



Elmira Heights Central School District Internal Controls Over Cash Disbursements

Report of Examination

Period Covered:

July 1, 2004 - April 30, 2006

2006M-187



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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 Elmira Heights Central School District — Internal Controls Over Cash Disbursements.

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 Elmira Heights Central School District (District) is located in the Village of Elmira Heights, in Chemung 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 three schools in operation within the District, with approximately 1,148 students and 173 employees. The District's expenditures for the 2004-05 fiscal year were \$15.8 million, which were funded primarily with State aid and real property taxes.

Because of its relatively small size, managers perform multiple functions for the District. For example, the purchasing agent also served as the accounts payable clerk during the 2004-05 fiscal year. The Business Manager also served as the District Treasurer; the payroll clerk was also the claims auditor for the 2004-05 fiscal year. A new Treasurer was appointed in July 2005, and there also was a new accounts payable clerk and claims auditor appointed in September 2005.

Objective

The objective of this audit was to determine if District officials were properly safeguarding their financial resources for the period July 1, 2004 to April 30, 2006. Our audit addressed the following related question:

- Has the District established adequate internal controls over cash disbursements to protect against fraud, abuse and professional misconduct, and are those controls operating effectively?

Scope and Methodology

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. Based on

that evaluation, we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We did determine that risk existed in the cash disbursement area and, therefore, we examined internal controls over cash disbursements for the period July 1, 2004 to April 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 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 our comments on issues raised in the District's response letter.

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*.

Cash Disbursements

An internal control system, which is established by management and implemented by District officials, is the integration of activities, plans, attitudes, policies and efforts of the people in an organization to provide reasonable assurance that the organization will achieve its objectives. In general, the objectives of internal controls over cash disbursements are to ensure that cash is disbursed only upon proper authorization, supported by the appropriate documentation, is for valid business purposes, and is properly recorded. When internal controls are not designed appropriately or operating effectively, it increases the risk that errors and irregularities may occur, and may not be detected and corrected.

We identified weaknesses in the claims audit process, authorized signatures and segregation of duties that, if not corrected, could lead to errors or irregular activities occurring and not being detected.

Claims Auditor

The Board is responsible for auditing the District's claims before they are paid.¹ If the Board chooses, it may adopt a resolution to appoint a claims auditor to assume the powers and duties of the Board with respect to auditing claims.² Conducting a proper audit of claims before the District pays them is an integral part of any internal control system over cash disbursements. The claims auditor should conduct a deliberate and thorough review to determine that proposed payments are proper and valid charges against the District, and that they are incurred by authorized officials. In addition, the claims auditor should determine that the District, or its representatives, actually received the goods and/or services described in the claims by viewing detailed receipts with written statements from District officials to that effect. In essence, the claims auditor is responsible for ensuring all claims are legitimate before they are paid.

A claims auditor should be separate from all other business operations. In addition, the State Education Department (SED) regulations prohibit a school district from appointing a BOCES employee as its claims auditor if the BOCES provides material and significant services to that district.

During the 2004-05 school year, the Board appointed as claims auditor an individual who was also the payroll clerk for the District.

¹ NYS Education Law, Section 1724

² NYS Education Law, Section 1709

Furthermore, the claims auditor did not report to the Board as legally required, nor was there a system in place to ensure that she reviewed all hand-written checks.

Based on the weaknesses in the claims audit function, we tested two months of disbursements to verify the review by the claims auditor. We found that the claims auditor only reviewed 10 out of 43 hand-drawn checks tested. As a result, the claims auditor did not review or approve \$540,000 of disbursements prior to payment.

Further, in July 2005, the claims auditor became an employee of the Greater Southern Tier Board of Cooperative Education Services (BOCES), as a result, the District contracted with BOCES for these services. The BOCES provides material and significant financial services to the District. For example, in the 2005-06 fiscal year, the District paid about \$1.7 million for services provided by BOCES. Although the District used BOCES services before SED adopted its regulations specifically prohibiting such an arrangement, a BOCES employee cannot be considered an independent auditor of the District's claims because of this significant financial relationship.

Authorized Signatures

In school districts, the treasurer is the custodian of all school district moneys. As such, the treasurer should sign accounts payable checks, payroll checks and other disbursements on behalf of the district. The board may, in its discretion, require that another officer of the district countersign such checks, other than checks for salary. When authorized by the board, checks may be signed with the facsimile signature of the treasurer and any other district officer whose signature is required. Annually, the Board appoints the Treasurer and grants them the authority to sign checks.

The District has contracted with BOCES to process the payroll checks on a bi-weekly basis. BOCES prints the payroll checks with the Treasurer's electronic signature. BOCES returns the checks to the District ready for mailing. The District does not verify the accuracy of the printed checks prior to their mailing. The Treasurer does not control the signature disk, nor is she notified when her signature is being used.

Segregation of Duties

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 (such as 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 of a good system of internal controls is management oversight.

The District has not designed adequate internal controls over wire and bank transfers. Wire and bank transfers were performed, recorded and approved by the same person, the Business Manager/Treasurer, during the 2004-05 fiscal year. In the 2005-06 fiscal year, the District had an accounts payable clerk record the journal entries for wire/bank transfers. The multiple functions of authorization, recordkeeping and safeguarding of cash are incompatible as they allow one person to circumvent all controls. In September 2004, there were 16 wire and bank transfers totaling almost \$346,000. None of these were approved or reviewed by another individual. As a result of the lack of segregation, these funds could have been spent for inappropriate purposes and not been detected. Based on the lack of segregation of duties, we reviewed the bank and wire transfers for September 2004, and found no exceptions.

Recommendations

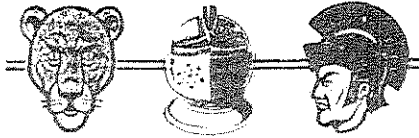
1. The Board should ensure that its appointment of the District's claims auditor is in accordance with SED regulations.
2. The Board should ensure that all disbursements and manual checks, are supported, reviewed and approved by the claims auditor prior to payment.
3. The Board should ensure that the Treasurer's electronic signature disk is secured at all times, and that the Treasurer authorizes usage.
4. The Board should design controls over wire and bank transfers. The Board should ensure that functions related to the approval and recordkeeping, performance and cash maintenance of wire and bank transfers are properly segregated.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

ELMIRA HEIGHTS
CENTRAL SCHOOL DISTRICT



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Mary Beth Fiore, Superintendent

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December 7, 2006

Binghamton Regional Office
Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton NY 13901-4417

RE: Response to the Draft Report Examination: Internal Controls Over Cash
Disbursements, Period Covered, July 1, 2004-April 30, 2006

To Whom It May Concern:

Please find attached the Elmira Heights Central School District's response to the report of your findings covering the period July 1, 2004 – April 30, 2006. This response addresses those sections of the report where we feel clarification is appropriate.

The District is appreciative of the recommendations made and pledges to the Elmira Heights Central School District community that we will be diligent in addressing these findings. Upon receipt of the final report the District will provide the Office of the State Comptroller with our Corrective Action Plan based upon your recommendations.

Should you have any questions or need additional information please do not hesitate to contact me.

Sincerely,

Mary Beth Fiore
Superintendent of Schools

Enclosures: 1

cc: Elmira Heights CSD Board of Education
Debra L. Palmer, Business Manager

Enter with high expectations – leave with confidence and pride.

School District Response to the NYS Comptroller's Draft Report, "Elmira Heights Central School District Internal Controls over Cash Disbursements, Period Covered July 1, 2004 – April 30, 2006":

Claims Auditor

The District agrees with the findings that there were weaknesses in the claims audit function spanning the time period of July 1, 2004 through June 30, 2005, but during the remaining time period of the audit we do not agree with the findings. Effective July 1, 2005 the payroll clerk became an employee of the SCT BOCES Central Business Office (CBO) where we contracted with them to provide the claims auditor function. The ultimate goal was to have an employee of the CBO not involved in the business operations audit the claims of the District. Although the BOCES as an organization has contracts and provides goods and services to the District, the individual claims auditor does not have the same interest.

The District disagrees with the interpretation by the Office of the Comptroller of the Commissioner's Regulation concerning the appointment of an internal claims auditor who is a BOCES employee. That practice has been in place for over ten years in the Broome Tioga BOCES CBO with the approval of the NYS Education Department. Education Law § 1709 (20-a) permits a central school district Board of Education to appoint a claims auditor using § 1950 of the Education Law.

See
Note 1
Page 14

Additionally, there are inconsistencies in the findings of other Districts who are also contracting with the GST BOCES CBO to provide the same services. We request that this finding be removed from the report.

See
Note 2
Page 14

It is also stated that the claims auditor did not report to the Board as legally required. The Board of Education appointed the employee to the position of Claims Auditor and she did report directly to the Board in that capacity. The fact that there were no written reports to the Board is because there were no exceptions to any claims that were unresolved. The language of the statute does not require a report to be issued at specific intervals in writing to the Board. The District believes this comment should be removed from the report.

See
Note 3
Page 14

Management was unaware that all hand drawn checks were not being reviewed by the claims auditor. Corrective steps have been taken to ensure this is being done.

Furthermore, we wish to clarify the composition of hand drawn checks which were not reviewed. Of the 43 checks tested, 4 were to establish a petty cash fund at the beginning of the school year and were correctly supported by Board resolution. Seven of the checks written were over \$100,000 each and were for recurring payments to the CST Health Care Plan (2 checks), SCT BOCES in payment of our monthly contract billing (4 checks) and payment for 2 new buses specifically authorized by voters.

Additionally, during the audit period, all Trust and Agency, Special Aid Fund and Capital Fund checks were considered "hand drawn" because they were typed by hand instead of printed by computer. Therefore, the number of hand drawn checks appears inflated.

Authorized Signatures

We recognize the legitimacy of the finding that we do not physically control the signature disk, however, we disagree with the statement that the treasurer is not notified when her signature is being used. The signature disk is under the control of only 2 BOCES employees and the treasurer is aware of each bi-weekly or special payroll that is run. Each payroll check file is also transmitted to our bank to match against paid checks. This list is then reconciled by the treasurer at the end of each month.

See
Note 4
Page 14

Segregation of Duties related to Wire and Bank Transfers

The statements, "Wire and bank transfers were performed, recorded and approved by the same person, the Business Manager/Treasurer, in the 2004-05 fiscal year" and "For the month of September 2004, there were 16 wire and bank transfers totaling almost \$346,000. None of these were approved or reviewed by another individual" are not accurate statements. There were callback procedures in place to a person other than the Business Manager/Treasurer for wire transfers. Additionally, a part-time account clerk was hired 7/1/04 who recorded all wire and bank transfers in the general ledger. This account clerk was subsequently appointed as the full time treasurer on 7/1/05 and since that time has performed wire and bank transfers that are reviewed and approved by the Business Manager.

See
Note 5
Page 14

Recommendations

The District is pleased that the report states that no irregular activities or exceptions were found in any of the areas tested. We are continuing to review the recommendations made and will respond with a corrective action plan that will be implemented to address any material weaknesses noted.

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

This finding is not based on our interpretation of the Commissioner's regulations. SED guidance on this issue is quite clear and can be found at www.emsc.nysed.gov/mgtserv/fiscal_accountability_legislation/htm/claims_auditor.htm. The claims audit relationship currently in place at the District is prohibited by SED regulations.

Note 2

We have only issued one audit report relating to the school district initiative, for the component school districts of the GST BOCES. This particular school was found to have an appropriate claims audit relationship.

Note 3

During audit fieldwork, District officials indicated the claims auditor reported to the Superintendent of Schools, not directly to the Board of Education. During the exit discussion, the Vice President of the Board of Education did not disagree with this statement, nor did District officials. We were presented no additional information that would indicate the claims auditor reported to the Board of Education.

Note 4

The District's response indicates that the treasurer "is aware of" what could be considered normal usage of the signature disk. However, there is no control or procedure in place to authorize usage of the signature disk. Basically, BOCES has full discretion and access to the disk at all times. This represents a control weakness that should be addressed by District officials.

Note 5

The District's response states that our findings concerning weaknesses in the wire and bank transfer process are not accurate. However, we have evidence that during the 2004-05 fiscal year, the Business Manager/Treasurer had the ability to prepare and record wire and bank transfers without prior approval.

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 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. Based on that evaluation we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected internal controls over cash disbursements for further audit testing.

When testing cash disbursements, we focused our testing on the claims audit function, authorized signatures, and bank and wire transfers. Our testing consisted of two months, September 2004 and December 2005. We also tested a judgmental sample of various claims from two months in our scope period. We focused on adherence to District policies and procedures, as well as pertinent laws and regulations pertinent to cash disbursements and claims processing. We examined the following records to determine the effectiveness of internal controls pertaining to the cash disbursements function, and to identify any associated effect of deficiencies found in those controls:

- Bank statements
- Transaction history reports
- Purchase orders
- Claims packets
- Cancelled checks
- Cash control accounts
- Bank reconciliations
- Hand-drawn checks

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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