

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

EXAMINATION REPORT
OF
CANNELTON CITY SCHOOLS
PERRY COUNTY, INDIANA
July 1, 2007 to June 30, 2009



FILED

08/16/2010

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OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Treasurer	Melissa B. Embry	07-01-07 to 06-30-10
Superintendent of Schools	Marion A. Chapman	07-01-07 to 06-30-10
President of the School Board	Christal Moskos William Garrett	07-01-07 to 06-30-08 07-01-08 to 06-30-10



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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF CANNELTON CITY SCHOOLS, PERRY COUNTY, INDIANA

We have examined the financial information presented herein of Cannelton City Schools (School Corporation), for the period of July 1, 2007 to June 30, 2009. The School Corporation's management is responsible for the financial information presented herein. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the financial information presented herein and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

The School Corporation's management did not provide accurate information to the Indiana Department of Education (IDOE) in the form of its financial reports for the years examined. The financial reports are used to compile the cash basis financial statements. Therefore, accurate financial statements were not available for audit. The cash receipts, disbursements, and balances as shown in the financial reports for the years ended June 30, 2008 and 2009, do not reconcile to the unit's corresponding bank statements.

In our opinion, the financial information referred to above does not present fairly, in all material respects, the financial information of the School Corporation for the years ended June 30, 2008 and 2009, based on the criteria set forth in the uniform compliance guidelines established by the Indiana State Board of Accounts.

As discussed in Note 9, the School Corporation's financial condition has been in decline for several years. The School Corporation has entered into increasing debt obligations that raise substantial doubt about the School Corporation's ability to meet operating expenses. The School Corporation is materially delinquent in the payment of federal withholding taxes, social security, and Medicare taxes.

The Schedule of Long-Term Debt, as listed in the Table of Contents, is presented for additional analysis and is not a required part of the basic financial information. It has not been subjected to the examination procedures applied to the basic financial information, and accordingly, we express no opinion on it.

STATE BOARD OF ACCOUNTS

April 7, 2010

CANNELTON CITY SCHOOLS
SCHEDULES OF RECEIPTS, DISBURSEMENTS, AND CASH AND INVESTMENT BALANCES
ALL GOVERNMENTAL AND FIDUCIARY FUND TYPES
As Of And For The Years Ended June 30, 2008 And 2009

	Cash and Investments 07-01-07	Receipts	Disbursements	Cash and Investments 06-30-08
Governmental Funds:				
General	\$ 67,819	\$ 2,749,598	\$ 3,178,944	\$ (361,527)
Debt Service	3,722	2,663	-	6,385
Capital Projects	(117,787)	54,841	42,830	(105,776)
Transportation Operating	(7,140)	-	418	(7,558)
Transportation School Bus Replacement	3,901	5,326	-	9,227
Special Education Preschool	15,959	10,704	19,861	6,802
School Lunch	76,754	97,526	108,944	65,336
Textbook Rental	5,239	9,813	6,247	8,805
Even Start Preschool	5,500	-	-	5,500
Weyerhauser Grant	81	-	-	81
Technology Plan Buddy	785	-	-	785
Perry County Substance Abuse Grant	(4,719)	500	4,073	(8,292)
Gifted & Talented	10,542	-	-	10,542
Professional Development Portfolio	-	-	120	(120)
United Way of Perry County	369	2,847	1,329	1,887
Title I	16,766	46,675	61,055	2,386
ECIA Title VI	1,214	-	-	1,214
Title V, Part A, Innovative	2,755	-	877	1,878
Drug-Free Schools	-	1,359	120	1,239
Title II Eisenhower	700	-	272	428
After School Program	1,444	6,450	4,912	2,982
Tobacco Grant	960	475	1,459	(24)
GAP / REAP	43,465	-	9,218	34,247
Learning to Give	-	700	168	532
Workforce Development Grant	1,415	-	6,485	(5,070)
Class Size Reduction	1	-	-	1
Special Ed Technology	2,213	-	-	2,213
Math & Science Partnership	90,661	-	26,190	64,471
Improving Teacher Quality	32,819	-	5,863	26,956
Ed Tech Competitive Grant	378	-	-	378
Tech Literacy Grant	25,127	-	11,678	13,449
Tech Literacy II	30,000	-	-	30,000
Ed Tech II	(65,028)	-	-	(65,028)
Special Arts Grant	498	-	-	498
Miscellaneous Programs 2	(8,645)	8,645	-	-
Miscellaneous Programs 3	11,487	-	11,487	-
Fiscal Stabilization - Education (Stimulus)	-	-	-	-
Fiduciary Funds:				
Welborn Family/School Activities	7,299	-	3,417	3,882
Miscellaneous Programs 1	(68)	-	-	(68)
Perry County Community Foundation	836	-	-	836
SINE - Model School	4,773	-	4,924	(151)
Vision Athena	449	-	-	449
Agency Fund:				
Payroll Withholdings	30,913	1,939,983	1,786,638	184,258
Totals	<u>\$ 293,457</u>	<u>\$ 4,938,105</u>	<u>\$ 5,297,529</u>	<u>\$ (65,967)</u>

The accompanying notes are an integral part of the financial information.

CANNELTON CITY SCHOOLS
SCHEDULES OF RECEIPTS, DISBURSEMENTS, AND CASH AND INVESTMENT BALANCES
ALL GOVERNMENTAL AND FIDUCIARY FUND TYPES
As Of And For The Years Ended June 30, 2008 And 2009
(Continued)

	Cash and Investments 07-01-08	Receipts	Disbursements	Cash and Investments 06-30-09
Governmental Funds:				
General	\$ (361,527)	\$ 3,342,237	\$ 3,522,484	\$ (541,774)
Debt Service	6,385	-	17,087	(10,702)
Capital Projects	(105,776)	17,460	109,273	(197,589)
Transportation Operating	(7,558)	-	1,220	(8,778)
Transportation School Bus Replacement	9,227	2,618	3,000	8,845
Special Education Preschool	6,802	6,525	9,351	3,976
School Lunch	65,336	128,489	109,389	84,436
Textbook Rental	8,805	3,528	2,295	10,038
Even Start Preschool	5,500	-	-	5,500
Weyerhauser Grant	81	-	-	81
Technology Plan Buddy	785	-	1,045	(260)
Perry County Substance Abuse Grant	(8,292)	7,024	-	(1,268)
Gifted & Talented	10,542	76,476	56,715	30,303
Professional Development Portfolio	(120)	4,992	50	4,822
United Way of Perry County	1,887	2,509	1,270	3,126
Title I	2,386	100,583	91,639	11,330
ECIA Title VI	1,214	-	-	1,214
Title V, Part A, Innovative	1,878	552	528	1,902
Drug-Free Schools	1,239	868	1,293	814
Title II Eisenhower	428	7,347	-	7,775
After School Program	2,982	-	283	2,699
Tobacco Grant	(24)	1,317	658	635
GAP / REAP	34,247	-	4,923	29,324
Learning to Give	532	1,450	507	1,475
Workforce Development Grant	(5,070)	-	8,813	(13,883)
Class Size Reduction	1	-	-	1
Special Ed Technology	2,213	-	298	1,915
Math & Science Partnership	64,471	-	64,313	158
Improving Teacher Quality	26,956	-	13,285	13,671
Ed Tech Competitive Grant	378	-	-	378
Tech Literacy Grant	13,449	3,000	17,773	(1,324)
Tech Literacy II	30,000	-	-	30,000
Ed Tech II	(65,028)	-	-	(65,028)
Special Arts Grant	498	-	-	498
Miscellaneous Programs 2	-	-	-	-
Miscellaneous Programs 3	-	-	-	-
Fiscal Stabilization - Education (Stimulus)	-	179,830	-	179,830
Fiduciary Funds:				
Welborn Family/School Activities	3,882	-	5,069	(1,187)
Miscellaneous Programs 1	(68)	-	-	(68)
Perry County Community Foundation	836	-	-	836
SINE - Model School	(151)	-	1,869	(2,020)
Vision Athena	449	-	-	449
Agency Fund:				
Payroll Withholdings	184,258	1,454,912	1,157,666	481,504
Totals	<u>\$ (65,967)</u>	<u>\$ 5,341,717</u>	<u>\$ 5,202,096</u>	<u>\$ 73,654</u>

The accompanying notes are an integral part of the financial information.

CANNELTON CITY SCHOOLS
NOTES TO FINANCIAL INFORMATION

Note 1. Introduction

The School Corporation was established under the laws of the State of Indiana. The School Corporation provides the following services: educational services.

Joint Ventures

The School Corporation is a participant with Dubois, Spencer and Perry County Schools in a joint venture to operate the Dubois-Perry-Spencer Exceptional Children's Cooperative, which was created to provide joint employment and purchase of supplies and equipment for an exceptional children's program. Complete financial statements for the Dubois-Perry-Spencer Exceptional Children's Cooperative can be obtained from Greater Jasper Consolidated Schools, Attn: Sara Harpenau (Telephone (812)-482-6661), 1520 St. Charles Street, Suite 1, Jasper, IN 47546.

The School Corporation is a participant with other Southwest Indiana schools in a joint venture to operate Patoka Valley Career and Technical Cooperative which was created to provide programs and services for vocational education. Complete financial statements for the Cooperative can be obtained from Patoka Valley Career and Technical Cooperative, Attn: Glenn Weil (Telephone (812)-482-7662), 1520 Saint Charles Street, Jasper, IN 47546.

The School Corporation is a participant in the Southern Indiana Education Center which was created to allow participating school corporations to share certain programs and services. The School Corporation is obligated by contract to remit a proportionate share semi-annually to supplement the Education Center. Complete financial statements for the Education Center can be obtained from Southern Indiana Education Center, Attn: J. Scott Turney (Telephone (812)-482-6641), 1102 Tree Lane Drive, Jasper, IN 47546.

Note 2. Fund Accounting

The School Corporation uses funds to report on its cash and investments and the results of its operations on a cash basis. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain governmental functions or activities.

Note 3. Budgets

- A. The operating budget is initially prepared and approved at the local level. In addition, funds for which property taxes are levied are subject to final approval by the Indiana Department of Local Government Finance.

CANNELTON CITY SCHOOLS
NOTES TO FINANCIAL INFORMATION
(Continued)

B. For the years ended December 31, 2008 and 2009, disbursements exceeded budgeted appropriations in the following funds by the amounts below:

Fund	2007	2008
General	\$ 1,262,203	\$ 1,864,350
Capital Projects	58,667	41,817
Transportation Operating	2,622	124
Special Education Preschool	-	3,816
Totals	<u>\$ 1,323,492</u>	<u>\$ 1,910,107</u>

Note 4. Cash and Investment Balance Deficits

At June 30, 2008 and 2009, the following funds reported deficits in cash and investments, which are violations of the Uniform Compliance Guidelines and state statute:

Fund	June 30, 2008	June 30, 2009
General	\$ (361,527)	\$ (541,774)
Debt Service	-	(10,702)
Capital Projects	(105,776)	(197,589)
Transportation Operating	(7,558)	(8,778)
Technology Plan Buddy	-	(260)
Perry County Substance Abuse Grant	(8,292)	(1,268)
Professional Development Portfolio	(120)	-
Tobacco Grant	(24)	-
Workforce Development Grant	(5,070)	(13,883)
Tech Literacy Grant	-	(1,324)
Ed Tech II	(65,028)	(65,028)
Welborn Family/School Activities	-	(1,187)
Miscellaneous Programs 1	(68)	(68)
SINE-Model School	(151)	(2,020)

Cash and investment deficits arose primarily from disbursements exceeding receipts due to the underestimate of current requirements; these deficits are to be repaid from future receipts.

Note 5. Property Taxes

Property taxes levied are collected by the County Treasurer and are distributed to the Township in June and December. State statute (IC 6-1.1-17-16) requires the Indiana Department of Local Government Finance to establish property tax rates and levies by February 15. These rates were based upon the preceding year's March 1 (lien date) assessed valuations adjusted for various tax credits. Taxable property is assessed at 100% of the true tax value (determined in accordance with rules and regulations adopted by the Indiana Department of Local Government Finance). Taxes may be paid in two equal installments which become delinquent if not paid by May 10 and November 10, respectively.

CANNELTON CITY SCHOOLS
NOTES TO FINANCIAL INFORMATION
(Continued)

Note 6. Deposits and Investments

Deposits, made in accordance with Indiana Code 5-13, with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

State statute (IC 5-13-9) authorizes the School Corporation to invest in securities including, but not limited to, federal government securities, repurchase agreements, and certain money market mutual funds. Certain other statutory restrictions apply to all investments made by local governmental units.

Note 7. Holding Corporation

The School Corporation has entered into a capital lease with Cannelton School Building Corporation (the lessor). The lessor was organized as a not-for-profit corporation pursuant to state statute for the purpose of financing and constructing or reconstructing facilities for lease to the School Corporation. The lessor has been determined to be a related party of the School Corporation. There were no lease payments during the years ended June 30, 2008 and June 30, 2009.

Note 8. Pension Plans

A. Agent Multiple-Employer Defined Benefit Pension Plan

Public Employees' Retirement Fund

Plan Description

The School Corporation contributes to the Indiana Public Employees' Retirement Fund (PERF), a defined benefit pension plan. PERF is an agent multiple-employer public employee retirement system, which provides retirement benefits to plan members and beneficiaries. All full-time employees are eligible to participate in this defined benefit plan. State statutes (IC 5-10.2 and 5-10.3) govern, through the PERF Board, most requirements of the system, and give the School Corporation authority to contribute to the plan. The PERF retirement benefit consists of the pension provided by employer contributions plus an annuity provided by the member's annuity savings account. The annuity savings account consists of members' contributions, set by state statute at 3% of compensation, plus the interest credited to the member's account. The employer may elect to make the contributions on behalf of the member.

PERF administers the plan and issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by contacting:

Public Employees' Retirement Fund
Harrison Building, Room 800
143 West Market Street
Indianapolis, IN 46204
Ph. (317) 233-4162

CANNELTON CITY SCHOOLS
NOTES TO FINANCIAL INFORMATION
(Continued)

Funding Policy and Annual Pension Cost

The contribution requirements of the plan members for PERF are established by the Board of Trustees of PERF.

Actuarial Information for the Above Plan

	PERF
Annual required contribution	\$ 4,990
Interest on net pension obligation	(2,415)
Adjustment to annual required contribution	2,752
Annual pension cost	5,327
Contributions made	7,280
Decrease in net pension obligation	(1,953)
Net pension obligation, beginning of year	(33,315)
Net pension obligation, end of year	\$ (35,268)
Contribution rates:	
School Corporation	7%
Plan members	3%
Actuarial valuation date	07-01-08
Actuarial cost method	Entry age
Amortization method	Level percentage of projected payroll, closed
Amortization period	30 years
Amortization period (from date)	07-01-97
Asset valuation method	75% of expected actuarial value plus 25% of market value

B. Cost-Sharing Multiple-Employer Defined Benefit Pension Plan

Teachers' Retirement Fund

Plan Description

The School Corporation contributes to the Indiana Teachers' Retirement Fund (TRF), a defined benefit pension plan. TRF is a cost-sharing multiple-employer public employee retirement system, which provides retirement benefits to plan members and beneficiaries. All employees engaged in teaching or in the supervision of teaching in the public schools of the State of Indiana are eligible to participate in TRF. State statute (IC 5-10.2) governs, through the TRF Board, most requirements of the system and gives the School Corporation

CANNELTON CITY SCHOOLS
NOTES TO FINANCIAL INFORMATION
(Continued)

authority to contribute to the plan. The TRF retirement benefit consists of the pension provided by employer contributions plus an annuity provided by the member's annuity savings account. The annuity savings account consists of member's contributions, set by state statute at 3% of compensation, plus the interest credited to the member's account. The School Corporation may elect to make the contributions on behalf of the member.

TRF issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by contacting:

Teachers' Retirement Fund
150 West Market Street
Indianapolis, IN 46204
Ph. (317) 232-3860

Funding Policy and Annual Pension Costs

The School Corporation contributes the employer's share to TRF for certified employees employed under a federally funded program and all the certified employees hired after July 1, 1995. The School Corporation currently receives partial funding, through the school funding formula, from the State of Indiana for this contribution. The employer's share of contributions for certified personnel who are not employed under a federally funded program and were hired before July 1, 1995, is considered to be an obligation of, and is paid by, the State of Indiana.

The School Corporation is to contribute at an actuarially determined rate. The current rate has been actuarially determined under the entry age normal cost method to be 6.82% of covered wages. The School Corporation's required contributions to the plan for the fiscal years ended June 30, 2009, 2008, and 2007, were \$45,934, \$46,535, and \$45,979, respectively. The School Corporation actually contributed 100% of the required contribution for each of the fiscal years, respectively.

Note 9. Postemployment Benefits

The School Corporation in addition to the pension benefits described below, provides postemployment health, dental vision, and life insurance benefits, as authorized by Indiana Code 5-10-8, to all certified employees who retire from the School Corporation on or after attaining age 50 with at least 17 years of service. Currently, five retirees meet these eligibility requirements. The School Corporation provides 100% of these postemployment benefits for full-time employees, and the School Corporation and retirees provide 63% and 37% of the postemployment benefits, respectively, for part-time employees. Disbursements for those postemployment benefits are recognized on a pay-as-you-go basis. During the year ended June 30, 2009, disbursements of \$33,688 were recognized for postemployment benefits.

Note 10. Subsequent Event-Declining Financial Condition

The School Corporation's financial condition has been precarious for a number of years. Sufficient funds were not in the bank account at June 30, 2008, to cover all outstanding checks. The School Corporation is in a constant struggle to meet expenses when they come due. The following items demonstrate problems with the School Corporation's financial condition:

CANNELTON CITY SCHOOLS
NOTES TO FINANCIAL INFORMATION
(Continued)

1. Due to outstanding bank loans which exceeded \$1,700,000 and a need to finance renovations and upgrades to the Cannelton Junior-Senior High School, the School Corporation entered into a lease agreement with Cannelton School Building Corporation, which issued \$2,785,000 in bonds in 2009. The School Corporation has also entered into an assignment and security agreement with German American Bank which places all revenue received by the School Corporation from property tax revenues, license excise tax revenues, commercial vehicle excise tax revenues, financial institutions tax revenues, local option-property tax replacement revenues and payments-in-lieu of taxes into an escrow account. The agreement effectively is in place until all the lease payments are completed in July, 2029.
2. The School Corporation failed to remit payroll withholdings, FICA (social security), and Medicare taxes for 39 out of 40 pay dates from July 15, 2008 through February 26, 2010. As of the pay date February 26, 2010, the School Corporation owed \$733,508 in back taxes.
3. The City of Cannelton, which is the taxing district for the School Corporation, has lost approximately 51% in population since 1980. Because the City has very little industry and a few small shops, the tax base consists largely of residential property. The combination of these factors has resulted in a decrease in the assessed valuation. The decrease in population has a definite impact on the amount of residential property that is occupied, which in turn, has a direct impact on the School Corporation's ability to raise property taxes to increase revenue support.
4. The assessed valuation for the City of Cannelton, which supports Cannelton City Schools, decreased by over 23% from 2002 to 2008. The maximum homestead credit for property taxes has increased from \$6,000 to approximately \$45,000 in recent years. The School Corporation's management, as well as the County Auditor, agrees that the City of Cannelton has not experienced any significant industrial or residential growth in a number of years. Management does not foresee significant growth in the near future.
5. Although the School Corporation's enrollment was up slightly over the last 2 years, the School Corporation has seen an approximate 19% reduction over the last 15 years. Due to the declining population in the area, any significant sustained enrollment increase has to be considered unlikely. Therefore, tuition support received from the State should remain somewhat stagnant.
6. The School Corporation owes \$548,093 for Average Daily Membership (ADM) enrollment for reporting errors made dating back to the 2003-2004 school year.

Management has not prepared specific plans as of the date of this report, to deal with the financial condition described above.

CANNELTON CITY SCHOOLS
 SUPPLEMENTARY INFORMATION
 SCHEDULE OF LONG-TERM DEBT
 June 30, 2009

The School Corporation has entered into the following debt:

Description of Debt	Ending Principal Balance	Principal and Interest Due Within One Year
Governmental activities:		
Promissory note:		
German American Bank	\$ 220,000	\$ 231,440
Capital Lease Obligation:		
Cannelton School Building Corp. - German American Bank	<u>2,785,000</u>	<u>-</u>
Total governmental activities long-term debt	<u>\$ 3,005,000</u>	<u>\$ 231,440</u>

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS

DECLINING FINANCIAL CONDITION

The balances and additional items during the examination period as well as a subsequent period which could have an effect on the School Corporation's General Fund are summarized as follows:

	<u>06-30-07</u>	<u>06-30-08</u>	<u>06-30-09</u>
General Fund Cash Balance, End of Period	\$ 67,819	\$ (361,567)	\$ (541,774)
Additional Items:			
ADM Judgments*	(441,953)	(544,709)	(548,093)
Federal Withholding, FICA, and Medicare Taxes Due	(0)	(0)	(450,946)
Outstanding Debt Service Requirements	(1,503,194)	(1,750,713)	(5,118,440)

*ADM Judgments as specified in February 14, 2008, and September 15, 2008, letters from Indiana Department of Education.

Please refer to Notes to the Financial Statements, Note 10, Declining Financial Condition. Also refer to any of the following Examination Results and Comments concerning Average Daily Membership (ADM).

Furthermore, normal operating transactions which could have a material effect on the General Fund are not listed in the aforementioned schedule. Monthly gross payroll (paid on a semi-monthly basis) averages approximately \$140,000. The School Corporation owed \$548,093 in ADM judgments and \$450,946 in federal taxes. Monthly tuition support for 2010 is averaging approximately \$158,000. The City of Cannelton, which is the taxing district for the School Corporation, has lost approximately 51% of its population since 1980. The assessed valuation for the City of Cannelton has decreased by over 23% from 2002 to 2008. Although the School Corporation's enrollment was up slightly over the last two years, the School Corporation has seen an approximate 19% reduction over the last fifteen years. These existing conditions present substantial doubt as to the ability of the Cannelton City School Corporation to continue operations. A similar comment was in prior reports.

The cash balance of any fund may not be reduced below zero. Routinely overdrawn funds could be an indicator of serious financial problems which should be investigated by the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

FINANCIAL REPORT OPINION MODIFICATION

The School Corporation's management did not provide accurate information to the Indiana Department of Education (IDOE) in the form of the School Corporation's financial reports for the years examined. The cash receipts, disbursements, and balances as shown in the financial reports for the years ended June 30, 2008 and 2009, do not reconcile to the corresponding bank statements. The School Corporation failed to remit payroll withholdings, FICA (social security), and Medicare taxes for 39 out of 40 pay dates from July 15, 2008 through February 26, 2010. As of the pay date February 26, 2010, the School Corporation owed \$733,508 in back taxes.

Due to the aforementioned items, an adverse opinion has been issued on the financial statements. The Independent Accountant's Report also includes an explanatory paragraph concerning the School Corporation's ability to continue to operate. The paragraph highlights the nonpayment of payroll withholdings and the School Corporation's ability to pay current expenses.

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

Accounting records and other public records must be maintained in a manner that will support accurate financial statements. Anything other than an unqualified opinion on the Independent Auditors Report on the financial statements may have adverse financial consequences with the possibility of an increase in interest rate cost to the taxpayers of the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

FEDERAL AND STATE AGENCIES - COMPLIANCE REQUIREMENTS

The School Corporation did not comply with directives of the Internal Revenue Service by not remitting federal withholding tax, FICA (social security), and Medicare taxes for 39 out of 40 pay dates from July 15, 2008 through February 26, 2010. The amounts owed for these back taxes (excluding any interest and/or penalty that might be applied) totaled \$450,946, \$659,040, and \$733,508, as of June 30, 2009, December 31, 2009, and February 26, 2010, respectively.

Officials and employees have the duty to pay claims and remit taxes in a timely fashion. Failure to pay claims or remit taxes in a timely manner could be an indicator of serious financial problems which should be investigated by the governmental unit.

Additionally, officials and employees have a responsibility to perform duties in a manner which would not result in any unreasonable fees being assessed against the governmental unit.

Any penalties, interest or other charges paid by the governmental unit may be the personal obligation of the responsible official or employee.

Political subdivisions are required to comply with all grant agreements, rules, regulations, bulletins, directives, letters, letter rulings and filing requirements concerning reports and other procedural matters of federal and state agencies, including opinions of the Attorney General of the State of Indiana, and court decisions. Governmental units should file accurate reports required by federal and state agencies. Noncompliance may require corrective action. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

Each governmental unit is responsible for compliance with all rules, regulations, guidelines, and directives of the Internal Revenue Service and the Indiana Department of Revenue. All questions concerning taxes should be directed to these agencies. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

PENALTIES, INTEREST, AND OTHER CHARGES

Penalties and interest totaling \$644.71 were paid to the Indiana Department of Revenue on December 19, 2008, for the period ending September 30, 2008.

Overdraft fees of \$129.00 and \$427.00 were paid to Fifth Third Bank and First State Bank, respectively, for the 2008-2009 fiscal year.

Loan late payment fees of \$481.25 and \$481.25 were paid to Fifth Third Bank on December 12, 2007, and May 12, 2009, respectively. A loan late payment fee of \$509.06 was paid to First State Bank on December 12, 2007.

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

Finance charges of \$161.50 were paid to Fischer's Furniture on February 20, 2009. Late payment fees of \$125.21 and \$28.72 were paid to Fifth Third Bank Credit for fiscal years 2007-2008 and 2008-2009, respectively.

Officials and employees have the duty to pay claims and remit taxes in a timely fashion. Failure to pay claims or remit taxes in a timely manner could be an indicator of serious financial problems which should be investigated by the governmental unit.

Additionally, officials and employees have a responsibility to perform duties in a manner which would not result in any unreasonable fees being assessed against the governmental unit. Any penalties, interest or other charges paid by the governmental unit may be the personal obligation of the responsible official or employee. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

TRANSACTION RECORDING

Some items such as the transactions of the accounts established with German American Bank through various agreements with German American Financial Advisers and Trust Company (German American) dated April 25, 2008, and an assignment and security agreement entered into on May 12, 2009, were not entered in the records of the School Corporation. The agreements stipulate that all School Corporation revenues from property taxes, license excise taxes, commercial vehicle excise taxes, financial institution taxes, local option-property tax replacement revenues and payments in-lieu-of taxes (collectively, the "pledged revenues") be deposited immediately into the specified account at German American. The May 12, 2009 agreement, entered into in conjunction with the issuance of the Cannelton School Building Corporation First Mortgage Bonds, Series 2009, authorizes the Bank, on the payment dates of the bonds, to "withdraw for its benefit the amount of principal and interest due and owing on the Bonds from the Account without further demand or notice by the Bank." The agreement further states: "After the timely payment of the current debt service payment on the Bonds when due, the Bank shall permit withdrawals from the account to or for the benefit of the School Corporation," and "without limiting the effect of Indiana Code 5-1-14-4, the School Corporation authorizes the Bank to sign and execute any financing statements or other documents or procure any documents necessary to protect the security interest under this agreement against the rights or interests of third persons."

IC 20-26-4-1(d) states in part:

". . . The treasurer is the official custodian of all funds of the school corporation and is responsible for the proper safeguarding and accounting for the funds. The treasurer shall:

- (1) issue a receipt for money received by the treasurer;
- (2) deposit money described in subdivision (1) in accordance with the laws governing the deposit of public funds; and
- (3) issue all warrants in payment of expenses lawfully incurred on behalf of the school corporation. However, except as otherwise provided by law, warrants described in this subdivision must be issued only after proper allowance or approval by the governing body."

All financial transactions pertaining to the governmental unit should be recorded in the records of the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

All documents and entries to records should be done in a timely manner to ensure that accurate financial information is available to allow the governmental unit to make informed management decisions and to help ensure compliance with IC 5-15-1-1 et seq., commonly referred to as the Public Records Law. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

AVERAGE DAILY MEMBERSHIP (ADM) - AMOUNT DUE THE STATE 2005-2006

Prior Report B31777 noted a difference between the student count reported for Average Daily Membership and the verified enrollment rosters resulting in an underreporting of four students for the 2005-2006 school year.

The Department of Education notified the School Corporation by letter dated September 15, 2008, of the recalculation of the Basic Grant based upon the State Board of Accounts audit and subsequent corrected counts for average daily membership which resulted in the School Corporation being required to refund a total of \$3,384.

Political subdivisions are required to comply with all grant agreements, rules, regulations, bulletins, directives, letters, letter rulings and filing requirements concerning reports and other procedural matters of federal and state agencies, including opinions of the Attorney General of the State of Indiana, and court decisions. Governmental units should file accurate reports required by federal and state agencies. Noncompliance may require corrective action. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

AVERAGE DAILY MEMBERSHIP (ADM) - AMOUNT DUE THE STATE 2003-2005

The report covering the period July 1, 2003 to June 30, 2005, noted a difference between the student count reported for Average Daily Membership and the verified enrollment rosters resulting in an over reporting of 16 students for the 2003-2004 school year and an underreporting of 1 student for the 2004-2005 school year. The Department of Education notified the School Corporation by letter dated January 25, 2008, that the incorrect counts had never been addressed. The School Corporation was instructed by the Department of Education to refile corrected counts for the affected years in order for the Office of Financial Management, Analysis, and Reporting to make any necessary corrections.

The Department of Education notified the School Corporation by letter dated February 14, 2008, of the recalculation of the Basic Grant based upon the State Board of Accounts audit and subsequent corrected counts for average daily membership which resulted in the School Corporation being required to refund a total of \$544,709 which remains unpaid. A similar comment was in the prior report.

Political subdivisions are required to comply with all grant agreements, rules, regulations, bulletins, directives, letters, letter rulings and filing requirements concerning reports and other procedural matters of federal and state agencies, including opinions of the Attorney General of the State of Indiana, and court decisions. Governmental units should file accurate reports required by federal and state agencies. Noncompliance may require corrective action. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

HONORS DIPLOMAS - AMOUNT DUE FROM THE STATE

The report covering the period July 1, 2003 to June 30, 2005, noted an error in the reporting of the honors diploma figures reported on Form 30A. The difference between the Form 30A and the School Corporation's records for the school year 2004-2005 resulted in an undercount of 1 student. The report concluded that School Officials should contact the Indiana Department of Education, Division of School Finance, to determine possible steps to be taken to correct any overpayment/underpayment the School Corporation has received or could receive in the future because of incorrect reporting.

The Department of Education notified the School Corporation by a letter dated January 25, 2008, that the incorrect counts had never been addressed. The School Corporation was instructed by the Department of Education to refile corrected counts for the affected years in order for the Office of Financial Management, Analysis, and Reporting to make any necessary corrections. A similar comment was in the prior report.

Political subdivisions are required to comply with all grant agreements, rules, regulations, bulletins, directives, letters, letter rulings and filing requirements concerning reports and other procedural matters of federal and state agencies, including opinions of the Attorney General of the State of Indiana, and court decisions. Governmental units should file accurate reports required by federal and state agencies. Noncompliance may require corrective action. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

OVERDRAWN CASH BALANCES

The cash balances of the General Fund, Capital Projects Fund, Transportation Operating Fund, Perry County Substance Abuse Grant Fund, Professional Development Portfolio Fund, Tobacco Grant Fund, Workforce Development Grant Fund, Ed Tech II Fund, Miscellaneous Programs 1 Fund, and SINE-Model School Fund were overdrawn at June 30, 2008. The cash balances of the General Fund, Debt Service Fund, Capital Projects Fund, Transportation Operating Fund, Technology Plan Buddy Fund, Perry County Substance Abuse Grant Fund, Workforce Development Grant Fund, Tech Literacy Grant Fund, Ed Tech II Fund, Welborn Family/School Activities Fund, Miscellaneous Programs 1 Fund, and SINE-Model School Fund were overdrawn at June 30, 2009. A similar comment was in prior reports.

The cash balance of any fund may not be reduced below zero. Routinely overdrawn funds could be an indicator of serious financial problems which should be investigated by the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

APPROPRIATIONS

The records presented for examination indicated the following expenditures in excess of budgeted appropriations:

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

Fund	Years	Excess Amount Expended
General	2007	\$ 1,262,203
General	2008	1,864,350
Capital Projects	2007	58,667
Capital Projects	2008	41,817
Transportation Operating	2007	2,622
Transportation Operating	2008	124
Special Education Preschool	2008	3,816

A similar comment was in several prior reports.

IC 6-1.1-18-4 states in part:

". . . the proper officers of a political subdivision shall appropriate funds in such a manner that the expenditures for a year do not exceed its budget for that year as finally determined under this article."

CONDITION OF RECORDS

The School Corporation Biannual Financial Reports (Form 9) filed with DOE were incomplete and not reflective of the activity of all funds. The ending fund balances of the financial reports filed with DOE do not agree to the ending balances of the School Corporation's Fund Reports for the fiscal years ended June 30, 2008 and 2009. The cash receipts, disbursements, and balances as shown in the financial reports for the years ended June 30, 2008 and 2009, do not reconcile to the School Corporation's corresponding bank statements.

At all times, the manual and/or computerized records, subsidiary ledgers, control ledger, and reconciled bank balance should agree. If the reconciled bank balance is less than the subsidiary or control ledgers, then the responsible official or employee may be held personally responsible for the amount needed to balance the fund. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

INTERNAL CONTROLS

There are several funds with large negative cash balances at June 30, 2008 and 2009, (See "Overdrawn Cash Balances") and the payroll withholding accounts are not being reconciled monthly.

Controls over the receipting, disbursing, recording and accounting for financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements and incorrect decision making. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

ERRORS ON CLAIMS

The following deficiencies were noted on claims during the examination period:

1. Claims were not adequately itemized.
2. Claims or invoices did not have evidence to support receipt of goods or services.

A similar comment was in prior reports.

IC 5-11-10-1.6 states in part:

"(b) As used in this section, 'claim' means a bill or an invoice submitted to a governmental entity for goods or services."

"(c) The fiscal officer of a governmental entity may not draw a warrant or check for payment of a claim unless:

- (1) there is a fully itemized invoice or bill for the claim;
- (2) the invoice or bill is approved by the officer or person receiving the goods and services;
- (3) the invoice or bill is filed with the governmental entity's fiscal officer;
- (4) the fiscal officer audits and certifies before payment that the invoice or bill is true and correct; and
- (5) payment of the claim is allowed by the governmental entity's legislative body or the board or official having jurisdiction over allowance of payment of the claim."

SUPPORTING DOCUMENTATION

Several payments were observed which did not contain adequate supporting documentation, such as receipts, invoices, and other public records. Due to the lack of supporting information, the validity and accountability for some money disbursed could not be established. A similar comment was in prior reports.

Supporting documentation such as receipts, canceled checks, tickets, invoices, bills, contracts, and other public records must be available for audit to provide supporting information for the validity and accountability of monies disbursed. Payments without supporting documentation may be the personal obligation of the responsible official or employee. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

NO WRITTEN POLICY OF NONCERTIFIED BENEFITS

There have been instances of noncertified employees being paid for vacation leave earned in a prior year. There is no formal personnel policy stating that leave can be accumulated from prior years. A similar comment was in prior reports.

All types of employee benefits should be detailed in a written policy. Payments for expenses not authorized in a written policy cannot be allowed. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 13)

INDEBTEDNESS

The School Corporation issued a tax anticipation warrant in 2003 that has been rolled over, and refinanced, but never actually repaid in full at any one time. The School Corporation entered into a loan with Fifth Third Bank, which originated as a line of credit in 2004. The School Corporation eventually borrowed a total of \$800,000 from Fifth Third Bank by June 30, 2006, to finance operations and to pay off the 2003 tax anticipation warrant from the Indiana Bond Bank. The School Corporation entered into a promissory note in 2007, with German American Bank. A portion of the loan proceeds of \$800,000 were used to pay \$200,000 on the debt with Fifth Third Bank and the remainder was used to finance operations. An additional \$100,000 was borrowed from German American Bank in October of 2007. A series of additional loans were borrowed from German American Bank through December 2008. Proceeds from the bonds issued by Cannelton School Building Corporation on May 12, 2009, were used to pay off all but one of these loans. The School Corporation owed \$220,000 to German American Bank as of June 30, 2009. The loan was paid off in January 2010. A similar comment was in prior reports.

A governmental unit may not incur indebtedness unless specifically allowed by statute. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

CREDIT CARDS

The Cannelton City Schools is using credit cards in some instances to purchase items without an approved credit card policy. A similar comment was in the prior report.

The State Board of Accounts will not take exception to the use of credit cards by a governmental unit provided the following criteria are observed:

- (1) The governing board must authorize credit card use through an ordinance or resolution, which has been approved in the minutes.
- (2) Issuance and use should be handled by an official or employee designated by the board.
- (3) The purposes for which the credit card may be used must be specifically stated in the ordinance or resolution.
- (4) When the purpose for which the credit card has been issued has been accomplished, the card should be returned to the custody of the responsible person.

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

- (5) The designated responsible official or employee should maintain an accounting system or log which would include the names of individuals requesting usage of the cards, their position, estimated amounts to be charged, fund and account numbers to be charged, date the card is issued and returned, etc.
- (6) Credit cards should not be used to bypass the accounting system. One reason that purchase orders are issued is to provide the fiscal officer with the means to encumber and track appropriations to provide the governing board and other officials with timely and accurate accounting information and monitoring of the accounting system.
- (7) Payment should not be made on the basis of a statement or a credit card slip only. Procedures for payments should be no different than for any other claim. Supporting documents such as paid bills and receipts must be available. Additionally, any interest or penalty incurred due to late filing or furnishing of documentation by an officer or employee should be the responsibility of that officer or employee.
- (8) If properly authorized, an annual fee may be paid.

(Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

CAPITAL ASSET RECORDS

Information presented for examination did not indicate an inventory or record of capital assets. A similar comment was in several prior reports.

Every governmental unit should have a complete inventory of all capital assets owned which reflect their acquisition value. Such inventory should be recorded on the applicable Capital Asset Ledger. A complete inventory should be taken at least every two years for good internal control and for verifying account balances carried in the accounting records. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

PRESCRIBED FORMS

The following prescribed or approved forms were not always in use:

Payroll Schedule and Voucher (Form 99)
Mileage Claim (Form 101)

Officials and employees are required to use State Board of Accounts prescribed or approved forms in the manner prescribed. (Accounting and Uniform Compliance Guidelines Manual for Indiana Public School Corporations, Chapter 9)

CANNELTON CITY SCHOOLS
EXAMINATION RESULTS AND COMMENTS
(Continued)

PRESCRIBED FORM (Applies to Cannelton Elementary School)

A substitute form which has not been approved by the State Board of Accounts was in use in place of the following prescribed form at Cannelton Elementary School:

Extra-Curricular Ledger (Form SA-6)

A similar comment was in the prior report.

Officials and employees are required to use State Board of Accounts prescribed or approved forms in the manner prescribed. (Accounting and Uniform Compliance Guidelines Manual for Extra-Curricular Accounts, Chapter 7)

CANNELTON CITY SCHOOLS
EXIT CONFERENCE

The contents of this report were discussed on April 7, 2010, with Marion A. Chapman, Superintendent of Schools; Melissa B. Embry, Treasurer; and Barbara B. Beard, Vice-President of the School Board. The official response has been made a part of this report and may be found on page 24.

Cannelton City Schools

Marion A. Chapman, Superintendent

125 S Sixth Street – Cannelton, IN 47520

August 3, 2010

State Board of Accounts
302 Washington Street, Room E418
Indianapolis, IN 46204-2769

In regards to the recent audit of the financial records of Cannelton City Schools, I believed it necessary to comment about one section of the report.

Please allow me to preface this concern by stating that I am in no way finding grievance with the auditor, Mr. Tom Alles. I believe him to be experienced, knowledgeable, and dedicated to his work. He represents the State Board of Accounts well.

I would like to address the Examination Result and comment entitled “Federal and State Agencies – Compliance Requirements”. The finding states the school system owes federal taxes totaling \$733,508 as of February 26, 2010. Since this finding we have entered an agreement with the IRS and the amount is considerably less. While I regret that this has happened, it was a result of the reduction in our state support payments prior to the year 2009. It was also the result of the well publicized budget issues in which I was forced to cut over \$1,000,000 from our budget since the year 2006. At the time of this audit and at present we do not have any other debts with all other previous debts being paid.

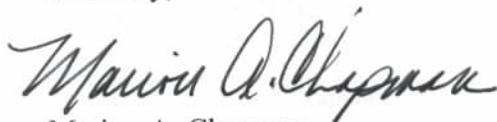
As stated during my one trip to the State Tax Board, and two trips to the State Board of Education, I was seeking assistance to help the school recover from this financial crisis created by previous school administration.

We have established contact with the IRS and are working together to resolve this issue.

Except for continuing to solve this issue, we have eliminated our other debt issues and are living within our budget.

Thank you for your consideration of this letter and don't hesitate to contact me if you have any questions.

Sincerely,



Marion A. Chapman
Superintendent

Phone 812.547.2637 - Fax 812.547.4142 - url www.cannelton.k12.in.us