted for 76.3 percent of total expenditures during fiscal year 2014. According to MSDE records, during the 2013-2014 school year, SMCPS had 2,119 full-time equivalent positions, which consisted of 1,488 instructional and 631 non-instructional employees.

Oversight

SMCPS is governed by a local school board, consisting of five elected voting members and one non-voting student member. The State and the St. Mary's County government provide the vast majority of SMCPS funding. In addition, MSDE exercises considerable oversight through the establishment and monitoring of various financial and academic policies and regulations, in accordance with certain provisions of the Annotated Code of Maryland. MSDE also works with SMCPS to comply with the requirements and mandates of federal law. St. Mary's County government exercises authority over the SMCPS primarily through the review and approval of SMCPS' annual operating and capital budgets.

External Audits

SMCPS engages a certified public accounting firm to independently audit its annual financial statements. Additionally, the auditor conducts what is referred to as a Single Audit of SMCPS federal grant programs (as required by federal regulations). We reviewed the resulting financial statement audit and Single Audit reports for fiscal years 2013 and 2014, and examined the related

work papers for fiscal year 2013, which were the latest available at the time we performed our audit fieldwork.

The fiscal year 2013 Independent Auditor's Report on Internal Control over Financial Reporting identified both a material weakness and a significant deficiency. The weakness cited was due to the omission of certain activity related to the Fiduciary Fund used by SMCPS to partially fund their Other Post Employment Benefits liability, as well as certain capital assets and associated long-term liabilities from the financial statements. As a result, the prior year's financial statements had to be re-stated. For example, audit adjustments were recorded to reflect a change in net position of \$6.2 million related to the Fund and additional audit adjustments were recorded to reflect capital lease expenditures of \$4.5 million. The significant deficiency cited was the failure of existing supervisory review procedures to detect a \$204,000 overstatement of the accrued compensated absences liability. SMCPS agreed with the auditor's findings and agreed to implement their recommended corrective actions. These conditions affected financial reporting requirements and did not impact our audit scope or objectives. The above conditions were not cited for the fiscal year 2014 audited financial statements.

Due to similarities between the work of the independent certified public accounting firm that audited the SMCPS' financial statements and conducted the Single Audit, and the risks and scope of our audit in certain areas, we relied on the results of the independent audits to reduce the scope of our audit work related to revenues, federal grant activity, and food service inventory.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of 20 of the 29 findings contained in our preceding audit report dated April 9, 2009 (the 29 findings resulted in 20 detailed recommendations in that report). We followed up on these 20 findings based on our current assessment of significance and risk relative to the audit objectives. We determined that SMCPS satisfactorily addressed 14 of these findings. The remaining 6 findings are repeated in this report.

Findings and Recommendations

Revenue and Billing Cycle

Background

SMCPS revenues consist primarily of funds received from St. Mary's County, the State, and the federal government. According to the SMCPS audited financial statements, revenues from all sources totaled \$234 million during fiscal year 2014. In addition, schools collect funds for other purposes such as student activities, clubs, and school publications. Because they are not considered school revenue, these school activity funds are accounted for separately by each school and reported in summary in the audited financial statements. Although this revenue is raised through student-related activities, SMCPS has a fiduciary duty to safeguard these funds. For fiscal year 2014 school activity fund collections totaled \$4 million and the June 30, 2014 balance was \$1.5 million.

External Audits

Due to the similarities between the work of the independent certified public accounting firm that audited the SMCPS financial statements and the objectives of our audit in this area, we placed significant reliance on the results of the firm's audit for certain revenues and accounts receivable for which the auditor's procedural review and testing disclosed no material weaknesses or significant deficiencies.

Internal Reviews of School Activity Funds

The SMCPS fiscal office staff conducts reviews of individual high school and middle school activity funds annually and elementary schools at least every other year. The fiscal office staff's review of internal controls and tests of compliance with SMCPS policies, procedures, and guidelines for school activity funds at SMCPS schools identified some control weaknesses at certain schools. The fiscal office staff reports we reviewed disclosed that internal control weaknesses identified were not prevalent.

Federal Funds

Background

SMCPS receives funds pertaining to federal government programs that are generally restricted in use for a specific program (such as the School Lunch Program or Special Education). According to the audited Schedule of Expenditures of Federal Awards, fiscal year 2014 expenditures totaled \$16.8

million, not including federally funded fee-for-service programs such as Medicaid reimbursement for special education services.

Single Audit Report Disclosed No Reportable Conditions Regarding Federal Grant Management

Due to work performed by the independent certified public accounting firm that conducted the Single Audit of SMCPs' federal grants and the objectives of our audit in this area, we relied on the auditor's work and results. Besides expressing an opinion on SMCPs' compliance with the terms of several grant programs, the auditor also considered the existing internal control structure's impact on compliance and audited the required Schedule of Federal Awards (which includes claimed and reported grant expenditures) for fiscal years 2013 and 2014. The related reports stated that SMCPs complied, in all material respects, with the requirements applicable to its major federal programs. With respect to internal controls over compliance with, and the operation of, major federal programs, the auditors did not identify any material weaknesses or significant deficiencies.

Medicaid Funds Were Requested for Eligible Services

SMCPs had established a procedure to identify children eligible for Medicaid-subsidized services. Medicaid is an entitlement program for which certain service costs can be reimbursed to SMCPs. Medicaid activity is not covered by the Single Audit of federal grants. Our tests disclosed that reimbursement was requested for all tested Medicaid-subsidized services. According to agency records, fiscal year 2014 reimbursement for Medicaid-subsidized services totaled approximately \$1.6 million.

Procurement and Disbursement Cycle

Background

According to the audited financial statements and SMCPs records, non-payroll disbursements totaled \$57.3 million during fiscal year 2014. Requisitions are computer generated by the requesting department and must be approved by supervisory personnel (such as a respective department head). Approved requisitions are then converted to purchase orders and approved by a supervisor in the fiscal office. The SMCPs procurement policy provides that procurements valued at \$25,000 or higher be approved by the Board and be competitively bid, with the exception of textbook purchases, emergency repairs, sole-source procurements (the basis for which must be justified), and the use of intergovernmental purchasing agreements. The policy also requires solicitation of written quotes for purchases of \$1,000 or greater. Payments are processed by the finance department through an automated

system that prints vendor checks and posts the payment to the financial records.

Finding 1

SMCPS did not adequately restrict users' capabilities on its automated procurement and accounts payable system.

Analysis

SMCPS did not adequately restrict users' capabilities on its automated procurement and accounts payable system. Five employees were assigned capabilities that allowed them to perform incompatible functions and reviews of the transactions processed by these employees were either insufficient or non-existent.

Three accounts payable employees could add vendors, initiate and approve invoices, and print and obtain checks. Further, SMCPS had not established independent electronic approval requirements for critical documents, including invoices, although the system had this capability. Also, although manual disbursement review procedures had been established, they did not adequately compensate for the incompatible capabilities. These manual reviews did not include a review of appropriate supporting documents and were not independent, as the reviews were performed by one of the three employees with incompatible capabilities.

Two information technology employees could add vendors, and initiate and approve requisitions, purchase orders, and invoices; even though these capabilities were not required for their job duties. Further, these employees had system administrator access allowing them to add or change employee accesses and capabilities, including their own, in the automated system. Finally, there was no independent approval of changes to user access capabilities on the automated system.

As a result, unauthorized purchases and disbursements could be processed without detection. We commented on the failure to segregate incompatible functions and restrict system access to critical system functions, including procurement and accounts payable, in our preceding audit report.

Recommendation 1

We recommend that SMCPS strengthen its controls over the automated procurement and accounts payable system and processes. Specifically, we recommend that SMCPS

- a. restrict users' capabilities to eliminate the ability of users to perform incompatible duties (repeat);
- b. restrict access to the automated procurement and accounts payable system to individuals whose job duties require such access;
- c. establish independent electronic approval requirements for critical purchasing and accounts payable transactions, and changes to user capabilities; and
- d. require that both electronic and manual approvals be based upon an independent supervisory review of applicable supporting documents.

Finding 2

Contracts were not always awarded through competitive procurements and contract billings were not always properly verified prior to payment.

Analysis

SMCPS did not always use competitive procurements and obtain Board approval for contract awards as required or verify the propriety of certain billings prior to payment. Our test of 20 contractors who received payments totaling \$10.2 million for goods or services in fiscal year 2014 disclosed the following conditions:

- Nine contracts for special education services, each of which were over \$25,000, with payments totaling \$1.2 million were not competitively bid or supported by sole-source justifications and were not approved by the Board, as required by SMCPS policy.
- The propriety of vendor billings for two contracts for various hourly services with payments totaling \$2.8 million was not properly monitored. Specifically, one contractor's employees prepared time sheets that were approved by SMCPS supervisory personnel; however, the approved time sheets were not compared to the hours charged per the related vendor invoices. We noted that for the second contractor who provided special education services, no time sheets were on file to support the charges billed. As a result, there was a lack of assurance that the amounts billed were proper. Our review of approved time sheets that were available for the one contractor supported the charges on the related invoices we tested.

Recommendation 2

We recommend SMCPS

- a. in accordance with Board policies, procure contracts of over \$25,000 in value through a competitive process, document the justification for any

- sole-source procurements, and submit all contracts to the Board for approval; and
- b. verify the propriety of vendor invoices, which should include the submission and review of approved supporting time sheets as appropriate, prior to payment.

Human Resources and Payroll

Background

Payroll expense represents the largest single cost component in the SMCPs budget. According to SMCPs records, fiscal year 2014 salary, wage, and benefit costs totaled \$184.4 million, or 76.3 percent of the \$241.7 million total operating expenditures. According to Maryland State Department of Education reports, during the 2013 – 2014 school year, SMCPs had 2,119 full-time positions, which consisted of 1,488 instructional positions and 631 non-instructional positions.

SMCPs uses an automated system to maintain human resources (HR) information, record employee time, track leave usage, and to process and record payroll transactions. The system automatically generates semi-monthly time records, and any adjustments are processed by central payroll personnel. The system also generates payroll checks and direct deposit advices. Payroll processing involves both automated processes (such as compiling leave and running edit reports) and manual processes (such as data entry of new employee information).

Finding 3

HR and payroll system user capabilities were not adequately monitored and restricted. In addition, independent documented reviews of personnel and payroll transactions were not performed.

Analysis

Capabilities assigned to users that allowed them to perform critical HR and payroll system functions were not adequately monitored and restricted. In addition, certain employees were assigned capabilities that allowed them to perform incompatible functions and independent documented reviews of personnel and payroll transactions were not performed.

- Procedures for granting user access to the HR and payroll system and for the periodic verification of the propriety of existing user's access capabilities were inadequate. Specifically, the same employee was

responsible for submitting requests to the Information Technology Services Department (ITS) to establish user access capabilities and periodically monitoring the continued need for existing employee system access capabilities, without independent supervisory review.

- Certain critical HR and payroll system access capabilities, such as those allowing the changing of employee salary and direct deposit information, were not adequately restricted. Our review of the 16 users with these critical access capabilities, disclosed that 2 users could perform unnecessary or incompatible functions. Specifically, we noted that one ITS employee had unnecessary access and could perform all personnel and payroll functions, and an employee responsible for performing supervisory functions had payroll transaction processing capabilities. A similar condition regarding inappropriate access to critical system functions was commented upon in our preceding audit report.
- There was no independent review to ensure that processed employee personnel and payroll transactions were correct and appropriate. Available transaction reports of new employees added to the system or changes to employee data, including salary changes, were not generated for verification to source documentation by an independent employee. A similar condition regarding the lack of an independent review of personnel and payroll transactions was commented upon in our preceding audit report. Our test of human resources and payroll changes and adjustments did not disclose any inappropriate transactions.

Recommendation 3

We recommend that SMCPS

- a. ensure requests to establish user access capabilities are subject to independent supervisory review and documented approval,**
- b. limit access of critical functions to those employees who require such capabilities to perform their assigned job duties (repeat),**
- c. eliminate access to incompatible system functions (repeat), and**
- d. perform a periodic documented independent review of critical personnel and payroll transactions processed (repeat).**

Inventory Control and Accountability

Background

According to SMCPS audited financial statements, the undepreciated value of its capital equipment inventory totaled \$16.3 million as of June 30, 2014. SMCPS uses automated records maintained by its central fiscal office to track

equipment inventory with a cost of \$2,500 or more, and capitalizes inventory with a cost of \$5,000 or more for financial statement purposes. Sensitive equipment, defined as equipment items valued under \$2,500 that are subject to theft (such as computers), is recorded separately on a spreadsheet on a personal computer.

Finding 4

SMCPS equipment policies were not comprehensive and proper controls and recordkeeping were not established over sensitive equipment.

Analysis

SMCPS had not established a comprehensive equipment policy that specifies the related procedures and recordkeeping requirements to ensure uniform accountability and control over its schools' equipment inventory. SMCPS' current written policy did not provide a detailed description of the annual equipment inventory process to be performed by the schools, including the related recordkeeping requirements. Furthermore, the policy lacked specific requirements pertaining to tagging equipment, reporting of lost and stolen items, approving disposals, and separating the duties of equipment custody, inventorying, and recordkeeping.

Additionally, while the existing policy stated that items considered sensitive in nature that cost less than \$2,500 should be tracked and inventoried, the policy did not explicitly state how this was to be done. As a result, adequate controls were not established over SMCPS' sensitive equipment inventory records, which as of March 2014 listed 16,500 items totaling approximately \$10.6 million.

- An employee recorded sensitive inventory additions, disposals, and adjustments on a spreadsheet on a personal computer without independent verification of the transactions to supporting documents by supervisory personnel.
- At the time of our review, the inventory listed approximately 5,000 sensitive items (primarily information technology equipment) as disposed of during fiscal years 2009 to 2014, for which there was no recorded cost and no documentation of the disposals being approved.
- Numerous items on the sensitive inventory records had no value recorded and the recorded values of other items were significantly overstated. For example, our test of 15 sensitive items with a recorded value totaling

\$35,500 disclosed that 3 items with a listed value of \$18,900 had actually cost \$1,900 based on procurement records, and were overstated by \$17,000.

- As of July 2014, a documented physical inventory of sensitive equipment items had never been conducted.

Because of these deficiencies, equipment could be misappropriated without detection. Similar conditions regarding the lack of a comprehensive policy for disposals of equipment and physical inventories not being performed for sensitive equipment were commented upon in our preceding audit report.

Recommendation 4

We recommend that SMCPs

- a. establish and follow a comprehensive equipment policy for maintaining inventory records, tagging equipment, conducting physical inventories, reporting lost and stolen items, disposing of equipment (repeat), and separating key equipment functions;**
- b. conduct periodic physical inventories of sensitive items and reconcile results to the detail records, with differences investigated, and lost and stolen items properly reported (repeat); and**
- c. maintain complete and accurate inventory records for sensitive equipment items by recording the value of each item, and ensuring that additions, disposals, and adjustments are independently verified to approved supporting documents.**

Information Technology

Background

The SMCPs Information Technology Services Department (ITS) maintains and administers the SMCPs' computer network, computer operations, and instructional information systems applications. SMCPs operates a wide area network, with Internet connectivity, which connects the individual schools' local networks to the SMCPs centralized computer resources. ITS also supports the student information and the financial management systems, which include critical applications pertaining to student grades, student attendance, budgeting, accounts payable, and purchasing.

Finding 5

Controls over accounts, passwords, database access and logging, and monitoring of database security and audit events were not sufficient.

Analysis

Controls over accounts, passwords, database access and logging, and monitoring of database security and audit events were not sufficient.

- We reviewed the SMCPS' network domain that had approximately 3,400 active accounts as of August 2014. We identified 259 active domain accounts that belonged to terminated employees. We also noted 336 active (non-student) domain accounts with passwords that had not been changed in over a year and 30 of these accounts' passwords were set to never expire. Finally, we identified 13 accounts on the student information database with passwords not subject to length and complexity requirements. Best practices included in the State of Maryland Department of Information Technology's (DoIT) *Information Security Policy* stipulate that changes in employee status should be reflected immediately upon user exit from employment, and that passwords should be changed at least annually, be a minimum of eight characters, and meet specific complexity requirements.
- Two accounts had been granted excessive access and privileges to the student information database beyond what was required to perform their job duties. Specifically, these two accounts had been inappropriately given the ability to perform all configuration and maintenance activities (including deletion) on this database.
- Virtually no security and audit events for the student information database were being logged. As a result, significant database security and audit events could occur and go undetected, thus permitting unauthorized or inappropriate activities to adversely affect the integrity of the production data files.

Recommendation 5

We recommend that SMCPS

- a. implement strong account and password requirements in accordance with the best practices identified in the DoIT *Information Security Policy*;
- b. limit the assignment of access and privileges to the student information database to only those accounts requiring such access and privileges; and

- c. log all critical security and audit events, review these logs on a regular basis with appropriate investigation of unusual activity, document these reviews, and retain the documentation for subsequent verification.

Finding 6

The SMCPs computer network was not adequately secured.

Analysis

The SMCPs computer network was not adequately secured.

- Thirty-one publicly accessible servers were located in the SMCPs internal network rather than isolating these servers in a separate protected network zone. These 31 servers, if compromised, could expose the internal network to attack from external sources. Recommended security procedures, per the National Institute of Standards and Technology's *Guidelines on Firewalls and Firewall Policy*, include placing publicly accessible servers in an external protected zone to protect those servers as well as the entity's internal network.
- SMCPs did not use host-based intrusion protection systems (HIPS) on the 27 critical web servers that processed encrypted traffic. The absence of HIPS coverage for such traffic created a network security risk in that SMCPs' network-based intrusion detection prevention system cannot read encrypted traffic flowing into its network, whereas HIPS can read and analyze such traffic and protect critical web servers from malicious traffic.
- At 10 of SMCPs' 31 locations with wireless network connectivity, a wireless network connection to the SMCPs network could be obtained without authentication. As a result, anyone in the vicinity of these 10 locations could gain network level access to the entire SMCPs wired wide area network, including SMCPs critical systems.

Recommendation 6

We recommend that SMCPs

- a. relocate all publicly accessible servers to a separate protected network zone to limit security exposures to the internal network segment;
- b. perform a documented review and assessment of its network security risks and identify how HIPS coverage should be best applied to its network, and based on this review and assessment, implement HIPS coverage as necessary; and

- c. secure its internal network by only allowing properly authenticated users to access the internal network through its wireless connection network.

Finding 7

Workstations and servers were not sufficiently protected against malware.

Analysis

SMCPS workstations and servers were not sufficiently protected against malware.

- Anti-malware software was not installed on SMCPS servers and workstations that used certain operating systems. In this regard, we were advised by SMCPS network personnel that 229 workstations and 8 servers did not have anti-malware software installed.
- Although SMCPS used an enterprise-wide management tool to provide malware protection for the majority of its workstations and servers (excluding the aforementioned 229 workstations and 8 servers), SMCPS did not use the management capabilities of this tool (or manual procedures) to verify that the anti-malware software and related signature files were current for covered SMCPS workstations and servers. As a result of this condition, SMCPS lacked assurance that its covered workstations and servers were properly protected from malware.
- Certain workstations were configured with users having administrator rights. Administrator rights should be provided only to network administrators since these rights are the highest permission level that can be granted to users and it allows users to install software and change configuration settings. Our testing of eight employees' workstations disclosed that six of the related eight employees' user accounts were defined with administrator rights, rather than with user rights, and did not need these administrative rights. As a result, if these workstations were infected with malware, the malware would run with administrative rights and expose these workstations to a greater risk of compromise than if the workstations' user accounts were restricted to only user rights. In addition, users with administrative rights could disable their workstation's anti-malware software.
- Over 600 of the SMCPS' computers were running an operating system that was no longer supported by the software vendor. As a result of this condition, vulnerabilities associated with this operating system discovered

after the end-of-support date are no longer patched by the vendor, thereby exposing these computers to additional security risk.

- Seven of the eight workstations tested had not been updated with the latest releases for software products that are known to have significant security software related vulnerabilities. Although the vendors for these software products frequently provide software patches to address these vulnerabilities, SMCPs had not updated its workstations for these patches. For example, eight workstations tested for one of these software products noted that seven workstations were running older versions of this software, some of which dated back to March 2009.

Best practices specified by the DoIT *Information Security Policy* state that entities should configure security settings of information technology products to the most restrictive mode consistent with operational requirements and protect against malicious code by implementing protections that, to the extent possible, include a capability for automatic updates.

Recommendation 7

We recommend that SMCPs

- a. use its enterprise-wide management tool to ensure that anti-malware software is installed on all computers and that the related signatures are kept up-to-date,
- b. restrict administrative privileges on workstations to network administrators,
- c. only operate computers with vendor supported and fully patched operating systems, and
- d. ensure that all computers are kept up-to-date for all critical security related updates to potentially vulnerable installed software.

Facilities Construction, Renovation, and Maintenance

Background

SMCPs employs a staff of 162 employees to maintain its 27 schools and other administrative and support facilities. According to the fiscal year 2014 Capital Improvement Plan, necessary construction, major renovations, and systemic improvements to SMCPs facilities over the next six years were estimated to cost \$98.8 million.

Processes are in Place to Minimize Energy Costs

SMCPS has developed a comprehensive Energy Conservation Plan and has established goals, strategies and processes to minimize energy costs. For example, SMCPS utilizes an energy management system to monitor energy usage and employs an energy management program manager to monitor energy practices. In addition, SMCPS has installed certain higher efficiency replacement equipment (such as heating, ventilation and air conditioning) at a number of schools and has obtained available energy rebates. According to documents prepared by SMCPS (which were not audited), SMCPS has avoided over \$3 million in energy costs from fiscal year 2008 to fiscal year 2014.

SMCPS Contracts and Expenditures for Capital Projects Were Proper

Our review of nine construction-related procurements totaling \$25 million disclosed that SMCPS had used appropriate processes to procure all nine contracts, including obtaining Board approval. In addition, our test of invoices totaling \$3.7 million for these contracts disclosed that the invoices were properly reviewed and approved and the amounts invoiced were in accordance with the related contract terms.

Transportation Services

Background

SMCPS has approximately 17,900 students eligible to receive student transportation services. These students were transported on 198 buses of which 184 were owned and operated by contractors. According to SMCPS audited financial statements, fiscal year 2014 transportation costs totaled \$15.5 million, with \$12.6 million (81 percent) representing payments for contracted services. Of the 4.1 million reported route miles for the 2013-2014 school year 28 percent represented miles traveled to transport disabled students. Payments to bus contractors consist of amounts for the purchase of a bus (known as a per vehicle allotment or PVA, which consists of a reimbursement for the cost of the bus and a flat rate of return on investment), operation costs (covering contractor overhead costs, such as taxes, utilities, insurance, and management), hourly reimbursements for drivers and attendants, a per mile maintenance fee, and fuel costs.

Finding 8

SMCPS did not periodically perform a system-wide analysis of bus routes and use of related bus capacities to maximize the efficiency of its bus routes.

Analysis

SMCPS did not periodically perform a system-wide analysis of bus routes and use of related bus capacities to maximize the efficiency of its bus routes. Specifically, although SMCPS used routing software to develop its bus routes, it did not use the software to evaluate the efficiency of ridership on the buses on those routes to determine if any of those routes should be combined to increase per route student ridership. SMCPS did consider relevant factors, such as target capacities and student ride times in developing bus routes, but such factors alone do not ensure the efficiency of bus routes on a system-wide basis.

Our analysis of student ridership disclosed that ridership was significantly less than SMCPS' desired bus capacity. Specifically, our review of 340 regular routes' bus manifests (related to 156 buses) for the 2012-2013 school year disclosed that 157 routes (46 percent) were operated below 75 percent of SMCPS' desired capacity,¹ with 31 of those 157 routes operating at less than 50 percent of desired capacity. Further, 25 buses (representing 16 percent of the 156 buses reviewed) had no routes that were above 75 percent of the desired capacity. We recognize that St. Mary's County includes large rural areas, which can make it difficult to meet target capacities in all cases. However, as our analysis included all regular routes, the buses cited were not isolated to only rural regions of the county.

Recommendation 8

We recommend SMCPS periodically perform a system-wide analysis of all bus routes using the routing software to determine how per route ridership can be increased and the overall number of routes decreased to improve bus transportation efficiency.

¹SMCPS school bus capacities are lower than manufacturer stated capacities and differ depending on the school level. For example, the capacity for high school and elementary school routes is 48 and 59 students, respectively, based on 72-passenger buses (manufacturer stated capacity).

Finding 9

Certain SMCPS payments to bus contractors did not consider market conditions, actual costs, or available discounts.

Analysis

Certain elements used to determine payment amounts to bus contractors did not reflect market conditions, actual costs, or available discounts. SMCPS' bus contracts are for an initial six years with annual renewals generally granted over the 12-year useful life of the bus. Our review of the contract payments disclosed the following conditions:

- SMCPS pays contractors an annual PVA for each bus. The PVA reimburses the bus contractor for the cost of the bus with depreciation payments spread over the 12-year life of the bus, and provides an annual return on investment (ROI) for using the bus contractor's funds to buy the bus. Prior to fiscal year 2012, SMCPS had not developed a formal methodology to substantiate how the PVA was determined, which had previously included a ROI rate of 12 percent (a rate apparently in effect since 1981). Beginning in fiscal year 2012, SMCPS established a formula to calculate their PVA that included an average borrowing rate (established by obtaining rates from bus vendors and a local bank) for the ROI rate, which for fiscal year 2014 was 6 percent. The implementation of this new formula coincided with the creation of a separate reimbursement paid on a per vehicle basis for operation costs (see next bullet for comment on the operation cost reimbursement component). Consequently, any savings from the reduction in PVA due to the lowered ROI was offset by the additional reimbursement for operation costs. Adding an operations cost component on a per vehicle basis is a unique approach to the historical PVA formula that has been used by LEAs since 1981.

To estimate the financial impact to SMCPS of using their ROI rates over the life of a bus, we calculated the PVA for each of the 63 new buses placed into service from July 2009 through December 2013 using the prime interest rate² and SMCPS' 12-year estimated useful life in the PVA formula, and compared our PVA results to the SMCPS' PVA payments.³ This comparison showed that the SMCPS annual PVA payments per bus

²The use of the prime interest rate was recommended in a November 1999 study commissioned by another Maryland school system. Also, in 1975 an MSDE study recommended the prime rate as a reasonable ROI interest rate. The prime rate is actually a lending rate that nearly always exceeds the available market investment rate: therefore, it is deemed to be reasonable for the ROI calculation.

³Since SMCPS began using its revised formula in fiscal year 2012, the fiscal year 2014 rate of 6 percent has been the lowest rate used by SMCPS. Consequently, for conservatism, in our calculation we used 6 percent for the comparison to the prime interest rate.

were \$2,500 to \$4,300 higher than the payments would have been had the prevailing prime rate been used in the calculation. The effect is that, over the 12-year life of these 63 new buses, SMCPs will pay out approximately \$2.3 million more than if the prime rate was used for ROI to determine the PVA payments. This analysis does not include the effect of the new operation cost component, which was applied to all buses retroactively, or the effects for any new bus purchases that were made after December 2013 and the lost interest income that could have been earned by SMCPs on the aforementioned \$2.3 million. A similar condition regarding the appropriateness of the ROI used in the PVA calculation was commented upon in our preceding audit report.

- Beginning in fiscal year 2012, SMCPs included in their payments to bus contractors an amount for the reimbursement of certain costs of operation including overhead, such as taxes, rent, utilities, insurance, substitutes, and management. For fiscal year 2013, this amount was \$4,590 per bus; however, SMCPs could not substantiate the reasonableness of this amount. We were advised by SMCPs transportation officials that in prior years bus contractors had been paid a negotiated amount per bus, but in an effort to establish a supportable basis for these amounts SMCPs attempted to utilize its new PVA formula to calculate an amount, but that methodology did not provide the desired results; hence the creation of the new payment component. Furthermore, the per bus operations cost component has been increased each year since adoption; this effectively resulted in increasing the PVA total each year whereas the prior method retained the same PVA total for each year of the 12-year life of the bus. For fiscal year 2013, these payments totaled approximately \$835,000.
- SMCPs could not show that payments to reimburse bus contractors for maintenance costs were reasonable. For example, for fiscal year 2014, SMCPs agreed to pay a \$0.73 per-mile fee to reimburse the contractors for bus maintenance costs, without determining the appropriateness of the rate based on independently derived estimates.
- SMCPs did not exclude federal excise taxes when paying bus contractors for fuel. SMCPs pays contractors for fuel usage based on the average for diesel fuel prices, including taxes, (based on SMCPs surveys of local gas stations), divided by a miles per gallon rate established by SMCPs. However, according to federal law, SMCPs contractors are exempt from the \$0.244 per gallon excise tax on diesel fuel and are able to receive a credit for federal fuel taxes paid when they file their income tax returns. As a result, SMCPs' total fuel payments to bus contractors were \$479,000 higher than necessary for fiscal years 2010 through 2013.

Recommendation 9

We recommend that SMCPs

- a. use market investment rates as a basis for establishing contractor rates for the annual PVA (repeat),
- b. develop supportable cost estimates as the basis for establishing reasonable contractor rates for operation costs and per mile maintenance costs, and
- c. exclude federal fuel excise taxes from contractor payments.

Finding 10

Internal controls over payments to bus contractors were not adequate.

Analysis

Payments to bus contractors were not reviewed to ensure propriety. Specifically, one employee was responsible for entering data, including route miles, times, PVA, and fuel information, for each of the 184 contractor-owned buses into a system used to calculate the monthly payments. A summary report is generated of the monthly payments to each contractor and approved for payment in the Transportation Department. However, the summary report was not subject to review or comparison to supporting documents by an independent employee, even on a test basis. Further, the summary report was forwarded to the Finance Department for final processing and disbursement, however, no supporting documentation was included. Although, there was a lack of assurance that payments are accurate, our tests of these payments did not disclose any errors.

Recommendation 10

We recommend that SMCPs ensure that an employee independent of the payment processing verifies the accuracy and propriety of contractor payments, by comparison to supporting documentation, and documents the verification process.

Food Services

Background

SMCPs has 27 cooking cafeterias and 1 satellite kitchen at its 27 schools (1 school has multiple cafeterias due to housing students in multiple buildings). Food and related supplies are received and stored at each school. In fiscal year 2014 SMCPs had 141 food service positions (consisting of 133 cafeteria positions and 8 administrative positions). According to the audited financial

statements, food service revenues (\$7,047,646) exceeded operating expenditures (\$6,955,892) for fiscal year 2014, and for four of the last five years.

Finding 11

Cash receipt duties were not properly segregated as transactions could be voided by cashiers without independent review or approval.

Analysis

Cashiers in school cafeterias could void transactions on their automated point-of-sale cash register system without independent review or approval. SMCPs advised that it had previously instituted certain practices for direct supervisory oversight of voids, but the processes resulted in unacceptable delays in processing food sales in serving lines and were abandoned. The system is capable of generating output reports of voided transactions for subsequent review; however, SMCPs did not generate or analyze these reports for unusual activity, such as cashiers with high volumes of voids that may warrant further investigation or corrective actions.

A similar condition regarding the ability of school cafeteria cashiers to process voids without independent review or approval was commented upon in our preceding audit report. According to SMCPs records, over 63,000 void transactions were processed during fiscal year 2013 (we could not readily determine the related dollar value). According to SMCPs audited financial statements, food service revenues generated from charges for services totaled approximately \$3.1 million in fiscal year 2013.

Recommendation 11

We recommend that independent supervisory personnel review and approve voids at least on test basis, and that the reviews be documented (repeat). For example, SMCPs could generate periodic reports of all void transactions and document the analysis of this information for unusual trends that should be investigated, such as cashiers with abnormally high numbers of voids.

Finding 12

SMCPS did not perform documented independent verifications of validated deposits. In addition, electronic on-line student food services payments per bank statements were not reconciled to related student accounts.

Analysis

SMCPS procedures related to the deposit of cash collections and accounting for on-line payments posted to student food service accounts were not comprehensive.

- Although we were advised that SMCPS performed independent verifications of cafeteria sales to subsequent deposit, these verifications were not documented. Consequently, there was a lack of assurance that all collections per the automated cash register system had been properly deposited. We were able to confirm during our test of 20 days of collections received in March 2013 totaling \$22,400 that all funds tested were properly deposited. However, there was no evidence of an independent deposit verification being performed for any of the days tested. Cash collections for fiscal year 2013 totaled approximately \$2.1 million.
- No reconciliations were performed of on-line payments made (for example, by parents) to purchase student meals with the amounts credited to students' food services accounts. Although SMCPS was generating reports of student accounts from their electronic student food services system, they were not used to verify that all amounts credited to the accounts agreed with the funds received in SMCPS' bank account. As a result of the aforementioned condition, errors or irregularities in the processing of these deposits and the crediting of student accounts could occur and not be readily detected. During fiscal year 2013, on-line payments for student food services per related bank statements totaled approximately \$1,018,800, while only \$961,400 was credited to students' accounts per the electronic student food services system, a difference of \$57,400. While certain bank fees were charged for processing these payments and timing differences in recording the activity may have existed, SMCPS was not aware of this difference nor could they explain it.

Recommendation 12

We recommend that SMCPS

- a. perform documented independent verifications of cafeteria sales deposits;**
 - b. perform periodic reconciliations of on-line payments received as recorded on the bank statements and the amounts credited to students' accounts;**
- and**

- c. **investigate discrepancies identified, including the aforementioned difference, and take appropriate corrective actions, as warranted.**

School Board Operations

Background

The Board of Education of St. Mary's County (the Board) is composed of five elected members and one non-voting student representative. In its oversight responsibilities, the Board contracted with a certified public accounting firm for independent audits of the SMCPs financial statements and federal programs. The Board has not established any special committees.

SMCPs Adopted an Ethics Policy that Met the Requirements of State Law

In December 2011 the Board adopted a detailed ethics policy that conforms to State Law and includes provisions for conflicts of interest and financial disclosure and was approved by the State Ethics Commission. Provisions of this policy are applicable to Board members as well as all SMCPs employees. SMCPs established an Ethics Panel consisting of five members who are nominated by the Superintendent and appointed by the Board to interpret ethics policies and provide advice on policy implementation. The Panel also reviews and rules on any reported complaints of ethics violations. According to the ethics policy, annual financial disclosure statements are required to be filed by Board members, candidates for the Board, the Superintendent, and a number of other administrators (such as the Chief of Fiscal Services and Human Resources and school principals) by April 30th of each year. Our review of the 65 employees required to submit financial disclosure forms for calendar year 2012 disclosed that forms were submitted as required.

Other Financial Controls

Healthcare Background

SMCPs self-insures its employee and retiree healthcare costs. SMCPs contracts with a third party administrator (TPA) firm for health care claims processing services for employee medical (including vision), dental, and prescription costs. SMCPs also contracts with the TPA carrier for stop-loss coverage to protect against the risk of large claims each year. SMCPs verifies the eligibility of employee dependents prior to enrollment in the health care plans. Medical providers submit claims to the TPA who pays them on behalf of SMCPs. SMCPs subsequently reimburses the TPA for the paid claims and pays the TPA an administrative fee for these services. SMCPs healthcare expenditures totaled approximately \$34.4 million during fiscal year 2014

including \$1.6 million for administrative fees and \$1.2 million for stop-loss fees.

Finding 13

SMCPS did not competitively bid healthcare contracts for administrative services and stop-loss coverage and did not maintain copies of the annual agreements on file.

Analysis

SMCPS had not competitively bid the third party healthcare administrator and stop-loss insurance contracts for seven years and the Board had not approved the annual agreements. Furthermore, SMCPS did not have copies of the annual administrator agreements and stop-loss agreements on file for most of the seven-year period. As of August 2014, the only healthcare contracts on file were for fiscal years 2013 and 2014; those agreements were signed by SMCPS, but were not approved by the Board. Subsequently, certain prior years' contracts were obtained at our request from the health plan services vendor.

The SMCPS' TPA and stop-loss insurer contracts have been annually renewed since being awarded for plan year 2008. In 2006, SMCPS, in collaboration with the St. Mary's County Government (SMCG) issued a request for proposals for administrative claims processing and stop-loss insurance services. For each service, a one-year contract for the fiscal year 2008 plan year was awarded to an entity that had been its incumbent healthcare provider since 1982.

The original TPA contract, which was signed by a SMCG representative, provided for automatic renewal and an annual administrative fee increase of one percent plus the annual percentage change in the consumer price index. However, the resultant annual renewal agreements for each subsequent year, while including an increased fee amount, were silent on the issue of how the fee increases were determined by the TPA (it was not documented that they were calculated in accordance with the 2008 contract renewal terms).

We were advised that SMCG and SMCPS executed a separate stop-loss insurance coverage contract with the vendor for plan year 2008, but SMCPS was unable to locate a copy of the contract. When we eventually obtained the 2013 to 2015 stop-loss contracts, we noted that the insurer presented SMCPS with a premium amount in the contract, which SMCPS paid without evidence of negotiation or review to evaluate for reasonableness.

We determined that the administrative fees for medical, dental, and prescription claim processing increased by between 20 to 25.88 percent from 2008 to 2015. From 2013 to 2015, the premiums for stop-loss coverage increased by 10 percent (the amounts paid for previous years was not readily available since the related contracts were not on file).

Recommendation 13

We recommend that SMCPs

- a. periodically select healthcare services vendors (third-party administrator and stop-loss coverage) through competitive procurement processes;
- b. ensure that all healthcare contracts include provisions that specify how future year fees and rates will be determined, if the contract is to be subject to renewal;
- c. ensure fees billed are in accordance with the contract provisions;
- d. ensure all healthcare contracts are approved by the Board; and
- e. maintain copies of healthcare contracts and other related key records for at least 6 years or until audited.

Finding 14

SMCPs did not ensure the propriety of payments for employee and retiree healthcare costs.

Analysis

SMCPs lacked procedures and controls to ensure that amounts paid to the TPA were proper. Our review of SMCPs' procedures and controls over the contract and related payments for medical claims and administrative fees disclosed the following conditions:

- SMCPs paid for claim reimbursements invoiced by the TPA without any verification that the amounts invoiced were proper. SMCPs did not receive detailed claims data and therefore could not verify that the billed amounts agreed to the amounts of reported claims. Furthermore, SMCPs did not audit the propriety of the claims paid on its behalf by the TPA to ensure that the services were actually provided, were covered by the health plans, and were appropriately priced.
- SMCPs did not ensure that administrative fees for processing medical claims and stop-loss insurance premiums (which are based on the number of plan participants) paid to the TPA were proper. Although SMCPs compared the number of participants being billed on the monthly TPA invoice for the largest health care coverage category (medical) to its payroll medical coverage deduction count for reasonableness, SMCPs did

not verify the rates for the various fee categories (medical, vision, and dental) and stop-loss insurance premiums invoiced were in accordance with contract provisions.

- SMCPs did not verify the amount of claims that exceeded the stop-loss limit were proper. SMCPs relies on the TPA to notify it of any payments above the stop-loss limit. The amount computed by the TPA to be in excess of the stop-loss amount reduces the expenditure amount that SMCPs is responsible for. Since SMCPs did not receive detailed documentation of all claims paid and any stop-loss reductions made, SMCPs lacks assurance that it did not pay claims that should have been covered by the stop-loss insurance.

A similar condition regarding the need to ensure the propriety of healthcare costs was commented upon in our preceding audit report.

Recommendation 14

We recommend that SMCPs establish procedures to verify the amounts paid for health insurance and TPA service fees. Specifically, we recommend that SMCPs

- a. obtain documentation to support actual claim payments;**
- b. ensure that all amounts billed for claims, service fees and premiums are proper (repeat); and**
- c. use detailed claims payment data to ensure that claims paid above the stop-loss limit are reimbursed by the insurer (in this case the TPA).**

Audit Scope, Objectives, and Methodology

We conducted a performance audit to evaluate the effectiveness and efficiency of the financial management practices of the St. Mary's County Public Schools (SMCPS). We conducted this audit under the authority of the State Government Article, Section 2-1220(e) of the Annotated Code of Maryland, and performed it in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We had two broad audit objectives:

1. Evaluate whether the SMCPS procedures and controls were effective in accounting for and safeguarding its assets.
2. Evaluate whether the SMCPS policies provided for the efficient use of financial resources.

In planning and conducting our audit of SMCPS, we focused on 11 major financial-related areas of operations as approved on September 14, 2004 by the Joint Audit Committee of the Maryland General Assembly in accordance with the enabling legislation. The scope of the work performed in each of these areas was based on our assessments of significance and risk. Therefore, our follow-up on the status of findings included in our preceding audit report on SMCPS dated April 9, 2009, was limited to those findings that were applicable to the current audit scope for each of the 11 areas.

The audit objectives excluded reviewing and assessing student achievement, curriculum, teacher performance, and other academic-related areas and functions. Also, we did not evaluate the SMCPS Comprehensive Education Master Plan or related updates, and we did not review the activities, financial or other, of any parent teacher association, group, or funds not under the local board of education's direct control or management.

To accomplish our objectives, we reviewed applicable State laws and regulations pertaining to public elementary and secondary education, as well as policies and procedures issued and established by SMCPS. We also interviewed personnel at SMCPS and the Maryland State Department of Education (MSDE), and staff at other local school systems in Maryland (as appropriate). Our audit procedures included inspections of documents and

records, and observations of SMCPs operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives, generally for the period from July 1, 2010 through June 30, 2013. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected. For certain areas within the scope of the audit, we relied on the work performed by the independent accounting firm that annually audits SMCPs' financial statements and conducts the federal Single Audit.

We used certain statistical data—including financial and operational—compiled by MSDE from various informational reports submitted by the Maryland local school systems. This information was used in this audit report for background or informational purposes, and was deemed reasonable.

We also extracted data from the SMCPs automated financial management system for the purpose of testing expenditure and payroll transactions. We performed various audit procedures on the relevant data and determined the data were sufficiently reliable for the purposes the data were used during the audit.

SMCPs' management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate. In addition to the conditions included in this report, other less significant findings were communicated to SMCPs that did not warrant inclusion in this report.

We conducted our fieldwork from January 2014 to August 2014. The SMCPs response to our findings and recommendations is included as an Appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise SMCPs regarding the results of our review of its response.

APPENDIX



St. Mary's County Public Schools
Central Administration
Office of the Superintendent
23160 Moakley Street, Suite 109
Leonardtown, Maryland 20650

Phone: 301-475-5511 ext. 32178; Fax: 301-475-4270

Mr. J. Scott Smith
Superintendent

September 10, 2015

Mr. Thomas Barnickell, III
Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Room 1202
Baltimore, Maryland 21201

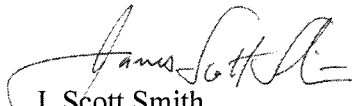
RE: Performance Audit Report

Dear Mr. Barnickell:

This is in response to your letter of August 21, 2015. Attached are the responses on behalf of St. Mary's County Public Schools to your audit report comments and recommendations. Per your request, an electronic copy is being sent to the Office of Legislative Audits at response@ola.state.md.us.

If you have any questions, please contact my office at 301-475-5511, ext. 32178.

Sincerely,



J. Scott Smith
Superintendent of Schools

JSS:dsa

Enclosure

cc: Mrs. Karin Bailey, Chairman, Board of Education
Mrs. Tammy McCourt, Assistant Superintendent of Fiscal Services & Human Resources
Dr. Jeff Walker, Assistant Superintendent of Supporting Services

St. Mary's County Public Schools

Financial Management Practices Performance Audit Management Response

Recommendation 1: We recommend that SMCPs strengthen its controls over the automated procurement and accounts payable system and processes. Specifically, we recommend that SMCPs: a) restrict users' capabilities to eliminate the ability of users to perform incompatible duties; b) restrict access to the automated procurement and accounts payable system to individuals whose job duties require such access; c) establish independent electronic approval requirements for critical purchasing and accounts payable transactions, and changes to user capabilities; and d) require that both electronic and manual approvals be based upon an independent supervisory review of applicable supporting documents.

Management's Response: There have been a number of changes to both staff and their associated duties within this past year, a thorough review of their access will be performed in FY 2016. A process set up in FY2015 includes the communication of all accounting software access changes to both the Assistant Superintendent of Fiscal Services and Human Resources and the Director of Information Technology.

To allow for an increased level of internal review, an independent level of approval will be instituted with accounts payable. Additionally, SMCPs is in the process of implementing a work flow solution for procurement processing, with the upgrade of our accounting software in FY2016.

Recommendation 2: We recommend SMCPs: a) in accordance with Board policies, procure contracts of over \$25,000 in value through a competitive process, document the justification for any sole-source procurements, and submit all contracts to the Board for approval; and b) verify the propriety of vendor invoices, which should include the submission and review of approved supporting time sheets as appropriate, prior to payment.

Management's Response: The existing Board procurement policies and regulations require board approval of contracts over \$25,000. The existing policies and regulations will be reviewed and modified to allow for greater clarity to staff. Once updated, training will be provided to all departments and schools.

SMCPs has a process in place for the hourly services contract, which was instituted in FY2015. Purchase orders must be generated for all temporary, contracted workers. Additional internal review will be provided by a Fiscal/Compliance Records Specialist for confirmation of the accuracy of the invoice to supporting timesheets.

Recommendation 3: We recommend that SMCPs: a) ensure requests to establish user access capabilities are subject to independent supervisory review and documented approval, b) limit access of

critical functions to those employees who require such capabilities to perform their assigned job duties (repeat), c) eliminate access to incompatible system functions (repeat), and d) perform a periodic documented independent review of critical personnel and payroll transactions processed (repeat).

Management's Response: As mentioned in the answer to #1, there have been a number of changes to both staff and their associated duties within this past year, a thorough review of their access will be performed in FY 2016. A process set up in FY2015 includes the communication of all accounting software access changes to both the Assistant Superintendent of Fiscal Services and Human Resources and the Director of Information Technology. At the time of the legislative audit, SMCPS did not have the staffing to segregate the necessary duties due to turnover. All payroll vacancies have since been filled. The Coordinator of Fiscal Services reviews the system generated audit reports of Pay Table and Payroll Activity.

Recommendation 4: We recommend that SMCPS: a) establish and follow a comprehensive equipment policy for maintaining inventory records, tagging equipment, conducting physical inventories, reporting lost and stolen items, disposing of equipment (repeat), and separating key equipment functions; b) conduct periodic physical inventories of sensitive items and reconcile results to the detail records, with differences investigated, and lost and stolen items properly reported (repeat); and c) maintain complete and accurate inventory records for sensitive equipment items by recording the value of each item, and ensuring that additions, disposals, and adjustments are independently verified to approved supporting documents.

Management's Response: Procedures are established in the fiscal services department for an annual update of inventory for all items over \$2,500 with required forms. We concur that a detailed process should be developed governing the fiscal records relating to the disposal of equipment, addressing physical inventories, reconciliation of inventories to financial records. This will improve accountability for our equipment resulting in the safeguarding of our property.

Recommendation 5: We recommend that SMCPS: a) implement strong account and password requirements in accordance with the best practices identified in the DoIT Information Security Policy; b) limit the assignment of access and privileges to the student information database to only those accounts requiring such access and privileges; and c) log all critical security and audit events, review these logs on a regular basis with appropriate investigation of unusual activity, document these reviews, and retain the documentation for subsequent verification.

Management's Response: All accounts will be reviewed, with necessary changes made so that all passwords are changed annually. We will develop a standard operating procedure that would review password expiration dates, restricted access for terminated employees, and modification of active directory settings. Access to the student information database has been thoroughly reviewed, with access limited now to only those employees requiring such access and privileges.

Recommendation 6: We recommend that SMCPS: a) relocate all publicly accessible servers to a separate protected network zone to limit security exposures to the internal network segment; b) perform a documented review and assessment of its network security risks and identify how HIPS coverage should

be best applied to its network, and based on this review and assessment, implement HIPS coverage as necessary; and c) secure its internal network by only allowing properly authenticated users to access the internal network through its wireless connection network.

Management's Response: We concur with this recommendation. The 31 servers will be placed onto a Demilitarized Zone (DMZ). A host based IDPS will be implemented as appropriate.

Recommendation 7: We recommend that SMCPs: a) use its enterprise-wide management tool to ensure that anti-malware software is installed on all computers and that the related signatures are kept up-to-date, b) restrict administrative privileges on workstations to network administrators, c) only operate computers with vendor supported and fully patched operating systems, and d) ensure that all computers are kept up-to-date for all critical security related updates to potentially vulnerable installed software.

Management's Response: We concur with the recommendations. However, due to budgetary constraints, we are challenged in implementing all of the recommendations at this time. We are close to removing the remaining Windows XP workstations. Removing the Administrative rights from the local workstations is underway and will continue over the current school year. We will use the A/V management dashboard and continue to improve the application and updates to the workstations.

Recommendation 8: We recommend that SMCPs periodically perform a system-wide analysis of all bus routes using the routing software to determine how per route ridership can be increased and the overall number of routes decreased to improve bus transportation efficiency.

Management's Response: SMCPs currently reviews bus routes and bus capacities to maximize efficiencies where possible. However, SMCPs Department of Transportation will review its procedure related to desired bus capacity to ensure it accurately reflects desired average student and desired maximum student capacities.

Recommendation 9: We recommend that SMCPs: a) use market investment rates as a basis for establishing contractor rates for the annual PVA (repeat), b) develop supportable cost estimates as the basis for establishing reasonable contractor rates for operation costs and per mile maintenance costs, and c) exclude federal fuel excise taxes from contractor payments.

Management's Response: SMCPs will review its payment amounts to school bus contractors, and ensure that supportable cost estimates and documentation is maintained. SMCPs believes its current rates are appropriate and reasonable. SMCPs payment rates to school bus contractors are among the lowest compared to other Maryland school systems. SMCPs will review the current fuel rates used for payments to school bus contractors. SMCPs already has the lowest fuel rate among school systems in the state of Maryland.

Recommendation 10: We recommend that SMCPs ensure that an employee independent of the payment process verifies the accuracy and propriety of contractor payments, by comparison to supporting documentation, and documents the verification process.

Management's Response: There are currently several employees involved in the payment calculation and approval process within the Department of Transportation. Additional internal review will be provided by a Fiscal/Compliance Records Specialist for confirmation of the accuracy of the invoice.

Recommendation 11: We recommend that independent supervisory personnel review and approve voids at least on test basis, and that the reviews be documented (repeat). For example, SMCPs could generate periodic reports of all void transactions and document the analysis of this information for unusual trends that should be investigated, such as cashiers with abnormally high numbers of voids.

Management's Response: We concur with this recommendation. A new process has been developed for recording of all voids and recapping them daily for the cafeteria manager's review. The daily voids will then be sent to the Food Service Coordinator along with the daily sales report for review and action. This new process was implemented August 2015.

Recommendation 12: We recommend that SMCPs: a) perform documented independent verifications of cafeteria sales deposits; b) perform periodic reconciliations of on-line payments received as recorded on the bank statements and the amounts credited to students' accounts; and c) investigate discrepancies identified, including the aforementioned difference, and take appropriate corrective actions, as warranted.

Management's Response: We concur with the recommendation of documented independent verifications of cafeteria sales deposits. This began in August 2015. Reconciliations of electronic on-line payments to the bank statements were implemented in December 2014. Following a detailed internal review conducted in the spring, the Department of Food Services will continue to work with the Department of Fiscal Services into the new school year to implement additional verification and reconciliation processes.

We disagree that there are discrepancies in funds. The difference in funds were a result of the vendor on-line payment processing fees being collected from parents for using the prepay website services.

Auditor's Comment: SMCPs has not been able to substantiate its assertion that the identified differences were attributable to online vendor processing fees.

Recommendation 13: We recommend that SMCPs: a) periodically select healthcare services vendors (third-party administrator and stop-loss coverage) through competitive procurement processes; b) ensure that all healthcare contracts include provisions that specify how future year fees and rates will be determined, if the contract is to be subject to renewal; c) ensure fees billed are in accordance with the contract provisions; d) ensure all healthcare contracts are approved by the Board; and e) maintain copies of healthcare contracts and other related key records for at least 6 years or until audited.

Management's Response: SMCPs had acknowledged the need for the competitive procurement of health care related benefit plans, administrative services, and stop-loss coverage. Prior to the issuance of these discussion notes, SMCPs began this process by initiating and completing a request for proposal for prescription drug benefits with the assistance of an independent contractor. SMCPs will take into

consideration the need to include provisions in health care related contracts for the governance of fee and rate increases. The Department of Human Resources will ensure that all health care contracts are approved by the Board and will maintain related documentation for a minimum of 6 years or until audited.

Recommendation 14: We recommend that SMCPs establish procedures to verify the amounts paid for health insurance and TPA service fees. Specifically, we recommend that SMCPs: a) obtain documentation to support actual claim payments; b) ensure that all amounts billed for claims, service fees and premiums are proper (repeat); and c) use detailed claims payment data to ensure that claims paid above the stop-loss limit are reimbursed by the insurer (in this case the TPA).

Management's Response: SMCPs does recognize the need to ensure the propriety of payments for employee and retiree health care benefit costs. This is an undertaking that cannot be fully implemented as an in-house solution. SMCPs will be addressing this limitation by proposing the securing of the services of a third party vendor for the verification and audit of health care insurance claims to include the reconciliation of claims paid above the stop-loss limit.

AUDIT TEAM

Raymond G. Burton, CPA, CFE

Edward L. Shulder, CPA

Audit Managers

Stephen P. Jersey, CPA, CISA

Information Systems Audit Manager

Ken H. Johanning, CPA, CFE

Senior Auditor

R. Brendan Coffey, CPA, CISA

John C. Venturella, CISA

Information Systems Senior Auditors

Jaime A. DeWitt, CPA

Isatta B. Mead

Staff Auditors

J. Gregory Busch

Edward O. Kendall

Information Systems Staff Auditors