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An Analysis of Kentucky School Activity Fund Requirements for Internal Controls and Segregation of Duties Compared With National Standards and Requirements in Surrounding States

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**An Analysis of Kentucky School Activity Fund Requirements
For Internal Controls and Segregation of Duties Compared
With National Standards and Requirements in Surrounding States**

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Executive Summary

Across the United States, K-12 school systems receive and disburse a significant amount of funds at the school level. These funds are classified as school activity funds and may be broken into two distinct categories: 1) student activity funds and 2) district activity funds. Student activity funds are generally derived from fundraising activities of students to support a particular student group or organization such as the Y-Club, senior class, or student council. District activity funds are generated in the normal course of school business and may include funds such as locker fees, parking permit fees, school picture sales, or vending machine commissions. District activity funds are not raised by any specific student group and therefore should be accounted for at the district level. Athletic event ticket sales may also be considered district activity funds as these tickets are sold to the general public and not exclusively to students.

School activity funds do not include funds raised by PTA, PTO, athletic booster groups, or other support organizations. These organizations operate independently of the school or school district under their own tax identification number. School districts may exercise some control over the activities of these organizations, but do not account for the funds raised by these organizations in school district bank accounts.

A significant amount of funds received by individual schools is in cash, increasing the need for internal controls and segregation of duties. Internal controls provide schools with reasonable assurance that student activity funds are properly managed and accounted for according to all applicable laws and regulations. Segregation of duties is

one way of achieving this control by ensuring that no one person completes all steps for critical processing of cash such as receipt, deposit and recording of funds.

The Kentucky Department of Education is tasked with promulgating regulations to govern school activity funds for Kentucky K-12 school districts. This document is commonly referred to as “Redbook”. The current version was adopted in 2013 with a new 2019 edition set to become effective August 1, 2019. These two guidance documents were compared line by line to determine what changes in guidance have been made related to internal controls and segregation of duties for school activity funds. Further comparisons were made between the 2013 “Redbook” and the guidelines issued by the National Center for Education Statistics (NCES) and the seven states bordering Kentucky.

The analysis included in this paper finds that Kentucky has strong student activity fund guidance in comparison to surrounding states and encompasses most of the NCES guidance. Recommendations are made on ways Kentucky could add supplementary guidance for school principals and bookkeepers on the importance of internal controls and segregations of duties by modeling some examples from NCES and Tennessee.

Introduction

Local boards of education provide students with activity programs that enrich their overall learning experience and provide new learning experiences. Student participation in these activities often leads to the collection of funds at the school level in the form of student participation fees or proceeds from fundraisers conducted by students. Schools must have a process to receive and expend these funds for the

intended student activity purposes. This necessitates that schools be given guidance on how to properly record and account for these funds. Kentucky issues this guidance through the Kentucky Department of Education's "Accounting Procedures for Kentucky School Activity Funds" also known as "Redbook". "Redbook" provides a minimum standard that schools must follow in accounting for student activity funds.

Through comparison to the guidance issued at the state level by the seven states bordering Kentucky and guidance from the National Center for Education Statistics (NCES), the strength of Kentucky's 2013 "Redbook" guidance is assessed.

Recommendations are made for how Kentucky might improve guidance related to internal controls and segregation of duties in future versions of "Redbook" by learning from the NCES guidance and guidelines issued by the seven states bordering Kentucky.

Literature Review

Internal Controls and Segregation of Duties

"Internal controls are a framework, of policies, procedures, analysis and strategies put in place by the organization to prevent fraud, ensure the veracity and reliability of financial and accounting information and to protect the organization's financial assets, including but not limited to its cash flow." (Schaeffer, 2014, p. 8) Segregation of duties is one type of internal control. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines segregation of duties as dividing or allocating tasks between individuals in order to reduce the risks of error and fraud. By this definition, the

objective of segregation of duties is to reduce risk by implementing a set of checks and balances for critical activities (Maniere, Bergh, & Haggard, 2007).

Newspaper headlines typically focus on large-scale corporate frauds, but fraud occurs most frequently in small and medium sized businesses. Misappropriation of assets including cash, is one of the most common types of fraud (Brown, 2011). In fact, the Association of Certified Fraud Examiners (ACFE) 2018 Report to the Nations studied 2,690 cases of occupational fraud. The ACFE determined that misappropriation of assets was the most common type of occupational fraud with 89% of cases involving the misappropriation of assets. Occupational fraud refers to fraud perpetrated against an organization by employees or officers of the organization. In other words, occupational frauds are committed by individuals internal to the organization as opposed to those external to the organization such as a vendor (2018 Report to the Nations, 2018).

Misappropriation of assets can be broken down into subcategories, such as theft of cash on hand, theft of cash receipts, and fraudulent disbursements. Fraudulent disbursements are of particular concern for school activity funds. A school bookkeeper can easily perpetrate fraudulent disbursement schemes if internal controls are lax. These include billing schemes where a fictitious vendor may be used and/or where un-allowed personal purchases are made, expense reimbursement schemes where fake or overstated reimbursements are processed for payment, and check and payment tampering schemes where checks may be manipulated using forged signatures or altered payee names (2018 Report to the Nations, 2018).

In 30% of the fraud cases analyzed by the Report to the Nations, a lack of internal controls was cited as the root cause of the fraud. Another 19% were attributable to the overriding of existing internal controls. Further, lack of management review accounted for 18% of cases and poor “tone at the top” with another 10% of cases (2018 Report to the Nations, 2018). Establishing a “tone at the top” that internal controls are a priority for the organization can be an effective tool for smaller organizations to deter fraudulent activity. If management routinely reviews transactions then the potential for fraudulent activities to be uncovered serves as a deterrent for fraudulent behavior (Brown, 2011).

Audits of Kentucky’s 173 K-12 school districts for the fiscal year ended June 30, 2018 contained a number of audit comments and findings related internal controls, segregation of duties and school activity funds. The audit comment summary provided by Jackie Chism, Educational Financial Analyst for the Kentucky Department of Education, tallied that district audits for FY18 contained 7 comments about a lack of internal controls, 37 comments related to improper segregation of duties and another 203 comments pertaining to school activity funds management (Chism, 2019).

School Activity Funds

School activity funds can be classified into two types: student activity funds and district activity funds. Student activity funds are monies collected by students, typically under the supervision of a teacher sponsor, for educational or recreational purposes. The students may participate in determining how the funds collected are used, but the school acts as a fiduciary for the funds (Risk Advisory Student Activity Funds, 2016). Student activity funds may be divided into four categories. General student activities account for activities that impact all students such as school pictures or a school store.

A second category relates to specific classes such as the junior class or class of 2019. Clubs make up a third category of student activities and includes all extracurricular clubs such as the chess club or science club. Finally, athletics make up the fourth category of student activity funds (Cuzzetto, 2004).

Schools across the country handle millions of dollars each year in student activity funds. A significant portion of these funds are generated by student-led fundraisers and athletic gate receipts. Often these collections are in cash, which makes student activity funds particularly susceptible to theft, misuse or errors (Risk Advisory Student Activity Funds, 2016). Dillon Mullan reported on the significance of gate proceeds to athletic programs for a handful of schools in Northeast Mississippi and found that Friday night football gate proceeds ranged from \$7,000 to \$18,000 per game with attendance of 1,300 to 3,000 per game for the schools studied (Mullan, 2018).

Staff sponsors providing supervision of students and fundraising activities may have little financial training or knowledge of internal controls. There is a widespread misconception that student generated funds are subject to a different set of rules and do not need to be safeguarded as strictly as other school district funds (Risk Advisory Student Activity Funds, 2016).

According to Don Mullinax, former inspector general for the Los Angeles Unified School District, many district leaders lack ways to uncover fraud and when they do find fraud, it is not always reported. Further, Mullinax claims that district administrators and principals often consider fraud detection and prevention not to be part of their job duties because they were trained to be educators and do not have a background in financial management or accounting (Dessoiff, 2009). The University of Kentucky's Education

Leadership Principal Program requires only one course in school finance as part of the principal certification program (Educational Leadership Studies: Principal Preparation/Education Specialist (Ed.S), 2019). The required course, EDL 627, focuses on a district level view of school finance, rather than a school principal level view, as illustrated by the course description: “Study of concepts in school finance and school business management. Attention is given to national, state, and local issues. Emphasis is also given to school support services including transportation, facility planning and maintenance, food service, and risk management.” (EDL 627 School Finance and Support Services (3 Hours), 2019).

Research Design

This study seeks to analyze and assess the strengths and weaknesses of the Kentucky Department of Education guidance document for school activity funds titled “Accounting Procedures for Kentucky School Activity Funds”. This document is also commonly referred to as “Redbook” throughout the Kentucky K-12 education community. Kentucky’s “Redbook” is incorporated by reference into 702 KAR 3:310 and is periodically reviewed by a panel of Kentucky Department of Education staff, school finance officers and independent auditors who engage in school district audits. This committee recommends additions and deletions from the current “Redbook” to the Kentucky State Board of Education for adoption approximately every 3-5 years. The current version of Redbook became effective July 1, 2013. The review and approval process is underway for an updated version of “Redbook” to become effective August 1, 2019. The research questions to be addressed through this analysis include:

- How does Kentucky’s 2013 “Redbook” guidance compare with the proposed 2019 “Redbook” draft guidance?
- How does Kentucky’s 2013 “Redbook” guidance on segregation of duties compare with the “benchmark” guidance of the National Center for Education Statistics (NCES) and with the standards in surrounding states?

The analysis will be conducted by a review of the guidance, equivalent to Kentucky’s “Redbook” each state provides to its local school districts. This documentation will be located by reviewing each state’s department of education website for resource documents or by contacting someone via e-mail if the appropriate document is not located during the website search. The emphasis of this review will be to assess how each state addresses the topics of segregation of duties and the importance of internal controls at the school level. This study is not subject to the University of Kentucky’s Institutional Review Board (IRB) review and approval process due to the nature of the research being conducted.

Research Analysis

Kentucky

Kentucky’s 2013 “Redbook” became effective July 1, 2013 at the start of the 2014 fiscal year. The 2013 edition represented a significant change from prior versions of “Redbook” with most sections completely rewritten, others entirely removed and new sections added. The result was a “Redbook” nearly twenty pages longer than the 2008 version it replaced. Soon after the implementation of the new 2013 “Redbook” questions began to arise concerning some of the new regulations. Specifically, districts

were concerned with the definition of a district activity versus a school activity and the definition of operational expenditures, which were now clearly disallowed. It soon became clear to the Kentucky Department of Education (KDE) that further guidance was warranted and a Frequently Asked Questions (FAQ) document was developed in consultation with a workgroup of district finance officers and auditors. The development of a FAQ document in lieu of another revision of “Redbook” was deemed the most expedient course of action since the FAQ document could be developed in a matter of weeks and was not subject to the approval process of a full “Redbook” revision.

The FAQ document was updated a number of times until arriving at the final version dated August 1, 2015. This version is sixteen pages long and divided into sections for common terms and definitions, receipts, expenditures and external support groups/organizations (Redbook Frequently Asked Questions, 2015). The revision process for the 2019 version of “Redbook” was considered a review process for minor changes and to fold the FAQ document into the official “Redbook”. Some auditors had argued that the FAQ document was not “Redbook” and some of the contradictory guidance it contained did not make the school or district compliant with the 2013 “Redbook” for audit purposes.

A line-by-line comparison of the 2013 and 2019 versions of “Redbook” reveals that very little has been changed between the two versions and in fact only a small amount of the FAQ document has been added to the 2019 “Redbook”. Most notably a section has been added to address district activity funds including their definition and details on which funds collected at the school level must be transferred to the district, which funds may be transferred to the district and which funds must remain at the school level.

Additional procedures for the transfer of such funds has also been included (Accounting Procedures for Kentucky School Activity Funds , 2019).

Both editions contain an appendix titled “Appendix A – Segregation of Duties”. As defined, segregation of duties means that more than one person is involved in the execution of critical accounting procedures. A list of reasons is given for having segregation of duties including the fact that significant amounts are collected by schools as cash and the need to emphasize internal control measures aimed at protecting collected monies (Accounting Procedures for Kentucky School Activity Funds , 2019).

Three duties are specifically listed as needing to be segregated for proper internal control purposes including signing checks, maintaining accounting records, and reconciling bank statements (Accounting Procedures for Kentucky School Activity Funds, 2013).

After the reasons for the segregation of duties is a section about the parties responsible for implementing the segregation of duties. The responsible parties include the school principal, school bookkeeper, and a third party other than the school principal or bookkeeper. The tasks generally associated with each person and their respective financial and reporting responsibilities in the process are listed. Finally, recommendations for internal controls over school activity fund collections are given. These include ensuring that procedures are in place to adequately document with physical evidence the audit trail for all transactions of the school activity fund. The documentation includes the use of pre-numbered receipts, use of purchase orders, issuing receipts, and making timely and complete deposits (Accounting Procedures for Kentucky School Activity Funds , 2019).

The most noticeable change to Appendix A is the deletion of approximately one page of additional suggested segregation of duties examples. The 2013 “Redbook” contains examples of segregation of duties procedures for the processes of handling receipts, paying bills, and preparing bank reconciliations. Each procedure enlists the use of the three individuals mentioned in the prior paragraph as being responsible for segregation of duties. For example, the suggested procedures for preparing the bank reconciliation tasks the school principal with opening the bank statement and reviewing the signatures on all checks and comparing the deposits with a listing of receipts from the school bookkeeper. The bookkeeper then clears the checks in the accounting system and reconciles the bank statement. Finally, the third person reviews the bank reconciliation prepared by the school bookkeeper (Accounting Procedures for Kentucky School Activity Funds, 2013).

While not specifically spelled out as segregation of duties much of “Redbook” is written in such a way as to insist that segregation of duties occur. The major sections such as receipt and expenditures are further divided into procedural sections with much of the guidance being given in such a prescribed way that segregation of duties must occur in order for the school to be compliant with “Redbook” regulations. One such example of this is in the general guidelines for receipts. “Redbook” clearly states that the school bookkeeper is not to collect funds directly from parents or students. All mail must be opened by someone other than the school bookkeeper and any checks received should be recorded on a multiple receipt form before being presented to the school bookkeeper for the preparation of a receipt and deposit. The school bookkeeper should count all money jointly with the person turning in the money at the time it is given to the school

bookkeeper. Additionally, an employee other than the school bookkeeper should verify the deposit total and that the deposit includes all receipts written since the last deposit. Further, this person should confirm that the bank deposit verification matches the deposit slip after the deposit is made (Accounting Procedures for Kentucky School Activity Funds , 2019).

Many sections of “Redbook” also include the statement “proper segregation of duties shall be maintained” (Accounting Procedures for Kentucky School Activity Funds , 2019). This represents a strengthening of the language used in comparison to the 2013 “Redbook” that said: “proper segregation of duties shall be maintained whenever possible” (Accounting Procedures for Kentucky School Activity Funds, 2013).

National Center for Education Statistics (NCES)

Approximately every five years the National Center for Education Statistics (NCES) revises its guide “Financial Accounting for Local and State School Systems”. The most recent version is dated 2014 and was released in March of 2015. Chapter 8 of this document details activity fund guidelines. Interestingly, sections of Kentucky’s 2013 “Redbook” and the accompanying FAQ document are taken word for word from the NCES guidelines without citation. Specifically, the FAQ discussion of the differences between school activity funds and district activity funds and “Appendix A – Segregation of Duties” from “Redbook” are almost identical to the NCES guidance document (Allison, 2015).

The NCES guidance related to internal controls and segregation of duties is broad and provides less detail than most state documentation. NCES guidance on internal

controls emphasizes the need for clear lines of authority over district and school activity funds and proper policies to guide operations. At the highest level of authority is the local board of education. Their responsibility is to adopt policies to govern the establishment and operation of all activity funds within the district. Under the authority of the local board is the superintendent, who is responsible for administering board policies. Next in the line of authority is the district treasurer or chief financial officer who should have overall responsibility in accounting for and reporting of all school district funds including school activity funds. This person should be responsible for the implementation and enforcement of internal controls. At the school level the highest level of authority resides with the school principal. The principal has overall responsibility to oversee the collection and disbursement of all school activity monies and must adequately supervise all bookkeeping responsibilities. The lowest level of authority listed in the NCEs guidance is the sponsor. The sponsor is the employee of the district who supervises the activities of the student organization (Allison, 2015).

The NCEs standards include several general policy suggestions aimed at ensuring districts have proper internal controls. These include the use of pre-numbered receipts, disallowing the use of signature stamps, recommending the requirement of multiple signatures on checks, the use of purchase orders for all disbursements and requiring daily deposits of all receipted funds (Allison, 2015).

As previously noted the section entitled "Segregation of Duties Related to Activity Funds" is virtually identical to the same guidance in Kentucky's "Redbook" including the need to emphasize internal controls to protect collected monies due to both the large number of transactions at the school level and the amount of collections received in

cash. The same three critical duties of signing checks, maintaining fund accounting records and reconciling bank statements are listed as needing to be segregated for internal control purposes (Allison, 2015).

One notable remark made by the NCES guidance is the need for the work of any person handling money to be subject to checks and balances. NCES states there is a need for the duties of the school bookkeeper to be identified, described, and monitored to ensure that segregation of duties occurs (Allison, 2015).

Missouri

Missouri publishes an extensive document each year to guide local school districts financial accounting practices. The most current version on the Missouri Department of Elementary and Secondary Education website is entitled “FY2020 Missouri Financial Accounting Manual” and is effective July 1, 2019. While the document is over 200 pages in length, there is no reference to the phrase “segregation of duties”. There is minimal reference to student activity funds with the main reference being that the school board is responsible for all student activity funds. The only reference to internal controls is a definition of internal controls provided in appendix K. Missouri defines internal controls as “A plan of organization under which employees’ duties are so arranged and records and procedures so designed as to make it possible to exercise effective accounting control over assets, liabilities, revenues and expenditures.” (FY2020 Missouri Financial Accounting Manual, 2019).

Tammy Lehmen, Director of School Finance in the Division of Financial and Administrative Services for the Missouri Department of Elementary and Secondary

Education, confirmed via email that Missouri does not publish any requirements regarding school activity funds. Therefore, Missouri does not have a document equivalent to Kentucky's "Redbook" available for comparison.

Illinois

Illinois publishes a document entitled "Part 100: Requirements for Accounting, Budgeting, Financial Reporting and Auditing". This document is similar to the Missouri guidance in that it has limited reference to segregation of duties or internal controls. The only reference to internal controls contained in the document is where internal controls are to be tested as part of the independent audit process. Segregation of duties is not referenced in the document (Part 100 Requirements for Accounting, Budgeting, Financial Reporting and Auditing, 2008).

Illinois defines student activity funds as "funds owned, operated, and managed by organizations, clubs, or associations within the student body under the guidance and direction of one or more staff members for educational, recreational, or cultural purposes" (Part 100 Requirements for Accounting, Budgeting, Financial Reporting and Auditing, 2008). Section 100.80 of the document provides limited guidance over student activity funds with most of the authority being left up to the local school board. This section does mirror some of the guidance issued by NCES by giving authority to the local school board to set policies related to the establishment and purpose of student activity funds. Also, the section requires that records be kept in such a way that verification of amounts received, disbursed and assets on hand can be made. Local school boards are also required to designate individuals who will have approval authority. Certain duties are allocated to the treasurer for each activity fund including

the bank reconciliation process (Part 100 Requirements for Accounting, Budgeting, Financial Reporting and Auditing, 2008).

Indiana

Indiana's guidance document is called "Accounting and Uniform Guidance Manual for Extracurricular Accounts". There is no mention of the term segregation of duties in the document and only scarce mention of internal controls. Internal controls are specifically mentioned in relation to having the school treasurer be someone other than the principal of the school so that the principal can be a second signature on all checks issued from the extracurricular account. Additionally, internal controls for safeguarding the use of electronic signatures as well as controls over vending operations are mentioned.

Indiana recommends that vending operations, concessions and other sales be monitored by using a regular reconciliation of beginning inventory, purchases, sales and ending inventory (Accounting and Uniform Compliance Guidelines Manual for Extracurricular Accounts, 2019).

While some of the documentation is remarkably specific concerning the use of forms to be pre-numbered and printed in duplicate or triplicate and how such forms are to be utilized and filed, there is very little in the way of detail on how accounting or reporting tasks should be divided to create a segregation of duties. Most of the internal control guidance contained in this document is limited to items such as using pre-numbered receipts and checks, requiring that all disbursements be made by check and requiring an approval process for all purchases. There are few references to involving more than one person in any of these processes. There is also minimal discussion of any lines of authority beyond the requirement for a treasurer be appointed for each public school

(Accounting and Uniform Compliance Guidelines Manual for Extracurricular Accounts, 2019).

Ohio

Ohio's student activity guidance document is titled "Guidelines for Student Activity Programs" and is issued by the Ohio Auditor of State. Similar to NCEC guidance this document contains an extensive section detailing the lines of authority for student activity funds including the board of education, treasurer, superintendent, principal and advisors/sponsors. Authority to establish and create policies pertaining to student activity funds resides with the local board of education while responsibility for implementing those policies falls to the superintendent. The district treasurer is tasked with the enforcement of accounting and internal control procedures for all funds in the district. The school principal is responsible for approving requisitions and expenditures of the student activity funds. The duties of the advisor/sponsor for each activity includes preparing an annual budget for the group and supervising the activities of the group including fundraising activities (Guidelines for Student Activity Programs, 2018).

Ohio also includes a significant section on internal controls. This section heavily references generally accepted auditing standards established by the American Institute of Certified Public Accountants' (AICPA) Auditing Standards Board including the definition of an internal control, management's responsibility to develop and maintain an internal control structure and the five components of an internal control structure. It is interesting to note that Ohio references the attitudes, awareness and actions of management as being an important factor to set the tone for internal controls being taken seriously by the organization as a whole. Limitations on internal controls are also

discussed including that even the best internal controls can only provide reasonable assurance that the financial objectives of the organization are being met. Individuals responsible for reviewing information must be educated to understand the purpose of the controls or else they may fail to take appropriate action (Guidelines for Student Activity Programs, 2018).

West Virginia

West Virginia issues a document called “Accounting Procedures Manual for the Public Schools in the State of West Virginia”. The most recent version was adopted in 2012. This document addresses internal controls on the first page and states that a well-designed internal control structure is an integral part of any effective accounting system (Accounting Procedures Manual for the Public Schools in the State of West Virginia, 2012).

Some of the characteristics of a good internal control program are listed as providing proper authorization for all transactions and activities, having adequate segregation of duties, having proper documentation for transactions, providing safeguards over the use and access of records, and having independent checks over performance. The purpose of internal controls is stated as providing a means to promote operational efficiency and encouraging compliance with accounting procedures (Accounting Procedures Manual for the Public Schools in the State of West Virginia, 2012).

Overall, West Virginia has one of the most detailed documents examined. It is similar in length and complexity to Kentucky’s “Redbook”. While segregation of duties is not mentioned in the document, segregation of duties is inherent to some of the dictated

procedural requirements. Like many other states, internal control measures such as the use of pre-numbered receipts, disallowing the use of signature stamps, use of certain forms in duplicate and ticket sales procedures are present through the document (Accounting Procedures Manual for the Public Schools in the State of West Virginia, 2012).

Virginia

Virginia is similar to Missouri in that it does not have guidelines governing student activity funds issued at a state level. Christie Fleming, Director of Finance for Dinwiddie County Public Schools in Dinwiddie, VA and former Virginia Association of School Business Officials (VASBO) President confirmed via email that the Virginia Department of Education does not currently work with local school divisions to ensure that all divisions are following the same guidelines. She states that VASBO is working to achieve better collaboration but that new leadership may be necessary for that to occur. Currently, school divisions develop their own guidelines for student activity funds, but borrow heavily from each other so many across the state are similar.

Tennessee

Tennessee's guidance pertaining to student activity funds is part of a larger document entitled "Tennessee Internal School Uniform Accounting Policy Manual". Section 4 relates specifically to student activity funds. Title 2 of this section provides an extensive discussion of internal controls. Tennessee's guidance mentions that internal control objectives are to provide reasonable assurance but not absolute assurance that internal school funds are spent in accordance with applicable laws and regulations, internal

school funds are protected from loss, misuse, or waste and that reliable information is maintained for reporting purposes (Tennessee Internal School Uniform Accounting Policy Manual, 2011).

Tennessee is the only state reviewed with guidance that specifically states that one purpose of internal controls is to limit the opportunity for theft and detect errors or fraud in a timely manner. Additionally, this guidance is the only source to point out that internal controls also provide individuals handling student activity funds with documentation that they accounted for all funds in their possession properly (Tennessee Internal School Uniform Accounting Policy Manual, 2011).

The rest of Section 4: Title 2 of this document discusses the revenue/collection cycle, purchasing/disbursement cycle, payroll cycle, capital asset cycle, inventory cycle, and reporting cycle. Each cycle has subsections of internal control objectives, potential errors due to the lack of internal controls, and minimum recommended internal controls. For example, one of the internal control objectives for the revenue/collection cycle is all receipts are promptly deposited intact and recorded in the accounting records. A potential error due to poor internal controls associated with this objective is that bank deposits are not made intact within the required three banking days. As a minimum requirement one recommendation is that the same person not be responsible for receiving cash, making bank deposits, maintaining accounting records and preparing the bank reconciliation. Throughout this document there are numerous recommendations for the segregation of duties such as the one above, although segregation of duties is not mentioned specifically in this section (Tennessee Internal School Uniform Accounting Policy Manual, 2011).

Findings and Recommendations

Improvements for Future Versions of Kentucky's "Redbook"

In comparison to the documentation issued by the surrounding states and the National Center for Education Statistics (NCES) concerning student activity funds, Kentucky's "Redbook" guidance is one of the more thorough documents. However, there are recommendations that can be made to improve the guidance conveyed in future versions of "Redbook".

Recommendation 1:

While Kentucky uses some of the NCES documentation word for word as it pertains to the segregation of duties related to activity funds, it formats the section in an awkward numerical manner that disguises the true intent of the NCES guidance. If this information is to continue to be included in "Redbook" it should be referenced properly and included as formatted by NCES to provide clarity to the section.

Recommendation 2:

Kentucky's "Redbook" would also benefit from a section similar to the NCES section outlining the lines of authority for student activity funds. The 2008 version of "Redbook" did contain a similar section but it was removed with the 2013 revision (*Accounting Procedures for Kentucky School Activity Funds, 2008*). Certain aspects of the section are contained in the 2013 "Redbook" as well as the 2019 "Redbook". However, a clear outline of the authority of each participant in the student activity accounting process including the responsibilities assigned to that participant would provide additional emphasis to the need for oversight of student activity accounting. At a minimum, a

section discussing the role and responsibilities for the school principal over the student activity fund accounting process would go a long way in strengthening the internal control monitoring process.

Recommendation 3:

Another recommended addition to future versions of “Redbook” would be to reinstate and expand the examples of segregation of duties procedures that were deleted from the 2019 “Redbook”. While the examples of segregation of duties procedures in the 2013 version are somewhat dated, they do provide school principals and bookkeepers with ideas on how they could better distribute work so that one person does not have unchecked control or authority over a particular process. Schools should not necessarily be required to follow these examples exactly; the examples, however, would provide a resource to spark additional ideas for managing the workflow of the student activity accounting operations.

Recommendation 4:

Kentucky’s “Redbook” could also benefit from providing a section specifically on internal controls similar to Tennessee. This would include providing a definition of internal controls, why they are important, and how they help to prevent fraud as well as protect employees by providing documentation that they properly handled and documented funds within their control. Preventing potential errors associated with poor internal controls for each major process such as receipts, disbursements, fundraising and ticket sales would also provide school personnel with additional insights as to the importance of internal controls and segregation of duties.

Conclusions

Overall, Kentucky has strong guidance for student activity fund accounting in comparison to surrounding states. The Kentucky documentation also encompasses most of the guidance contained in the NCES document issued at the federal level. Even though Kentucky's "Redbook" is robust that does not mean that it could not be strengthened in future editions. West Virginia and Tennessee both offer guidance similar in depth to Kentucky. Kentucky could benefit from developing internal control guidance similar to Tennessee and folding that information into the appropriate sections of "Redbook".

It is surprising that nearly half of the states surrounding Kentucky do not issue any type of state-wide guidance on student activity funds but rely on individual districts to provide such documentation. It is also notable that a majority of the analyzed states offer guidance that does not refer to segregation of duties or internal controls in any direct or significant way.

With the primary focus of the school principal on providing instruction to students, monitoring student activity funds is a minor consideration for many principals and is viewed more as a nuisance than an important part of their daily work. School principals and bookkeepers alike need access to as much information as possible about the significance of internal controls and segregation of duties and the role that they play in safeguarding school funds. School bookkeepers often have little formal accounting training and may not have immediate access to formal "Redbook" training when they begin their position. Due to these circumstances, it becomes imperative that documents

such as “Redbook” include significant information about what internal controls and segregation of duties are and why they are so important.

Future Considerations

Statement No. 84 of the Governmental Accounting Standards Board (GASB 84) establishes criteria for identifying fiduciary activities of state and local governments. The requirements of GASB 84 become effective for reporting periods beginning after December 15, 2018 (Statement No. 84 of the Governmental Accounting Standards Board, 2017). The Kentucky Department of Education has determined that student activity funds held at the school level meet the criteria for fiduciary activity as defined by GASB 84. Therefore, all Kentucky school districts must implement a method to account for student activity funds in their financial statements at the end of the 2020 fiscal year.

Most Kentucky school districts account for student activity funds using a separate accounting software package than the software package used at the district level. This necessitates that school districts develop a way to import school financial information into the district system or that the funds be accounted for using the district financial software package. It may be interesting to see if this higher level of scrutiny leads to improved internal controls and segregation of duties at the school level. Audit findings related to these funds in future audits may pressure schools and school districts to strengthen the controls in place at the school level.

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