



Inlet Common School District

Internal Controls Over Purchasing

Report of Examination

Period Covered:

July 1, 2004 - January 31, 2006

2006M-104



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State of New York Office of the State Comptroller

Division of Local Government Services and Economic Development

November 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 Inlet Common School District — Internal Controls Over Purchasing.

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 Inlet Common School District (District) is located in the Town of Inlet, Hamilton County. The District is governed by the Board of Education (Board) which comprises three elected trustees. The District Clerk and District Treasurer are also elected however, they are not voting members of the Board. 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 Treasurer is responsible for the District's finances, accounting records and reports.

The District operates one school with five full-time employees and approximately 40 students attending pre-kindergarten through Grade 6. The District pays tuition for all children Grade 7 and above to attend the Town of Webb Union Free School in Old Forge, Herkimer County. The District's budgeted expenditures for the 2005-06 fiscal year are approximately \$1 million, funded primarily with real property taxes and state aid.

Objective

The objective of our audit was to assess the adequacy of the District's system of internal controls over purchasing. Our audit addressed the following specific questions:

- Does the District have a procurement policy providing guidelines to purchase goods and services in a manner designed to ensure that it receives quality goods and services at the best available price?
- Do written contracts support payments for services?
- Does the District have controls in place to identify and prevent the occurrence of prohibited conflicts of interest on the part of District officials?

Scope and Methodology

Our overall goal was to assess the adequacy of 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 area of purchasing and therefore, we examined internal controls over the procurement of goods and services for the period July 1, 2004 to January 31, 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 A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, the Board should prepare a plan of action that addresses the recommendations in this report and forward the plan to our office within 90 days. For guidance in preparing the plan of action, the Board may refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*. We encourage the Board to make this plan available for public review in the District Clerk's office.

Internal Controls Over Purchasing

A good system of internal control consists of policies, practices, and procedures that allow an organization to provide reasonable assurance that it is using its resources effectively (i.e., prudently and economically), that it is complying with applicable laws and regulations, and that its financial reports are reliable. A major component of a good system of internal control is management's attitude toward, and support for, internal controls, and its regular monitoring of such controls to make sure they are working effectively. The Board and other District officials are responsible for designing internal controls that help protect the District's assets and ensure the prudent and economical use of its moneys when procuring goods and services. Adequate internal controls need to be established to meet these responsibilities and to protect against favoritism, extravagance, fraud and corruption. Certain controls are designed to prevent errors and irregularities from occurring. Other controls act to detect errors and irregularities in a timely manner. When it comes to procurement, a good system of internal control uses each of these types of controls to minimize the risk that errors or irregularities may occur and go undetected.

The objectives of the District's procurement process should be to obtain services, materials, supplies and equipment of the desired quality, in the quantity needed, at the lowest price in compliance with applicable Board policies and legal requirements. The goal is to help ensure that taxpayer dollars are expended in the most efficient manner.

We found that the District does not have a comprehensive written purchasing policy. We also found that the District purchased transportation services without going through the required competitive bidding process and without having a contract, and the District procured certain goods and services from a business in which a Board member had a personal interest. We found no other errors or irregularities related to the District's purchases of goods or services.

Purchasing Policy

District officials are required to adopt written policies and procedures to ensure that the purchase of goods and services is performed in a manner to assure both the prudent and economical use of public moneys.¹ A good purchasing policy establishes the framework of internal control needed for management to provide purchasing oversight and should, at a minimum, contain the following:

¹ General Municipal Law Section 104-b

- Procedures for determining whether a procurement of goods or services is subject to competitive bidding.
- Requirements that quotations for goods and services shall be secured by use of written requests for proposals (RFPs), written quotations, or verbal quotations and the circumstances when each method shall be used.
- Requirement that adequate documentation of actions taken in connection with each purchase including the justification and documentation for any purchase not awarded for the lowest dollar amount offered.
- Provision for an annual review of the policy.

The Superintendent, with the assistance of the Principal is responsible for the establishment and implementation of the procedures and standard forms for use in all purchasing and related activities in the District. The Board has not adopted a comprehensive written purchasing policy covering both purchases subject to competitive bidding and the acquisition of those goods and services that are not required to be competitively bid. In the absence of a purchasing policy the Board has purchased transportation services without going through the competitive bid process and awarded contracts to a business partially owned by a Board member.

Transportation Services

The General Municipal Law mandates that certain school district purchases be subject to competitive bidding, the stated purpose of which is to assure the prudent and economical use of public moneys and to facilitate the acquisition of facilities and commodities of maximum quality at the lowest possible cost. Transportation contracts that exceed \$10,000 are among the type of services that are required to be competitively bid to ensure that the best price is received for those services.² We note that the District is allowed to extend a transportation contract for five years with annual increases equal to the consumer price index without additional bidding.³ However, there was no indication that District officials advertised for bids for transportation services within the past six years. Furthermore, there was no documentation that the Board had approved either a transportation contract or a contract extension for the 2005-06 fiscal year or that there were any written contracts from prior years between the District and the contractor. The only documentation provided was

² General Municipal Law Section 103 and Education Law Section 305(14)

³ Education Law 1604(23) and 8NYCRR Section 156.5

a State Education transportation form that does not detail the services to be provided by the contractor nor the cost to transport students for daily and extracurricular trips.

The District spent \$74,503 on transportation services during the 2004–05 fiscal year and has estimated costs of \$82,000 in its 2005–06 budget. Claims for transportation expenditures were paid to the Town of Webb Union Free School District (Webb UFSD) and a private contractor. District officials provided us with the 2004-05 State Education Department transportation contract form indicating that a contractor was hired to provide busing services at a cost totaling \$51,784. Payments made to the contractor during 2004-05 for the daily bus runs to and from the elementary school totaled \$48,652. Vouchers totaling \$3,132 were paid to the Webb UFSD for both maintenance of the contractor’s bus (\$2,361) and for bus rentals (\$771) in those instances when the contractor used a Webb UFSD bus. Webb UFSD received transportation costs of \$7,245 for the high school students. An additional \$15,474 was paid to the contractor for busing services related to field trips and other extra-curricular activities. As noted previously, there was no contract covering basic transportation services or any other documentation that supports the payment for additional bus runs, maintenance of the contractor’s bus or rental provisions with the Webb UFSD.

The absence of a detailed contract for transportation services could result in the District being billed for unauthorized items and paying more than necessary for these services. Without proper adherence to statutory requirements and the adoption of appropriate policies and procedures, the District cannot be assured that it is securing goods and services in the most economical manner and in the best interests of the District taxpayers.

Conflicts of Interest

Conflicts of interest may occur when a school district official or related party is involved in and financially benefits from business transactions that involve the school district. Article 18 of the General Municipal Law defines the area of conflicts of interest for most local government entities including school districts and sets reasonable standards of ethical conduct for the type of contracts and relationships that local officials may have. The law also requires that the governing body adopt a Code of Ethics to set forth additional guidance on the standards of conduct required of its officials and employees. The absence of such standards weakens internal controls and increases the risk that District employees or officials may inappropriately benefit from their involvement in certain transactions with the District.

The Board has not adopted a Code of Ethics to provide guidance on the standards of conduct reasonably expected of its officers and employees. We found the District made payments for electrical and heating work completed at the school to a business owned by a Board member and her husband. There was no disclosure in the minutes that the District was doing business with this company which is 50 percent owned by Board member, Katherine Humphrey Queen. During the period July 1, 2004 through January 31, 2006 the District made 15 payments to this Board member's business totaling \$9,392 for various general contract services such as installing outdoor lights and working on the heating system.

Article 18 of the General Municipal Law prohibits a municipal officer from having an interest in any contract with the municipality of which he/she is an officer; when, individually or as a member of the Board, he/she has the power to negotiate, prepare, authorize, or approve the contract; or approve payment under the contract. While there are certain exceptions to this law, they do not apply in this case. The contracts the District entered into with the Board member's firm are prohibited under Article 18 since the Board member has an interest in and the power to authorize or approve payment under such contracts.

Whenever a public official conducts business with the local government unit he serves, the public may question the propriety of the related transactions. The existence of such transactions may not only create the perception of impropriety but may result in the improper use of public moneys and a breach of the public trust. The lack of a purchasing policy and code of ethics creates a serious weakness in internal controls that increases the likely occurrence of prohibited transactions such as the ones noted above.

Recommendations

1. The Board should adopt a Purchasing Policy in accordance with General Municipal Law Section 104-b. The Purchasing Policy, once adopted, should be reviewed annually.
2. The Board should competitively bid transportation contracts.
3. The Board should require that a contract be signed detailing the transportation services and associated costs.
4. The Board should adopt a code of ethics, provide a copy to each employee, and require each employee to sign a statement indicating that he or she has read and understood the code of ethics.

5. The Board should review pertinent sections of Article 18 of the General Municipal Law and take appropriate steps to identify and avoid transactions that may constitute prohibited conflicts of interest.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Inlet Common School

Board of Education
John Levi II, Chair
John Frey
Kathy Queen



Superintendent, Donald Gooley
Principal, Sandra Knoblock

PO Box 207, Route 28
Inlet, NY 13360
Phone: 315.357.3305

October 3, 2006

Office of the State Comptroller
One Broad Street Plaza
Glens Falls, NY 12801

Dear Sir:

This is in response to the audit conducted for the Inlet Common School District for the period 07/01/04 to 07/31/06.

We would like to thank the Office of the State Comptroller for conducting the audit, and especially [REDACTED] who did a fine, professional job. We were pleased that the only area that the auditor felt needed addressing was purchasing. This is a complement to our Board, staff and especially Mary Marleau our District Treasurer.

Although the findings of the auditor seem fair and accurate, Inlet Common School District is located in a sparsely settled area where there are not a wide choice of vendors available to purchase goods and services.

I understand my task is to comment on the 5 recommendations that the auditor cited on page 8 & 9 of the audit.

1. The Board should adopt a Purchasing Policy in accordance with General Municipal Law § 104-b. The Purchasing Policy once adopted should be reviewed annually.

The district has begun writing a purchasing policy and it will be submitted as part of our corrective action plan which is due 12/07/06. We will review all our policies annually.

2. The Board should competitively bid transportation contracts.

Based on preliminary findings during the audit, the Board did competitively bid Transportation contracts for the 06-07 school year, and will continue to do so in the future.

3. The Board should require that a contract be signed detailing the transportation services and associated costs.

The Board did sign a contract for 06-07 detailing the transportation services and associated costs, and will continue to do so in the future.

4. The Board should adopt a code of ethics, provide a copy to each employee, and require each employee to sign a statement indicating that he or she has read and understood the code of ethics.

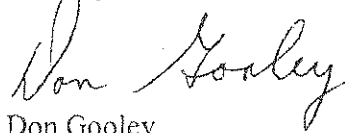
The district has already written a code of ethics and it will be adopted at the October 2006 Board Meeting. It will require each employee to sign a statement indicating that he or she has read and understood the code.

5. The Board should review pertinent sections of Article 18 of the General Municipal Law and take appropriate steps to identify and avoid transactions that may constitute prohibited conflicts on interest.

The Board members have received a copy of Article 18 of the General Municipal Law, and will take the appropriate steps to identify and avoid transactions that may constitute prohibited conflicts of interest. This article will be reviewed at the October 2006 Board Meeting.

The Board is well aware of its responsibility to initiate a corrective action plan pursuant to Section 35 of the General Municipal Law. This will be completed by 12/07/06 and it will be forwarded to the Office of the State Comptroller.

Best regards,



Don Gooley
Superintendent

DG/bf

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, Board of Education minutes and financial records and reports. We did not obtain information directly from computerized financial databases as the District maintains manual records.

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 upon 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 purchasing for further audit testing.

We interviewed District officials responsible for the purchasing function. We scanned all warrants. We also performed, on a test basis, an analysis of goods and services purchased during the audit period. We specifically focused on purchases for transportation services as well as purchases from businesses we identified as having a relationship with a Board member or other district officials.

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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