



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Procedural Review

Maricopa County Regional School District No. 509

Year Ended June 30, 2006



Debra K. Davenport
Auditor General

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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

September 21, 2007

The Governing Board of
Maricopa County Regional School District No. 509

The Board of Supervisors of
Maricopa County, Arizona

During the single audit of Maricopa County for the years ended June 30, 2005 and 2006, the Office of the Auditor General became aware of certain allegations, such as improper accounting practices and noncompliance with laws involving the Maricopa County School Superintendent and the Maricopa County Regional School District No. 509. As a result, we have performed a review of the related internal controls and compliance matters at the Maricopa County School Superintendent's Office and Maricopa County Regional School District No. 509 pursuant to Arizona Revised Statutes (A.R.S.) §41-1279.21(A)(1). The review was more limited in scope than would be necessary to express an opinion on the District's internal controls or compliance. Accordingly, we do not express an opinion on internal controls or compliance or ensure that all deficiencies in internal controls or instances of noncompliance were disclosed.

Our review consisted primarily of inquiries, observations, and selected tests of internal control policies and procedures, accounting records, and related documents. The results of our review disclosed certain deficiencies in internal control and noncompliance with laws that the District should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship. Our recommendations are described on the following pages.

This letter is intended solely for the information of the Maricopa County Regional School District No. 509 Governing Board and the Maricopa County Board of Supervisors and is not intended to be and should not be used by anyone other than the specified parties. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning its contents, please let us know.

Sincerely,

Debbie Davenport
Auditor General

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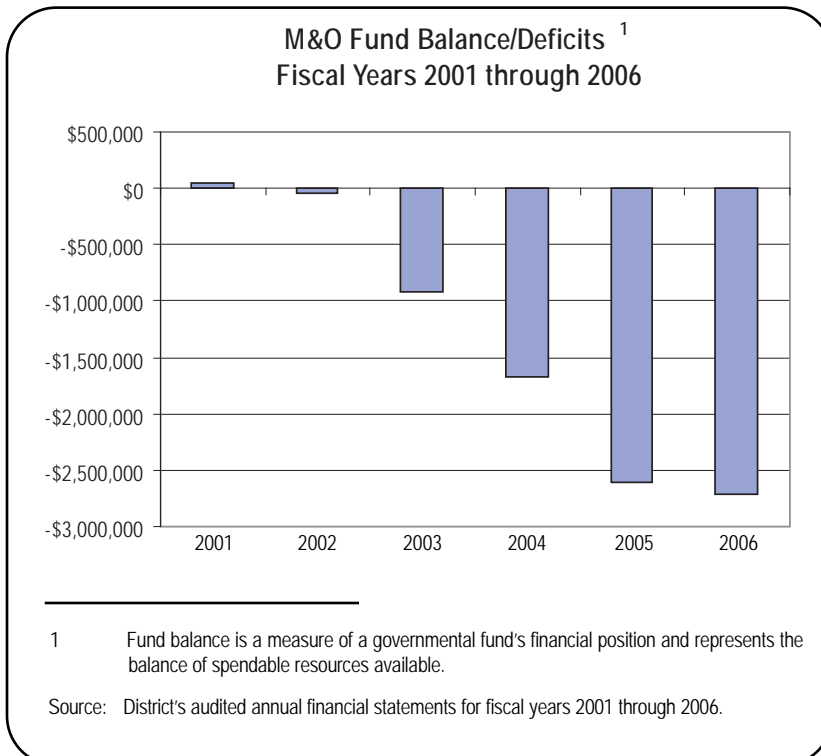
INTRODUCTION & BACKGROUND

The county school superintendent is an elected official who performs various duties for public school districts within the County pursuant to statute, such as maintaining revenue and expenditure records, processing school district warrants, and assisting with the school district budgeting process and other administrative responsibilities. In addition, the county school superintendent may operate accommodation school districts established pursuant to A.R.S. §15-308. As such, the Maricopa County School Superintendent operates the Maricopa County Regional School District No. 509. The District provides public education for preschool through high school students who are homeless, reside in areas without organized school districts, reside in behavioral health and detention facilities, or may require alternative education. Until November 30, 2006, the District was governed by the Maricopa County School Superintendent who acted as the sole governing board member in accordance with A.R.S. §15-101. The Maricopa County School Superintendent also had sole authority over the District's operations. However, since November 30, 2006, the District has been under the governance of a court-appointed, three-member board.

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The District should prepare a balanced budget annually

The District has a fiduciary responsibility to its students, their parents, and the State's taxpayers to provide a quality education and operate efficiently and within its means. The District receives funding from the State, the federal government, Maricopa County, and private citizens and organizations. A significant portion of the District's funding consists of state aid, similar to other public school districts. However, unlike other public school districts, the District does not receive property taxes because it has no taxing authority. Over the past several years, the District's expenditures exceeded its revenues. The District budgeted its expenditures in excess of funding sources and continued to operate in spite of revenue shortfalls, as evidenced by the District's declining financial position. Consequently, the District's M&O Fund has accumulated a fund deficit since fiscal year 2002. Specifically, the deficit grew from \$45,840 in fiscal year 2002 to \$2.7 million in fiscal year 2006. At June 30, 2006, the District's M&O Fund owed more than \$3.3 million to other district funds and the County Treasurer's Investment Pool. This liability is a component of the fund deficit for fiscal year 2006. The table below illustrates the fund balance/deficits for the District's M&O Fund for fiscal years 2001 through 2006.



During fiscal years 2001 through 2003, the County contributed \$365,000 annually to the District, and \$530,000 annually thereafter, although there was no formal agreement between either the County School Superintendent or District and the County Board of Supervisors. It is the District's position that the County Board of Supervisors should have made up for the funding shortfalls. However, the District did not formally request funding from the Board of Supervisors to cover the deficit for any of these fiscal years. Ultimately, the County School Superintendent, who acted as the District's governing board, who had sole authority over the District's operations, and who had the responsibility for the District's financial condition, did not ensure the District had the financial resources necessary to continue educating its students. Specifically, the District did not ensure that there was sufficient cash or future revenues available before making and authorizing expenditures and, thus, issued warrants regardless of whether there were enough funds to cover the warrants. Further, when the District became aware that anticipated revenues were insufficient to meet its needs, it did not reduce expenditures or otherwise ensure that budgeted expenditures were adequately funded. Moreover, future years' budgeted expenditures were not reduced in the efforts to control spending beyond the District's funding. Currently, there is no agreement with the County Board of Supervisors to resolve the District's funding issues.

To uphold its fiduciary responsibility to its stakeholders and to ensure that the District does not continue to operate with a M&O Fund deficit, the District should implement the following policies and procedures:

- Formalize an agreement with the County Board of Supervisors for funding the District.
- Prepare, and revise as appropriate, a district expenditure budget that does not exceed monies available.
- Authorize expenditures and issue warrants only when there is sufficient cash or immediate, future resources available.

The District must not give or loan public monies and must not provide employee benefits to private organizations

The District operates with public monies and, therefore, has a fiduciary responsibility to the public it serves. Article IX, Section 7, of the Arizona Constitution prohibits the state, county, city, town, municipality, or other subdivisions from giving or loaning its credit, or making donations, grants, or subsidies to any company or corporation. In addition, A.R.S. §35-301 prohibits the unlawful disbursement of public monies.

However, the District entered into transactions with the Maricopa County Schoolhouse Foundation (Foundation), a legally separate, nonprofit organization, which resulted in gifts of public monies by the District:

- The District entered into an employment contract with the Foundation's executive director as a district administrator and paid the salaries and benefits of this individual and his administrative assistant when neither performed work for the District. As a result, these individuals received benefits normally reserved for district employees, including medical, dental, and life insurance, and retirement benefits through the Arizona State Retirement System. Therefore, the salaries and benefits of these individuals, which totaled \$121,415 for the period of July 1, 2006, through February 28, 2007, constitute a gift of public monies. The Foundation has reimbursed only \$65,963 of this amount to the District.
- The District allowed the Foundation to use the District's administrative offices and other property without reimbursement of the related costs, which included rent, utilities, furniture and equipment, vehicle usage and gasoline, office supplies, postage, and other administrative costs. Therefore, these costs resulted in a gift of public monies to the Foundation. To date, the District has not made an effort to estimate these costs and collect reimbursement from the Foundation.
- The District gave the Foundation monies in the amount of \$89,000 that the District received as a distribution from an estate willed to the District's Thomas J. Pappas Tempe Elementary School. This resulted in a gift of public monies to the Foundation. To date, these monies have not been returned to the District.
- The District diverted donations in the amount of \$1,200 to the Foundation. The District informed auditors that this was done based on verbal instructions given by the donors who had made extracurricular activities fees tax credit contributions in excess of the allowable income tax credit. However, the check donations were made payable to the District, and there was no documentation specifying that the monies were to be paid to the Foundation. In addition, other check donations made payable to the District totaling \$10,613 were deposited into foundation accounts. These diversions resulted in a gift of public monies to the Foundation and to date, they have not been returned to the District.

To fulfill its fiduciary responsibility and safeguard cash donations, and to ensure compliance with all applicable state laws, including those governing the use of public monies, the District should establish policies and procedures that:

- Prohibit gifts or loans to benefit private individuals and organizations.
- Require district administrators or legal counsel to review all contracts and transactions with the Foundation to ensure compliance with all applicable laws.
- Recover all gifts of public monies provided to the Foundation.

The District's governing board must not unlawfully commit the District's resources

The District entered into loans for which there was no legal authority, and which were neither budgeted nor publicly disclosed. In addition, there were no legal documents supporting the loans. Specifically, in August 2006, the District obtained two loans; one in the amount of \$125,000 from the Foundation, and another in the amount of \$100,000 from a private citizen. For both loans, there was no written agreement detailing the loan's purpose, length, and repayment terms, interest rate to be charged, and other conditions. There is no statute that specifically authorizes an accommodation school district's governing board to obligate the District in such a way. To date, the District has not made any repayments on either loan.

To ensure that the District complies with all applicable state laws, it should implement the following policies and procedures:

- Consult legal counsel regarding the District's statutory authority prior to entering into any agreements, verbal or written, that may obligate the District or County.
- Ensure that authorized agreements obligating the District are in writing and include specific terms and conditions.
- Disclose and approve all actions made on the District's behalf.
- Ensure all estimated expenditures and obligations are included in the District's budget as required by A.R.S. §15-905(N).

The District must spend monies contributed for extracurricular activities as designated by donors and required by statute

During fiscal year 2006, the District received \$357,786 in fees or contributions and spent \$360,811 for extracurricular activities. However, the District did not have adequate internal controls over these contributions to ensure monies were expended in accordance with donors' designations and statutes.

According to A.R.S. §43-1089.01, taxpayers may receive income tax credits for fees or contributions made to public schools within the State in support of extracurricular activities. Taxpayers who contribute to extracurricular activities may designate a

particular school in a district and may also specify the extracurricular activity for which the contribution is to be spent. For contributions that a school receives that are not designated for a specific purpose, the school's site council determines how the contributions are spent. Extracurricular activities, defined by A.R.S. §15-342(24), are optional, noncredit, educational, or recreational activities which supplement the school's education program, whether offered before, during, or after regular school hours; however, the qualifying expenditures that extracurricular activities fees or contributions pay for are limited to those school-sponsored activities for which the school assesses a fee in order for students to participate. Statute disallows extracurricular activities, such as senior trips or events that are recreational, amusement, or tourist activities.

However, the District did not have adequate internal controls to ensure that extracurricular activities fees or contributions were spent as designated by donors. The District only monitored and adhered to the donor's contribution designation when expending such monies in the fiscal year in which they were received. Monies not fully expended in the year received were used for any extracurricular activity and, therefore, may not have been expended for the school or purpose designated by donors. For those extracurricular activities fees or contributions that the donor did not designate for a specific purpose, the District did not have a site council for each of its schools to determine how the contributions should be spent, as required by statute. It was not practical to extend our auditing procedures to determine whether extracurricular activities fees or contributions carried over from prior years were used as intended.

In addition, the District spent extracurricular activities fees or contributions on activities that did not meet the statutory definition of tax credit eligible extracurricular activities for 15 of the 25 expenditure items tested. Auditors specifically noted the following noncompliance totaling \$59,616:

- Expenditures totaling \$46,250 for transporting students to and from school for a federal program and catering expenditures of \$466 for another federal program were not valid extracurricular activities as defined by statute. The activities were for federally sponsored programs for which the District should not be assessing a fee for its students to participate.
- Eight expenditure items, totaling \$8,543, did not include sufficient documentation to conclude that the activity was an allowable extracurricular activity. In addition, the District did not have any supporting documentation for two of these expenditures, totaling \$2,253.
- Students were rewarded for meeting AIMS attendance goals with a field trip costing \$3,760 and consisting of miniature golf and arcade games. However, this activity is not an allowable tax credit expenditure because it was purely recreational. Further, according to Attorney General Opinion I87-123, only field trips or other activities that included demonstrable educational objectives were within the District's discretion.

- An expenditure item totaling \$597 for caps, gowns, and tassels was not an allowable extracurricular activity, as defined by statute.

To ensure that monies contributed for extracurricular activities are spent in accordance with donors' designations and state law, the District should implement the following procedures:

- Maintain detailed accounting records to document that monies received are used for the school and purpose intended by the donor, or the purpose determined by the site council, as prescribed by statute and the *Uniform System of Financial Records*, Memorandum No. 214.
- Monitor all expenditures of extracurricular activities by school and purpose to ensure contributions are spent as originally designated by donors or the site council.
- Prepare and retain adequate documentation supporting how the activity supplements the education program of the school to ensure the expenditures are for legally defined extracurricular activities.
- Establish a site council for each of its schools to direct the use of extracurricular activities fees or contributions not designated by donors for a specific purpose, as required by A.R.S. §43-1089.01(E).



Maricopa County **REGIONAL** School District
"The District of Miracles"

358 North Fifth Avenue • Phoenix, Arizona 85003 • Phone: 602-452-4700 • Fax: 602-452-4720

August 27, 2007

Office of the Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

Attn: Kathleen Wood

Re: Response to Audit

Dear Ms. Wood:

Thank you for the opportunity to respond to the audit completed by your office. Please find our answers and explanations below. We agree with the findings of the Auditor General in regards to areas for improvement for the District in the financial area.

1. The District should budget responsibly and ensure the District's expenditures are sufficiently funded.

A consultant, hired by the Receiver Board for Maricopa County Regional School District, is presently in negotiations to formalize an agreement with the District for funding. Additionally, the District is presently operating on a cash basis, not spending more than the revenues that are being generated from equalization aid, grants, gifts/donations, and tax credits. Expenditures are being carefully supervised to ensure that funds are available prior to spending. To this end, all requests are being reviewed by three people, one of whom is the consultant. This process will continue for the foreseeable future.

2. The District must not give or loan public monies and must not provide employee benefits to private organizations.

Invoices for salaries and benefits for Foundation employees, as well as furniture, utilities, postage, equipment usage, fuel, etc., were submitted to the Foundation in March. As of this date no payment has been received, but the invoices with "Second Notice" printed upon them have been resubmitted to the Foundation. If no answer is received, we will send again, registered mail. Additional invoices have been submitted to the Foundation for the \$89,000 left to the Tempe

Thomas J. Pappas Regional Elementary School and for the \$4,821 check from Target made out to the Thomas J. Pappas Elementary School. Again, if no response is received, we will make every effort possible to ensure receipt of the money owed to the District. Procedures are presently in place to ensure that checks made out to the District are placed in the proper Gifts/Donations or Tax Credit accounts. The District is working with its attorney to ensure that the District is in compliance with all laws and procedures in their association with the Foundation.

3. The District's Governing Board must not unlawfully indebted the District.

There will be no indebteding of the Maricopa County Regional School District in the future that is not in compliance with all laws and statutes. At the present time, Consultant is attempting to arrange a meeting with both parties that loaned money to the District to inquire as to the status of those loans, as we have been verbally informed that these were to be seen as gifts to the District. If this is not the case, the District will proceed to deal with the situation after obtaining legal advice.

4. The District must spend monies contributed for extracurricular activities as designated by donors and required by statute.

The organization of Site Councils is presently being done by the schools, in compliance with the statutes that pertain to these entities. Procedures are being put in place to document funds donated to Tax Credit, both restricted and non-restricted. Additionally, procedures are being put in place to ensure that monies are being spent according to the wishes of the donor(s). The state form for Tax Credit expenditures will be used to document the educational purpose for all Tax Credit spending and Site Councils will approve all expenditures.

Sincerely,

Perry K. Hill, Ed.D.
Consultant to the Board

PKH/clc