



# Oswego City School District Financial Condition and Internal Controls Over Financial Operations

Report of Examination

Period Covered:

July 1, 2001 - December 31, 2005

2006M-85



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# State of New York Office of the State Comptroller

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## **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 Oswego City School District — Financial Condition and Internal Controls over Financial Operations.

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

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# EXECUTIVE SUMMARY

The Oswego City 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. Responsibilities relating to the District's finances, accounting records and reports are largely those of the Assistant Superintendent for Business and the Treasurer. The Board appoints a Claims Auditor who assumes the powers and duties of the Board in regard to approving or denying claims against the District.

Internal controls are the policies and procedures adopted by District management, which when properly designed and implemented, help ensure that financial reporting is accurate, laws and regulations are complied with, and that the District operates efficiently and effectively. A good system of internal control can help prevent or identify errors and/or irregularities in a timely manner.

### **Scope and Objectives**

Our audit sought to identify the factors that contributed to the District's financial decline during the four-year period from July 1, 2001 to June 30, 2005. We also examined the District's internal controls over capital assets, purchasing, cash disbursements and payroll for the period July 1, 2004 to June 30, 2005 and over computer operations for the period July 1, 2004 to December 31, 2005. Our audit addressed the following related questions:

- Has the Board been provided with the financial information it needs to effectively monitor and control District finances?
- Has the Board adopted realistic budgets, and utilized long-term planning to identify and manage future operating and capital asset requirements?
- Have District officials designed and implemented effective internal controls over selected financial activities?

### **Audit Results**

During the four-year period from July 1, 2001 to June 30, 2005, the District relied heavily on the use of fund balance to finance operations. The budgets adopted for these four years contained

a cumulative appropriation of fund balance that totaled \$11.9 million. The District's general fund unreserved, unappropriated fund balance exceeded the statutory limit at the end of both fiscal years 2000-01 and 2001-02. However, by the end of the 2004-05 fiscal year, the District's fund balance was only \$437,171, or about one-fourth of what it had been at the end of the 2001-02. At the same time, reserves, excluding the reserve for encumbrances, totaled \$3.2 million, or just over half of what they did three years earlier. District officials appropriately reduced fund balance from the excessive levels of earlier years; however, with less fund balance available to finance the cost of operations, it has been increasingly important that District officials carefully monitor the District's finances, adopt realistic budgets, and develop long-range strategies for financing future operations. Despite four consecutive years of stagnant or declining revenues and generally rising expenditures, it was not until March 2005 that the Board took steps toward developing a multi-year financial plan to address its long-range operating and capital asset needs.

The development of realistic budgets is essential for the District to avoid fiscal stress. However, the District's estimate of employee benefits costs in the 2004-05 budget did not reflect a reasonable budgetary response to what has been a clear and obvious trend in these costs over previous years. Employee benefits costs in the 2004-05 budget were estimated at an amount (\$9.7 million) that was 10 percent less than the actual costs incurred in 2003-04 (\$10.8 million) and 23 percent less than the actual costs for 2004-05 (\$12.7 million). Health insurance costs projections were estimated at just under \$6 million for 2004-05 after the District experienced costs of nearly \$7.4 million in 2003-04 and \$6.7 million in 2002-03. The actual cost of health insurance rose to nearly \$7.9 million in 2004-05, or almost \$1.9 million more than had been budgeted.

Our examination of the Board's fiscal management practices also disclosed that the Board did not always receive timely financial information with which to effectively monitor the District's finances. At various times during the four-year period of our audit, the Board often received essential financial reports up to as much as nine months late. We also found that budget transfers were not always approved and documented and budget transfer reports were not always complete. In addition, the District inappropriately encumbered funds at year-end to be used to increase appropriations in various other accounts in the following year.

The Board had not established written procedures or guidelines for the audit of claims or developed a job description for the Claims Auditor. The Claims Auditor reported to the Assistant Superintendent for Business, her supervisor, rather than reporting directly to the Board. In addition, she has another District job, which is not compatible with her duties. Finally, the Claims Auditor did not compare the audited claims with the warrant and checks prepared by the Treasurer to ensure that the warrant was an accurate account of the audited and approved claims.

The Payroll Clerk and the Deputy Treasurer have computer access rights that are not compatible with other payroll duties they perform. The access rights allow them to activate and deactivate employees on the District's payroll system.

### **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 agree with our recommendations and indicated they planned to initiate corrective action.

# Introduction

## Background

The Oswego City School District (District) is located in the City of Oswego, the Towns of Minetto, Oswego, Scriba and Volney in Oswego County as well as the Town of Sterling in Cayuga 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. Responsibilities relating to the District's finances, accounting records and reports are largely those of the Assistant Superintendent for Business and the Treasurer. The Board annually appoints a Claims Auditor who assumes the Board's powers and duties in regard to approving or denying claims against the District.

There are seven schools in operation within the District, with approximately 5,400 students and 700 employees. The District's budgeted expenditures for the 2005-06 fiscal year are \$56.2 million, funded primarily with State aid, real property taxes and grants.

The District's financial difficulties have stirred contentious debate and raised concerns about the District's ability to maintain educational quality and adequately support programs. Staff reductions were made in both 2001-02 and 2003-04 and a hiring freeze was imposed in 2004-05. Also, mid-way through 2004-05 the Board directed that purchasing for the remainder of the year be limited to instructionally essential purposes and for reasons of health or safety. The Board has made additional staff reductions in 2005-06 which have increased the size of elementary classes and reduced the elective courses available at the secondary school level. In addition, extra-curricular activities have been reduced and certain summer school programs have been discontinued. Building repairs have been limited to only essential repairs.

To help identify areas of risk when planning the scope of our audit, we requested that District officials keep us informed regarding any suspected problems in District operations. Despite our request, District officials did not to alert us to their suspicions that money had been stolen from the school lunch fund. Subsequent to our audit field work, we were advised by District officials that a New York State

Police investigation into the suspected theft had taken place during our audit. Because this critical information was withheld from us, we were unaware of any problems with the District's student lunch program and therefore, we did not include it in our examination.

## **Objectives**

One of the objectives of our audit was to identify the factors behind the decline in the District's financial condition. Our other objective was to examine the District's internal controls over capital assets, purchasing, cash disbursements, payroll and computer operations. Our audit sought to answer the following questions:

- Has the Board been provided with the financial information it needs to effectively monitor and control District finances?
- Has the Board adopted realistic budgets, and utilized long-term planning to identify and manage future operating and capital asset requirements?
- Have District officials designed and implemented effective internal controls over selected financial activities?

## **Scope and Methodology**

Our audit examined the District's financial condition, fiscal monitoring activities and long-term financial planning for the period July 1, 2001 to June 30, 2005. We examined the District's internal controls over capital assets and inventories, procurement, cash disbursements and payroll for the period July 1, 2004 to June 30, 2005. We extended our evaluation of the computer controls related to these areas through December 31, 2005 to determine whether control weaknesses were corrected after the District's conversion to a new computer system in July 2005.

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 agree 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.

## Financial Condition

During the four-year period from July 1, 2001 to June 30, 2005, the District relied heavily on the use of fund balance to finance operations as expenditures for the period exceeded revenues by a cumulative \$8.36 million. The budgets adopted for these four years contained a cumulative appropriation of fund balance that totaled \$11.9 million. The District's general fund unreserved, unappropriated fund balance exceeded the statutory limit<sup>1</sup> at the end of both fiscal years 2000-01 and 2001-02. However, by the end of the 2004-05 fiscal year, the District's fund balance was only \$437,171, or about one-fourth of what it had been at the end of the 2001-02 when it was almost \$2.6 million. At the same time, reserves, excluding the reserve for encumbrances, totaled \$3.2 million, or just over half of the \$5.7 million of three years earlier. District officials appropriately reduced fund balance from the excessive levels of earlier years. However, with less fund balance available to finance the cost of operations, it has been increasingly important that District officials carefully monitor the District's finances, adopt realistic budgets, and develop long-range strategies for financing future operations.

The District's general fund revenues, and in particular, property taxes and related tax items have declined since 2000-01. (See Appendix C) Although the District's property tax rate rose 22 percent during the period, property tax revenue, including revenue from payments in lieu of taxes, actually declined by over \$3.3 million. The District's property tax revenues have been significantly impacted by Payment in Lieu of Tax Agreements (PILOTs) that were executed with Niagara Mohawk Power Corporation (NMPC). In 1998, a PILOT was entered into by the Oswego County Industrial Development Agency and NMPC. The agreement made a NMPC-owned electrical generating steam station facility exempt from District taxes. The seven-year agreement provided for declining annual PILOT payments to the District that were substantially less than the taxes that would have been levied on the property. In 2001, two more PILOT agreements were entered into with NMPC that made the Nine Mile I and II Nuclear Power Plants exempt from property taxes. These agreements also call for declining annual PILOT payments over ten years that are substantially less than what property taxes would have been.<sup>2</sup>

<sup>1</sup> School districts are prohibited from carrying forward to the next year an unreserved, unappropriated fund balance that exceeds two percent of the next year's budget.

<sup>2</sup> Appendix E details property taxes and PILOT payments over the last four years (does not include interest and penalties on taxes).

During the period we examined, the District's financial and budgetary reporting procedures were not adequate for purposes of properly monitoring the District's finances. Reports to the Board were not timely and the District's budgetary control procedures were not always followed. Our audit disclosed that the cost of employee benefits in the 2004-05 budget was significantly underestimated and was the primary reason that an additional \$1.36 million of fund balance was absorbed by operations than had been planned. We determined that balances reserved at year-end for encumbrances included amounts that did not represent true purchase commitments and which should not have been encumbered. These encumbrances appear to have been established for no other purpose than to provide additional appropriations in the ensuing year, thereby circumventing the budget process. In reviewing the District's appropriation of reserve fund balances, we found that the insurance reserve fund had not been legally established by the Board and that the moneys in the reserve have been unnecessarily restricted. Finally, the Board did not develop a long-term plan for meeting future operating and capital costs until early 2005 when the District was in the midst of a fourth consecutive year of declining revenues and rising expenditures.

### **Budgeting for Employee Benefits**

The development of realistic budgets is essential if the District is to avoid fiscal stress. District management should strive for structurally balanced budgets that enable operations to be financed without an over-reliance on fund balance or non-recurring revenue sources. Budgets should include reasonable estimates of recurring revenues and expenditures, consider the costs of all new activities or programs and reflect projected cost increases.

The District's budgets for 2003-04 and 2004-05 contained estimates for employee benefits costs that were significantly underestimated. The District's estimate of employee benefits costs in the 2004-05 budget did not reflect a reasonable budgetary response to what has been a clear and obvious trend in these costs over several years (see Appendix C). Employee benefits costs in the 2004-05 budget were estimated at an amount (\$9.7 million) that was 10 percent less than the actual costs incurred in 2003-04 (\$10.8 million) and 23 percent less than the actual costs for 2004-05 (\$12.7 million). Health insurance costs projections, in particular, were unrealistically low in the 2004-05 budget. They were estimated at just under \$6 million for 2004-05 after the District experienced costs of nearly \$7.4 million in 2003-04 and \$6.7 million in 2002-03. The actual cost of health insurance rose to nearly \$7.9 million in 2004-05, or almost \$1.9 million more than had been budgeted.

In addition, the cost of the District's required contributions to the State retirement systems were under-budgeted by \$865,000 in 2004-05. The cost related to the Teachers' Retirement System was more than \$1.4 million, but only \$640,000 was budgeted. This was partly due to an incorrect employee contribution rate used to calculate the cost of contributions. Although the Teachers' Retirement System had notified the District that a 5.63 percent contribution rate be used to calculate the estimated cost, the District used the previous year's rate of only 2.52 percent to develop its budget estimate. Additionally, the rate was incorrectly applied to 2003-04 salaries rather than to the estimated salaries for 2004-05. In addition, the District's costs associated with its contributions to the NYS Employees' Retirement System were \$816,000 for the year, but only \$711,000 was budgeted. We noted that the budget estimate for the Employees' Retirement System did not include all the accruable retirement costs that the District would recognize as expenditures in 2004-05.

Despite budget amendments during the year that included the appropriation of over \$1 million from reserves, the actual cost of employee benefits in 2004-05 exceeded the budget by nearly \$1.4 million after adjusting for encumbrances. As a result, the general fund was overexpended as a whole for the year with expenditures and year-end encumbrances exceeding available appropriations in the amended budget by over \$1.2 million.

**Monitoring  
Financial  
Condition**

Our audit disclosed that the Board did not always receive timely financial information and that District officials did not always comply with the District's adopted policies and procedures for amending the annual budget. As a result, the Board could not effectively monitor District finances and budget transfers were made without required approvals.

Timely Financial Reports — The Board needs accurate and current financial information to effectively oversee the District. Without such information, the Board cannot make informed decisions about the annual budget or about other fiscal matters. The Commissioner of Education's regulations for school districts require that school district treasurers provide the Board with monthly cash balance and reconciliation reports. The treasurer must also present the Board with budget status reports at least quarterly; monthly if budget transfers were made. The purpose of these reports is to help ensure that the Board receives the timely information it needs to monitor district spending and revenues against the annual budget and to stay apprised of the District's cash position and financial condition throughout the fiscal year.

We reviewed the District's internal financial reporting activity for the period July 1, 2001 through June 30, 2005 and found that the Board frequently did not receive cash balance and reconciliation reports and budget status reports on a timely basis. For example, the minutes of Board meetings indicated the following:

- Budget status reports for the period August 2002 through March 2003 were not presented to the Board until June 17, 2003, just two weeks prior to the end of the fiscal year.
- The budgetary report for July 2003 was not received by the Board until November 18, 2003. Similar delays were noted with respect to the monthly cash and reconciliation reports.
- No cash and reconciliation reports for 2002-03 were received until May 2003 when the Board was presented with the reports for the period July 2002 to February 2003. The cash and reconciliation reports for October to December 2003 were not received until May 2004.

District officials indicated that computer software problems in 2002 caused the significant delay in the preparation of both the budgetary reports and the cash balance and reconciliation reports for 2002-03. However, substantial reporting delays continued into late 2004, though a marked improvement in the timeliness of these reports was noted during the 2004-05 fiscal year.

Interim financial reports and budget status reports are important tools that the Board can use to monitor District finances. The delays in receiving these reports prevented the Board from possessing the timely information needed to accurately assess the District's fiscal condition and to take pre-emptive steps that might have helped diminish the financial difficulties now being experienced.

Budget Transfers — According to the District's written policy, the Superintendent is allowed to approve budgetary transfers of \$2,000 or less during the year. Transfers of over \$2,000 and all transfers from the contingency account require Board approval. A list of all transfers approved by the Superintendent is to be provided to the Board on a monthly basis. To document requests for budgetary transfers the Board has adopted a preprinted form that is to be signed by the originator (department head), the Assistant Superintendent for Business and the Superintendent. To provide for year-end expenditures and to expedite the closing of the books, the Assistant Superintendent for Business has been given authority to make all necessary transfers between

appropriation accounts at the end of the year.<sup>3</sup> All transfers made by the Assistant Superintendent for Business are to be presented to the Board for confirming approval at the next regularly scheduled Board meeting.

Our review of the District's budgetary control procedures for the years 2001-02 through 2004-05 showed that in actual practice the District's procedures deviated considerably from those in the written policy. For instance, in 2001-02 and 2002-03, budget transfer request forms were signed by the Assistant Superintendent for Business but not by the Superintendent. In 2003-04 request forms were signed only by the originator of the request and by the District's Purchasing Agent. Neither the Assistant Superintendent for Business nor the Superintendent signed requests. Only request forms for 2004-05 had all of the required signatures.

Also, contrary to District policy, we found no indication that the Board received a complete listing of all the general fund budgetary transfers made by the Assistant Superintendent of Business at the end of the 2002-03 and 2003-04 fiscal years. District records show that a total of more than \$4.8 million in budgetary transfers were made in May and June 2003 by the Assistant Superintendent for Business. However, the Board was only provided with a list that included transfers totaling \$3.1 million, or about \$1.7 million less. In May and June 2004, \$4.0 million in transfers were made but only \$1.8 million was reported to Board. Consequently, over \$2.2 million in budgetary transfers were not presented to the Board for its confirming approval.

We also noted that the year-end budget transfer reports that were presented to the Board only included those transfers of \$2,000 or more. Since the District's policy with respect to transfers made by the Assistant Superintendent for Business states that a list of "all such transfers" shall be compiled and reported to the Board "for confirming approval," transfers of less than \$2,000 should be included in the listing.

The policies and procedures that have been adopted by the District for amending the budget were designed to establish an orderly process for requesting, approving and reporting necessary budget modifications and to ensure that the Board, being responsible for the District's fiscal management, remains an integral part of that process. When these policies and procedures are not complied with, there is an increased risk that the Board's authority may be circumvented and that inappropriate and/or unapproved budgetary transfers may be

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<sup>3</sup>Although not stated in the written policy, the "end of the year" has been interpreted by District officials to mean the last two months of the year.

made. Budget transfer reports are the mechanism that the Board uses to review, approve or confirm the approval of budgetary amendments. They also help the Board in monitoring the District's budget and its spending. However, when these reports are significantly inaccurate, as we noted above, the Board is effectively removed from the approval function for substantial changes in the District's adopted annual spending plan.

## **Encumbering Practices**

Encumbrances are obligations in the form of unfilled purchase orders or unperformed contracts. An appropriation is reserved at the time orders are placed or contracts approved, and prior to the actual expenditure of funds. Encumbrances that exist at the end of the fiscal year are carried over to the next year and appropriations that have been budgeted for the next year are increased accordingly. Every encumbrance should represent a valid commitment for a specific future expenditure and should not be established simply as a means of making additional appropriations available in the following year. Encumbrances that are established without a genuine purchase or contractual commitment inflate reserved fund balance and circumvent the budget process. We found that in at least two years the District's encumbering practices resulted in significant amounts of year-end encumbrances that did not represent true commitments for specific future purchases or services.

The District's audited financial statements for the four years prior to 2003-04 reported large amounts of year-end encumbrances. The District reported the following amounts in its reserved for encumbrances:

Fiscal Year	Encumbrances
1999-00	\$ 835,115
2000-01	\$ 905,614
2001-02	\$1,546,084
2002-03	\$1,401,522

At the end of the 2003-04 fiscal year, the District carried \$665,817 in encumbrances; however, this balance was reduced by \$295,643 after the District's Certified Public Accountant concluded that the corresponding encumbrances did not meet the criteria for encumbering. In 2004-05, only \$140,862 was encumbered at the end of the year, significantly less than earlier years.

We performed a limited analysis of encumbrances that were reported at the end of 2001-02 and 2002-03, the two years with the largest amount encumbered and found that certain large purchase orders

encumbered and carried over to the following year were often later cancelled. However, the encumbered appropriations were not liquidated. Instead, the related appropriations were transferred to increase appropriations and cover expenditures in other accounts. For instance, an encumbrance related to a \$500,000 purchase order dated June 30, 2002 for energy consultant services was carried over to 2002-03. Records for 2002-03 show that the purchase order was cancelled almost a year later on May 14, 2003 and the \$500,000 appropriation was transferred to cover expenditures in 13 different accounts. While a total of \$637,800 in encumbrances was carried over to the energy consultant services account at the beginning of 2002-03, only \$112,360 in expenditures were ultimately charged to the account during the entire year.

A \$200,000 encumbrance reported at the end of the 2002-03 year was handled in a similar manner. A purchase order was created on May 15, 2003 and the encumbrance was carried over to the next year. A year later, on May 18, 2004, the \$200,000 purchase order was cancelled and the related appropriations used to cover expenditures in several other accounts.

Although the transfer of appropriations (except those of less than \$2,000) were included in the budget transfer report provided to the Board by the Assistant Superintendent for Business, the report did not indicate that the source of some of the appropriations being transferred was cancelled purchase orders encumbered in the previous year. The creation and subsequent cancellation of the above-mentioned purchase orders raises questions about their validity and suggests an encumbering practice designed to provide future appropriations outside the proper budget process. This serves to understate appropriations in the annual budget and denies those voting on the budget a true estimation of the cost of the next year's operations. It also reduces the effectiveness of the annual budget as a tool to manage the District's financial affairs.

## **Reserve Funds**

Reserve funds are created under various laws and are used to finance the cost of a variety of objects or purposes. The legal statutes under which the reserves are established (or sometimes mandated) determine how the reserves may be funded, expended and discontinued. Insurance reserves are created under General Municipal Law, §6-n. Moneys of an insurance reserve may be used to pay for certain liability and casualty losses arising from judgments, actions and claims against the District and may not be expended or appropriated for other purposes.

The District has set aside moneys in five different reserve funds that have been utilized extensively over the last four years to help finance operations. Reserve funds (not including the reserve for encumbrances and the mandatory reserve for debt) totaled over \$6 million at the end of 2001-02, but by the end of the 2004-05 they aggregated only about \$3.2 million. In addition, the insurance reserve fund was not legally established.

There was a net reduction in total reserve funds of over \$1.7 million during 2004-05 year, which was due in part to an end-of-year budget transfer that effectively reclassified \$680,000 in reserved fund balance as unreserved fund balance making it available for appropriation in the 2005-06 budget. The year-end budget transfer included \$146,000 that was transferred from a reserve the District has reported as an “insurance reserve fund.” Despite it being identified as such, we found no evidence that the Board had, in fact, created such an insurance reserve. The June 1993 Board resolution establishing this reserve identified it as a “Hospital/Medical Insurance Reserve” and cited no statutory basis for its creation. We found no legal authority for the District to establish a reserve for hospital and medical insurance and have concluded that the \$2.2 million in the District’s insurance reserve fund at June 30, 2005 is not a valid reservation of fund balance. Holding moneys in an invalid reserve fund unnecessarily restricts the use of these moneys and prevents its use for other purposes such as general operations.

## **Multi-year Financial Planning**

Multi-year financial planning is a critical tool for school districts and particularly important for districts that are financially stressed. Planning on a multi-year basis helps identify structural imbalances between revenues and expenditures and allows school officials to set long-term priorities and goals. Projecting operations for several years into the future provides a basis for assessing the impact and merits of alternative approaches to addressing financial problems. It also helps in leveling the rate of tax increases and in avoiding sudden and severe cost-cutting measures. Any long-term financial plan should be monitored and updated on an ongoing basis to ensure that decisions are guided by the most accurate information available.

The District was in its fourth consecutive year of fiscal decline before the Board took steps toward developing a long-term financial plan for the District. In March 2005, District officials prepared multi-year projections of revenues, expenditures and fund balances and presented to the Board a long-range plan for financing District operations including proposed strategies for cutting costs, eliminating future operating deficits and creating structural balance in future budgets. Also, in August 2005, the District retained the services of an

architectural and consulting firm to begin development of a five-year capital plan.

A prospective view of District finances using a comprehensive multi-year financial plan may have allowed District officials to better identify and manage the fiscal challenges that the District now faces.

## **Recommendations**

1. In order to properly monitor the District's fiscal affairs and annual budget, the Board should require timely and complete financial and budgetary information throughout the year.
2. The Board and District managers should comply with the District's adopted policies and procedures for amending the budget.
3. The Board should ensure that accurate estimates of employee benefit costs are included in the District's annual budget.
4. Year-end encumbrances should only be established for valid commitments of specific future expenditures.
5. The Board should review and comply with the statutory requirements regarding the creation and use of reserve funds. Moneys that currently exist in the District's invalid "insurance reserve" should be returned to unreserved fund balance and made available for appropriation unless the Board elects to use the moneys to create a legal reserve.
6. The District should continue long-term financial planning for future operational and capital requirements. Multi-year financial plans should be updated annually and reviewed/evaluated by the Board. The Board should modify the plans and projections as necessary and use them to measure the District's progress toward achieving and sustaining fiscal stability.

## Claims Auditor

The audit and approval of claims is one of the most critical elements of the District's internal control system. The appointment of a highly ethical, inquisitive Claims Auditor who has a clear understanding of the duties and responsibilities of the position provides a level of assurance that District funds will be properly expended for authorized purposes. Education Law requires that the Claims Auditor report directly to the Board and not to any other school district staff or management. The Claims Auditor's ability to act in a totally independent manner could be compromised if he/she is placed under the supervision or control of other school district personnel. Education Law also provides that the Claims Auditor should not be directly involved in accounting and purchasing functions of the school district. Such an arrangement could place the claims auditor in the position of approving the payment of claims that he/she had initiated.

We identified several deficiencies with the District's claims auditing function. The Claims Auditor does not report directly to the Board and her regular District job is not compatible with her claims auditing duties. In addition, the Board has not developed written procedures or guidelines for the audit of claims and no job description or list of duties has been adopted for the position of Claims Auditor. Finally, we noted that the Claims Auditor does not compare the actual approved claims with the warrant of claims prepared by the Treasurer's office.

### **Incompatible Duties and Reporting to the Board**

The Claims Auditor serves as the District's Benefits Coordinator and reports to the Assistant Superintendent for Personnel and Human Resources. The Benefits Coordinator's duties include preparing claims for Medicare reimbursements paid by the District to retired employees. The Claims Auditor is responsible for the audit and approval of these same claims. Therefore, the Claims Auditor's duties are incompatible because she can approve transactions that she initiated. This could lead to errors or irregularities occurring and not being promptly detected. We examined 15 of the 270 Medicare reimbursement claims that were paid in September 2004. Our testing disclosed no questionable payments.

In addition, the Claims Auditor does not report directly to the Board and does not consult with the Board regarding questions about claims. Instead, the Claims Auditor works under the direction of the Assistant Superintendent for Business whose duties include supervising the

accounting function and approving all District purchase orders. Internal control suffers under this arrangement because the Board is not alerted to questions or concerns that might arise during the claims audit process. Also, by involving the Assistant Superintendent for Business in the claims audit process, the audit function is not adequately separated from the procurement and accounting functions that the Assistant Superintendent oversees.

### **Job Description and Audit Procedures**

Although the Claims Auditor is guided by the District's purchasing policy and other written policies governing travel and conference attendance, officer and employees' expense reimbursements, and credit card use; the Board has not adopted any written procedures dealing specifically with the examination of claims. In addition, there is no written job description or a list of duties for the position of Claims Auditor.

The effectiveness of the District's claims audit process is enhanced when those responsible for the audit of claims are provided with clear and concise written policies, rules and procedures to follow in the performance of this vital internal control activity. Also, a written description of the specific duties of the Claims Auditor is an effective way to communicate the Board's expectations for the position. Uncertainty on the part of the Claims Auditor about his/her responsibilities or any aspect of the audit process could lead to improper payments being made.

### **Comparison of Approved Claims and Warrant**

Although the Claims Auditor compares the warrant of audited claims with corresponding checks, she does not compare the warrant with the actual audited claims. The Claims Auditor transmits the audited and approved claims to the Treasurer's office where checks are printed and a warrant listing all audited claims is prepared. Once this part of the process has been completed by the Treasurer, the warrant and the printed checks, but not the claims, are sent to the Claims Auditor for review and certification. The Auditor's signature certifies that the listed claims have been audited and it directs that the Treasurer pay them.

The Claims Auditor does not prepare any record or list of the audited and approved claims for comparison to the warrant. Consequently, the Auditor's ability to assess whether the warrant is a complete and accurate listing of the claims previously audited and approved rests solely on her memory. Since several hundred claims are typically processed in a month,<sup>4</sup> we question whether it is possible to ascertain

<sup>4</sup>For example, we noted that 641 payments were approved by the Claims Auditor for one month that we reviewed.

that the warrant and corresponding checks were accurate without comparing them with the actual approved claims or a record/listing prepared as the audit of claims is performed.

Our audit tests of 66 payments made during 2004-05 disclosed no inconsistencies between warrants, claims and cancelled checks. However, the current practice of certifying the amounts on the warrant without comparing the warrant and corresponding checks with the actual claims increases the risk that payment errors or irregularities could occur and not be detected.

## **Recommendations**

7. The Claims Auditor should not perform other duties that are incompatible with her duties and responsibilities as Claims Auditor.
8. The Claims Auditor should report directly to the Board.
9. The Board should develop written procedures and guidelines for the examination and approval of claims.
10. The Board should provide the Claims Auditor with written guidance that clearly communicates the duties and responsibilities of the position, as well as the Board's expectations.
11. The claims audit process should include a comparison of the actual audited vouchers or a list of approved claims with the warrant of audited and approved claims.

## Computer Access and Segregation of Duties

An effective system of internal control over computer operations requires that District employees' computer access be compatible with their duties. When individuals are allowed access to computer data or functions that are outside the scope of their responsibilities, there is an increased risk that data could be manipulated and that improper transactions could be initiated. Therefore, it is important that appropriate supervisory personnel assign individual computer access rights in a manner that separates incompatible duties. The computer system should be programmed to restrict individuals' access to only those transactions that are necessary for the performance of their jobs and the system should be capable of recording and generating reports of changes made to computer data.

For over 20 years the District used an AS400 IBM computer system that was largely developed in-house by the District's Information Technology Department. In July 2005, the District converted to a new software package known as Finance Manager that replaced almost all functions that had previously been performed on the AS400 system. AS400 system programs continue to be used for capital asset inventory purposes, tax collection and certain payroll data collection activities.

We reviewed the computer controls that existed during 2004-05 when the AS400 system was in use and determined that personnel in the Business Office<sup>5</sup> had access to computer applications that were not compatible with their duties. Because the District changed to a new computer system during the time of our audit field work, we extended our review of computer controls to December 31, 2005 to assess whether appropriate restrictions to access had been instituted in the new computer system.

The AS400 computer system's business applications included purchasing, general ledger accounting, accounts payable, cash receipts, budget preparation, budget monitoring, payroll processing, capital assets, warehouse inventory and tax collection among others. With few exceptions, all Business Office personnel had access to all applications in the business menu. For example, the Purchasing Clerk, Accounts Payable Clerk and the Assistant Accounts Payable Clerk had access rights that would have allowed them to post entries to

<sup>5</sup> The Business Office is comprised of the Assistant Superintendent for Business, Treasurer, Deputy Treasurer, Purchasing Agent, Purchasing Clerk, Accounts Payable Clerk, Assistant Accounts Payable Clerk, Payroll Clerk, Assistant Payroll Clerk, and the Director of the School Lunch Fund.

the general ledger, make budget adjustments and perform numerous other computer functions that were unrelated to their job duties. As a result, critical District information was vulnerable to unauthorized manipulation or possible loss. The Director of Information Technology instructed employees in the Business Office to only use those applications necessary for the performance of their duties and they were trusted to adhere to that rule.

When implementing Finance Manager, the Assistant Superintendent for Business assessed computer access requirements of the Business Office staff and imposed restrictions to limit employees' access to only those computer functions deemed necessary for the proper performance of their duties. These new access restrictions have helped to alleviate the most significant internal control weaknesses that existed with the AS400 system. However, weaknesses still exist because two Business Office staff have been assigned duties and have computer access rights that allow them to perform incompatible functions. Moreover, the computer system currently is not capable of reporting any inappropriate changes to computer data that might occur because of this control deficiency.

The Payroll Clerk is involved in several aspects of the District's payroll process including inputting employees' timesheet information to the computer system, printing payroll checks, generating payroll reports and sealing payroll checks in envelopes. The Payroll Clerk has also been assigned responsibility and given computer access rights for activating and deactivating employees on the system. The Deputy Treasurer has similar access rights and is responsible for performing these duties in the absence of the Payroll Clerk.

The ability to activate or deactivate employees on the payroll system should not be given to those involved in other key areas of the payroll process such as entering timesheet information, printing checks or handling checks after they have been signed. Such an arrangement could increase the risk of payments to former employees, who have not been properly deactivated, or of payments to fictitious employees. In fact, our review of the District's employee master file disclosed that at September 30, 2005, two employees, who were listed as active employees, had not been employed by the District since the 2003-04 school year. We determined that neither of these individuals received compensation from the District after their employment ended.

At the time of our field work, reports detailing changes made to employees' payroll information were not being generated by the District's computer system. The absence of change reports makes

monitoring of changes more difficult and increases the risk that any unauthorized modifications or errors will not be promptly detected.

## **Recommendations**

12. Because of their involvement in other key areas of the payroll process, the Payroll Clerk and the Deputy Treasurer should not have computer access rights that would allow them to activate or deactivate employees in the payroll system.
13. To allow proper monitoring of changes made to employee payroll information on the District's computer system, District officials should take steps to acquire the necessary computer capabilities for automatically recording and reporting when changes are made.

## Capital Assets

Capital assets are those assets that have a useful life of more than one year and include land, buildings and building improvements, furnishings, vehicles, computers and other electronic equipment. District officials must ensure that capital assets are protected from loss, that their value is maintained and that they are used effectively. This can be achieved by adopting policies, maintaining perpetual inventory records, conducting periodic physical inventories and establishing other safeguards such as tagging all assets with unique control numbers that identify individual assets and signify that the assets belong to the District. Periodic physical inventories help ensure the accuracy and completeness of recorded amounts and identify obsolete or missing assets. The District's capital assets represent a significant investment of resources. At June 30, 2005, the District reported \$83.8 million in capital assets of which \$77.2 million was for land, buildings and improvements, and \$6.6 million was for equipment.

The District adopted its capital asset policy in 1999. According to the policy, the Assistant Superintendent for Business has responsibility for "maintaining a continuous and accurate inventory of equipment owned by the District." The policy requires that a property record be maintained for each asset which should contain, where possible: date of acquisition, description, cost or value, location, responsible official, estimated useful life, and the date and method of disposition. It further requires that the assets be inventoried annually and that discrepancies between the inventory and the District's property records be explained.

A comprehensive physical inventory of all District assets valued at \$500 or more was taken in 1999-2000 and a numbered identification tag was attached to each asset counted. However, a perpetual inventory record of the assets was not established and the District has not conducted another physical inventory of its capital assets since that time. In September 2003, the Board increased the minimum asset value for inventory control purposes directing that only assets valued at \$1,000 or more should be tagged and included in inventory.

Our audit disclosed that the District's procedures with regard to its capital assets do not conform to adopted policies and that control over District assets needs to be improved. We found that the only inventory record maintained for the District's capital assets was a computer spreadsheet that is used to account for those assets valued

at \$5,000 or more. We were informed by District personnel that the primary purpose of this record is to provide detailed support for assets reported on the District's annual financial statements. The spreadsheet does not include such information as the location of various assets or identifying numbers that correspond with asset tag numbers. Also, we noted that the record did not reflect asset dispositions that occurred in 2004-05. None of the 20 asset dispositions listed in the 2004-05 asset disposal summary were recorded in the inventory record.

We selected 11 assets to determine whether the assets had been tagged as required by the District's capital asset policy. Of the 11 assets selected, only one had a tag to identify it as District property. Untagged items included a sand and salt spreader valued at \$6,000; a video lab cart that was purchased for \$1,025; and a \$1,500 laminator.

Incomplete asset inventory records, the failure to affix identifying tags on all District assets, and the absence of annual physical inventories increases the risk that District assets could be lost or misused without timely detection by responsible District officials.

## **Recommendations**

14. The Board should take steps to ensure that the District's capital asset policies are complied with.
15. All capital assets included in the District's inventory should be tagged with unique control numbers that identify the individual assets and signify that the assets belong to the District.

## Procurement

Every school district should have written policies and procedures governing the procurement of all goods and services. Written policies and procedures foster a greater degree of accountability on the part of school district officials involved in the procurement process and provide greater assurance that procurements will be based upon the best interests of the taxpayers. General Municipal Law sets forth requirements for competitive bidding. It also requires that school districts adopt policies to ensure that competition is sought for procurements that fall below the dollar thresholds for competitive bidding. Competition provides the greatest assurance that goods and services of the desired quality are acquired in the most prudent and economical manner at the lowest possible price and that procurement is not influenced by favoritism, improvidence, extravagance or fraud.

We reviewed the District's adopted policies and procedures over purchasing to assess their adequacy and also to determine whether the District's purchasing practices complied with those policies and procedures. We found that the District utilizes "open accounts" when purchasing from certain vendors, a practice that does not comply with its purchasing policies and procedures.

For several years the District's business office established what was referred to as "open accounts" with certain vendors. An open account with a vendor permitted District personnel to make purchases from that vendor up to a pre-established monthly dollar limit without requiring requisitions and approved purchase orders. At the end of each month, a confirming purchase order was prepared listing all the invoices for the purchases that had been made. During 2004-05, 16 different vendors had open accounts with the District. The District conducted business with 10 of the 16 vendors and made purchases totaling about \$154,000 during the year. An open account is more commonly referred to as a blanket purchase order.

The use of open accounts circumvents the District's normal purchasing procedures which require an approved purchase order prior to committing the District to the purchase of goods or services. There is nothing in the District's purchasing policy that permits the use of open account agreements. In July 2005, the District discontinued this longstanding practice.

For reasons of efficiency, however, the Board may ultimately decide that the limited use of open accounts/blanket purchase orders is appropriate. Blanket purchase orders eliminate the necessity for the issuance of separate purchase orders for small dollar items (i.e., automotive supplies) which are purchased frequently from the same vendor. They also allow purchasing of items on an “as needed” basis. However, the use of blanket purchase orders should be carefully controlled with established limits, rules and procedures set forth in the District’s purchasing policy.

A verbal purchase order, subject to subsequent confirmation by a written purchase order, may sometimes be necessary in cases of emergency or other instances where immediate action is required. The District’s purchasing policy includes guidance with respect to emergency purchases and exceptions to competitive bidding requirements, but the policy does not address confirming purchase orders. Without established rules and procedures for the use of confirming purchase orders, District personnel may be uncertain as to the correct actions to take in the event of emergency situations requiring immediate procurement.

## **Recommendations**

16. If, for reasons of efficiency, District officials decide that the use of blanket purchase orders is appropriate, their use should be strictly controlled with established limits, rules and procedures set forth in the District’s procurement policy.
17. The Board should consider adopting specific written rules and procedures for the use of confirming purchase orders.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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



Education Center

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November 13, 2006

Office of the State Comptroller  
Syracuse Regional Office  
State Office Building, Room 409  
333 East Washington Street  
Syracuse, NY 13202

To Whom It May Concern:

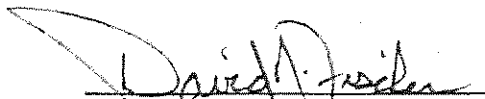
The Oswego City School District wishes to express its gratitude to the Office of the State Comptroller for extending its resources to perform an audit review requested by the District. We are certainly aware that your resources were stretched in assisting our District with this review.

Your audit which examined the District's internal controls over capital assets, purchasing, cash disbursements, payroll and computer operations has provided sound recommendations to improve our procedures and controls over generally accepted accounting principles.

The District has performed an initial review of your findings and have found them to be correct in their presentation in this document entitled "Oswego City School District, Financial Condition and Internal Controls over Financial Operations, Report of Examination, Period Covered: July 1, 2001 – December 31, 2005, 2006M-85".

The Board and management will review your recommendations and within ninety (90) days submit a plan of action that addresses the recommendations in this report pursuant to Section 35 of the General Municipal Law.

Respectfully,

  
David N. Fischer  
Superintendent of Schools

  
William "Dave" White  
Board of Education President

/jac

## APPENDIX B

### AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objectives relating to the District's financial condition, we reviewed financial accounting records, annual financial reports, budgets, interim financial and budgetary reports, PILOT agreements and long-term operating and capital plans. We also reviewed relevant New York State laws, pertinent regulations of the New York State Commissioner of Education, minutes of the meetings of the Board and the various internal policies and procedures that have been adopted by District management for budgetary and fiscal control. We also interviewed District officials and other personnel.

To assess the adequacy of the internal controls put in place by District officials, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. We interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents such as District policies and procedures, 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 cash disbursements, procurement of goods and services, capital assets and inventories, and compensation for personal services for further audit testing.

- We interviewed appropriate District officials in order to obtain an understanding of the organization, the District's accounting system and to identify key personnel.
- We obtained copies of District policies and procedures and evaluated the adequacy of these policies.
- We reviewed the District's EDP system for control weaknesses. Our purpose was to determine if controls over the District's EDP system were lacking or circumvented, and to recommend procedures to strengthen internal controls over computer-generated financial records.
- We conducted tests to determine that cash disbursements and other bank activity were properly accounted for, adequately supported and approved.
- We verified that bank reconciliations were properly completed and performed tests to confirm the sequential integrity of checks.
- We tested procurement transactions for compliance with statutory bidding requirements and with the District's procurement policy, and reviewed vendor history files, warrants of paid claims and other expenditure data to identify unusual purchases.

- We examined individual claims to determine that they were supported by adequate documentation and that they had been audited and approved by the Claims Auditor before they were paid. We also determined if the related purchases had been authorized prior to receipt of the goods/ services and if the purchases were necessary and for proper District purposes. We conducted tests to verify that purchased items had actually been received.
- We examined policies, record keeping and physical and procedural safeguards relating to District capital assets. We conducted tests to physically verify that selected capital assets were received and on hand.
- We reviewed time records, payroll journals, leave time records, personnel files, collective bargaining agreements and employee contracts, and performed tests to determine if employees' compensation for personal services was correct.

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 C

### REVENUES AND EXPENDITURES

	2000-01	2001-02	2002-03	2003-04	2004-05
<b>REVENUES</b>					
Real Property Taxes	\$45,016,942	\$42,931,315	\$42,022,182	\$38,764,717	\$39,613,763
Charges for Services	49,694	39,759	22,755	61,674	64,998
Use of Money and Property	1,372,677	625,127	329,667	248,079	260,410
Sale of Property and Comp for Loss	17,661	6,596	39,025	227,000	20,564
Miscellaneous	734,469	937,511	1,089,511	355,193	493,439
Interfund Revenues	142,175	103,013	139,306	196,784	244,869
State Sources	7,050,515	7,034,560	7,771,497	9,583,709	9,890,687
Federal Sources	410,874	399,520	395,096	749,159	901,307
Total Revenues	\$54,795,007	\$52,077,401	\$51,809,039	\$50,186,315	\$51,490,037
Interfund Transfers	0	0	0	170,000	0
Total Revenues (and Transfers)	\$54,795,007	\$52,077,401	\$51,809,039	\$50,356,315	\$51,490,037
<b>EXPENDITURES</b>					
General Support	\$8,308,586	\$7,944,583	\$7,557,463	\$6,734,376	\$6,697,433
Instruction	31,557,149	31,000,742	32,263,909	32,043,838	32,268,322
Pupil Transportation	2,049,139	2,025,353	2,103,490	2,157,417	2,228,041
Employee Benefits	8,516,692	10,066,333	9,734,259	10,851,749	12,727,108
Debt Service	1,652,395	1,576,248	1,178,081	1,148,844	846,000
Total Expenditures (and Transfers)	\$52,083,961	\$52,613,259	\$52,837,202	\$52,936,224	\$54,766,904
Interfund Transfers	29,230	52,560	251,537	52,783	583,733
Total Expenditures (and Transfers)	\$52,113,191	\$52,665,819	\$53,088,739	\$52,989,007	\$55,350,637
Operating Surplus (Deficit)	\$2,681,816	(\$588,418)	(\$1,279,700)	(\$2,632,692)	(\$3,860,600)

## APPENDIX D

### CHANGES IN FUND BALANCE

Fiscal Year End	2000-01	2001-02	2002-03	2003-04	2004-05
Worker's Compensation Reserve	\$109,653	\$109,653	\$109,653	\$109,653	\$11,028
Unemployment Ins. Reserve	631,519	606,616	594,480	517,819	163,819
Reserve for Liability	1,526,103	1,526,103	1,526,103	1,526,103	683,103
Insurance Reserve	2,926,665	3,236,785	3,228,483	2,572,278	2,226,278
Reserve for Tax Certiorari	520,118	613,511	591,305	291,305	194,305
	\$5,714,058	\$6,092,668	\$6,050,024	\$5,017,158	\$3,278,533
Reserve for Encumbrances	\$905,614	\$1,546,084	\$1,401,522	\$370,174	\$140,862
<b>Total Reserved Fund Balance</b>	<b>\$6,619,672</b>	<b>\$7,638,752</b>	<b>\$7,451,546</b>	<b>\$5,387,332</b>	<b>\$3,419,395</b>
Unreserved Fund Balance Appropriated in Next Budget	\$3,711,158	\$3,000,000	\$2,650,000	\$2,500,000	\$680,000
Unreserved Fund Balance Not Appropriated	\$2,567,146	\$1,670,806	\$928,311	\$509,834	\$437,171
<b>Total Fund Balance End of Year</b>	<b>\$12,897,976</b>	<b>\$12,309,558</b>	<b>\$11,029,857</b>	<b>\$8,397,166</b>	<b>\$4,536,566</b>

## APPENDIX E

### REAL PROPERTY TAXES AND OTHER TAX ITEMS

	2000-01	2001-02	2002-03	2003-04	2004-05
Real Property Taxes	\$33,430,881	\$31,809,719	\$14,042,129	\$15,599,228	\$16,287,206
PILOT Agreements	9,275,562	7,322,788	23,054,560	17,697,909	17,455,612
School Tax Relief (STAR)	2,258,100	3,728,288	4,845,107	5,361,235	5,764,545
Total	\$44,964,543	\$42,860,795	\$41,941,796	\$38,658,372	\$39,507,363

## APPENDIX F

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# Oswego City School District Financial Condition and Internal Controls Over Financial Operations

Report of Examination

Period Covered:

July 1, 2001 - December 31, 2005

2006M-85

