

Novi Community School District

Report to the Board of Education

June 30, 2012

October 23, 2012

To the Board of Education
Novi Community School District

We have recently completed our audit of the basic financial statements of Novi Community School District (the "School District") as of and for the year ended June 30, 2012. In addition to our audit report, we are providing the following results of the audit, informational items, and other comments and recommendations which impact the School District:

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We are grateful for the opportunity to be of service to Novi Community School District. Should you have any questions regarding the comments in this report, please do not hesitate to call.

Very truly yours,

Plante & Moran, PLLC



Laura K. Claeys



Christopher Geck

cc: Dr. Steven Matthews, Superintendent
Ms. Carmen Jaroslowski, Director of Finance
Mr. Steven Barr, Assistant Superintendent of Business and Operations

Results of the Audit

October 23, 2012

To the Board of Education
Novi Community School District

We have audited the financial statements of Novi Community School District (the "School District") as of and for the year ended June 30, 2012 and have issued our report thereon dated October 23, 2012. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated May 14, 2012, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. We are responsible for planning and performing the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the School District. Our consideration of internal control was solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters and our audit of the financial statements does not relieve you or management of your responsibilities.

Our audit of the School District's financial statements has also been conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Under *Government Auditing Standards*, we have made some assessments of School District's compliance with certain provisions of laws, regulations, contracts, and grant agreements. While those assessments are not sufficient to identify all noncompliance with applicable laws, regulations, and contract provisions, we are required to communicate all noncompliance conditions that come to our attention. We have communicated those conditions in a separate letter dated October 23, 2012 regarding our consideration of the School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements.

We also are obligated to communicate certain matters related to our audit to those responsible for the governance of the School District, including certain instances of error or fraud and significant deficiencies in internal control that we identify during our audit. In certain situations, *Government Auditing Standards* require disclosure of illegal acts to applicable government agencies. If such illegal acts were detected during our audit, we would be required to make disclosures regarding these acts to applicable government agencies. No such disclosures were required.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the entity's financial statements and report does not extend beyond the financial statements. We do not have an obligation to determine whether or not such other information is properly stated. However, we read the management's discussion and analysis and budgetary comparison schedules and nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information or manner of its presentation appearing in the financial statements.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters on May 16, 2012.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the School District are described in Note I to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2012.

We noted no transactions entered into by the School District during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred, except for the prior period adjustment that is disclosed in Note I of the financial statements. During the year, the School District identified several fixed assets which did not meet the School District's criteria for being capitalized. As a result, the items were removed from the fixed assets listing. This correction of an error was applied retrospectively and net assets at July 1, 2011 have been restated.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. There were no significant components in the financial statements based on sensitive management estimates.

The disclosures in the financial statements are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. There were no such misstatements identified.

Disagreements with Management

For the purpose of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 23, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the School District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the School District, and business plans and strategies that may affect the risks of material misstatement with management each year prior to retention as the School District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition of our retention.

As required by OMB Circular A-133, we have also completed an audit of the federal programs administered by the School District. The results of that audit are provided to the Board of Education in our report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 dated October 23, 2012.

To the Board of Education
Novi Community School District

October 23, 2012

In addition to the comments and recommendations in this letter, our observations and comments regarding the School District's internal controls, including any significant deficiencies or material weaknesses that we identified, have been reported to you in the 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*. This report is included in the supplemental schedule of federal awards (single audit report) and we recommend that the matters we have noted there receive your careful consideration.

This information is intended solely for the use of the Board of Education and management of Novi Community School District and is not intended to be and should not be used by anyone other than these specified parties.

Informational Items

Novi Community Schools

Informational Items

These items have been discussed with the administration and are presented here for your information as the policy-making body of the School District.

Redefining State Aid and the Foundation Allowance - The fiscal year ended June 30, 2012 was the first year under a redefined funding approach for Michigan schools. While the foundation allowance concept remains, three key changes had a significant impact on the School District's funding level in 2011-2012 and, while modified, those changes are carried forward into 2012-2013. The three changes include a permanent \$470 per pupil reduction of the School District's foundation allowance, the creation of the incentive payment concept (best practices), and an additional categorical to aid in paying for the increased cost of the retirement system (MPSERS).

- **Foundation Allowance** - In the 2011-2012 fiscal year, the School District's foundation allowance was reduced to \$8,329. The \$470 reduction effectively reduced the foundation allowance funding by 5 percent. In the 2012-2013 fiscal year, some districts will receive an increase in foundation allowance of up to \$120 per pupil. Because of the School District's current foundation allowance level, Novi Community School District did not qualify for a foundation increase and the foundation allowance will continue at the 2011-2012 funding level.
- **Best Practices** - The governor identified many educational initiatives shortly after taking office. One key initiative was the concept of encouraging "best practices." This concept was built into the State Aid Act for the first time in 2011-2012 and continues into 2012-2013. In 2011-2012, five best practice initiatives were identified in the State Aid Act. To qualify for the \$100 per pupil incentive, the School District was required to implement at least four out of five of the initiatives. The School District qualified for the incentive and received the additional \$100 per pupil. For 2012-2013, the concept of funding best practices continues. New initiatives have been added to the existing list in the State Aid Act. The amount has been reduced to \$52 per pupil and the School District will be required to meet seven of eight best practices in order to receive the funding. The School District has already submitted for and has been certified as meeting seven of the eight best practices which will allow the School District to receive the \$52 per pupil for 2012-2013.
- **MPSERS Cost Support and MPSERS Reform** - The contribution rate the School District is required to pay continues to rise. The School District has no ability to influence the rate and no choice regarding its participation in the program. Recognizing that the costs are increasing rapidly under the current system, the 2011-2012 State Aid Act included funding to help pay for some of the increased cost. The categorical aid is formula-driven, using the School District's MPSERS payroll participation data. The School District received \$784,000 in categorical aid to help offset the impact of the approximately 4 percentage point increase in the retirement rate. The 2012-2013 State Aid Act continues the MPSERS cost support categorical, using the same formula, but is not expected to cover the additional costs that the School District is expected to incur with any MPSERS rate increases. Currently, the legislature is addressing other options to change the retirement system, but no conclusions have yet been reached. It is not expected that the MPSERS cost support funds will extend beyond June 30, 2013.

Novi Community Schools

Informational Items (Continued)

The most recent bill, Public Act 300, signed by the governor on September 4, 2012, caps the employer contribution rate at 24.46 percent, increases employee contributions, provides for future employees to receive defined contribution plan coverage instead of the current defined benefit plan for health care, and begins prefunding healthcare benefits from a pay-as-you-go method to a combination of employee contributions, employer contributions, and state funding.

The rate cap at 24.46 percent will mean that the School Aid Fund (SAF) will be responsible to fund any unmet required contributions determined by the actuaries. A concern is that the state funding needed to keep the rate down may limit the ability for the SAF to provide any increases in the foundation allowance and other categoricals. This will be a key factor to watch over the next few years. In fact, the Office of Retirement Services (ORS) contacted districts on September 21, 2012 to inform them the rate could not be capped at 24.46 percent due to recent legal challenges presented to the system. Effective October 1, 2012, the contribution rate will increase to 25.36 percent of covered payroll. This seemingly small increase (.9 percentage points) represents a 3.7 percent increase in the rate. This rate will remain in effect until further notice from the ORS.

Your current budget for 2012-2013 assumed the contribution rate would remain at 24.46 percent of covered payroll. Subsequent budget amendments should include changes in the rate as the year progresses.

Federal Program Related Items

Written Procedures for Grants

The Michigan Department of Education (MDE) continues to emphasize the importance of maintaining adequate written procedures for grants, as discussed in the 2011-2012 Accounting and Audit Alert. Additionally, the MDE has added example procedures to the Office of Audits website for reference. These requirements are described in 34 CFR Part 80, 2 CFR Part 215 and OMB Circular A-133 Compliance Supplement Part 6, and include the following:

- Financial management systems
- Payments
- Allowable costs
- Period of availability
- Matching or cost sharing (if applicable)
- Program income (if applicable)
- Procurement
- Equipment and real property (if applicable)
- Supplies
- Copyrights (if applicable)
- Subawards to debarred and suspended parties
- Monitoring and reporting program performance (if applicable)
- Financial reporting
- Retention and access requirements for records

Novi Community Schools

Informational Items (Continued)

In addition, districts should also have written procedures for:

- Cash management
- Conflict of interest
- Payroll
- Federal timekeeping

Special Education Excess Cost

The concept of “excess cost” has been a compliance matter within the Special Education Cluster federal program; however, due to a lack of guidance from the State of Michigan, school districts were not required to comply with the excess cost in the past. “Excess costs” are those costs incurred for the education of an elementary school or secondary school student with a disability that are in excess of the average annual per-student expenditure in a school district during the preceding school year. School districts will be required to compute the minimum average amount of per-pupil expenditure separately for children with disabilities in its elementary schools and for children with disabilities in its secondary schools, and not on a combination of the enrollments in both. The Michigan Department of Education is currently working on a tool which would assist districts in computing the minimum average amount. Once this tool is finalized, the department will provide additional guidance, and the School District will be required to show compliance. It is important the School District be aware of this requirement and be prepared to demonstrate compliance for fiscal year 2012-2013.

Special Education Maintenance of Effort

For fiscal year 2010-2011, the State of Michigan piloted an approach which analyzed maintenance of effort on an aggregate basis by the ISD. Therefore, if an ISD passed, the local district was deemed to have passed as well. ISDs that did not pass upon initial review by the State are responsible for working with the State to determine if an exception had been met and/or if there were further issues to resolve. Because the approach for the 2010-2011 fiscal year was a pilot, the School District should continue to track maintenance of effort individually and coordinate the plan within the ISD to ensure the effort is being maintained. There is no indication currently that the countywide testing approach will be suspended.

Special Education Proportionate Share

One of the requirements of the IDEA federal grant is that the School District expend a proportionate share of its allocation on services related to parentally placed private school children with disabilities enrolled in private elementary and secondary schools. Recently, the Michigan Department of Education issued guidance on the computation for determining the percentage, which was required to be tested in the audit for the year ended June 30, 2012. The School District should be aware of this requirement and should continue to retain documentation supporting the percentage computed as well as evidence of expenditures related to these required services.

Other Comments and Recommendations

Novi Community School District

Other Comments and Recommendations

We commend the business office, especially Carmen Jaroslowski, for the assistance, responsiveness, and receptiveness displayed during the audit process. Her level of professionalism and that of the entire team made the audit process smooth for our first year serving as the auditor.

As the result of our audit procedures for the year ended June 30, 2012, we offer the following suggestions for your review and consideration:

- **Capital Assets** - The School District currently utilizes an excel spreadsheet to track its capital assets. We recommend the School District consider implementing the use of capital asset software, which will allow the School District to more efficiently and effectively track its capital assets. Using excel spreadsheets to track capital assets leaves more room for errors in calculating the annual depreciation expense and can also incorrectly track the cost basis and accumulated depreciation due to the potential for inadvertent formula errors. Capital asset software will also allow the School District to store more data related to each asset, including fields such as “type” or “department.” This will enable the School District to run queries which will allow specific types of reports to be generated, which will be useful for department managers when they review the listing of capital assets in their department for consideration of potential factors such as the need for impairment or disposal.

It has been brought to our attention that effective July 2013, the School District plans to utilize a new accounting software package and the new software will include a capital assets module which will give the School District a better means of tracking and recording the capital assets.

- **Bank Reconciliations** - During our review of the bank account reconciliations, we noted that the reconciliations were not being signed by the preparer or the reviewer and that there was no date stamp indicating when the reconciliation was performed or reviewed. We recommend that this practice be adopted so that there is no question as to who is preparing and reviewing the reconciliations. This will also serve as documentation to support the fact that the reconciliations are being prepared and reviewed on a timely basis.
- **Manual Journal Entries** - During our review of the manual journal entries that were posted to the accounting system, we noted that there is no preparer or reviewer signoff on the journal entry. There does not appear to be a requirement to have manual journal entries reviewed before they are posted to the general ledger. We recommend that all manual journal entries are documented in a way that verifies who posted the entry, as well as who reviewed the entry and authorized it for posting to the general ledger.

Novi Community School District

Other Comments and Recommendations (Continued)

- **Construction Manager Contract** - During our testing of the capital projects, we noted that there was no signed contract in place between the School District and the construction manager. The lack of a signed contract could create a situation where the School District is billed for items they should not be billed for or billed in an amount which does not align with industry standards. The lack of a signed contract could make it difficult for the School District to discuss any charges they feel are not correct.

Subsequent to our initial audit procedures being performed, a signed contract between the construction manager and the School District was put into place. The contract was dated as of September 2012.

- **Segregation of Duties** - We offer the following recommendations to the School District as they relates to areas in which segregation of duties could be strengthened:
 - The finance director and the two finance department assistants have access to the blank check stock and have the ability to print checks with the signature included on the check. Though there are mitigating controls to protect against unauthorized disbursements, we suggest that the School District limit the accessibility to cash disbursements. If two individuals are required to have access to run and print checks, the third person should have his or her access removed and that person should be the only person with access to the blank check stock. As a backup, the assistant superintendent of business and operations should have a key to the blank check stock in case of an absence by the finance director. In addition, the assistant superintendent of business and operations should periodically (on an unannounced basis) review the access rights settings of the individuals in the finance department to ensure that access rights are appropriate. This will serve as an extra level of review over access rights, since the assistant superintendent of business and operations does not have the ability in the accounting system to modify access rights.
 - One of the finance assistants has the ability to add a vendor to the accounting system and prepare disbursements. Since adding a new vendor is likely an infrequent event, the School District should consider removing this access to the individuals that will be preparing disbursements and granting that access only to the third individual that will have physical access to the check stock (but no ability to print a check). Alternatively, an edit report should be run periodically to verify new vendors added to the system.
 - The finance director has the ability to change employee pay rates within the payroll system. The individual responsible for changing pay rates in the system should be separate from the individual responsible for reviewing pay rates. It was also noted that the payroll clerk has the ability to modify pay rates in the payroll system. We recommend that the ability to modify pay rates be removed from the finance department and that the human resources department be the responsible party for modifying employee pay rates. This will create segregation of duties between those that process payroll and those that modify the inputs that determine an employee's pay.

Novi Community School District

Other Comments and Recommendations (Continued)

- The human resources department should be approving all changes and inputs that have an impact on amounts that are paid to employees. This includes pay rates, payout of accumulated sick/vacation leave, early retirement incentives, supplemental pays, and any other type of compensation that is made to an employee. Since the finance department is responsible for preparing the disbursement to the employee, having the personnel/human resources department approve the inputs and changes will ensure proper segregation of duties. The approval should be documented in writing, dated in order to validate the timeliness of the approval, and the approved documentation should be maintained on file so that it is available for future review.
- **Cash Handling**
 - **Safe Access** - At one of the school buildings, the secretary and principal have access to the safe. If cash is collected while the secretary is not present, the principal places the cash in the safe for the secretary to deposit the next day. If the principal does not tell the secretary that the cash is in the safe, the secretary is not aware of its presence until the next time the safe is opened. This provides the risk is that cash may reside in the safe for extended periods of time before being deposited in the bank. We recommend that the School District implement a cash log at each of its buildings that can be used to document the date the cash was receipted by the secretary and the date the cash was deposited at the bank. We understand that the School District is in the process of reviewing the current procedures and controls related to cash handling.
 - **Agency Funds** - The School District has numerous agency funds for various student groups and building needs. We recommend that the School District continue to review the number of accounts, the activity in those accounts, and conclude whether any of the accounts should be consolidated, closed, or changed in any fashion in order to reduce the number of activities which need to be tracked and reconciled.
- **Contract Change Orders** - During our testing of capital projects, we noted that the School District does not have a formal policy regarding project change orders on bids that have been approved by the Board of Education. The School District should consider implementing a formal policy that should include establishing a minimum threshold that must be met in order for a change order to be deemed significant enough to require approval by the Board of Education.
- **Information Technology (IT) Recommendations** - As a result of our review of the School District's policies and controls surrounding the IT environment, we offer the following recommendations.
 - **Formal Documentation of User Access** - No formal process for notifying IT staff of new hires, access changes, or employee terminations exists. We recommend completion of a formal and approved form upon one of the aforementioned events. These forms should be retained throughout the duration of the employee's tenure.

Novi Community School District

Other Comments and Recommendations (Continued)

- **User Access Review** - We noted that management does not review user access to systems. We recommend that management implement a process to review user access at least annually. This is best achieved when the review is performed by someone other than IT (as they administer access). Access reports should be provided by IT to each supervisor or human resources for review of access. Any exceptions should be clearly documented with IT remediation.
- **Backups** - The School District performs backups of the systems; however, those backups are never tested to ensure they function properly. We recommend that the School District perform periodic tests of the backup files in order to ensure the system is properly performing the backups.
- **User Access** - The current settings of the system allow five invalid login attempts before a user ID is set to inactive. The counter resets automatically after ten minutes. We recommend that once the number of invalid login attempts is reached, the user ID should be set as inactive until the user who is attempting to login contacts the IT administrator to verify identity prior to having the user ID reset and set to active.
- **Administrator Access** - The Microsoft Windows built-in administrator account and password is being shared by three network administrators. To increase accountability for system changes, we recommend that unique accounts be established.
- **Password Complexity - Network** - Network passwords are not set to expire. We recommend that network passwords be set to expire every 30 days and that the same password cannot be used more than once over a one-year period. We also recommend that the minimum required password length be increased.