



Berlin Central School District Internal Controls Over Capital Assets and the Financial Management System

Report of Examination

Period Covered:

July 1, 2004 - February 28, 2006

2006M-102



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State of New York Office of the State Comptroller

Division of Local Government Services and Economic Development

September 2006

Dear School District Officials:

One of the Office of the State Comptroller's top priorities is to identify areas where school districts can improve their operations and provide guidance and services that will assist school district officials in making those improvements. Further objectives are to develop and promote short-term and long-term strategies to enable and encourage school district officials to reduce costs, improve service delivery and to account for and protect their school districts' assets.

The reports issued by this Office are an important component in accomplishing these objectives. These reports are expected to be a resource and are designed to identify current and emerging fiscally related problems and provide recommendations for improvement. The following is our report on the Berlin Central School District — Internal Controls over Capital Assets and the Financial Management System.

This audit was conducted pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article 3 of the General Municipal Law. The report contains opportunities for improvement for consideration by school district officials.

If we can be of assistance to you or if you have any questions concerning this report, please feel free to contact the local regional office for your county listed at the back of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government Services
and Economic Development*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Berlin Central School District (District) is governed by the Board of Education (Board), which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The District's audited financial statements included capital assets (e.g., furniture, equipment and computers) with a total net book value at June 30, 2005 of about \$6.2 million. The District annually contracts with Industrial Appraisal, an outsider vendor, to record and update the capital asset listing for the District.

The District's business office has four employees that perform all aspects of cash disbursements: payroll, accounts payable, journal entries and bank reconciliations. The District utilizes the Info-Matic financial management system to perform all business office functions.

Scope and Objectives

The objectives of this audit were to determine if District officials were properly safeguarding their financial resources for the period July 1, 2004 to February 28, 2006. Our audit addressed the following related questions:

- Has the District designed proper internal controls over capital assets and are they operating efficiently?
- Has the District designed proper internal controls over the business office, particularly the financial management system?

Audit Results

We found that the Business Administrator, who is the purchasing agent for the District, has the authority to prepare and execute wire transfers, create journal entries, and access banking information, and also acts as the Information Technology Coordinator (system administrator) for the District. This position allows him full access to the financial management system and the responsibility of creating user accounts and monitoring activity. This is a significant internal control weakness that the District should correct immediately. Based on this risk, we tested payments made to the Business Administrator. We did not note any exceptions.

Our audit also revealed that assets totaling about \$48,000 purchased during the 2004-05 and 2005-06 school years were not recorded on the capital asset inventory record. Further, we determined that the District does not monitor the fixed asset inventory, nor are assets tagged to identify them as District property. The District needs to improve procedures to ensure the capital asset inventory is accurate, detailed, complete, and up-to-date.

Comments of District Officials

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action. Appendix B includes OSC comments concerning the District's response letter.

Introduction

Background

The Berlin Central School District (District) is located in the Towns of Berlin, Stephentown, Petersburg, Poestenkill and Grafton, in Rensselaer County. The District is governed by the Board of Education (Board), which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are four schools in operation within the District, with approximately 1,000 students and 215 employees. The District's budgeted expenditures for the 2005-06 fiscal year were \$16 million, funded primarily with State aid and real property taxes.

The District's audited financial statements included capital assets (e.g., furniture, equipment and computers) with a total net book value at June 30, 2005 of about \$6.2 million. The District annually contracts with Industrial Appraisal, an outside vendor, to maintain and update the capital asset listing for the District. Capital assets purchased that are equal to or greater than \$500 are capitalized and placed on the capital asset listing. At the end of each school year, the Assistant Treasurer updates Industrial Appraisal with a listing of all assets purchased throughout the year to ensure the capital asset inventory is up-to-date and accurate.

Because of the District's relatively small size, managers perform multiple functions. For example, the Business Administrator serves as the purchasing agent, and is responsible for recording and reporting the District's financial activity. The District's four-person business office processes financial transactions utilizing a computerized financial management system known as Info-Matic.

Objectives

The objectives of this audit were to determine if District officials were properly safeguarding their financial resources for the period July 1, 2004 to February 28, 2006. Our audit addressed the following related questions:

- Has the District designed proper internal controls over capital assets and are they operating efficiently?

- Has the District designed proper internal controls over the business office, particularly the financial management system?

**Scope and
Methodology**

During this audit, we examined internal controls over capital assets and the business office of the Berlin Central School District for the period July 1, 2004 to February 28, 2006.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

**Comments of District
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action. Appendix B includes OSC comments concerning the District's response letter.

Financial Management System Access

The District uses a software package known as “Info-Matic” to process its financial transactions. The use of information technology affects the fundamental manner in which the District initiates, processes, records, and reports transactions. The extent to which the District uses computer processing in significant accounting applications, as well as the complexity of that processing, determines the specific risks that information technology poses to the District’s internal controls. The District’s widespread use of information technology presents a number of internal control risks that must be addressed. These risks include unauthorized access to data, changes to data in master files, and potential loss of data.

Info-Matic Administration

To ensure proper segregation of duties and internal controls, the financial management system should only allow users’ access to the computer functions necessary to fulfill their job responsibilities. Having access controls in place prevents users from being involved in multiple aspects of financial transactions. Generally, a system administrator is designated as the person who has oversight and control of the system, and the ability to add new users as well as change users’ passwords and rights. With this ability, administrators are able to control and use all aspects of the software. A good system of controls requires that this position be separate from the business office function.

However, we found that the Business Administrator is the Information Technology Coordinator (system administrator) for the District. This enables the Business Administrator to create a new user, update the user’s access rights, and perform other administrative functions including management overrides. The Business Administrator is also the purchasing agent for the District, and has the authority to prepare and execute wire transfers, create journal entries and access banking information. As such, the Business Administrator can initiate and conceal inappropriate transactions.

Based on this weakness, we performed a variety of tests of payments made to the Business Administrator and related payroll items for the scope period. No exceptions were noted.

Recommendations

1. The Board should designate an individual outside of the daily business office operation as the person responsible for assigning user access rights to the financial management system.

2. The Board should review access logs to ensure that employees are performing duties consistent with their job descriptions and are authorized to access certain information.
3. The Board should appoint someone independent of the daily business office operation to review audit logs from the financial management system.

Capital Assets

Capital assets are those assets that have a useful life of more than one year and include such things as land, buildings, furnishings, vehicles and electronic equipment such as computers. The District's inventory of capital assets represents a significant investment of resources. It is essential that District officials ensure that capital assets are protected from loss; that their value is maintained; and that they are used effectively. This protection can be accomplished by adopting policies, maintaining perpetual inventory records, conducting periodic physical inspections, and establishing other safeguards.

The District's capital assets are a significant investment. The District's audited financial statements included capital assets (e.g., furniture, equipment and computers) with a total net book value at June 30, 2005 of about \$6.2 million. We examined the District's policies and practices relating to capital assets and found that internal controls were inadequate to protect these assets against loss, waste, and misuse. The District has provided policy guidance for capitalization thresholds and the process for surplusing District assets. However these policies do not set forth the duties, records, and procedures required to achieve adequate internal controls. In addition, the District has not formally appointed a property control manager to monitor capital assets and ensure the accuracy and completeness of the District's asset records.

Inventory Records

Inventory records are used to control and determine custody of District property, and to properly safeguard District property. Furthermore, these records can be useful in determining insurance coverage and preparing claims for insurance recoveries in the case of loss or damage. Finally, complete and accurate accounting records are useful for preparing financial reports in conformity with generally accepted accounting principles.

The detailed inventory records must be complete, accurate, and up-to-date. Each piece of moveable property should have a record that includes a description of the item (including make, model and serial number), the District's assigned identification number (where appropriate), the date, amount, vendor, and voucher number for the purchase; the department having custody and the location within the District; and the source of funds used to purchase the item.

It is important for District officials to institute safeguards that are unique to particular assets. For example, District personnel should include identification numbers and markings on laptop computers,

audio-visual (AV) equipment, and other assets of a similar nature in the inventory records. The person in charge of the inventory records should perform periodic physical inspections, and have restricted access to the property/assets. For example, the property control manager should not be the person accepting receipt of new assets, or authorizing disposal of the assets.

The District contracts with Industrial Appraisal to maintain the capital asset listing. At the end of the fiscal year, the Assistant Treasurer updates Industrial Appraisal as to purchases and dispositions made throughout the year; Industrial Appraisal updates the capital asset inventory listing based on the District supplied information. The District does not place inventory tags or complete property record cards to identify assets as they are purchased or received. Our audit testing disclosed that about \$48,000 in assets purchased in the 2004-2005 and 2005-2006 years were not recorded on the capital asset listing.

We judgmentally selected 54 items from the capital asset listing to verify their existence in the District. We could not locate two items, a saw and a vacuum, with a combined value of \$2,000.¹ For our testing, we located items with descriptions and locations consistent with the asset listing; however, we could not make a definite match for 30 computers. This was due to generic asset descriptions for the computers. The total cost for the computers was \$29,088. None of the 54 items tested had inventory tags from the District.

We also judgmentally selected 145 items purchased in the 2004-2005 and 2005-2006 school years to verify that these items were physically located in the District and recorded on the capital asset listing, where appropriate.² While we were able to verify the existence of all items selected, we noted the following:

- Twenty-one items, with a value of \$48,382, were not recorded on the capital asset listing.
- One hundred items could not be positively verified to the asset listing due to generic descriptions and locations in the listing. A typical example would be computer purchases that were listed on the asset record as located “throughout the high school.”
- Twenty-two items were found in locations different from the location stated on the capital asset listing.

¹ These items were purchased in 1976.

²The capital asset listing was updated for purchases through June 1, 2006. Thus, all purchases selected should have been recorded on the capital asset listing.

Recommendations

4. District officials should develop a comprehensive capital asset policy. The policy should communicate management's objectives and set forth the job descriptions, types of records, procedures, and also establish the minimum value of assets to be tracked for departmental inventory control.
5. District officials should designate a property control manager to be responsible for tracking capital assets and ensuring the accuracy and completeness of the District's asset records. The individual responsible for the inventory control records should not have access to capital assets.
6. Each piece of property meeting the criteria for inclusion in the asset inventory should be identified when it is received by the District through the use of an asset tag and/or the creation of a property record tag. The serial number or unique property identification number of the property should also be documented on the asset listing.
7. The District should ensure that its inventory record of capital assets is comprehensive and up-to-date. The property control manager should promptly record all additions and deletions of capital assets. The District should conduct periodic physical inventories and compare the results with the information on the inventory control records. District officials should investigate and resolve any differences noted during this comparison.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials' response to this audit can be found on the following pages.

Berlin Central

School District

P.O. Box 259, 53 School Street, Berlin, New York 12022
Telephone: (518) 658-2690 Fax: (518) 658-3822

September 12, 2006

Re: Response to Report of Examination for the Period July 1, 2004 – February 28, 2006

OFFICE OF THE STATE COMPTROLLER
Statewide Unit
State Office Building, Room 1702
44 Hawley Street
Binghamton, NY 13901

Dear [REDACTED]:

In order to comply with recent laws and regulations regarding State audits of public school districts, I hereby submit a response to the most recent audit conducted by your office on the Berlin Central School District.

Info-Matic Administration

Simply put the issue and single finding in this area is that the Business Administrator has system "administrator rights" in the financial system including the assignment of rights, ability to add new users, and change passwords and user rights. While the Comptroller's report states that there are a number of internal control risks associated with the Business Administrator having "administrative rights" in the financial system, it fails to recognize all of the other sound internal controls in place throughout the Business Office that would significantly reduce the financial system risks. The internal controls in the Business Office were reviewed by the Controller's staff and no exceptions or recommendations were sited.

See
Note 1
Page 17

In response to the audit recommendations, the "administrative rights" will be re-assigned from the Business Administrator to the Superintendent. The Board of Education will appoint the network manager to periodically review audit logs from the financial management system and to provide the Board of Education with an access log at least annually. These actions will address the three recommendations in the Comptroller's report stated in the Info-Matic Administration section.

Capital Assts

During the audit, 54 items were selected from the capital asset listing for physical verification. All items were located except for a vacuum and saw. These two items have a combined original cost of \$2,000, were purchased in the 1970's, and had been fully depreciated with a book value of \$0.00 for over two decades. All other 52 items tested were physically verified. Additionally, there were no findings of misuse or waste of assets.

During the audit, 145 items were selected from the purchases records. Of the items selected, the report states that "100 items could not be positively verified ...due to generic descriptions". However, the report goes on to say "we were able to verify the existence of all items selected." These items primarily involve one block purchase of personal computers. While the asset description indicates the make and model number, it didn't include the serial number.

In response to the audit, as President of the Board of Education, I will direct staff to formulate a policy that communicates management's objectives and sets forth the types of records, procedures, and minimum value of assets to be tracked for inventory. I will propose to the Board of Education that the District appropriate funds and designate a property control manager. The property control manager will be provided with a job description. I will also propose to the Board of Education that funds be allocated to perform a physical inventory that includes the bar coding of assets.

Unfortunately, the directives contained in the Comptroller's audit report dated August, 2006 represent additional unfunded mandates that will force our District to divert scarce financial resources from instructional programs to administrative functions. For a rural school district that is highly dependent on State-Aid, this will force reductions in our instructional program at the same time that other State Agencies and the Federal Government are demanding higher levels of student achievement. In closing, we will do what we need to do in order to meet these most recent directives, but please recognize that we are shifting scarce financial resources from the classroom to administrative functions in order to do so.

See
Note 2
Page 17

Sincerely,



Frank Zwack
President, Board of Education

APPENDIX B

OSC COMMENTS TO THE DISTRICT'S RESPONSE LETTER

In response to the comments in the District's response letter, we provide the following information.

Note 1

As system administrator, the Business Administrator can create, modify and delete any and all records, assign others users' access rights, and create management overrides. None of the other controls in place in the District mitigate these specific risks associated with a senior manager. This is a significant vulnerability for the District that must be addressed.

Note 2

The District references an "unfunded mandate" in regard to monitoring and tracking capital assets. However, we did not recommend appropriating funds or any actions that would result in material additional costs to the District. The improvement opportunities for the District involve implementing procedures and designating certain staff to oversee purchasing, receiving of goods, and recordkeeping for District assets. The District has already designated a purchasing agent, the Business Administrator, to handle the initial purchase process. The District's business office that consists of four staff members can allocate the remaining functions to improve internal controls. The corrective actions needed in this area should not require significant expenditure and/or reduce any level of instructional program.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: cash receipts and disbursements, purchasing, payroll and personal services, and capital assets and consumable inventories.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents such as District policies and procedures manuals, Board of Education minutes and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its database(s). Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected capital assets and internal controls over the business office.

We examined the following records and reports in an effort to determine if capital assets and inventories were protected against loss, waste and misuse and to identify the possible effect if they were not adequately safeguarded:

- Industrial Appraisal capital asset listing
- Vendor payment history
- Detail warrants, cancelled checks and invoices
- Financial statements
- General ledger printouts

We also conducted a walk-through to physically verify the existence of selected assets from the capital asset listing.

We examined the following records and reports to determine if the District had properly designed and implemented internal controls and segregation of duties over the business office:

- Employee personnel files
- Collective bargaining agreements and individual employment contracts
- Board minutes
- Payroll registers
- Detail warrants, cancelled checks and invoices
- Vendor payment history

We interviewed employees in the District's business office concerning the payroll process and the reimbursement process.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). Such standards require that we plan and conduct our audit to adequately assess those District operations within our audit scope. Further, those standards require that we understand the District's management controls and those laws, rules and regulations that are relevant to the District's operations included in our scope. An audit includes examining, on a test basis, evidence-supporting transactions recorded in accounting and operating records and applying such other auditing procedures, as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for the findings, conclusions and recommendations contained in this report.

APPENDIX D

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