

Board of Education of Howard County

**Independent Auditor's Report on Internal Control
over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial
Statements Performed in Accordance with
*Government Auditing Standards***

June 30, 2019

Independent Auditor's Report on Internal Control over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

To the Board of Education
Howard County, Maryland

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Howard County Public School System ("HCPSS"), a component unit of Howard County, Maryland, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise HCPSS's basic financial statements, and have issued our report thereon dated October 31, 2019, which included adverse opinions on the General Fund and the Aggregate Remaining Fund Information as indicated on page 1.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered HCPSS's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of HCPSS's internal control. Accordingly, we do not express an opinion on the effectiveness of HCPSS's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as items 2019-001, 2019-002, and 2019-003 that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether HCPSS's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Howard County Public School System's Response to Findings

Howard County Public School System's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Howard County Public School System's response was not subjected to the auditing procedures applied in the audit of the financial statements and accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CohnReznick LLP

Baltimore, Maryland
October 31, 2019

Howard County Public School System
Schedule of Findings and Questioned Costs
June 30, 2019

2019-001 - Revenue Recognition

Statement of Condition: The accounting records for the Restricted Programs Fund required numerous material adjustments to be proposed and recorded in order for the financial statements to be fairly presented in accordance with accounting principles generally accepted in the United States of America.

Criteria: Internal controls over financial reporting should exist to ensure that material misstatements are prevented or detected and corrected by management in a timely manner.

Cause: Management did not have a sufficient understanding over the terms of various grants and similar programs.

Effect: Management may produce interim or annual financial statements that are materially misstated.

This is similar to a finding from the prior audit.

Recommendations: We have the following recommendations related to the internal control processes that impact revenue recognition in the Restricted Programs Fund:

- We recommend that HCPSS ensure the individuals responsible for both the recording and approval processes related to revenue recognition in the Restricted Programs Fund have a sufficient understanding of the laws, agreements and accounting principles pertinent to the grants and similar programs associated with the fund.
- We recommend that, no less than quarterly, HCPSS review the activity recorded to each grant or similar program and reconcile it to related grant reimbursement or funding requests. We recommend that the review and reconciliation process be documented.

View of Responsible Officials:

Overview Statement from the Responsible Officials:

During the audit period, HCPSS experienced a high rate of staff turnover for its fiscal management functions. Several key positions were vacant or vacated during this audit period. The absence of crucial fiscal management positions brought to the district management's attention underlying concerns with the fiscal management control environment and the organizational structure. Management acknowledges that there have been material weaknesses and has developed a corrective action plan.

This corrective action plan generally addresses the three findings identified in the audit report. A summary of the action plan applicable to all findings and recommendation is only included in the first finding to avoid repetition. Under the response for each finding, management has included additional information specific to understanding the finding and the actions that will be taken to implement the audit recommendation. Overall, management accepts all of the recommendations and thanks the audit team for their exceptional work in identifying areas to enhance the District's fiscal stewardship.

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In August 2019, the Superintendent reorganized the business functions of the school system to begin strengthening the fiscal management environment with a focus to improve accountability and to build sustainability in the system's business operations. First, a comprehensive organizational restructuring was implemented for the budget and finance functions. This restructuring aims to establish clearer alignment of the budget and finance work programs. The goal is to enhance the District's budget planning, accounting, fiscal oversight, and financial stewardship. To that end, the technology function, which was with the Finance function, has been reassigned to a different management team. In addition, a Chief Administrative Officer ("CAO") position was created. This position reports directly to the Superintendent and has oversight of the budget and finance teams. The budget neutral reorganization enabled the CAO to add capacity within the budget and finance positions, including filling two separate leadership roles – one to oversee budget and one to oversee accounting and payroll.

The second part of the action plan is a fundamental review of the budget and finance work processes, policies, and procedures. Expertise in the area of public school financial management will be sought to guide the District's process improvement according to national best practices and accounting standards. The objective is to ensure the necessary work programs, staffing levels, designation of duties, and policies and procedures are in place for sound fiscal management, use of generally accepted accounting principles, and effective staff training.

View of Responsible Officials Pertaining to 2019-001

HCPSS does not disagree with this finding and accepts both recommendations. The grants management work program is being reviewed by the CAO. Appropriate policies, procedures, and trainings will be adopted to ensure effective performance and timely reconciliation, review, and reporting for all grants.

2019-002 - Yearend Close Process

Statement of Condition: There were multiple audit adjustments required to accounts that are reconciled and adjusted as part of the yearend close process. Additionally, the HCPSS' financial statements were not finalized timely in relation to its external deadlines.

Criteria: Internal controls over financial reporting should exist to ensure for timely reporting of financial statements that are free of material misstatement.

Cause: The financial close process is not designed to prevent, detect and correct material misstatements or to produce complete, timely and accurate reports.

Effect: The lack of sufficiently designed and documented accounting policies and procedures related to the financial close and reporting process resulted in HCPSS not meeting its financial reporting requirements and in preparing draft financial statements that were not free from material misstatement. Material misstatements were noted in the General Fund.

Recommendations: We have the following recommendations to allow HCPSS to design and implement a sufficient yearend close process:

- HCPSS should fill all open accounting, budgeting, and financial reporting related positions with qualified candidates as soon as possible;
- HCPSS should incorporate a position above the Accounting Manager whose responsibilities include supervising and reviewing the yearend financial close process to ensure that significant errors occurring in the preparation process are caught in a timely manner;

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- The HCPSS should ensure the accounting department is adequately staffed with qualified personnel so that upper level management doesn't have to step into the preparer role, and can adequately review the closing process results;
- The financial close process be formally documented, in a manner that is detailed and thorough, to be used to enhance the yearend closing process with regards to accuracy, efficiency and timeliness, as well as better prepare the accounting department in the event of significant employee turnover.

View of Responsible Officials:

HCPSS does not disagree with this finding and accepts all four recommendations. As noted in the Overview Statement, the accounting function was significantly impacted by staff turnover. To ensure continuity of service and an effective year-end close process, HCPSS will review all existing practices and adopt the necessary policies, procedures, and trainings to ensure best accounting practices are followed.

2019-003 - Internal Service Fund Accounting

Statement of Condition: It was determined that material adjustments to the accounting records would be needed to report in accordance with generally accepted accounting principles.

Criteria: Internal controls over financial reporting should exist to ensure that material misstatements are prevented or detected and corrected by management in a timely manner.

Cause: Management did not have a sufficient understanding of various accounting principles that impact internal service fund accounting and financial reporting.

Effect: Management has produced financial statements that are not in accordance with accounting principles generally accepted in the United States of America resulting in an adverse opinion on the General Fund and Aggregate Remaining Fund Information opinion units.

Recommendations: We recommend that HCPSS hire additional resources to implement all generally accepted accounting principles applicable to internal service funds. This includes, but is not limited to:

- Accounting principles regarding establishing amounts that the internal service funds charge other user funds
- Accounting principles regarding recovering deficits when charges to other funds do not recover the operating expenses of an internal service fund
- Formalize a plan to eliminate the deficit in the Health and Dental Fund in a reasonable time frame
- Accounting principles regarding the maintenance of interfund balances
- Accounting principles regarding the presentation of charges to user funds in excess of operating expenses and provisions for catastrophe losses

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View of Responsible Officials:

HCPSS does not disagree with this finding and accepts all five recommendations. Ensuring generally accepted accounting principles are followed in the Internal Service Funds will help address this finding as well as the factors discussed by management in the Overview Statement. However, the deficit net position balance at June 30, 2019 in the Health and Dental Fund is a result of several years of underfunding for health care costs. HCPSS has initiated efforts to contain the growth of the deficit. Specifically:

- The Board of Education ("BOE") reduced spending in other budget areas to fund current year health care costs for the FY19 and FY20 budgets;
- The Superintendent has committed to keep spending freezes in effect to generate savings that can be applied to pay down the deficit incrementally; and
- The Superintendent intends to bring forward at the November 7, 2019 BOE meeting and a subsequent County Council meeting, a request to use the entire unassigned General Fund balance to reduce the deficit. This will reduce the deficit from \$39.2 million to \$24.0 million, a significant reduction for a debt that accrued over numerous fiscal years.

HCPSS will continue to use these three strategies until the budget deficit is eliminated. HCPSS will also request the use of any available one-time funds from Howard County Government to help eliminate the deficit. Unfortunately, due to the variable nature of the annual yearend and turnover savings, HCPSS cannot commit to specific dollar amounts that will be used to reduce the deficit each year. Finally, eliminating the deficit is the first measure to stabilize the Health and Dental Funds. Therefore, HCPSS will undertake additional measures such as establishing fund balance and reserve policies to ensure the fund is sustainably managed.

Board of Education of Howard County, Maryland
 Howard County Public School System
 10910 Clarksville Pike
 Ellicott City, Maryland 21042

HCPSS RESPONSES TO MANAGEMENT LETTER

In planning and performing our audit of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Howard County Public School System ("HCPSS"), a component unit of Howard County, Maryland, as of and for the year ended June 30, 2019, in accordance with auditing standards generally accepted in the United States of America, we considered HCPSS's internal control over financial reporting ("internal control") as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of HCPSS's internal control. Accordingly, we do not express an opinion on the effectiveness of HCPSS's internal control. We refer you to our Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* dated October 31, 2019.

During our audit, we became aware of the following matters, which we believe represent opportunities for strengthening internal controls and operating efficiency:

Resource Management

During the fiscal year and up through our report date, the finance department experienced turnover or maintained vacant positions at the Chief Business and Technology Officer, Accounting Manager, Executive Director - Budget, Coordinator - Financial Planning and Analysis, and Business Process Specialist positions. Due to the loss of key personnel mentioned above and their institutional knowledge, as well as a lack of formalized standard operating procedures in several internal control processes, we observed several challenges in obtaining timely and accurate information related to our audit; specifically, accurate final adjusted trial balances, supporting schedules, and draft financial statements.

Recommendations

To minimize impacts from any future turnover and to help with continued job satisfaction, we recommend that the finance department management consider the following:

- Cross train roles and duties;
- Reassess and/or implement formalized standard operating procedures to make sure all areas of the finance department are operating at an optimal level. Ensure that the documented policies and procedures include all key processes, roles and responsibilities as well as how each process incorporates the use of HCPSS's financial system, WorkDay;
- Consider a post-implementation review of the recently implemented enterprise management system, WorkDay, to ensure that the expected benefits of implementing the new system are achieved, maintained, and codified and opportunities for further improvement are identified and implemented. Without a post-implementation review, it can be difficult to demonstrate that the investment in the project was worthwhile and whether there are any additional opportunities to enhance the use of the system in a cost-effective manner.

Management Response

Management concurs with the recommendations. In August 2019, the Superintendent reorganized the business functions of the school system to begin strengthening the fiscal management environment with a focus to improve accountability and to build sustainability in the system's business operations. First, a comprehensive organizational restructuring was implemented for the budget and finance functions. This restructuring aims to establish clearer alignment of the budget and finance work programs. The goal is to enhance the District's budget planning, accounting, fiscal oversight, and financial stewardship. To that end, the technology function, which was with the Finance function, has been reassigned to a different management team. In addition, a Chief Administrative Officer (CAO) position was created. This position reports directly to the Superintendent and has oversight of the budget and finance teams. The budget neutral reorganization enabled the CAO to add capacity within the budget and finance positions, including filling two separate leadership roles – one to oversee budget and one to oversee accounting and payroll.

Additionally, HCPSS will undertake a fundamental review of the budget and finance work processes, policies, and procedures. Expertise in the area of public school financial management will be sought to guide the District's process improvement according to national best practices and accounting standards. The objective is to ensure the necessary work programs, staffing levels, designation of duties, and policies and procedures are in place for sound fiscal management, use of generally accepted accounting principles, and effective staff training.

A post-implementation review for WorkDay is a sound practice. At the appropriate time, management will conduct a review.

Grant Management

We noted that reimbursement/funding requests related to grants were not submitted by HCPSS timely, including, in at least one instance, for over three months. Infrequent submissions result in extended delays in receiving monies, less cash available for expenditure, and results in a loss of interest income.

Recommendations

We recommend that HCPSS develop formal procedures related to grant management that, at a minimum, includes:

- Roles and responsibilities for preparing funding requests and recording related receivables in the financial reporting system;
- Formal review process that is distinct from the person who prepares the request and the person who records the request into the financial reporting system;
- Frequency of funding requests, which we believe should be no less than monthly;
- Maintains documentation that supports the request amount and is reconciled to the financial reporting system at that point in time;
- Procedures to reconcile receipts of grant funding to initial requests;
- Procedures for identifying and acting on receivables that are not received from agencies timely;
- Identification of alternative procedures in the absence of personnel that are key to the process.

Management Response

Management concurs with the recommendations. HCPSS is undertaking a fundamental review of the budget and finance work processes, policies, and procedures. Expertise in the area of public school financial management will be sought for the Finance Coordinator position to guide the District's process improvement according to national best practices and accounting standards. The objective is to ensure the necessary work programs, staffing levels, designation of duties, and policies and procedures are in place for sound fiscal management, use of generally accepted accounting principles, and effective staff training. This fundamental review will give specific attention to Grants Management.

Management Estimates

We noted that management did not have established procedures to sufficiently support its estimates for Incurred but not Reported ("IBNR") claims liabilities. Management utilized estimates provided by third party administrators and historically used a third-party actuary to provide estimates every third year. No documentation was available to support management's consideration of the validity of these estimates.

Recommendations

We recommend that HCPSS review accounting principles related to management estimates and the use of third party experts, and that HCPSS establish procedures to document its comfort with the estimates recorded. This could include, but would not be limited to, reviewing actual experiences to the prior methods to gain comfort over methodologies being used. It would also be prudent to utilize the same methodology annually, assuming it continues to produce reasonable estimates.

Management Response

Management concurs with the recommendation. The recommendation specifically relates to the methodologies used for worker's compensation insurance IBNR. HCPSS will review current policies and procedures to ensure accounting best practices are adhered to.

External Reporting

HCPSS has various financial reporting requirements with the Maryland State Department of Education (MSDE). During the course of our audit we were made aware of various reports for which the historical submissions to MSDE may have improperly excluded internal service fund activity. The impact of including this activity could result in the "Current Expense Fund" (as defined by MSDE's Financial Reporting Manual for Maryland Public Schools) showing a deficit net position on the reports to MSDE. The historical reports do not reflect a deficit net position.

Recommendations

We recommend HCPSS management review the reporting requirements for each submission required by MSDE and document their understanding of how to properly report internal service fund activity, whether it has been done properly historically, and if not, how it should be corrected.

Management Response

All financial reports submitted to MSDE have been accepted by MSDE and HCPSS understands that these reports are consistent with MSDE reporting requirements as outlined in the Financial Reporting Manual for Public Schools. For clarification on this recommendation, management reached out to MSDE staff to confirm that financial reports are being submitted properly. MSDE gave no indication to the contrary. That stated, HCPSS intends to be abundantly clear that it is meeting all reporting requirements. Therefore, this matter will be given further review as recommended.

Information Technology

We noted several matters and areas of improvement related to the Information Technology design and controls which have been communicated directly to management.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with HCPSS personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This communication is intended solely for the information and use of the Board of Education of Howard County and management of Howard County Public School System, and the Maryland State Department of Education, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Baltimore, Maryland
October 31, 2019