



**Financial and Operational Forensic  
Analysis of Pulaski County Special  
School District's Budget and  
Expenditure Patterns**

**Provided to:**

**Office of the Attorney General for the  
State of Arkansas**

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## **I. Introduction**

Navigant was engaged by the Office of Attorney General for the State of Arkansas (“AG”) to provide forensic accounting and other related services in connection with desegregation funding (“Desegregation Funding” or the “Funding”) provided by the Arkansas Department of Education (“ADE”) to the three Pulaski County school districts (collectively referred to as the “School Districts”)—Pulaski County Special School District (the “PCSSD”), North Little Rock School District (the “NLRSD”) and Little Rock School District (the “LRSD”).<sup>1</sup>

Specifically, Navigant was engaged to perform a financial and operational forensic analysis of the budget and expenditure patterns of the School Districts to determine how the Funding has been historically expended and identify areas where cost savings can be achieved. Navigant was also requested to identify any areas or incidents of weakness in internal controls, and policies and procedures that may have allowed fraud, waste, mismanagement or abuse of the Funding to have occurred. Additionally, Navigant was engaged to perform an impact analysis to serve as the underlying rationale for any proposed wind down of the Desegregation Funding to ensure that the reduction in Funding will not have an adverse impact on the academic and fiscal integrity and standards of the School Districts.

This report serves as a preliminary report of the analyses and interviews Navigant has performed to date in connection with the PCSSD and addresses the processes and internal controls at the ADE.<sup>2</sup>

## **II. Executive Summary**

### **A. Overview**

In accordance with the AG’s request, Navigant focused its forensic analysis on the PCSSD’s financial records in connection with the Funding for fiscal years 2006-2010 and fiscal year (“FY”) 2011 to date.<sup>3</sup> The objective was to assess the accuracy and completeness of the PCSSD’s accounting of the Funding and the extent that the expenditures incurred for desegregation purposes can be identified and vouched to supporting documentation.

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<sup>1</sup> In 1989, the State of Arkansas entered into the Pulaski County School Desegregation Case Settlement Agreement (“Settlement Agreement”) with the School Districts in which the State was required to provide additional funding currently totaling approximately \$60-70 million annually to the School Districts to implement and fund student desegregation programs. There were subsequent modifications and updates to the Settlement Agreement issued by the court including Plan 2000 and an agreement between LRSD and the ADE executed on March 19, 2001.

<sup>2</sup> Navigant will also analyze the budget and expenditure patterns of the other school districts in Pulaski County, which are LRSD and NLRSD.

<sup>3</sup> The ADE’s and the School Districts’ FY begins on July 1. For FY 2011, Navigant reviewed transactions recorded in the Arkansas Public School Computer Network (“APSCN”) through December 7, 2010.

Mr. Scott Richardson, Assistant Attorney General of the AG, was the primary point of contact to assist Navigant by providing appropriate documentation, access to representatives from the ADE and the PCSSD and other information Navigant required performing its analysis.

Navigant conducted 16 interviews of representatives from the PCSSD and the ADE. Navigant obtained Funding documentation from the ADE and obtained access to APSCN, the online accounting and reporting application used by most school districts in Arkansas.<sup>4</sup>

The ADE created specific codes for the School Districts to utilize and properly record the Funding in APSCN for tracking purposes. These include a combination of Source of Fund and the associated Revenue Account codes as follows:

Source of Fund Code and Description	Related Revenue Account(s)
386 Pulaski County Magnet School Revenue	32800 and 32808 - 32811
387 Majority to Minority ("M-to-M") Revenue	32812
387 Teacher Retirement & Insurance Court Settlement	32814
388 Magnet & M-to-M Transportation	32813

The ADE informed Navigant that the Revenue Account codes related to the Funding begins with "328."

**B. Summary of Preliminary Findings**

1. Recording of Funding and Related Expenditure

The chart on the following page summarizes the Desegregation Funding and related expenditures and outflows recorded by the PCSSD:

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<sup>4</sup> Navigant was informed by the ADE that LRSD does not utilize APSCN for accounting and reporting. For further details on the procedures performed by Navigant to date, see section V of this report.

(in millions)

<b>Recorded by the PCSSD in APSCN</b>	<b>FY 2006 - FY 2011</b>
<b>ADE Desegregation Funding</b>	<b>\$105.9</b>
Additional Magnet Review Committee <sup>5</sup> Revenue (funded by the School Districts)	0.7
Specific Expenditures related to Desegregation Purposes	(61.5)
<b>Remaining Desegregation Funding</b>	<b>45.1</b>
Transfers to Non-Desegregation General Unrestricted Accounts	(\$35.0)
<b>Balance – Unaccounted Use of Desegregation Funding</b>	<b>\$10.1</b>

a. Funding from the ADE

Only approximately 63% of the \$105.9 million Funding for FY 2006 to December 2010 from the ADE was properly recorded by the PCSSD with the ADE designated desegregation Source of Fund and related Revenue Account codes in APSCN. The remaining approximately 37% of the Funding was recorded in APSCN, however, without the ADE designated desegregation Source of Fund and related Revenue Account codes.

b. Expenditures and Other Outflows Recorded in APSCN

There were specific expenditures tied to desegregation purposes totaling \$61.5 million and transfers to non-desegregation general unrestricted accounts totaling \$35 million recorded in known desegregation Source of Fund codes.

i. Appears related to desegregation purposes

Approximately 58% (\$61.5 million) of the use of the Funding recorded appears to relate to specific expenditures tied to desegregation purposes.

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<sup>5</sup> The Magnet Review Committee (“MRC”) was established by the court in connection with the Settlement Agreement to provide certain monitoring and oversight responsibilities with respect to the Magnet School Funding for the School Districts. The ADE is ordered by the court to annually fund \$92,500 to the MRC to pay for MRC expenditures; accordingly, the ADE prepares a check payable annually for \$92,500 to the MRC, but it is deposited by the PCSSD in its bank account and in APSCN accounting records in Source of Fund code 2014 (Magnet Review) for FY 2006 and FY 2007 and then subsequently in Source of Fund code 386 for FY 2008 to FY 2011. The MRC submits documentation related to expenses incurred to the PCSSD for reimbursement.

Navigant noted that additional funding for the MRC totaling \$675,138 was recorded by the PCSSD in APSCN for FY 2006 to FY 2011. This additional funding was not funded by the ADE and it appears to be additional MRC funding provided by the PCSSD and the other School Districts. Additionally, the \$0.7 million noted in the chart does not include this additional \$675,138 funding by the School Districts. The \$0.7 million only relates to the \$92,500 annual Funding by the ADE for the MRC.

- ii. Does not appear related to desegregation purposes
  - a) Approximately 33% (\$35 million) of the use of the Funding recorded appears to relate to transfers to non-desegregation general unrestricted accounts. Therefore it is unclear as to whether these funds were expended for desegregation purposes.
  - b) The remaining approximately 9% (\$10.1 million) of the Funding was not accounted for as a specific expenditure or transfer. Therefore, this remaining amount does not appear to be expended for desegregation purposes.

Accordingly, the remaining Desegregation Funding of \$45.1 million (\$35 million and \$10.1 million) described above does not appear to be utilized by PCSSD for its intended purpose.

- 2. ADE personnel advised that it does not track the use of the Funding it remits to the School Districts or perform any oversight to ensure that the Funding is being used for its intended purposes.
- 3. There appears to be poor tone at the top and a high degree of nepotism demonstrated by the Superintendent, Board Members and senior level employees, particularly in the hiring of consultants.

In general, there is a lack of documented policies and procedures provided to new and existing employees for guidance, proper segregation of duties and accountability. Specifically with respect to Desegregation Funding, there are no policies and procedures and controls in place at either the ADE or the PCSSD to address the appropriate tracking of the receipt and expenditure related to the Funding.

- 4. Various departments have the ability to add or modify records in the vendor master list, a material internal control weakness that could result in misappropriation of funds involving the use of fictitious vendors.
- 5. There is potential for the misappropriation of PCSSD funds or goods by the Maintenance, Transportation and Food Service departments.

### **III. Details of Preliminary Analyses Performed by Navigant**

#### **A. Analysis of Desegregation Funding**

- 1. The ADE

Navigant obtained and analyzed a schedule of the Funding payments made by the ADE to the PCSSD. Navigant traced these payments to verify the receipt of the Funding by the PCSSD.

ADE personnel stated that they do not track the use of the Funding remitted to the School Districts or perform any oversight function in connection with the Funding, such as to ensure that the School Districts are accounting for the Funding in the desegregation Source of Fund codes and that the Funding is used for its intended purpose. The ADE stated that they do not independently verify the accuracy and justification of the desegregation transportation expense reimbursement requests submitted by the School Districts. The ADE also does not verify that the Funding is recorded by the School Districts in APSCN in its designated desegregation Source of Fund or Revenue Account codes.

## 2. The PCSSD

The PCSSD utilized the accounting software FinancePlus to maintain its books and records through June 30, 2010. The PCSSD went “live” in APSCN beginning on July 1, 2010 and therefore records and prepares accounting entries directly in APSCN for FY 2011. PCSSD representatives stated that its accounting records prior to July 1, 2010 in FinancePlus were migrated to APSCN.<sup>6</sup>

Navigant’s review of Funding records provided by the ADE and in APSCN<sup>7</sup> noted that the ADE allocated approximately \$124.7 million to the PCSSD, of which approximately \$105.9 million was paid directly to the PCSSD, as summarized in the following chart:<sup>8</sup>

**ADE Desegregation Funding to the PCSSD**  
**FY 2006 to FY 2011** (in millions)

Funding Category	Amount
Magnet School Funding	\$18.8
Health Insurance & Teacher Retirement	\$31.2
M-to-M Revenue	\$56.8
Magnet & M-to-M Transportation	\$17.3
Magnet Review Committee	\$0.6
<b>Total ADE Funding, FY 2006 to FY 2011 (Oct.)</b>	<b>\$124.7</b>

<sup>6</sup> The PCSSD’s information technology (“IT”) personnel and SunGard, a consultant hired by PCSSD, were involved in the migration of the data from FinancePlus to APSCN. The PCSSD Budget Coordinator stated that she only performed manual crosschecks of the migrated budget information for FY 2010 and did not review or verify the integrity or accuracy of the data migrated to APSCN for other years. Navigant did not perform a forensic analysis to confirm that the data was migrated properly, accurately and completely.

<sup>7</sup> Funding records received from the ADE were for payments recorded as of October 25, 2010. Navigant analyzed Funding transactions recorded in APSCN for FY 2006 through current FY 2011 (December 7, 2010).

<sup>8</sup> A summary of the ADE Desegregation Funding and related expenditures by FY recorded by the PCSSD in APSCN is annexed hereto in Appendix A. PCSSD representatives stated that the PCSSD does not receive any funding in connection with desegregation programs from Federal sources.

The Magnet School Funding for the School Districts is calculated by the ADE and the portions allocated to the PCSSD and the NLRSD are sent directly to the LRSD because the six Stipulation Magnet Schools are in the LRSD.<sup>9</sup> Accordingly, the Magnet School Funding allocated to the PCSSD totaling approximately \$18.8 million is not recorded in the PCSSD’s APSCN accounting records.<sup>10</sup> Therefore, excluding this \$18.8 million from the total Funding of approximately \$124.7 million, Navigant traced and analyzed \$105.9 million of ADE Funding in the PCSSD’s APSCN accounting records.

Navigant noted that the PCSSD’s receipt of the \$105.9 million Funding was not always recorded properly with the ADE designated desegregation Source of Fund and related Revenue Account codes in APSCN. Some of the Funding was initially recorded by the PCSSD in a general unrestricted fund and then subsequently reclassified at the end of, or after, the FY end. Navigant’s analysis revealed that of the \$105.9 million that the ADE paid to the PCSSD for FY 2006 to FY 2011, the PCSSD APSCN accounting records reflect only approximately \$66.9 million, or 63%,<sup>11</sup> in the appropriate combination of Source of Fund and the associated Revenue Account codes established by the ADE to record the Funding, as noted in the following chart:

**Summary of Funding Currently Reflected in APSCN (in millions)  
FY 2006 to FY 2011**

		Source of Fund code		
		Desegregation-Related	Non-Desegregation-Related	
Revenue Account code	Desegregation-Related	\$66.9	\$27.5	
	Non-Desegregation-Related	\$ -	\$11.5	
		<b>\$66.9</b>	<b>\$39.0</b>	<b>\$ 105.9</b>
		<b>63%</b>	<b>37%</b>	<b>100%</b>

<sup>9</sup> The six Stipulation Magnet Schools in LRSD are Parkview High, Mann Middle, Williams Elementary, Carver Elementary, Gibbs Elementary and Booker Elementary.

<sup>10</sup> Navigant will review the total Magnet School Funding during its analysis of the LRSD.

<sup>11</sup> Of the \$105.9 million the ADE paid to the PCSSD, only approximately \$62.2 million, or 59%, was initially recorded by the PCSSD in APSCN with the desegregation Source of Fund and Revenue Account codes. Subsequent reclassifications made by the PCSSD in APSCN resulted in approximately \$66.9 million, or 63%, of the Funding recorded properly with the desegregation Source of Fund and Revenue Account codes, as noted in the chart.



Although Navigant was able to identify the Funding that was recorded in APSCN with only the appropriate desegregation Source of Fund or Revenue Account code, this accounting error results in a lack of reporting transparency and commingling and inaccurate reporting of Desegregation Funding. Accordingly, Desegregation Funding recorded in APSCN without both the appropriate desegregation Source of Fund and related Revenue Account codes are commingled with, and are not apparently distinguishable from, unrestricted revenue funds recorded in APSCN by the PCSSD.

Furthermore, Navigant’s analysis revealed that the PCSSD’s recording of the receipt of the Funding improved over time. For example, for FY 2010, 100% of the Funding received by PCSSD was recorded with the appropriate desegregation codes, which was in contrast to FY 2006 where the entire Funding received by PCSSD was improperly recorded in APSCN with an unrestricted general operating fund code. Although by FY 2010, 100% of the Funding was recorded with the appropriate desegregation code, it appears that this coincided with the PCSSD’s migration of its accounting records in FinancePlus to APSCN, and the PCSSD directly reporting in APSCN in real time beginning on July 1, 2010. Accordingly, based on the trends in the following chart, it is highly probable that the PCSSD also commingled and inappropriately recorded the Funding in the fiscal years prior to FY 2006:

**% Recorded in Source of Fund With**

	<b>Desegregation Code</b>	<b>General Operating Fund Code</b>
<b>FY 2006</b>	0%	100%
<b>FY 2007</b>	60%	40%
<b>FY 2008</b>	73%	27%
<b>FY 2009</b>	67%	33%
<b>FY 2010</b>	100%	0%
<b>FY 2011</b>	100%	0%

**B. Analysis of Expenditures Related to Desegregation Funding**

Navigant’s analysis revealed that expenditures recorded by the PCSSD did not appear to correspond to the respective Desegregation Source of Fund codes used to record the Funding. PCSSD representatives stated that expenditures related to desegregation purposes were recorded to Source of Fund Code 900.<sup>12</sup> PCSSD representatives also stated that beginning in FY 2010, Source of Fund Code 900 was no longer used to record desegregation related expenditures; instead, such expenditures were required by APSCN to be recorded to the related Source of Fund codes that were used to record the receipt of the

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<sup>12</sup> Desegregation expenditures related to salaries were recorded to 1900 and operations were recorded to 2900 until FY 2010. The Source of Fund Code 900 did not distinguish among the different types of Desegregation Funding.

corresponding Funding (i.e. 386, 387 and 388).<sup>13</sup> The following chart summarizes the expenditures related to desegregation purposes as recorded by the PCSSD in APSCN:<sup>14</sup>

**PCSSD Expenditures Related to Desegregation Recorded by PCSSD**  
**FY 2006 to FY 2011** (in millions)

	<b>Amount</b>
Amount in Specific Expenditure Accounts	\$61.5
Transfers to Non-Desegregation General Unrestricted Account(s)	\$35.0
<b>Total Outflows Recorded in Desegregation Accounts</b>	<b>\$96.5</b>

As noted in the chart above, approximately \$61.5 million recorded with desegregation Source of Fund codes appear to relate to specific expenditures.

Other expenditures recorded in these desegregation Source of Fund codes in APSCN were in lump sum<sup>15</sup> amounts totaling approximately \$35 million and were adjustments made at the respective FY ends. These lump sum amounts were recorded with either Expenditure Account code #69310 “To Salary Fund” or #69320 “To Operating Fund.”<sup>16</sup> It appears that the purpose of these lump sum journal entries was to increase the total expenditures in the desegregation Source of Funds at the end of the FY, which in effect increased the available funds to be used in non-desegregation general unrestricted salary and operating fund accounts.

PCSSD representatives stated that the intent of these journal entries is to reclassify amounts to a non-desegregation general unrestricted fund, whereby it is no longer possible to track whether these amounts are expended for desegregation purposes.<sup>17</sup> Accordingly, these reclassified amounts lose its

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<sup>13</sup> The PCSSD representatives stated that beginning in FY 2010, expenditures recorded in Source of Fund codes 1900 and 2900 had to be reversed to the specific Desegregation Source of Fund codes established by the ADE (i.e. 386, 387 and 388); otherwise APSCN will not allow the PCSSD to proceed with the fiscal year-end financial reporting close process.

<sup>14</sup> See the summary of the ADE Desegregation Funding and related expenditures by FY recorded by the PCSSD in APSCN in Appendix A.

<sup>15</sup> These lump sum amounts totaling \$35 million do not appear to represent individual expenditures and consist of a total of five journal entries during FY 2007 to FY 2009.

<sup>16</sup> The PCSSD’s Business Procedures Manual noted that these Expenditure Accounts are part of the series “Code 69300 Fund Transfers (Permanent),” which are used to record transfers to another fund.

<sup>17</sup> The PCSSD employees did not refute that the effect of transferring to a non-desegregation general unrestricted fund equates to moving excess funds to a “slush fund.”

restricted purpose identity and can no longer be properly matched with related desegregation expenditures.

The following chart summarizes the Desegregation Funding and the related expenditures recorded in APSCN that Navigant identified:

**Desegregation Funding and Expenditures Recorded by the PCSSD  
FY 2006 to FY 2011 (in millions)**

	Amount	Percent
ADE Desegregation Funding	\$105.9	
Magnet Review Committee Revenue (funded by the School Districts) <sup>18</sup>	0.7	
<b>Total Desegregation Funding in APSCN</b>	<b>\$106.6</b>	<b>100%</b>
Less: Amount in Specific Expenditure Accounts	(61.5)	58%
<b>Remaining Desegregation Funding</b>	<b>\$45.1</b>	<b>42%</b>

As noted in the chart above, only approximately \$61.5 million of desegregation expenditures were recorded to specific Expenditure Accounts, or 58% of the Funding were spent and recorded. The remaining Desegregation Funding of \$45.1 million appears to represent the amount that the PCSSD did not spend for its intended purpose. Accordingly, it does not appear that the PCSSD has a process to track the disposition of any remaining Funding balance at the end of each FY.<sup>19</sup> For example, in FY 2006, Funding totaled approximately \$19.3 million and recorded expenditures were \$10.6 million, resulting in a remaining Desegregation Funding balance of \$8.7 million.<sup>20</sup>

### C. Other Preliminary Findings and Observations

During Navigant’s interviews of representatives from the PCSSD and the ADE, numerous issues and concerns were expressed regarding potential misconduct, misappropriation of PCSSD assets and significant internal control weaknesses. In response to these issues and Navigant’s preliminary assessment of the PCSSD’s financial and operational internal control environment, Navigant prepared a preliminary list of recommendations in section VI of this report.<sup>21</sup>

<sup>18</sup> Navigant noted that additional funding for the MRC totaling \$675,138 was recorded by the PCSSD in APSCN for FY 2006 to FY 2011. This additional funding was not funded by the ADE and it appears to be additional MRC funding provided by the PCSSD and the other School Districts.

<sup>19</sup> The PCSSD CFO stated that a Program code in APSCN should be created to account for the Funding surplus.

<sup>20</sup> See the summary of the ADE Desegregation Funding and related expenditures by FY recorded by the PCSSD in APSCN annexed hereto in Appendix A.

<sup>21</sup> See summary matrix of potential issues and observations prepared by Navigant annexed hereto in Appendix B.

## 1. High Degree of Nepotism

PCSSD representatives stated that there is a high degree of nepotism engaged in by the current PCSSD Superintendent, members of PCSSD board (“Board Member,” or collectively, the “Board”) and senior level employees.

### a. Hiring of Employees and Consultants

The PCSSD Chief Financial Officer (“CFO”) stated that there are no written policies and procedures regarding the hiring of consultants. She explained to Navigant that typically before a consultant is hired the following unwritten procedures are followed:

- Verify budgeted funds are available
- Obtain details of consultant services
- Review of contracts by the PCSSD attorney
- Obtain approval from supervisor of division where consultant will provide services
- Obtain approval of the Superintendent
- Obtain approval by the Board

The above procedures notwithstanding, it appears that the Superintendent can and has in fact overridden these procedures. PCSSD employees stated that the Superintendent has been able to place his friends as consultants in departments where there does not appear to be a need. PCSSD representatives interviewed by Navigant stated that there are numerous instances of friends and former associates of the Superintendent, the Board and senior level employees being hired as employees or consultants with the PCSSD. These PCSSD representatives also stated that these employees and consultants may not have the requisite knowledge and experience for their hired roles,<sup>22</sup> and may be paid above the PCSSD’s established salary rate schedule.

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<sup>22</sup> A PCSSD employee stated that consultants hired by the PCSSD are required to have a minimum of ten years of related experience in the services provided to the PCSSD, however, it is not clear whether this requirement is documented.

The following individuals were initially hired as consultants and are currently full-time employees of the PCSSD:

- Director of IT<sup>23</sup>
- Maintenance Support Services<sup>24</sup>

The following individuals were hired as and still are employed as consultants at the PCSSD:

- Temporary Accountant in PCSSD's Accounting department<sup>25</sup>
- Consultant in PCSSD's Human Resource department<sup>26</sup>

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<sup>23</sup> Navigant was informed that the Director of IT worked with the Superintendent when they were both colleagues in Oregon. At the time that the Director of IT was hired as a consultant in the PCSSD's IT department, he was still living in Oregon. It is not clear whether the PCSSD paid for his air travel expenses. Navigant was also informed that the wife of the Director of IT is employed as a teacher in the PCSSD.

<sup>24</sup> Navigant was informed that the Maintenance Support Services employee, a retired Air Force Colonel, was referred to the PCSSD as a consultant in the Maintenance department by the Superintendent. The Maintenance Support Services employee became a consultant to the PCSSD around June 2010 while he was still living in South Carolina where he was also employed in another position in the private sector. Navigant was also informed that the PCSSD paid for his flights to and from South Carolina/Arkansas.

A PCSSD employee provided Navigant with a consulting invoice submitted by the Maintenance Support Services employee to the PCSSD in connection with consulting services he provided during October 1, 2010 to November 7, 2010 totaling \$18,908.24, which represent consulting services for 26 days at a daily rate of \$727.24.

<sup>25</sup> Navigant was informed that the Temporary Accountant, a friend of the Assistant Superintendent for Equity and Pupil Services, was hired as a temporary accountant to fill the role of a PCSSD accountant who was reassigned to another role in the Accounting department. Navigant was also informed that temporary accountants are usually recruited from a temp agency and the Temporary Accountant's hiring was due to a referral from the Assistant Superintendent for Equity and Pupil Services.

<sup>26</sup> Navigant was informed that the Human Resources Consultant, a friend of the Superintendent, was hired as a consultant in the PCSSD's Human Resources department in July 2010. Navigant was also informed that it appeared that the Human Resources department was adequately staffed and did not need the services of a consultant.

A PCSSD employee provided Navigant with documentation related to the PCSSD payments of consulting invoices submitted by the Human Resources Consultant to the PCSSD in connection with consulting services he provided during July 21, 2010 to October 29, 2010 totaling \$43,800 and \$2,772 for mileage.

A copy of the Human Resources Consultant's contract was provided to Navigant, which noted a fixed term of six months (July 21, 2010 to December 21, 2010) at an hourly rate of \$100 for six hour work days. Navigant estimated that on an annualized basis, at an hourly rate of \$100 for six hour work days, this consultant contract can cost approximately \$156,000 (52 weeks x 5 days x 6 hours x \$100). Furthermore, Navigant noted that the Human Resources Consultant's contract was signed by him and the Superintendent. Currently, it is unknown whether the Board approved this consultant contract, and if so what documentation is available to denote Board approval.

PCSSD employees also informed Navigant that other recent consultants hired to provide services to the PCSSD include the following:

- President of Performance Fact, hired by the Board to develop a long term strategic operating plan (approximate fee of \$200,000)
- A diversity training consultant (approximate fee of \$300,000)

b. Travel Advances and Reconciliation of Travel Expenses

i. Travel Advances

The Board voted in June 2010 to discontinue the practice of permitting the issuance of travel advances to Board Members, the Superintendent and employees who travel to out of town conferences or for other business matters for the PCSSD.<sup>27</sup>

In spite of this new policy, the Superintendent still submits travel advance requests to the Accounts Payable department and they continue to be processed and paid. Navigant was informed by PCSSD employees that as recent as late November 2010, the Superintendent submitted a check request in connection with a trip to China to attend an education conference. PCSSD Accounts Payable personnel stated that the travel advances requested by the Board and the Superintendent typically require immediate processing.

Navigant noted that PCSSD Check Request Form B-104 requires numerous signatures including the Principal/Supervisor/Director, the Assistant Superintendent of Division and the Assistant Superintendent-Business Affairs.<sup>28</sup> PCSSD Accounts Payable personnel also stated that they feel uncomfortable voicing their concerns because these check requests are initiated by the Board, the Superintendent and other high level employees. Although the CFO is aware of the new policy, she continues to allow travel advance requests to be processed and paid as denoted by her signature on the check request form. PCSSD employees believe that the CFO also feels pressured by the Board to continue to allow travel advances even though it is apparent that travel advances should no longer be provided to Board Members or employees.

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<sup>27</sup> These travel advances are used to reimburse for expenses incurred prior to the trip (i.e. conference registration fees and airfare) and to pay for anticipated expenses (i.e. lodging and meal expenses).

<sup>28</sup> Navigant noted that Assistant Superintendent-Business Affairs is the PCSSD CFO.

ii. Reconciliation of Travel Expenses

Accounts Payable personnel stated that when the Board Member, the Superintendent or employee returns from a trip, they should timely submit to the Accounting department an expense report with the related receipts and other supporting documentation and return any unused portion of the travel advance.<sup>29</sup> Accounts Payable personnel also stated that because there is no process in place to require Accounting department personnel to keep track of travel advances issued or follow up with individuals who received travel advances upon their return from the trip, it is based on the “honor system” in which the Accounting department relies on the individuals to timely submit their related travel expense report upon their return. Only when an expense report is submitted will Accounting department personnel be prompted to review the expenses incurred for appropriateness and proper supporting documentation, and to reconcile to the travel advance issued.

Therefore based on this current practice it is possible that there are travel advances issued for which the related expense report have not been submitted and properly reconciled to determine any unused portion of the travel advance that should be refunded to the PCSSD.

2. Lack of Operating Policies and Procedures

Based on Navigant’s interviews, PCSSD Accounting department personnel conceded that there are no written operating policies and procedures related to the accounting, utilization and processing of Desegregation Funding. When Navigant interviewed Business Affairs Division personnel about the budgeting and use of the Funding, Navigant was frequently referred to the Assistant Superintendent for Equity and Pupil Services and the Director of Transportation for explanations because they believed they were the only two employees who were familiar and primarily involved with the use of the Funding.

Although the PCSSD developed a Business Procedures Manual effective July 15, 2009, many PCSSD employees interviewed were not aware of this resource.

The following section describes the lack of policy and procedures in connection with accounting for the Funding and other functions based on the interviews conducted by Navigant to date:

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<sup>29</sup> Accounts Payable personnel stated that any unused portion of the travel advance is typically refunded by a personal check issued by the individual who received the travel advance. The check is sent to the Accounting department for deposit to the PCSSD’s bank account, however, Accounts Payable personnel stated that they are not involved with any reconciliations or processing refunds of travel advances after they issue them.

a. Accounting for Desegregation Funding and Related Expenditures

PCSSD Accounting department personnel explained that they typically become aware of the receipt of the Funding sent by wire transfer from the ADE when they see the related deposit reflected in the PCSSD’s bank account statement. Accounting department personnel would then locate the remittance documentation sent by the ADE that corresponds to the purpose of the deposit. Sometimes the remittance documentation is received by the PCSSD prior to the deposit to notify accounting personnel about the incoming deposit. Accounting personnel update APSCN to reflect the deposit and the related information on the remittance documentation.

PCSSD Accounting personnel stated that they do not have discretion on how the Funding should be utilized. They only record related expenditures if documents reference Source of Fund code 1900 and 2900.<sup>30</sup> Accounting personnel also stated they were not timely informed by the PCSSD Budget Coordinator<sup>31</sup> who was aware of the ADE established specific desegregation Source of Fund codes (i.e. 386, 387 and 388) in the Arkansas Financial Accounting Handbook for Arkansas Public Schools,<sup>32</sup> which is utilized by the school districts to record activity related to the Funding. Accordingly, accounting personnel continued to use Source of Fund code 1900 and 2900 to record expenses related to desegregation purposes, however, this code does not distinguish and properly allocate the expenditures among the different related Funding categories.

b. Use of Funding for Desegregation Programs

The Assistant Superintendant for Equity and Pupil Services is the primary PCSSD employee with the discretionary authority to determine the use of the Funding. She is the Principal/Division Head approval signer in connection with payment of expenditures with the Funding. Therefore, this practice appears to permit the Assistant Superintendant for Equity and Pupil Services to unilaterally decide how the Funding is used. There are no Accounting personnel or anyone from other

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<sup>30</sup> Per PCSSD employees, Source of Fund codes 1900 and 2900 have historically been used to record all desegregation related expenditures. These codes are no longer used by the PCSSD since it began to report live in APSCN on July 1, 2010.

<sup>31</sup> Navigant was informed that the PCSSD Budget Coordinator is not familiar with the different categories of Funding and therefore would not be aware of the proper use of the related desegregation codes established by the ADE.

<sup>32</sup> This handbook was issued by the ADE to assist educational agencies in collecting, recording and reporting information about its operations and includes a chart of account codes to be utilized for consistency and comparability.



departments who understand or are involved in the decision-making regarding how the Funding should be utilized. Accordingly, there is no proper oversight or checks and balances regarding how the Funding is utilized. Additionally, no one else can independently assess whether the Funding was expended properly and for its intended desegregation purpose.<sup>33</sup>

c. Desegregation Transportation Operating Expenditure Reimbursement

The School Districts receive desegregation Funding from the ADE related to operating expenditures incurred in connection with PCSSD’s transportation of its Magnet and M-to-M students.<sup>34</sup> The School Districts are required to calculate and prepare a transportation expenditure reimbursement request to the ADE.<sup>35</sup> PCSSD’s Director of Transportation is the only individual who is involved in the collection of data and the preparation of this reimbursement calculation.

The calculation involves allocating a percentage of transportation expenses that are recorded in the general operating fund.<sup>36</sup> PCSSD Accounting personnel conceded that they do not understand how the Magnet and M-to-M transportation reimbursement amount is calculated nor does anyone else in the PCSSD. Accordingly, there is no proper oversight or checks and balances to ensure that the reimbursement request is proper, accurate and complete.

The ADE stated that they do not perform any verification or audit to confirm the validity of the reimbursement amounts requested by the School Districts before the ADE makes the payments.

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<sup>33</sup> For example, the Assistant Superintendent for Equity and Pupil Services determines which teachers’ salaries are paid from the Funding.

<sup>34</sup> The desegregation transportation expense reimbursement that is paid by the ADE is referred to as desegregation Source of Fund code 388.

<sup>35</sup> Operating expenses include bus driver salaries, maintenance of buses and overhead. Navigant performed a preliminary review of a sample of transportation expense reimbursement requests from the School Districts and noted that it appears each School District utilized a different methodology to calculate their respective reimbursement amounts and there was no consistency in the supporting documentation submitted.

<sup>36</sup> Navigant learned that there is a degree of subjectivity involved in preparing the reimbursement amount as it involves estimates and assumptions. Because some transportation expenditure categories cannot be directly attributed to transportation of only Magnet and M-to-M students, PCSSD’s Director of Transportation’s calculation involves applying a percentage, which is derived from the pro-rata number of school bus routes designated to transport Magnet and M-to-M students, to certain transportation expenditure categories.

d. Other Functions

i. Fuel Purchase for School Buses and Fleet

Navigant learned from its interviews that PCSSD Transportation department personnel and school bus drivers utilize a credit card system to purchase petroleum products such as gasoline and diesel fuel for its fleet including school buses. The PCSSD does not have a documented policy and procedure in connection with the issuance and proper use of the cards<sup>37</sup> nor for the review and reconciliation of the monthly invoice of the purchases. Furthermore, there is a lack of proper segregation of duties involved in the custody, recording and reconciliation of the purchases.

PCSSD's Director of Transportation is primarily involved in overseeing the credit card system. He is responsible for deactivating lost cards and issuing temporary spare cards. Furthermore, PCSSD's Director of Transportation stated that he and his secretary review the monthly petroleum products invoices, which average about \$40,000, for reasonableness and to identify any anomalies for follow up.<sup>38</sup> The Director of Transportation's purchases of fuel using his card are also reflected on these invoices. Therefore PCSSD's Director of Transportation reviews and approves his own expenses.

ii. Disposal/Transfer of PCSSD Assets

PCSSD's Director of Transportation explained that some school buses and other fleet vehicles that are fully depreciated or non-operational are either auctioned or sold for scrap metal. He conceded that there are no written policies and procedures in connection with the transfer or disposal of fleet vehicles. PCSSD's Director of Transportation stated that he is only involved with making the arrangements to have the vehicle picked up by the auctioneer (for auction) or by a tow company (to sell for scrap metal).

a) Auction of School Buses

At the sole discretion of PCSSD's Director of Transportation, PCSSD school buses can be disposed of when they are retired, at

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<sup>37</sup> All buses (small and large) run on diesel fuel so the bus drivers' cards can only be used to purchase diesel. A card is issued to each bus and requires a PIN to make a purchase. Transportation office personnel (non-bus drivers), however, have multi-product cards that can purchase both gasoline and diesel fuel.

<sup>38</sup> For example, PCSSD's Director of Transportation stated that a bus fuel tank capacity is 60 gallons, and a driver who purchased 100 gallons of diesel in one transaction may also be fueling a colleague's bus whose card malfunction. In these instances PCSSD's Director of Transportation will follow up with the drivers to confirm.

which point they are then removed from the fleet and auctioned.<sup>39</sup> PCSSD’s Director of Transportation initiates the process by email to the PCSSD Accounting Department Secretary to inform her which buses will be sent for auction and request removal from insurance coverage and the fixed asset listing that is maintained by the Accounting department. He further stated that the PCSSD Accounting Department Secretary primarily deals with the auctioneer, and she receives the settlement report and the check payment, net of auctioneer commissions. Navigant noted that the Accounting department does not have any other involvement or oversight responsibilities in connection with auction of PCSSD fleet vehicles. Navigant did not review documentation in connection with any payments from the auctioneer, and it was not confirmed who receives the proceeds from these sales.

b) Salvaged Bus Shell and Parts

When school buses are not operational, they can be salvaged for parts to be used on other similar model school buses that still are operational.<sup>40</sup> PCSSD’s Director of Transportation stated that after the reusable parts are removed, the remaining bus shell, or metal frame, and other non-reusable metal components are sold to a scrap metal company. PCSSD’s Director of Transportation stated that he believes the scrap metal company issues the check payable to the PCSSD when scrap metals are sold.<sup>41</sup> PCSSD’s Director of Transportation also stated that he requests the PCSSD Accounting Department Secretary to remove fleet vehicles sold for scrap metal from insurance coverage, and the fixed asset listing that is maintained by the Accounting department.

There does not appear to be an established policy and procedure to document the sale of salvaged fleet vehicles or the spare parts obtained from its disposal. It is unclear whether any departments, other than the Transportation department, keep

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<sup>39</sup> PCSSD’s Director of Transportation stated, for example, that buses that cost more to repair and maintain than to purchase are sold by auction. PCSSD’s Director of Transportation also stated that the PCSSD utilizes AAA Auction Service as its vendor to auction fleet vehicles that are being disposed of and auctioned off. PCSSD’s Director of Transportation also stated that the average sale values for the auctioned school buses are typically less than \$1,500.

<sup>40</sup> PCSSD’s Director of Transportation stated, for example, that some non-operational buses are salvaged in which reusable parts or sections (i.e. engine components) are used to repair buses that are operational.

<sup>41</sup> PCSSD’s Director of Transportation stated that the PCSSD typically receives \$410 (\$500 less \$90 towing fee) for the sale of a bus shell.

track of which fleet vehicles are sold as scrap metal. Navigant noted that the Accounting department does not have any other involvement or oversight responsibilities in connection with the scrap metal sales of fleet vehicles. Navigant did not review documentation in connection with any payments from the scrap metal company, and it cannot be confirmed who receives the proceeds from these scrap metal sales.

### 3. Governance and Tone at the Top

Navigant identified the following preliminary issues related to the tone at the top and governance at the PCSSD:

#### a. Board, Superintendent and Senior Level Override

PCSSD employees stated that Board Members, the Superintendent and senior level employees tend to override or circumvent existing protocols involved with the Accounts Payable department’s processing of certain payments. These PCSSD employees also stated that certain Board Members, the Superintendent and senior level employees still request and receive travel advances although the Board voted in June 2010 to discontinue this practice.<sup>42</sup>

#### b. Perceived and Actual Abuse of Power/Position

Accounts Payable personnel stated that Board Members, the Superintendent and other senior level employees frequently utilize their position and authority to circumvent certain processes. For example, these individuals frequently request “emergency” checks to be processed by the Accounts Payable department in connection with travel advances, reimbursement of travel expenses and invoice payments to certain vendors and consultants. Accounts Payable personnel are pressured to process such requests immediately because in certain instances the requestor would remain in the Accounts Payable department until the check is issued. Accordingly, Accounts Payable personnel are intimidated and feel compelled to process these requests without challenging their authority or fully reviewing the request. Accounts Payable personnel also stated that they process approximately three such emergency check requests daily.

Board Members, the Superintendent and other senior level employees also potentially abuse their position to have the PCSSD hire their friends as consultants. According to PCSSD employees, they believe that these consultants lack the requisite experience and knowledge required for their hired positions and may be overpaid.

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<sup>42</sup> The most recent travel advance request was in connection with the Superintendent’s trip to China in late November 2010.

c. Lack of Channels for Reporting Concerns and Suspicious Behavior

PCSSD employees typically perform the duties similar to their predecessors in the same roles and are not encouraged to question suspicious requests or activities. Some PCSSD employees described the work culture as “don’t ask, don’t tell,” whereby employees are expected to fulfill their daily job functions and not question authority.<sup>43</sup> There does not appear to be an appropriate channel in which employees can safely and anonymously voice their concerns regarding improper practices and suspicious behavior in the PCSSD.

4. Accounts Payable Department

Accounts Payable department personnel stated that they do not have any particular procedures in connection with processing expenditures paid with Desegregation Funding. The Accounts Payable personnel typically record the payments with the Source of Fund referenced on the payment documentation by the individual or department requesting the payment.

Accounts Payable personnel process payments by either of the following:

- Check request
- Purchase Order

There are two clerks in the Accounts Payable department that process payment requests; one is primarily responsible to process check request payments and the other to process purchase order payments.

a. Payment by Check Requests

Accounts Payable personnel conceded that although check requests should only be used for payments of amounts up to \$500<sup>44</sup> for items such as employee expense reimbursements and for payment of expenses related to professional services, these procedures are not frequently followed.

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<sup>43</sup> Navigant learned that a staff accountant had expressed concerns to the former PCSSD CFO regarding the accounting treatment of certain transactions. According to the staff accountant, the former PCSSD CFO dismissed the concerns and reassigned the staff accountant to work on an unrelated assignment. Subsequently, during the PCSSD’s annual financial statement audit by its independent auditors, the staff accountant employee informed the independent auditors regarding her concerns, which resulted in an update to the notes to the financial statement audit report.

<sup>44</sup> This policy was noted in the PCSSD’s Business Procedures Manual, which was noted with an effective date of July 15, 2009.

Accounts Payable personnel explained that check requests are accompanied with a check request form, invoice and/or other supporting documentation. This documentation is initially submitted to the Budget Coordinator to verify that there are available funds in the budget code referenced by the check payment requestor. The request is then approved by the CFO denoted by her signature on the form and then forwarded to Accounts Payable personnel to process the request for payment and input the payment in APSCN.

Check request payments for goods or services purchased by a PCSSD department or individual are typically submitted to expedite payment and do not require review by Purchasing department personnel to match the invoice with any associated approved purchase order. Because check requests circumvent any oversight by the Purchasing department, instances of duplicate payments occurred when a check request is processed simultaneously with a possible purchase order payment for the same goods and services.<sup>45</sup> A duplicate payment is made because the Accounts Payable clerk responsible for processing payment on purchase orders was not aware that a check payment on the same invoice was previously issued.<sup>46</sup> Navigant was informed by the Director of Purchasing that there has not been any formal audit conducted to identify these duplicate payments. Therefore, there may be vendors who received duplicate payments from the PCSSD that were not detected.

Accounts Payable personnel stated that a majority of the duplicate payments involve invoices submitted by the Maintenance department. Check batches are printed twice a week.<sup>47</sup> The checks are printed with the signature plates of the Superintendent and the Board President. It does not appear that there are any additional reviews, approvals or authorizations before the checks are issued.

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<sup>45</sup> Purchasing department personnel stated that because check payment requests for vendor invoices do not require a purchase order number, they cannot look up and verify there was a previous payment by purchase number before the check is issued.

<sup>46</sup> A contributing factor to duplicate payments to vendors is that invoices are not always directly sent to the Accounts Payable department. The department that initiated the purchase can receive the invoice from the vendor and can subsequently submit the invoice and related supporting documentation to the Accounts Payable department for payment twice, by check request and another with the associated purchase order. Additionally, the vendor payment files in the Accounts Payable department are maintained by check number order. Therefore, previous payments for a vendor are not readily apparent.

<sup>47</sup> Accounts Payable personnel stated that check runs usually occur on Tuesdays and Fridays, however, there are instances where checks are printed three to four times in one day to accommodate urgent check requests. These urgent check requests usually originate from the Superintendent, Board Members and the Assistant Superintendent for Equity and Pupil Services.

Accounts Payable personnel stated that they do not always mail processed checks directly to vendors or employees. Accounts Payable personnel also stated that checks to vendors are typically held for pickup if payments were overdue, or if the vendor needed to deposit the check as soon as possible. Checks that are not mailed by Accounts Payable personnel and held for pick up can present an opportunity for misappropriation.<sup>48</sup>

Accounting department personnel stated that in October 2010 the Board approved a policy that purchases more than \$500 require the preparation of a purchase requisition, which is reviewed by the Purchasing department before an approved purchase order is issued. As a result of the new purchasing policy, payments by check requests have decrease significantly; however, this new purchasing policy still appears to be circumvented by the Superintendent, Board Members and senior level employees.

b. Payments of Purchase Orders

The purchase process begins with a need to purchase goods or services by an employee. Typically a bookkeeper, secretary or a department supervisor will submit a purchase requisition in the PCSSD’s online requisition system. The Purchasing department reviews the purchase order details such as price and vendor information to determine if it was properly authorized and appropriate. Purchasing department personnel stated that, for example, requested goods or services that are estimated to cost more than \$5,000 are required to be accompanied by written quotes for price comparison or have solicited bids, however, there is no written policy to document this requirement.

When the goods or services are received, the Accounts Payable clerk would match the invoice to the purchase order and other related documentation such as the shipping/receiving documentation to ensure the validity of the requested payment.

c. Vendor Master List

Navigant’s preliminary observations noted that APSCN, by design default, either allows full write-access or only read-only access to the vendor master list. There does not appear to be any consideration on proper segregation of duties when assigning write-access to certain departments or employees. Therefore, PCSSD’s process creates an internal control weakness which could permit an employee to add a fictitious or a related party vendor to the vendor master list, and then submit fictitious invoices to the Accounts Payable department for payment.

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<sup>48</sup> Accounts payable personnel stated that checks issued for employee expense reimbursement are commonly held for pick up by the employee or their designee.

Additionally, APSCN does not permit the deletion, deactivation or suspension of vendors that are no longer used to purchase goods or services. Navigant noted that there are multiple vendor ID numbers issued for the same vendor.<sup>49</sup> Therefore, for these inactive vendors or vendors with multiple vendor IDs, PCSSD employees denote in a field in the vendor master list with “DO NOT USE.” This, however, will not prevent an employee from using these vendors for fraudulent purposes such as to manipulate funds or to erroneously pay vendors. Accounts Payable personnel stated that there are instances where an employee still referenced these “DO NOT USE” vendors when requesting payment for goods or services purchased.

Currently, Accounts Payable personnel can add new vendors and admitted that they regularly do so. Accounts Payable and Purchasing personnel conceded that there is no segregation of duties nor written policies and procedures in connection with adding a new vendor.

Accounts Payable personnel explain that when they process a vendor invoice, they first perform a query in APSCN to determine whether the vendor is in APSCN’s vendor file. If the vendor is not in APSCN, Accounts Payable personnel create a new vendor file using the information on the invoice (i.e. company name, address, telephone number). If the vendor’s EIN is not noted on the invoice, it will not preclude the creation of a new vendor ID. Furthermore, currently there is no requirement to perform any due diligence vetting procedures on a new vendor to confirm its identity, existence and other information regarding the nature of its business and identification of potential related parties. Additionally, there are no requirements for a completed W-9 to be submitted before or after a payment has been processed and made to a new vendor.

## 5. Procurement

Navigant’s interviews reveal that there are potential risks present in the Maintenance, Transportation, Food Service, Courier and Warehouse departments. PCSSD Accounting personnel informed Navigant the following two procurement methods were discontinued as of July 1, 2010:<sup>50</sup>

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<sup>49</sup> For example, two different vendor ID numbers are issued for the same vendor due to a different mailing address or a slight variation in the spelling of the vendor name, which may be indicative of a fictitious vendor.

<sup>50</sup> According to the PCSSD’s CFO, there is a proposed policy before the Board that will require all procurement requests to be approved by the Director of Purchasing.



a. Blanket Purchase Orders

The PCSSD previously allowed its departments to procure goods and services using blanket purchase orders. Blanket purchase orders are created to be utilized for frequently purchased items or services and designed to eliminate processing of multiple one-time purchase orders. Typically, a blanket purchase order allows purchases of goods or services without any pre-approval at a particular vendor, up to a fixed dollar amount and over a period of time. PCSSD Accounting personnel stated that blanket purchase orders were frequently used by the Maintenance, Transportation, Courier and Food Services departments.

The use of blanket purchase orders may have exposed the PCSSD to fraud, waste and abuse. For example, a PCSSD employee informed Navigant that some Maintenance department employees run their own maintenance business outside of their full-time PCSSD employment, and therefore some goods purchased using blanket purchase orders may have been diverted by these Maintenance department personnel for their personal use in their own businesses.

Typically, the invoice for the related purchase sent by the vendor includes a reference with the blanket purchase order number, which is then processed and paid by the Accounts Payable department.

b. MD and TD Purchase Orders

Navigant was informed by Purchasing department personnel that the PCSSD previously allowed the Maintenance and Transportation departments to use purchase order forms specifically for their departments called “MD” (for Maintenance department) and “TD” (for Transportation department) to expedite the payment of vendor invoices related to these departments’ purchases. When these departments needed goods or services, they would initiate the purchases with vendors directly. Subsequently, these departments would directly receive the goods or services along with the related invoice and other documentation (i.e. shipping document). Then department personnel would prepare a payment request package that consist of a completed MD or TD purchase order form and the invoice and other related documentation. The MD or TD purchase order form would include a reference number that is assigned by the department and the form would be signed by the department supervisors to denote authorization for the purchases and approval for payment. This payment request package is then submitted to the Accounts Payable department for payment processing.

Accordingly, purchases made by the Maintenance and Transportation departments using the MD and TD purchase order forms lack appropriate checks and balances because they bypassed any review and

approval process of the Purchasing and Accounting departments.<sup>51</sup> Furthermore, there is no segregation of duties because the Maintenance and Transportation departments essentially had the ability to initiate, authorize and approve payment of its purchases.

c. Vendor Access

During Navigant’s visit to the PCSSD’s administrative offices in early December 2010, it was determined that the Purchasing department is currently not the only department to have authorization to change vendor details. Navigant learned that Accounts Payable personnel and anyone else with access to vendor information can make changes to vendor record information.

d. Long Term Vendor Relationships

A PCSSD employee stated that there are certain vendors that have provided goods and services to the PCSSD for numerous years. Many of these vendors may have developed a long relationship with certain employees. These employees can become complacent when dealing with these vendors.<sup>52</sup> Additionally, there is a potential for employees to enter into a kickback arrangement with these vendors.

e. Potential Misappropriation in Food Services Department

A PCSSD employee stated that Food Services Department employees may have ordered additional perishable foods from an outside food vendor that normally supplies the schools’ lunch menu items. The additional perishable foods were delivered to the Food Services warehouse and were not part of the school’s lunch menu.

6. High Employee Turnover

Some PCSSD employees expressed concerns regarding the loss of historical institutional knowledge. For example, in the past five years, the PCSSD has had three CFOs and four Superintendents. Some employees are concerned about the high employee turnover and the loss of continuity. Additionally, the scarcity of experienced personnel in the PCSSD can potentially be disruptive to the integrity of PCSSD’s operations. The risk of fraud, waste and abuse can increase during the transition periods.

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<sup>51</sup> PCSSD employees explained to Navigant that the use of MD and TD purchase order forms are similar to check payment requests in that the related purchases do not involve review and approval by the Purchasing Department.

<sup>52</sup> Purchasing department personnel stated that they were aware of a vendor who charged \$400 for a toner that can be purchased elsewhere for \$40.

#### 7. Insufficient Staff Levels

Employees in the Accounts Payable and Purchasing departments feel that they are understaffed and under immense pressure to properly perform their duties. Both departments feel that it would be beneficial to increase staffing so that the departments can function more effectively and efficiently with the necessary checks and balances and segregation of duties in place to deter and detect any potential instances of fraud and misconduct.

#### 8. Misappropriation/Embezzlement of Proceeds from Disposal of PCSSD Assets

##### a. Maintenance Department

A PCSSD employee expressed a concern that Maintenance department personnel may be misappropriating PCSSD funds. Additionally, the PCSSD employee believes that the Maintenance department maintains a separate checking account to deposit proceeds from the sale of maintenance scrap material and/or supplies. PCSSD employee also stated that some Maintenance department employees run their own maintenance-related businesses (i.e. plumbing and painting) outside of their full time PCSSD employment and may have misappropriated supplies ordered by the Maintenance department for use in their own businesses.

##### b. Transportation Department

Navigant learned that the Director of Transportation has the sole discretion to decide how fully depreciated or non-operational fleet vehicles should be disposed of either by auction or salvaged for parts and the remaining metal frame sold as scrap metal. Additionally, it is unclear who receives and accounts for the proceeds from the auction and scrap metal sales of the PCSSD's fleet vehicles. Furthermore, there is no documented process to determine how fleet vehicles should be disposed of and how the proceeds are received by PCSSD and accounted for.

### **IV. Limitations**

The preliminary observations and assessments detailed in this report are based on Navigant's methodology, data collection, interviews, analyses and the procedures performed to date. Navigant relied on the quality, availability and veracity of the information and data provided by the ADE, the PCSSD and third parties during the course of its work.

Navigant's preliminary observations and analyses do not constitute legal advice or a legal opinion.

Navigant based its preliminary observations and analyses solely on the information and documents provided and has not verified the information and documents or otherwise sought independent confirmation thereof. In making observations and analyses, Navigant has, in part, relied on assertions made by the representatives of the PCSSD and the ADE.

Given the limitations discussed above, the procedures performed by Navigant, and the extent of the information collected, Navigant cannot be certain at this time that all of the information collected is accurate or complete. Had Navigant performed additional procedures beyond those described, it is possible that additional information may have come to Navigant's attention that would have been relevant to its efforts.

The preliminary findings and observations set forth herein are based solely on the work performed through the date of this report. As work progresses, it is possible that the analyses and findings may change as additional information is obtained and additional procedures are performed.

Navigant did not conduct an audit, compilation or review of PCSSD's financial statements or financial information as those terms are understood in the United States and defined by professional guidance promulgated by the American Institute of Certified Public Accountants. Accordingly, Navigant does not express an opinion or other form of assurance on any financial statements or financial information. Navigant's findings are limited to the information reviewed and the procedures performed.

## **V. Procedures Performed to Date**

Navigant performed the following procedures to date:

### **A. Interviews Conducted**

1. Representatives of the PCSSD
  - a. Accounting/Auditing Department
    - i. Chief Financial Officer
    - ii. Acting Director of Accounting and Auditing
    - iii. Staff Accountant
    - iv. Accounts Payable Specialist
    - v. Accounts Payable Clerk
    - vi. Payroll Specialist II

- b. Purchasing Department
    - i. Director of Purchasing
    - ii. Buyer
  - c. Business Office
    - i. Coordinator of Budget Management
    - ii. Federal Programs & Special Education Budget Manager
  - d. Other Departments
    - i. Assistant Superintendent for Equity and Pupil Services
    - ii. Director of Transportation
2. Representatives of the ADE
- a. LEA Financial Analyst
  - b. Assistant Director, APSCN
  - c. Associate Director for Finance
  - d. Senior Transportation Manager, Public School Academic and Facilities and Transportation

**B. Meeting with Representatives of the ADE**

- 1. Assistant Commissioner, Division of Fiscal and Administrative Services
- 2. Coordinator, Fiscal Distress
- 3. Public School Program Coordinator
- 4. Accounting Coordinator

**C. Documents and Information Reviewed**

- 1. ADE Funding summary schedule.
- 2. PCSSD journal entries recorded in APSCN for FY 2006 to FY 2011 (as of December 7, 2010) to known Desegregation codes.

3. PCSSD accounting department organization chart.
4. Arkansas Financial Accounting Handbook for Arkansas Public Schools, Arkansas Educational Service Cooperatives and Open Enrollment Public Charter Schools dated July 1, 2010.
5. Business Procedures Manual for Budget Coding: Expenditure Classification for the PCSSD effective July 15, 2009.
6. Legislative Audit Investigative Report, dated May 14, 2010, regarding review of selected PCSSD transactions.

## **VI. Recommendations**

To assist the PCSSD in mitigating fraud, waste and abuse risk going forward, Navigant has compiled the following preliminary list of recommendations based on the interviews conducted and the review of relevant documentation and information to date:

### **A. Separate Reporting of Desegregation Funding**

Navigant recommends that the PCSSD record and maintain its financial information and the related transactions in connection with the Funding in accordance with the appropriate desegregation codes established by the ADE. The Funding and related expenditures should not be commingled with general unrestricted fund accounts and should be transparent.

### **B. Train Employees on the Proper Use of Desegregation Funding**

PCSSD finance, accounting and budgeting employees should be familiar with the purpose of the Desegregation Funding and how the Funding should be properly utilized for desegregation programs.

### **C. Retain an Independent Monitor**

Retain an independent monitor to execute anti-fraud programs for the purpose of deterring, preventing, uncovering and reporting unethical and illegal conduct, particularly over PCSSD's processes related to financial reporting and operations.<sup>53</sup>

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<sup>53</sup> For example, an independent private sector inspector general ("IPSIG") is a mechanism often used by government entities involved with large contracts to monitor an organization's compliance with relevant laws and regulations and to prevent, uncover and report illegal acts. IPSIG services involve the design and execution of fraud prevention and detection programs customized to respond to particular fraud, abuse, waste, corruption or other illegal conduct. See the International Association of Independent Private Sector Inspectors General's website at <http://www.iaipsig.org>.

#### **D. Conduct Annual Audits on the Use of Desegregation Funding**

Separate annual audits should be conducted related to Desegregation Funding by PCSSD accounting personnel, Legislative Audit, the independent monitor or another independent third party.

#### **E. Establish, Implement and Communicate Policies and Procedures**

Navigant recommends that formal internal control structure policies and procedures be implemented in connection with the following:

##### **1. Establish and communicate written policy and procedures**

Written accounting policies and procedures should be created to document the proper procedures to record financial transactions, process and approve expenditures, and review and audit of the books and records. These policies and procedures should be communicated to all employees who are involved with the accounting function and they should receive formal training and updates at least annually. Furthermore, these policies and procedures should be communicated to new employees during the on-boarding process.

Relevant, documented and practical operating policies and procedures that are communicated to PCSSD personnel can minimize ambiguity, promote consistency in carrying out one's functions and establish accountability.

##### **2. Hiring of consultants or employees**

A prospective employment candidate—whether a consultant or employee—should be processed through the Human Resources function and no one should be allowed to override any existing controls to circumvent the hiring process, particularly for candidates referred by a current employee, Board member or Superintendent.

A formal questionnaire should be formulated and required of all prospective hires to complete as part of the application process. The questionnaire should require detailed information related to the prospective hire's relevant work experience. Additionally, the Human Resources function should perform comprehensive background checks on all prospective hires. The results of the background checks should be reviewed in conjunction with the information provided on the questionnaire for corroboration and to identify any potential conflicts of interest or other issues that may disqualify hiring.

Complete personnel files should be maintained by the Human Resources function for all new employees and consultants should properly include documentation and approvals regarding status (full time or part time), pay rate, start date, Form W-4 and other requirements.

### 3. Vendor master list

#### a. Restrict write-access

The Accounts Payable and operation departments such as Transportation should only have read-only access to the vendor master list because they process payments and purchase goods and services from vendors, respectively. Accordingly, these departments should not have the ability to add vendors or modify vendor information. The Purchasing Department should be responsible for adding or modifying vendor records and maintaining the vendor master files.

#### b. Establish and implement a formal due diligence process for new vendors

Before a new vendor is added to the vendor master list, an employee should prepare a documentation folder to include the vendor's Form W-9 and other due diligence documentation that verifies the identity and existence of the vendor, and to identify any potential affiliations with PCSSD employees or Board Members.

A formal questionnaire should be formulated to require detailed information related to the prospective vendor including names of principals, address, EIN and Tax ID #s, contact person(s), industry code and other pertinent information. This questionnaire should be required to be completed by the employee who request approval of a new vendor. The completed questionnaire should be submitted to the Purchasing department who should review and perform due diligence vetting procedures to corroborate the information provided. If approved, a different Purchasing department employee should add the new vendor to the master vendor list.

#### c. Implement segregation of duties

There should be a formal vetting process for vendors with the approval process segregated from the employee requesting the addition of the vendor to the vendor master list.

For example, when a new vendor is requested to be entered into the vendor master file, an employee should prepare a request to enter the new vendor into the vendor master list and provide any supporting documentation. A Purchasing department employee should review the request, obtain a completed W-9, conduct due diligence, prepare a vendor folder and approve the request only if no exceptions are found.

Once the new vendor is approved, another employee should enter the vendor into the vendor master list. No employee with the capacity to process checks or make payments should be allowed to modify vendor



information. Only Purchasing department personnel should have the authority to add vendors to or update the vendor master list.

Currently, there is no apparent audit trail of when a new vendor was added to the vendor master list in APSCN and by whom.<sup>54</sup>

#### **F. Conduct an Independent Inspection of the PCSSD’s Fleet Vehicles**

An independent third party should perform an inspection of the PCSSD’s fleet vehicles to assess its condition, and to determine which vehicles should be sold by auction or salvaged for parts and the remaining metal frame sold as scrap metal. This assessment should be documented and a copy should be sent to the Accounting department to update its insurance coverage and fixed asset records.

#### **G. Board Independence**

Require an affirmation by Board Members and the Superintendent to attest that there were no conflicts of interest or to disclose any related party transactions at least annually. This affirmation should be required to be submitted to the AG.

#### **H. Establish a Good Control Environment at the Top**

The strength of internal controls in any organization starts at the “top of the organization.” Board Members and senior level employees should encourage acceptable behavior among its constituents through its actions and communication of effective policies and procedures as well as codes of ethics.

#### **I. Establish, Implement and Communicate a Code of Ethics and a Employee Handbook**

##### 1. Code of Ethics

The PCSSD should ensure it has a Code of Ethics (the “Code”) that is distributed and signed by the Board, the Superintendent and all employees. This Code should be reviewed and approved by the Board. To strengthen the governance of the School District, it is imperative that identified violations of the Code are addressed timely and appropriately. Senior level employees should be responsive to issues raised by employees. There should be training sessions at least annually to communicate the Code and it should also be signed annually by all employees to affirm their understanding. The Board should also review the Code at least annually and incorporate updates or modifications.

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<sup>54</sup> A forensic analysis of the vendor file’s metadata may reveal this information.

Additionally, the Board should be required to complete an annual affirmation regarding adherence to its compliance to the Code as well as the disclosure of potential conflicts of interest.

## 2. Employee Handbook

The School District should establish and distribute a handbook to provide information to all employees, Board Members and the Superintendent. This handbook should highlight the contractual terms and conditions of employment as well as the policies and procedures that everyone is expected to adhere to. The handbook also may include the PCSSD's policies, practices, procedures and details of miscellaneous provisions relating to employment. Penalties and ramifications for violating the Employee Handbook should be clearly stated and strictly enforced.

Furthermore, all employees should provide a signed acknowledgement to document that they read and understood the handbook.

## **J. Consider Additional Staffing**

The PCSSD should assess staff levels in the Accounts Payable and Purchasing departments to ensure that current employees can adequately perform their duties without compromising the PCSSD's fiscal and operational integrity.

## **K. Establish an Employee Hotline and Post Office Box**

An anonymous reporting hotline and a post office box should be established to provide a channel for employees to escalate issues related to potential fraud, waste, abuse and misconduct. Employees should be informed about this hotline and post office box and be encouraged to be forthcoming in raising concerns or questions about compliance principles or policies.

It is therefore important to establish a means whereby employees can anonymously submit reports to document instances of potential risks and misconduct.

Navigant recommends that an independent firm be utilized to follow up on issues submitted to the hotline and the post office box. The hotline should have procedures established regarding how to respond to inquiries or reports. Hotline personnel should have the necessary and appropriate qualifications and experience to respond to concerns raised, be able to solicit necessary information from the caller (i.e. who, what when, where, why and how) and maintain the confidentiality and the callers' anonymity. A log should also be maintained to document the caller's allegation(s) and the disposition. The PCSSD's Legal and Human Resources departments should be aware of the issues reported on the Hotline and be involved in the resolution and follow up processes.

A strict non-retaliation policy should also be communicated and enforced. Above all, the PCSSD should publicize the existence of the hotline and the post office box through means of posters, wallet cards, and other communications, including on employee paystubs.

**L. Mandatory Rotation of the PCSSD's Independent Financial Statement Auditor Every Five Years**

Establishing mandatory rotations of independent auditors may help to maintain the auditor's independence in fact and appearance. The new auditors' testing approach may identify potential risk areas that may have been overlooked by the previous auditors.

Term limits may encourage auditors to be more thorough and accountable, because of potential reputational damage if subsequent auditors discover deficiencies in prior year audits. Lastly, rotating independent auditors may prevent Board Members and other high-level PCSSD employees from developing relationships with auditors to a point that may be perceived by others as impacting independence.

# Appendix A



Arkansas Department of Education - Desegregation Funding Analysis  
Pulaski County Special School District  
Appendix A: Summary of Desegregation Funding and Expenditures by Fiscal Year

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 <sup>2</sup>	Grand Total	%
<b>ADE Desegregation Funding:</b>								
387 - Health Insurance & Teacher Retirement	\$ 4,426,814	\$ 5,810,592	\$ 4,760,153	\$ 6,313,112	\$ 6,538,422	\$ 3,394,655	\$ 31,243,748	29.3%
387 - Majority to Minority Incentive	11,617,363	11,056,440	9,275,397	11,204,951	10,478,331	3,143,499	56,775,981	53.3%
388 - Magnet & M-to-M Transportation	3,142,012	3,263,248	3,257,653	2,922,700	3,482,737	1,219,560	17,287,911	16.2%
Magnet Review Committee Revenue	92,500	92,500	92,500	92,500	92,500	92,500	555,000	0.5%
<b>Total ADE Desegregation Funding</b>	<b>\$ 19,278,689</b>	<b>\$ 20,222,781</b>	<b>\$ 17,385,703</b>	<b>\$ 20,533,263</b>	<b>\$ 20,591,990</b>	<b>\$ 7,850,214</b>	<b>\$ 105,862,639</b>	
Magnet Review Committee Revenue (School Districts) <sup>1</sup>	73,816	110,931	63,062	241,777	93,000	92,552	675,138	0.6%
<b>Total Desegregation Funding in APSCN</b>	<b>\$ 19,352,506</b>	<b>\$ 20,333,711</b>	<b>\$ 17,448,765</b>	<b>\$ 20,775,040</b>	<b>\$ 20,684,990</b>	<b>\$ 7,942,765</b>	<b>\$ 106,537,777</b>	<b>100.0%</b>
<b>Less Expenditures Recorded in Desegregation Funds:</b>								
Salaries	4,365,174	4,365,546	4,191,938	4,839,815	8,297,021	2,268,590	28,328,084	46.1%
Employee Benefits	1,184,761	1,157,819	1,124,868	1,272,925	1,755,991	649,453	7,145,816	11.6%
<b>Purchased Services:</b>								
Advertising	8,002	9,676	8,672	21,270	13,803	50	61,473	0.1%
Fleet Insurance	88,421	102,645	-	-	202,642	-	393,708	0.6%
Legal Fees	-	101,145	86,473	94,592	343,658	52,214	678,081	1.1%
Maintenance And Repairs	11,714	10,488	8,846	8,031	94,566	192,897	326,542	0.5%
Other Professional Services	133,987	73,003	508,255	28,898	43,072	3,956	791,170	1.3%
Rent	-	450	900	3,550	5,650	-	10,550	0.0%
Services Purchased from Other LEAs in State	-	-	-	202,632	117,400	63,950	383,982	0.6%
Travel	16,780	11,160	3,611	14,204	11,327	3,304	60,385	0.1%
Tuition to Other LEAs in State	3,918,743	4,255,559	3,545,208	2,174,509	3,437,508	1,151,998	18,483,525	30.1%
Gasoline	418,380	330,436	-	-	1,318,658	-	2,067,474	3.4%
Supplies, Books and Materials	200,937	244,935	96,463	155,482	492,029	35,224	1,225,070	2.0%
Equipment	49,182	43,495	22,957	49,450	60,262	112,401	337,747	0.5%
Heating Oil	-	-	-	-	26,239	-	26,239	0.0%
Dues and Fees	4,595	2,309	1,704	6,004	1,693	955	17,260	0.0%
Magnet Review Committee Expenditures	200,295	203,431	187,940	209,399	217,729	109,500	1,128,294	1.8%
<b>Total Expenditures Recorded in Desegregation Funds</b>	<b>\$ 10,600,971</b>	<b>\$ 10,912,097</b>	<b>\$ 9,787,834</b>	<b>\$ 9,080,760</b>	<b>\$ 16,439,247</b>	<b>\$ 4,644,492</b>	<b>\$ 61,465,400</b>	<b>100.0%</b>
<b>Remaining Desegregation Funding Balance</b>	<b>\$ 8,751,535</b>	<b>\$ 9,421,614</b>	<b>\$ 7,660,931</b>	<b>\$ 11,694,280</b>	<b>\$ 4,245,743</b>	<b>\$ 3,298,274</b>	<b>\$ 45,072,377</b>	
<b>Less Transfers to Non-Desegregation Funds:</b>								
Transfer To Salary Fund (1000 - General Unrestricted)	-	-	-	11,515,475	-	(650)	11,514,825	
Transfer To Operating Fund (2000 - General Unrestricted)	-	12,131,399	11,337,842	-	-	-	23,469,241	
<b>Net Desegregation Funding Balance</b>	<b>\$ 8,751,535</b>	<b>\$ (2,709,784)</b>	<b>\$ (3,676,911)</b>	<b>\$ 178,804</b>	<b>\$ 4,245,743</b>	<b>\$ 3,298,924</b>	<b>\$ 10,088,311</b>	

Notes:

- 1) Additional school district funding for Magnet Review Committee reflected in APSCN and not funded by the ADE.
- 2) Transactions recorded in APSCN as of December 7, 2010.

# Appendix B



Arkansas Department of Education - Desegregation Funding Analysis  
 Pulaski County Special School District  
 Appendix B: Matrix of Potential Issues Identified During Desegregation Funding Analysis

Potential Issues Identified	Potential Misconduct	Potential Fraud	Lack of Segregation of Duties	Lack of Written Policies & Procedures	Lack of Additional Review, Oversight and Compliance
<b>A. Nepotism:</b>					
Nepotism / Hiring of Friends & Family	X			X	X
<b>B. Lack of Policies &amp; Procedures:</b>					
Understanding of Mandates Surrounding Desegregation Funding	X	X	X	X	X
Culture of "Following Precedence"	X			X	X
Lack of Procedures for Review & Reconciliation of Gas Cards				X	X
<b>C. Governance / Tone At The Top:</b>					
Board, Superintendent & Senior Level Employee Override	X	X		X	X
Perceived and Actual Abuse of Power/Position	X			X	X
Lack of Channels for Reporting Concerns and Suspicious Behaviors				X	X
<b>D. Accounts Payable:</b>					
Pre-populated Signature Blocks		X	X	X	X
Changes to Vendor Master List	X	X	X	X	X
Check Requests & Duplicate Payments	X	X	X	X	X
Holding Checks for Pickup	X	X	X	X	X
Invoices Not Sent Directly to Accounts Payable	X	X	X	X	X
<b>E. Procurement:</b>					
Blanket Purchase Orders and MD & MT Forms <sup>1</sup>	X	X	X	X	X
Procurement Does Not Exclusively Maintain Vendor Master List	X	X	X	X	
Long Term Vendor Relationships	X	X		X	X
Misappropriation in Food Services Department	X	X	X	X	X
<b>F. Embezzlement/Misappropriation of Proceeds:</b>					
Embezzlement/Misappropriation of Proceeds from Asset Disposal	X	X	X	X	X
<b>Count:</b>	14	12	10	17	16

Notes:

1) Per PCSSD employees, use of blanket purchase orders and MD & MT Forms have been disallowed as of July 1, 2010.