

OKLAHOMA STATE BOARD OF COSMETOLOGY

JULY 1, 2005 THROUGH JUNE 30, 2007



MANAGEMENT AUDIT



Jeff A. McMahan

Oklahoma State Auditor
& Inspector

**Audit Report of the
Oklahoma State
Board of Cosmetology**

**For the Period
July 1, 2005 through June 30, 2007**



January 14, 2008

**TO THE EXECUTIVE DIRECTOR OF THE OKLAHOMA
STATE BOARD OF COSMETOLOGY**

Pursuant to 62 O.S. § 212, transmitted herewith is the audit report for the Oklahoma State Board of Cosmetology for the period July 1, 2005 through June 30, 2007. The Office of the State Auditor and Inspector is committed to serving the public interest by providing independent oversight and by issuing reports that serve as a management tool to the State. Our goal is to ensure a government that is accountable to the people of the State of Oklahoma.

We wish to take this opportunity to express our appreciation to the agency's staff for the assistance and cooperation extended to our office during the course of our engagement.

Sincerely,

JEFF A. McMAHAN
State Auditor and Inspector

Mission Statement

The mission of the Oklahoma State Board of Cosmetology is to safeguard and protect the health and general welfare of the people of the state of Oklahoma by performing a variety of services from developing curriculum for cosmetology schools to administering examinations for prospective practitioners of the cosmetology arts.

Board Members

Gretchen Payne Chair
Freda Poe Vice Chair
Loyd Saxton Member
LaFaye Austin Member
Ken Young Member
Carol DeWitt Member
Jerry Kelon Carter II Member
Tuan Nguyen Member
Janet Dale Webb Member

Key Staff

Betty Moore Executive Director
Candis Ross Administrative Assistant to the Director
Jennifer McCree Principal Assistant



**TO THE EXECUTIVE DIRECTOR OF THE OKLAHOMA
STATE BOARD OF COSMETOLOGY**

We have audited the Oklahoma State Board of Cosmetology (Board) for the period July 1, 2005 through June 30, 2007. The objectives of this audit were to determine if:

- The Board's internal controls provide reasonable assurance that revenues and expenditures were accurately reported in the accounting records, and financial operations complied with applicable finance-related laws and regulations;
- The Board complied with 74 O.S. § 3601.2, 62 O.S. § 211 and the Department of Central Services' Purchase Card Procedures;
- Recommendations included in prior engagements were implemented.

As part of our audit we obtained an understanding of internal controls significant to the audit objectives and considered whether the specific controls have been properly designed and placed in operation. We also performed tests of certain controls to obtain evidence regarding the effectiveness of the design and operation of the controls. However, providing an opinion on internal controls was not an objective of our audit and accordingly, we do not express such an opinion.

We also obtained an understanding of the laws and regulations significant to the audit objectives and assessed the risk that illegal acts, including fraud, violation of contracts, grant agreements, or other legal provisions could occur. Based on this risk assessment, we designed and performed procedures to provide reasonable assurance of detecting significant instances of noncompliance with the laws and regulations. However, providing an opinion on compliance with these laws and regulations was not an objective of our audit and accordingly, we do not express such an opinion.

Our audit was conducted in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such procedures as we considered necessary in the circumstances.

This report is a public document pursuant to the Oklahoma Open Records Act (51 O.S. § 24A.1 et seq.), and shall be open to any person for inspection and copying.

JEFF A. McMAHAN
State Auditor and Inspector

January 11, 2008

Background

The Oklahoma State Board of Cosmetology (Board) licenses and regulates the profession of cosmetology, esthetics, manicuring, instructors and establishments where these services are performed as well as regulates health and safety issues in schools approved by the Board. The Board’s operations are governed by 59 O.S. § 199.1 through 199.15 as well as Title 175 of the Oklahoma Administrative Code. Oversight is provided by a nine-member board comprised of a member from each congressional district with the additional members appointed at large. Six members shall, at the time of appointment, have had at least five years continuous practical experience in the practice of cosmetology in this state, one member shall be a lay person, one member shall be an administrator of a licensed private cosmetology school, and one member shall be an administrator of a public school licensed to teach cosmetology. The Board pays for its operations through the various fees they charge. The fees include, but are not limited to, multiple types of licenses as well as examinations.

Table 1 summarizes the Board’s sources and uses of funds for fiscal years 2006 and 2007.

Table 1-Sources and Uses of Funds for FY 2006 and FY 2007

Sources:	2006	2007
Cosmetology License Fee	<u>\$706,696</u>	<u>\$840,738</u>
 Uses:		
Personnel Services	\$582,088	\$648,297
Professional Services	21,882	20,905
Travel	86,329	66,210
Misc. Administrative	62,956	36,568
General Operating	55,467	43,773
Office Furniture and Equipment	8,515	5,871
Other	<u>45,057</u>	<u>31,473</u>
Total Uses	<u>\$862,294</u>	<u>\$853,097</u>

Source: Oklahoma CORE Accounting System.

Through conversations with Board management in early 2007, the State Auditor’s Office (SA&I) learned the Board believed they were in a financial crisis. They were not aware of what had caused the situation but knew their actual cash was much less than they originally believed.

By November 2007, management believed the situation had been corrected by working with the Office of State Finance (OSF). OSF determined management had mistakenly reported transfers from the clearing account to their revolving fund as “vouchers” on eleven OSF-Form 11 clearing account reconciliations dating back to December 2003. Therefore, OSF was classifying the transfers as expenditures in preparing the Board’s “Summary of Receipts and Disbursements” report in the CORE accounting system. These errors grossly misstated the Board’s clearing account cash balance on this report. OSF made a \$768,017 adjustment in February 2007 to correct the invalid expenditures which had been reported. We reviewed each of the reconciliations in question and determined the amount presented as “vouchers” was identified as transfers on the prior month’s “fax request for transfer of funds” sent to the State Treasurer. The total of the eleven months’ transfer amount was \$768,017.

There appears to have been confusion on management’s part as to how to obtain an accurate, available cash balance from the CORE system during this period. Therefore, they relied solely on their former OSF budget analyst for this information. Management stated the analyst consistently informed them they had sufficient cash. Therefore, they were spending much more than they were bringing in based on the presumption of a large cash balance. Table 2 presents the Board’s deposits and expenditures for each month of the period.

Table 2 – Deposits and Expenditures by Month – FY 2006 and 2007

Month	Deposits	Expenditures - Fund 200	Approximate Personnel Services	Deposit Over/(Under) Expenditures
Jul-05	56,905	19,251	48,507	(10,853)
Aug-05	75,582	27,085	48,507	(10)
Sep-05	67,873	27,788	48,507	(8,422)
Oct-05	75,727	9,359	48,507	17,861
Nov-05	44,030	42,919	48,507	(47,396)
Dec-05	35,807	7,655	48,507	(20,355)
Jan-06	103,413	41,934	48,507	12,972
Feb-06	45,252	4,797	48,507	(8,052)
Mar-06	90,002	31,012	48,507	10,483
Apr-06	62,895	17,039	48,507	(2,651)
May-06	60,948	6,520	48,507	5,921
Jun-06	76,911	48,594	48,507	(20,190)
Jul-06	56,738	8,358	54,000	(5,620)
Aug-06	75,654	32,876	54,000	(11,222)
Sep-06	65,471	15,213	54,000	(3,742)
Oct-06	53,482	38,410	54,000	(38,928)
Nov-06	44,848	6,912	54,000	(16,064)
Dec-06	75,575	5,530	54,000	16,045
Jan-07	98,648	18,126	54,000	26,522
Feb-07	82,844	12,632	54,000	16,212
Mar-07	87,549	17,548	54,000	16,001
Apr-07	95,344	24,601	54,000	16,743
May-07	84,168	22,580	54,000	7,588
Jun-07	97,774	5,538	54,000	38,236

SOURCE: Oklahoma CORE Accounting System -- Amount presented for personnel services is an estimate based on information from OSF's combining trial balance report.

Based on this trend, the Board had \$4,435 in their fund 200 as of June 30, 2007. Through conversation with management and review of other OSF-Form 11 reconciliations, it appears management is now clear on how to complete the reconciliation.

Recommendation: The OSF-Form 11 reconciliations we inspected were approved by an employee independent of the preparer; however, we recommend this review include agreeing all amounts reported back to source documentation.

Views of Responsible Officials: Because the agency is so small in personnel numbers, the practice has not been to have someone, other than the preparer, perform a detailed review of each OSF Form 11 reconciliation, since the Director had been reviewing these documents and approving by signing them monthly after the Assistant to the Director prepares them. This had been the agency's past practice and other auditing teams have approved this process. The agency agrees to comply with the recommendation while allowing the Assistant to the Director to prepare the OSF Form 11 reconciliation (because she has more immediate access to the information to prepare the document) and, in the absence of an Executive Director at this time, the Principal Assistant will conduct a detailed review including ensuring that all amounts report back to source documentation. This process will be in place immediately until a new Director is appointed by the Board and a policy and procedure can be in place in the agency's policy and procedures manual with key personnel named in the process. The agency believes this will strengthen the Board's internal control process related to receipts, expenditures and capital assets.

Objective 1 – Determine if the Board’s internal controls provide reasonable assurance that revenues and expenditures were accurately reported in the accounting records, and financial operations complied with applicable finance-related laws and regulations.

Conclusion

Based on the procedures performed, the Board’s internal controls related to receipts, expenditures, and capital assets are generally effective; however, several areas, as noted below, need to be strengthened.

Methodology

To accomplish our objective, we performed the following:

- Reviewed 62 O.S. § 7.1;
- Documented internal controls related to the receipting, expenditure, and capital assets process;
- Tested controls which included:
 - Determining if checks are endorsed upon receipt;
 - Reviewing 40 deposits from the period to ensure the deposit slip was initialed by the reviewer and was supported with the appropriate receipt log;
 - Determining if receipts are stored in a secure location prior to deposit;
 - Reviewing 40 deposits from the period to ensure the bank deposit date was within one day of the deposit slip date;
 - Reviewing 40 deposits to ensure the deposit was posted into CORE within one day of being deposited at the bank;
 - Reviewing a CORE deposit report for the period to ensure funds are being transferred from the Board’s clearing account to the revolving fund at least once per month;
 - Reviewing six transfer fax forms from the period to ensure they were reviewed;
 - Reviewing six OSF-Form 11 reconciliations to ensure the preparer and reviewer are independent of each other and the reconciling items are adequately supported.
 - Reviewing 41 expenditure claims to ensure they were properly authorized. This included ensuring the invoice supported the payment, the invoice was mathematically accurate, and the correct account code was used;
 - Determining if the employee responsible for receiving warrants from OSF is independent of the posting and approval process;
 - Determining if an inventory listing is maintained and contains the items’ inventory tag number, description, cost, serial number (if applicable), and date sent to surplus (if applicable);
 - Reviewing 15 assets from the inventory listing to verify their existence on the floor, ensuring they are identified as property of the State, and ensuring the inventory tag number and serial number agree to the listing;
 - Reviewing 10 assets from the floor to verify they are identified on the inventory listing, ensuring they are identified as property of the State, and ensuring the inventory tag number and serial number agrees to the listing;
 - Determining all items surplusd during the period had an approved DCS Form 001 supporting their removal.

Observations

Securing Funds Prior to Deposit

An effective internal control system provides for adequate safeguarding of assets. Based on conversation with management, funds are maintained in a safe in the Administrative Assistant to the Director’s office prior to deposit. However, the safe is kept unlocked during business hours while Board personnel access the safe for items throughout the day. Improprieties could occur and not be detected in a timely manner.

Recommendation: We recommend either the safe be locked when funds awaiting deposit are placed inside or the funds be maintained in a locking file cabinet. In both cases, access should be limited to essential personnel only.

View of Responsible Officials: The agency has no problem securing the deposit by locking the safe so the awaiting deposit can be secured inside so that only limited, essential personnel only have access to the safe and contents during this time of day. Most generally, the deposit may sit in the safe for 15 minutes on an average mail/deposit day. The agency agrees this will avoid improprieties that could occur and not be detected in a timely manner.

Reconciliation to CORE Records

An effective internal control system provides for adequate reconciliation of accounting records. Based on observation of an OSF-Form 11 reconciliation for each month of the period, management reconciles their clearing account to the State Treasurer's Office. However, they do not formally reconcile their clearing account or revolving fund to CORE records. Without an official reconciliation to CORE, transactions that were inadvertently not posted or posted incorrectly may go undetected.

Recommendation: We recommend management develop a formal process for reconciling their clearing account and revolving fund to CORE on a monthly basis. This should include a detailed review by someone other than the preparer.

View of Responsible Officials: Because the agency is so small in personnel numbers, the practice has not been to have someone, other than the preparer, perform a detailed review for reconciling the clearing account and revolving fund to CORE on a monthly basis. This has been the agency's past practice, since the review of these prepared documents were done and informally approved by the Director after the Assistant to the Director prepares them. Additionally, the Board votes on and approves these reports quarterly. The agency agrees to comply with the recommendation while allowing the Assistant to the Director to prepare the reconciliation (because she has more immediate access to the information to prepare the document), with the Principal Assistant, in the absence of an Executive Director, performing a detailed review of the reconciliation for the clearing account to the revolving fund to CORE on a monthly basis. This process will be in place immediately until a new Director is appointed by the Board and a policy and procedure can be placed in the agency's policy and procedures manual with key personnel named in the process. The agency believes this formalized process with an official reconciliation to CORE and the clearing account or revolving fund, transactions that were inadvertently not posted or posted incorrectly will not go undetected. The agency further believes that posting deposits into CORE within one day of receipt (as has been the practice since June 2007 already and as listed in the recommendation to follow) will assist in the process to officially reconcile to CORE. It is also important to note that the agency can never balance to the CORE reports because the agency makes at least two deposits daily and the agency always has deposits in transit.

Posting Deposits to CORE in a Timely Manner

An effective internal control system provides for prompt recording of accounting transactions. Based on procedures performed, 37 of 40 deposits were not posted into CORE within one day of deposit. The average span between the bank deposit date and the CORE journal date was 6 days. In the CORE system, the cash is not available until the journal entry is made and added to the agency's cash balance. Therefore, the available cash balance on CORE reports could be misstated. Management indicates this issue was brought to their attention by OSF in June 2007 and has been making more timely entries since that time.

Recommendation: We recommend management exercise diligence and ensure their deposit entries are posted into CORE within one day of receipt.

View of Responsible Officials: The Assistant to the Director has been posting deposit entries into CORE within one day of receipt since June 2007 as recommended in this report in an effort to resolve any posting problems into CORE. The agency agrees to continue to complying with practice and recommendation. The Principle Assistant has registered for a Journal Entry Class to attend on January 30, 2008 so she can perform this duty in the absence of the Assistant to the Director.

Review of Expenditure Claims Prior to Approval

62 O.S. § 7.1 E. states in part, "At least once each month each state agency shall transfer monies deposited in agency clearing accounts to the various funds or accounts, subdivisions of the state, or functions as may be provided by

statute and no money shall ever be disbursed from the agency clearing account for any other purpose, except in refund of erroneous or excessive collections and credits...”

An effective internal control system provides an adequate review of supporting documentation.

During procedures performed, we noted one claim was paid from the clearing account for reimbursement of travel costs. On a separate claim, management did not appear to review the invoice in detail prior to authorizing payment. The amount requested and the supporting detail differed by \$900. There was no indication on the invoice that management inquired as to the difference.

Recommendation: We recommend management exercise diligence in reviewing expenditure claims to ensure the correct fund and account code are used as well as ensuring the invoice is mathematically correct.

View of Responsible Officials: The agency recognizes that there has been a problem in the past with ensuring the correct fund and account code is used as well as ensuring the invoice is mathematically correct. Agency management has been working diligently to ensure these types of errors do not occur in the future. The agency agrees to adopt their own formalized process during the interim period when a new Director is appointed by the Board, to have the Principle Assistant perform a review, including review of the supporting documentation, to ensure the correct fund, account code and the invoice is mathematically correct prior to submission to OSF. When a new Director is hired, the agency agrees to develop a policy and procedure for the manual to formalize the checking and review process.

Incomplete Data on Inventory Listing

Oklahoma Administrative Code (OAC) 580:70-3-1 states in part

...(c) **Inventory report contents.** The inventory report shall be signed by the agency inventory control officer and shall include for each tangible asset:

- (1) the agency number;
- (2) the asset tag number;
- (3) the model and serial number, if any;
- (4) the manufacturer;
- (5) the description;
- (6) product name;
- (7) physical location;
- (8) acquisition date and cost;...

Based on procedures performed, four out of 15 items did not have the serial numbers recorded on the inventory listing. Without all required identification information being maintained, it may be difficult to determine the identity of a particular asset.

Recommendation: If an asset has a specific identification number, we recommend management ensure it is properly recorded on their inventory listing.

View of Responsible Officials: Agency staff, the Administrative Technician, is responsible for maintaining the inventory listings and performing the statutorily required inventory. The agency agrees to comply with the recommendation immediately and list the serial number on equipment when applicable.

Inadequate Supporting Documentation

An effective internal control system provides for adequate supporting documentation. Based on review of the Board’s inventory report, a computer monitor was identified as being surplus on May 31, 2006. However, based on discussion with management, the monitor was not surplus but replaced by their computer support vendor because it was no longer in working condition. However, the vendor did not provide management with any supporting documentation when the replacement occurred. We requested management call the vendor for support and they were provided a service report which indicated the vendor went to the Board’s office on the morning of May 31, 2006 and replaced a Compaq monitor. However, there is no indication on the service report of the serial number or tag number of the monitor that was removed from the Board’s possession or serial number of the new monitor. Additionally, the inventory listing does not identify

the serial number of the item which was replaced. Therefore, even if the service report identified the serial number of the monitor which was replaced, we could not determine if it was the monitor on the inventory listing.

Recommendation: As equipment is retired from service through the normal surplus process or due to malfunction, appropriate documentation should be maintained.

View of Responsible Officials: As stated previously, the agency agrees that the serial number would be helpful when performing the statutorily required inventory in cases where the computer support vendor has replaced a piece of equipment and tracking the equipment for surplus. The agency will communicate the requirement that the computer support vendor supply the agency with the serial number of the “replaced” piece of equipment so that the inventory listing can promptly be updated as required to more easily determine the identity of a particular asset.

Objective 2 – Determine if the Board complied with 74 O.S. § 3601.2, 62 O.S. § 211 and the Department of Central Services’ (DCS) Purchase Card Procedures.

Conclusion

Based on procedures performed, it appears the Board is in compliance with 74 O.S. § 3601.2 and adequately addressed concerns previously noted in the DCS Audit Unit’s purchase card review. However, the Board is not in compliance with 62 O.S. § 211 and should transfer \$5,727.25 to the State’s general fund.

Methodology

To accomplish our objective, we performed the following:

- Reviewed 74 O.S. § 3601.2 and performed procedures to determine if the executive director’s salary was in compliance with the law;
- Reviewed 62 O.S. § 211 and performed procedures to ensure the Board transferred 10% of the fees charged, collected, and received to the State’s general fund ;
- Reviewed DCS’ Purchase Card Procedures;
- Reviewed DCS Audit Unit’s purchase card review on the Board for fiscal year 2005 and performed procedures to determine if the Board corrected the issues identified in that report.

Observations

62 O.S. § 211 states, “Unless otherwise provided by law, all self-sustaining boards created by statute to regulate and prescribe standards, practices, and procedures in any profession, occupation or vocation, shall...pay into the General Revenue Fund of the State ten percent (10%) of the gross fees...charged, collected and received by such board.” During procedures performed to ensure the Board transferred 10% of all fees received to the State’s general fund, we noted the following:

- Based on review of transfers made throughout the period, the Board typically made transfers to the state monthly. The State Treasurer’s (OST) monthly statement for October 2005 indicated \$63,105.50 was deposited in the Board’s clearing account. Board documentation indicates a form was faxed to the OST on November 3, 2005 instructing them to transfer \$6,310 (10% of total amount deposited) from the clearing account to the State’s general fund. According to CORE records and conversation with OST management, this transfer never occurred. OST management stated their records indicate a transfer request for this amount was not received via fax. Board management did not notice this transfer was not identified on the subsequent month’s OST statement. Additionally, during the other months of the period, it appears Board management transferred \$582.25 more than required to the State’s general fund.

Recommendation: We recommend the following:

- The Board should no longer request OST make their transfers to the State's general fund and their revolving fund. The transfers should be made by Board personnel;
- The Board should transfer \$5,727.75 (\$6,310 - \$582.25) to the State's general fund to represent the difference between 10% of fees deposited in October 2005 and the excess amount paid throughout the remaining period.

Views of Responsible Officials: The agency recognizes that there has been a problem in the past with ensuring transfers from the clearing account to the state general fund was performed correctly. The agency has implemented formal check processes as previously stated in other responses that ensure transfers are correct prior to submission. The agency further recognizes that corrections have not been made as requested to OST in a timely manner. The Board's Budget Committee gave approval to the Assistant to the Director to perform the transfers, rather than requesting OST do this because of past problems. Please note: This recommendation is confusing because past Auditor teams have suggested that the Assistant to the Director not have the authority to do the transfer.

Auditor's Response: Based on review of the previous report issued by the State Auditor's Office on April 19, 2006, there were no recommendations related to Board personnel not having the authority to perform the transfers.

Objective 3 – Determine if recommendations from prior engagements were implemented.

Conclusion

Based on review of the prior engagement report issued by the State Auditor's Office on April 19, 2006, there were no findings reported. Therefore, procedures related to this objective were not performed.

Other Items Noted

The State of Oklahoma's Information Security Policy, Information and Guidelines states in part: "...The confidentiality of all information created or hosted by a State Agency is the responsibility of that State Agency...The objective of the owning State Agency is to protect the information from inadvertent or intentional damage, unauthorized disclosure or use..." This policy includes "any data or knowledge collected, processed, stored, managed, transferred or disseminated by any method." Based on conversation with management, sensitive data is maintained in hard copy format within the Board's office and may not be adequately secured after business hours. We found no evidence to suggest sensitive data had been compromised, but the lack of safeguarding the information makes it a risk.

Recommendation: We recommend management explore options for adequately securing sensitive data after business hours.

Views of Responsible Officials: Sensitive data has always been in physical files of licensees and placed on shelves in the office of the Board. Past Auditor teams have not found this to be a problem. To secure these records, the Board would have to budget and build a locking wall system to secure these files. This could pose a problem with the present budget situation; however, it might be something to consider when funds become available. Everyone in the office needs access to the files during working hours. It would be a great inconvenience to secure these records from office staff. Again, funds are not presently available for this but the agency will ask the Board's approval for this future project when future budgets are considered.



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