



Dalton-Nunda Central School District Internal Controls Over Payroll

Report of Examination

Period Covered:

July 1, 2005 - June 30, 2006

2006M-189



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State of New York Office of the State Comptroller

Division of Local Government Services and Economic Development

December 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 Dalton-Nunda Central School District — Internal Controls Over Payroll.

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*

Introduction

Background

The Dalton-Nunda Central School District¹ (District) is located in the Towns of Mount Morris, Nunda, Portage, West Sparta, Granger, Grove and Genesee Falls in Livingston, Allegany and Wyoming Counties. 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 two schools in operation within the District, with approximately 868 students. The District's budgeted expenditures for the 2005-06 fiscal year were approximately \$17.6 million funded primarily with State aid, real property taxes and grants.

The District employs approximately 260 employees and its bi-weekly payroll distribution is about \$310,000 during the school year. The payroll clerk enters and deletes employees in the financial management system (Finance Manager).

Objective

The objective of this audit was to determine if District officials were properly safeguarding their financial resources for the period July 1, 2005 to June 30, 2006. Our audit addressed the following related question:

- Are internal controls over payroll appropriately designed and operating effectively?

Scope and Methodology

During this audit, we examined internal controls over payroll of the District for the period July 1, 2005 to June 30, 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 B 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

¹ Also known as the Keshequa Central Schools.

A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated that they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, the Board must approve a corrective action plan that addresses the findings in this report, forward the plan to our office within 90 days, forward a copy of the plan to the Commissioner of Education and make the plan available for public review in the District Clerk's office. For guidance in preparing the plan of action, the Board should refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*.

Payroll

The primary objective for internal controls over payroll processing is to ensure that employees are paid wages and salaries, and provided benefits, to which they are duly entitled. Internal controls for payroll normally consist of written policies and procedures, including an employee manual that delineates employee responsibilities in preparing and disbursing payroll, and provides guidance regarding employee entitlements. An important component of any internal control system is proper segregation of duties, ensuring that no one person controls all phases of a transaction. Concentrating key duties (i.e., authorization, recordkeeping and custody) with one individual with little or no oversight weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected and uncorrected in a timely manner. Another important component is management oversight.

Our audit disclosed that the former Superintendent performed services as a consultant to the District prior to entering into a contract. In addition, records were not maintained to support the additional services rendered. We also identified weaknesses in segregation of duty in the payroll process that could lead to irregular activities occurring and remaining undetected.

Consultant Payments to Superintendent

Beginning in May 2005, the District engaged the Superintendent, Lucinda Miner, as a consultant to lead a search effort for a new superintendent. This consulting work was deemed to be over and above the normal duties of the Superintendent. At the outset of her consulting services, there was no contract in place that outlined what services she would provide, how she would provide these services in addition to her serving as the full-time superintendent through the end of the school year, and the amount of compensation she would receive for these services.

The School Board decided, in June of 2006, to hire an interim Superintendent for the 2006-2007 school year and to appoint a permanent Superintendent from within the District for the 2007-2008 school year. A contract for Ms. Miner's consulting services for \$14,250 was executed on June 9, 2006, and approved by the Board on June 20, 2006, subsequent to the consulting services being performed. The contract and Board minutes are silent as to how the \$14,250 contract amount was arrived at.

The District's internal claims auditor had concerns when she reviewed the proposed payment in August. There was no documentation to

support what Ms. Miner actually did as the District's consultant, nor were there any time records maintained regarding these services. The internal claims auditor did not approve this payment and requested that the Board vote on the payment. The Board subsequently approved the payment on September 14, 2006.

Due to the fact that there was no contract in place prior to the services being rendered, there was a lack of documentation to support the services rendered, and that Ms. Miner was serving as the full-time Superintendent at the same time, we question whether the payment of \$14,250 to Ms. Miner was appropriate.

Segregation of Duties

The District's payroll clerk was directly responsible for the following payroll duties: creating manual and computerized employee records, adding and deleting employees, entering all payroll changes, collecting time sheets, entering the hours worked and salaries paid, entering leave records and employee absences, posting expenditures to the subsidiary ledgers, preparing paychecks, disbursing paychecks, and maintaining employee files. The only mitigating control included in the District's payroll system is the business administrator's verification of the mathematical accuracy of the payroll after the payroll clerk processes payroll checks. We note since the July 21, 2006 payroll run, the business administrator now reviews each payroll prior to and after payroll checks are processed.

Based on the lack of segregation of duties during our scope period, we selected 20 employees from District payroll records to verify that they were indeed employees of the district. The selected employees' names were traced to staff directories and their Social Security numbers were matched to W-4s on file at the District. We did not note any exceptions based on our testing. In addition, we tested the accuracy of 20 employees' salaries during the audit period and verified the supervisory approval of time cards. We found two of the 20 time cards did not have supervisory approval for the pay period; overall, no other issues were noted during the payroll testing.

Recommendations

1. The Board should have a signed contract in place for professional services prior to the commencement of any work being performed in relation to that service. This contract should contain terms that outline the services to be performed as well as the compensation to be paid for the services.
2. The Board should assign payroll duties to employees in such a manner that incompatible duties are segregated. The payroll clerk should be responsible for entering the hours worked/salary information for the pay period, entering leave records

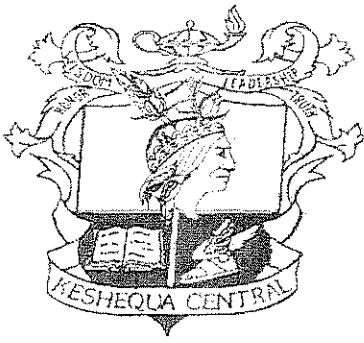
and employee absences, posting expenditures to the subsidiary ledgers, and preparing paychecks for the treasurer to sign. Payroll department employees should not distribute payroll checks to the District's buildings.

3. The District should conduct periodic payroll payouts where the employees are required to show identification and sign for their paycheck. To ensure all employees will sign, the District should provide notification to the employees and stop direct deposit for the pay period the payout will be conducted.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Keshiqua Central Schools

Edward Stores, Superintendent of Schools

P.O. Box 517, 13 Mill Street

Nunda, New York 14517

Phone: (585) 468-2541 Fax: (585) 468-3814

Response to the New York State Comptroller's Draft Audit Report

November 3, 2006

Segregation of Duties over Payroll

Due to the limited staff in the Business Office, it is difficult to attain the recommended level of checks and balances (segregation of duties) relating to payroll functions.

The Business Administrator currently reviews each payroll prior to the printing of payroll checks and then verifies and certifies the payroll after payroll checks are processed. This process mitigates the likelihood that errors or irregularities would occur and remain undetected.

In addition, we will review this recommendation with our Internal Auditor to determine whether other controls are warranted.

Consultant Payments to Superintendent

Under payroll on page 5 the report concludes that the former Superintendent performed services as a consultant to the District prior to entering into a contract. It is important to note that the district had dismissed the lawyer for the district at the same time discussions were taking place with the former superintendent about doing a search for a new superintendent. A new lawyer was subsequently authorized to develop a contract. The lawyer is Laura Purcell of the Harris Beach agency in Rochester. She attempted to reach the NYS Teacher's Retirement system to get approval for the district to enter into such an agreement. That approval was ultimately received but the approval process did take considerable time. On advise from counsel the Board of Education felt that the approval was a formality and did have Ms. Miner begin work.

The district concedes that there was no written contract in place at the time Ms. Miner performed the duties as search consultant but feels that the discussions that took place with Ms. Miner constitute a verbal agreement or contract if you will. We recognize that the problem with these kinds of agreements is that not all remember the discussions the same way. In the future, written contracts of this nature will be executed and records kept regarding expectations for when the work is to be performed and how remuneration is to be made.

Again, we recognize that having a signed contract with Ms. Miner in place after the district had decided to appoint an interim superintendent and create the position of Assistant Superintendent

gives the appearance of "closing the barn door after the horses are out". Had deliberations between the new school attorney and TRS gone more smoothly and more timely, a signed contract would have been in place in a more timely fashion.

Lastly, in the future, written contracts will be submitted to professionals who work daily with such things to be sure that such contracts contain all appropriate standards for whatever is to be performed. All of the things mentioned in the report will be spelled out including what work is to be performed, when the work is to be performed and how compensation is to be determined.

Sincerely,



Kevin Whiteman, President
Keshequa Central School
Board of Education

APPENDIX B

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 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 databases. 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 segregation of duties over payroll for further audit testing.

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

- Employee personnel files
- Collective bargaining agreements and individual employment contracts
- Board minutes
- District staff directory
- Payroll registers generated from Finance Manager
- Payroll schedules and time cards for hourly employees

We interviewed employees in the District's business office concerning the payroll process and the administration of Finance Manager.

We reviewed the audit log for the payroll function from July 1, 2005 through June 30, 2006 for user changes in the payroll function.

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.

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