



Board Agenda Item #	Agenda # II E
Date:	September 7, 2017
To:	Magnolia Board of Directors- Finance Committee
From:	Caprice Young, Ed.D., CEO & Superintendent
Staff Lead:	Nanie Montijo - CFO
RE:	SSCAL 1 <sup>st</sup> Management Letter (Draft) and MPS Response Letter

Proposed Board Recommendation

Informational/Discussion item, no action required.

Background

Presentation of School Services of California's 1<sup>st</sup> Management Letter regarding MPS fiscal oversight from January 2017 through June 2017.

Budget Implications

n/a

How Does This Action Relate/Affect/Benefit All MSAs?

n/a

Name of Staff Originator:

Nanie Montijo, CFO

Exhibits (attachments):

SSCAL 1<sup>st</sup> Management Letter (Draft)  
MPS Response Letter

August 25, 2017

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Ms. Nanie Montijo  
Chief Financial Officer  
Magnolia Education and Research Foundation  
DBA Magnolia Public Schools  
250 E. 1<sup>st</sup> Street, Suite 1500  
Los Angeles, CA 90012

RE: Management Letter #1

Dear Ms. Montijo:

Thank you for allowing School Services of California, Inc., (SSC) to assist Magnolia Public Schools (MPS) with the fiscal oversight activities as specified in the settlement agreement with the Los Angeles Unified School District (LAUSD). This is the first management letter submitted for the project.

### **Scope and Methodology**

MPS requested SSC to conduct fiscal oversight activities for each month from January 2017 through December 2017 for the following schools:

- Magnolia Science Academy
- Magnolia Science Academy 2
- Magnolia Science Academy 3
- Magnolia Science Academy 4
- Magnolia Science Academy 5
- Magnolia Science Academy 6
- Magnolia Science Academy 7
- Magnolia Science Academy Bell

The fiscal oversight activities conducted by the SSC team consist of the following activities as specified in the agreement between the Magnolia Education and Research Foundation and the Fiscal Crisis and Management Assistance Team dated August 25, 2015:

- Review a sample of monthly financial transactions that have been entered and processed in the charter's accounting system. This includes sample testing of various general ledger, accounts payable, accounts receivable, and payroll transactions. Testing for this review is based on sample selections; it does not include all transactions and records for this period. Documents chosen for testing are also reviewed for proper authorization. Sample testing and review results are intended to provide reasonable, but not absolute, assurance regarding the accuracy of the charter school's financial transactions, bank records, and reporting.
- Evaluate monthly reports, including but not limited to profit and loss, balance sheet, cash flow statements, and interim reporting requirements.
- Review each completed report for accuracy, reasonableness, and make recommendations, if any.
- Compare budget to actuals and make recommendations regarding any areas that may exceed the budget.
- Review the bank reconciliations and compare to the general ledger or balance sheet accounts.
- Prepare a monthly management letter summarizing our findings and make recommendations or suggest action steps (if applicable).

### Project Orientation Activities

On June 1, 2017, a project orientation conference call was held between the SSC project team and MPS. After the call, the SSC project team requested initial documents for project orientation purposes, such as staff contact lists, audit reports, the chart of accounts, and a list of bank accounts. On June 7, 2017, the SSC project team conducted an initial project orientation site visit to the MPS main office and met with the following staff members:

- Caprice Young, Ed.D., Chief Executive Officer (CEO)
- Nanie Montijo, Chief Financial Officer (CFO)
- Brock Atar, Senior Financial Analyst
- Cafer Turan, Senior Financial Analyst
- Lesia Charles, Accounts Payable Clerk
- Aubrey Marsh and Alexa Grau, EdTec Inc. (EdTec) (back office support provider) representatives

The purpose of the meeting was to determine the duties and authority of each individual related to the finances of the eight schools, the technology and overall procedures in use, and the segregation of duties between each staff member as well as between MPS and EdTec. We determined a protocol for regular communication with the CEO and CFO during the project and set up procedures to use online drop boxes for generating, requesting, and receiving the financial information necessary to conduct the fiscal oversight activities.

## Fiscal Oversight Activities

During the site visit on June 7, 2017, the SSC project team requested a detailed general ledger report of all transactions for all schools for the months of January through April 2017. The report was received from MPS on June 8, 2017, and on June 9, 2017, the SSC team reviewed the report, selected transactions for testing, and requested backup documentation for the transactions. On June 21, 2017, the SSC team received the first of the backup to the sample transactions. The results of our review are below.

## Fiscal Oversight Findings

### Financial Systems

MPS uses a variety of systems to handle its financial transactions. The primary financial support is provided by EdTec, who maintains the general ledger through NetSuite software, including budget and actuals. EdTec also prepares interim financial reporting and compiles the bank reconciliations on a monthly basis. Payroll is processed twice a month through PayCom, an independent third party. The payroll records are submitted to EdTec and loaded into NetSuite. Cash disbursements, and the related approvals, are maintained in CoolSIS, a third party software that is independent from both PayCom and NetSuite. The checks are cut by EdTec using downloads from CoolSIS.

### Monthly Financial Reports

EdTec provides monthly financial statements for each school. The financial statements include a cash flow as well as an income statement that includes the adopted budget, revised budget, current forecast, and several analytical columns.

The income statement provides a summary page with subsequent pages that break out revenues and expenses by detailed object code. The income statement provides significant detail and is setup in a very user-friendly format. However, the income statement combines unrestricted and restricted resources into one column. Local educational agencies in the state of California are required to report all activity using a resource code that identifies whether activity is unrestricted or restricted. The level of detail provided in the general ledger allows MPS to report financial information in this manner. This method of reporting is important for two reasons: (1) it's important to show that restricted resources are spent in an appropriate manner; and (2) whether or not the restricted programs require any support from unrestricted resources which is known as a contribution. Combining all the resources into one column prevents this analysis from occurring.

The segregation of NetSuite from PayCom and CoolSIS prevents MPS management from running real time reports. Although EdTec generates monthly reports by the 28<sup>th</sup> of the following month, and is available for questions during the month, MPS management is unable to query NetSuite on a daily basis to perform budget analysis, or even review account lines to ensure sufficient budget is available for purchases or to cover payroll expenses.

### **Accounts Payable (Cash Disbursements)**

SSC selected 10 transactions for each month for a total of 40 selections. Each selection was reviewed by applying the following criteria:

- Request for purchase was accompanied by a pre-approval, prior to the receipt and/or payment of the invoice
- Payment does not exceed the total value of the request
- Payment is supported by appropriate supporting documentation (request, invoice, packing slip, etc.)
- Payment is properly coded
- Payment is recorded in the general ledger

The results of the testing identified that a significant number of accounts payable transactions (16 of 40) had no evidence of pre-approval prior to the receipt of an invoice. Pre-approval is important for several reasons:

- Ensure goods or services are appropriate and in compliance with applicable laws
- Determine sufficient resources are available
- Review purchases for best price

The absence of the pre-approval is in conflict with MPS' Financial Policies and Procedures Manual (Manual) and creates additional risks relative to the reasons listed above.

The results of our testing also disclosed that 12 of 40 transactions did not have sufficient support to identify that the goods had been received. Prior to payment of an invoice, an individual in the organization should provide documented evidence that all goods have been received, which can be notated through a signature on a packing slip.

### **Bank Reconciliations**

SSC selected two reconciliations each month for a total of eight selections. Each selection was reviewed by applying the following criteria:

- Reconciling items appears reasonable in nature and amount

- Electronic transfers appear reasonable in nature and amount
- Outstanding items appear reasonable and timely
- Cash balance on the reconciliation matches cash balance on bank statement
- Reconciled cash balance matches cash balance in the general ledger

The results of our testing identified four separate reconciliations that included outstanding checks at least six months old. The first bank reconciliation included one check to a vendor that was issued eight months prior. A second bank reconciliation included three outstanding checks to vendors and employees from eleven and nine months prior. The third reconciliation included three payroll checks issued six months prior, and one check to a vendor issued seven months prior. Finally, the fourth reconciliation included a payment to LAUSD that was six months old. The presence of outstanding checks is not unusual; however, MPS should review the items monthly to determine the cause behind the outstanding items and whether the item should be written off.

The MPS Manual includes a component on bank reconciliations. This component states that any “outstanding check over six months old should be reviewed for disposition including write-off by journal entry.” Absent a unique circumstance, the testing above disclosed two items which should have been written off per the manual. The manual also notes that the CEO or designee is responsible for review and approval of all reconciliations. The bank reconciliations are prepared by EdTec, and reviewed monthly by the Senior Financial Analysts. Evidence was provided that showed communication between EdTec and the Senior Financial Analysts regarding the outstanding items.

### **Accounts Receivable (Cash Receipts)**

SSC selected 10 transactions for each month for a total of 40 selections. Each selection was reviewed by applying the following criteria:

- Supported by copy of prenumbered receipt(s)
- Supported by deposit receipt from bank and cash count slip (local deposits)
- Supported by supporting documentation from LAUSD (state and federal deposits)
- Amount is properly included on monthly bank statement and reconciliation
- Amount is properly coded
- Amount is properly recorded in the general ledger

The results of our testing disclosed that 10 of 40 transactions did not have sufficient support to identify if all cash received was included in the deposit. The transactions related to fundraising at the school site, and a cash count form was completed and signed, but there were no prenumbered receipts to accompany the cash count form. The absence of the receipts, while not in conflict with

the MPS Manual, does create risks. The prenumbered receipts provide a method to verify the completeness of the deposit. Without an accurate receipt log, there is no way to determine if all the cash collected was included in the deposit.

The results of our testing also disclosed that 8 of 40 transactions did not have sufficient support to verify the total award. Many of the state and federal transactions flow through LAUSD. Although the supporting journal entry was included, there was no award letter from the state or federal agency to support the amounts in the journal entry.

## **Payroll**

SSC selected 5 transactions for each month for a total of 20 selections. Each selection was reviewed by applying the following criteria:

- Salary is supported by a signed contract, as applicable
- Hours are supported by timesheet report from PayCom, as applicable
- Gross pay is properly calculated
- Net pay is properly calculated and based on reasonable deductions
- Payment is recorded in the general ledger

The results of our testing identified that all transactions included accurate support for the number of hours worked. Hourly employees submit their time into PayCom and their supervisor is required to approve the hours electronically.

The results of our testing disclosed areas for improvement around the structure of the contracts. MPS' current practice is to provide an employee with a contract that states the pay rate, as well as extra duty pay and performance pay. The extra duty pay rates are documented on a prescribed schedule attached as a contract addendum, but no prescribed salary schedule was provided to support the base pay rate. It's conceivable that these pay rates are discussed internally, but no documentation was provided to support the final rates affixed to the contracts.

The contract is signed by the employee and the site principal. In the case of principal contracts, a regional director affixes their signature. However, there does not appear to be any additional layer of review from the central office. Furthermore, MPS processes payroll twice a month, but the classified contracts state that employees will be paid biweekly. This could create confusion for employees if they are expecting checks more frequently.

Although MPS has a Manual that covers many of the financial processes, it does not contain any language related to payroll. The absence of procedures could lead to discrepancies in duties from site to site. MPS staff is constantly updating the Manual, and an update related to payroll processes was approved by the Board in March, 2017.

## Recommendations

1. **Consider reviewing financial reports with segregation between unrestricted and restricted.** The current format of the reports combines unrestricted and restricted, and convolutes the financial picture of the school. It prevents the user from determining if the restricted programs require support from unrestricted programs. MPS should consider an additional level of reporting, at least at the summary level, which separates unrestricted and restricted activity.
2. **Consider consolidating to one financial system.** MPS processes its payroll and cash disbursements through two independent systems that are maintained by separate third parties. The information from both of these systems is then transmitted to NetSuite, a different third party system. In an effort to streamline services, and increase accessibility to information, MPS should consider a service that incorporates all three processes into one database.
3. **Consider developing a pre-approval process for accounts payable.** MPS policies require employees to enter all purchase requests into CoolSIS before the order is submitted. The practice of requesting preapproval appears to be the exception, as a significant number of transactions were entered after the invoice was received. MPS should consider reinforcing the practices of obtaining pre-approvals as outlined in the MPS Manual.
4. **Consider requiring additional documentation prior to making payments to vendors.** The MPS Manual states that invoice and supporting documentation, such as a packing slip and/or receiving reports, shall be provided to the back office provider to document that all goods have been received. This internal control provides assurance that all goods were received, and were checked off at the time of receipt. The absence of supporting documentation to accompany the invoice could generate a payment for goods that were never received. MPS should consider reinforcing the practices of requiring supporting documentation before making payments to vendors as outlined in the MPS Manual.
5. **Consider requiring school sites to maintain prenumbered receipt books and remit the copies of the receipts with the deposits.** Submission of cash count forms from the sites is an important step in the internal control process surrounding cash receipts. However, a critical step when collecting cash is the ability to verify the completeness of the cash that is submitted. The absence of prenumbered receipts that should accompany the cash creates a void around the ability to verify that all the cash has been submitted. MPS should consider requiring sites to submit prenumbered receipts, or some alternate form, along with all cash deposits.
6. **Consider attaching a copy of the award letter to supporting documentation from LAUSD.** Similar to the recommendation above regarding prenumbered receipts, the absence of an award letter for deposits from LAUSD prevents the central office staff from determining if the deposit of state and federal funds is complete. MPS should consider attaching the award letter to the deposits to ensure that the correct amount of money was deposited.



7. **Consider amending the language of the contracts to match the pay periods.** Matching up the language in a signed contract to the practice of MPS is very important to prevent any miscommunication with employees. Absent a change, MPS may need to institute a separate pay cycle for the employee with a contract that contains the “biweekly” language. MPS should consider changing the language in the contracts going forward to semimonthly, or twice a month.
8. **Consider including an additional signature on employee contracts for a designee from the central office.** MPS operates a number of schools which operate very autonomously. However, in a typical central office setting, the central office is responsible for offering employment contracts and signing said contracts. In the case of MPS, the principals are responsible for signing the contracts which include pay rates. MPS should consider adding a higher level of approval from the central office to verify the components of the contract.

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## Conclusion

This management letter encompasses the fiscal oversight activities for January 2017 through April 2017. Thank you for allowing SSC to provide our services to MPS. If you have any questions about our work or this management letter, please do not hesitate to contact us.

Sincerely,



CAROL WOLFE  
Chief Financial Officer



MATT PHILLIPS, CPA  
Director, Management Consulting Services

cc: Caprice Young, Ed.D., CEO, MPS  
Jose Cole-Gutierrez, Director, Charter Schools Division, LAUSD

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Sept 1, 2017

Jose Cole Gutierrez, Director CSD  
Los Angeles Unified School District  
333 South Beaudry Avenue, 20<sup>th</sup> Floor  
Los Angeles, CA 90017

**RE: MERF's Response to SSCal First Management Letter**

Dear Mr. Gutierrez:

The purpose of this letter is to respond to the SSCAL's Management Letter #1 covering January 1, 2017 through April 30, 2017.

MPS staff agrees to all the fiscal oversight findings stated in this letter. However, as of this writing, the following changes and modifications in conducting financial business transactions are either already implemented or in process:

- MPS requires separate financial reports for unrestricted and restricted general fund accounts from Edtec starting July 1, 2017
- MPS and the Coolsis team developed enhancements to the existing system to customize the software to better serve our needs.
  - Board Approved Budgets will be uploaded to the purchasing software and will be part of the purchasing and payment approval process. Budget Tracker Enhancement will allow a budget check on all account codes to ensure the items does not exceed budgeted amounts. This process is scheduled to be in place by October 2017.
  - Vendors information and resource codes are now system requirements before sending any request for approval.
  - Payment history report is now available to all users.



- Approval limits by level of authority have been set to ensure compliance to fiscal policy
- Preferred vendors and invoices are centralized to CMO office for visibility on timely payments and accounts payable aging.
- Pre-numbered receipts are required back up documents for all cash deposits
- Human Resources Department made changes to all 2017-18 contracts to match fiscal year and pay periods.
- Additional signatures on employee contracts are executed via Paycom PAF routing feature.