



South Country Central School District Financial Condition and Purchasing

Report of Examination

Period Covered:

July 1, 2004 - December 31, 2005

2006M-77



Table of Contents

	Page
AUTHORITY LETTER	3
EXECUTIVE SUMMARY	5
INTRODUCTION	7
Background	7
Objective	7
Scope and Methodology	7
Comments of District Officials and Corrective Action	8
FINANCIAL CONDITION	9
Inaccurate Financial Information	9
General Fund Deficit	12
Tax Anticipation Notes	14
Recommendations	14
PROCUREMENT	16
Purchase Orders	16
Competitive Bidding	17
Professional Service Contracts	18
Recommendations	19
APPENDIX A Response From District Officials	20
APPENDIX B Audit Methodology and Standards	27
APPENDIX C How to Obtain Additional Copies of the Report	29
APPENDIX D Local Regional Office Listing	30

State of New York Office of the State Comptroller

Division of Local Government Services and Economic Development

October 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 district's 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 South Country Central School District — Financial Condition and Purchasing.

This audit was conducted pursuant to the State Comptroller's authority as set forth in Article 5, Section 1 of the State Constitution, and Article 3 of the General Municipal Law. The report contains opportunities for improvement for consideration by the school district officials.

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

Respectfully submitted,

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



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

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

The District is currently operating on a contingency budget funded primarily with State aid and real property taxes. Since the District is in a deficit position, District officials have obtained approval from the State Legislature to issue \$4.6 million in deficit financing bonds.

District purchasing policies outline responsibilities for District purchasing activities, including General Municipal Law requirements. District purchases for the 2004-05 fiscal year totaled approximately \$20 million.

Scope and Objective

The objective of our audit was to examine the District's controls over financial activities and purchasing for the period July 1, 2004 through December 31, 2005. Our audit addressed the following related questions:

- Did District officials accurately record and report the financial activities of the District to allow for timely evaluation of the District's financial condition ?
- Do internal controls over purchasing ensure the District meets its procurement needs in the most economical way possible?

Audit Results

District officials did not accurately record and report the District's financial activities to allow the Board to timely monitor and evaluate the District's financial condition. As a result, the general fund's balance deteriorated from a positive balance prior to the 2003-04 fiscal year to an unreserved fund deficit of \$4.6 million — 6 percent of the \$82 million budget for the 2004-05 fiscal year — as of June 30, 2005.

The Board and District officials are responsible for effective financial planning and management activities, which include maintaining and reporting timely and accurate financial information; preparing and adopting reasonable budgets; and ensuring District expenditures do not exceed the approved budget. However, District officials failed to regularly provide the Board with reliable financial data, and prepared financial statements that did not include accrued liabilities in the general fund. This misstatement was not detected by the District's external auditor. A subsequent audit by a new firm in November 2005 disclosed that the District's reported unreserved fund balance of \$2.1 million as of June 30, 2004 was actually a fund deficit of \$3 million — a \$5.1 million difference. About \$1.5 million of this difference was due to an accounting change required of school districts by the Government Accounting Standards Board. District budgeting practices, including consistently overestimating unclassified revenue and regularly appropriating significant amounts of unreserved fund balance to help finance District operations, also increased the deficit.

As a result, the Board approved budgets in 2004-05 and 2005-06 did not address the District's fund deficit, which increased to \$4.6 million as of June 30, 2005. We attribute the District's deteriorated financial condition to the lack of comprehensive policies and procedures for financial management and budgeting; District officials' failure to maintain accurate financial information and timely report such information to the Board; inadequate Board oversight of District officials' performance; and incompetent independent audits.

The District has adopted sound purchasing policies that clearly outline responsibilities for purchasing activities, require the use of a purchase order system and define when and how competitive bidding will be used to purchase goods and services. However, these policies are not consistently enforced. Of the 33 purchases we reviewed, 5 purchases totaling \$10,344 had no purchase orders, and 3 purchases totaling \$37,582 had purchase orders that were dated later than the related invoices. The District also paid \$31,000 for sports clothing and \$17,960 for copiers without soliciting bids, and obtained certain professional services without Board-approved contracts. As a result, the District may have overpaid for the above goods and services.

Comments of District Officials

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

Introduction

Background

The South Country Central School District (District) is governed by the Board of Education (Board), which comprises nine 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 6 schools in operation within the District, with approximately 4,750 students and 740 employees. Appropriations budgeted for the 2005-06 fiscal year totaled \$82 million. The District is currently operating on a contingency budget funded primarily with State aid and real property taxes. Since the District is in a deficit position, District officials have obtained approval from the State Legislature to issue \$4.6 million in deficit financing bonds.

The District has purchasing policies that outline responsibilities for District purchasing activities, including the use of a purchase order system and competitive bidding in conformance with General Municipal Law requirements. District purchases for the 2004-05 fiscal year totaled approximately \$20 million.

Objective

The objective of our audit was to examine the District's controls over financial activities and purchasing. Our audit addressed the following related questions:

- Did District officials accurately record and report the financial activities of the District to allow for timely evaluation of the District's financial condition?
- Do internal controls over purchasing ensure the District meets its procurement needs in the most economical way possible?

Scope and Methodology

During this audit, we examined the financial condition, budget preparation and purchasing procedures of the South Country Central School District for the period July 1, 2004 to December 31, 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 agreed with our recommendations and indicated they planned to initiate corrective action.

The District 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 your plan of action, you 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

The Board and District officials are responsible for effective financial planning and management activities, which include maintaining and reporting timely and accurate financial information; preparing and adopting reasonable budgets; and ensuring District expenditures do not exceed the approved budget. However, we found that District officials failed to regularly provide the Board with reliable financial data, and prepared financial statements that did not include accrued liabilities in the general fund. This misstatement was not detected by the District's external auditor. A subsequent audit by a new firm in November 2005 disclosed that the District's reported unreserved fund balance of \$2.1 million as of June 30, 2004 was actually a fund deficit of \$3 million — a \$5.1 million difference. Further, District budgeting practices, including consistently overestimating unclassified revenue and regularly appropriating significant amounts of unreserved fund balance to help finance District operations, have increased the deficit.

As a result, the Board approved budgets in 2004-05 and 2005-06 did not address the District's fund deficit, which increased to \$4.6 million as of June 30, 2005. We attribute the District's deteriorated financial condition to the lack of comprehensive policies and procedures for financial management and budgeting; District officials' failure to maintain accurate financial information and timely report such information to the Board; inadequate Board oversight of District officials' performance; and incompetent professional services.

Inaccurate Financial Information

District management needs timely and accurate financial information to monitor appropriations and revenues and to quickly and effectively deal with financial condition problems. The lack of timely and correct financial reporting from District officials, inaccurate financial statements, and lack of competent audit services were significant factors leading to the Board's failure to identify and take steps to address the District's deteriorating financial condition.

Inaccurate Annual Financial Report — The annual financial report for the fiscal year ended June 30, 2004, as prepared by the Assistant Superintendent for Business, overstated the unreserved general fund balance by approximately \$5 million. The main reason for this misstatement was that District personnel failed to record and report liabilities of approximately \$3.5 million, including unrecorded accounts payable (\$1.8 million), unrecorded retirement obligations

(\$1.4 million), and accrued payroll (\$304,000). The majority of the remaining \$1.5 million was attributable to an accounting change the District properly made to conform to Government Accounting Standards Board requirements issued in December 2004 (refer to the External Audit section, p. 11).

Missing, Late or Incorrect Periodic Financial Reports — The Assistant Superintendent for Business did not provide the Board with periodic trial balances showing current financial condition, and provided cash flow reports only during the last quarter of each year, when it would be too late to address cash flow problems. The Board received appropriation status reports (showing appropriations and expenditures to date and the available balance) during the year, but these reports were incorrect, since significant liabilities were not recorded as expenditures.

Lack of Budget Status Reports — The District's Treasurer did not provide the Board with quarterly budget status statements showing the status of the District's revenue and appropriation accounts to allow the Board to determine whether revenues are meeting expectations and appropriations are not over-expended. At a minimum, the revenue status report must show estimated revenues, amounts actually received as of the date of the report and estimated revenues for the remainder of the fiscal year. The appropriation status report must show at least original and revised appropriations, transfers and adjustments, expenditures to date, outstanding encumbrances, and balances in appropriations.

Inaccurate Financial Statements — The District's financial statements are required to be prepared in conformity with generally accepted accounting principles. District officials responsible for District finances must have a basic knowledge of these principles to prepare financial statements that are complete and accurate, and in a condition to allow them to be audited by an independent certified public accountant. The financial statements prepared by District officials for the fiscal year ended June 30, 2004 were inaccurate because they understated liabilities in the District's general fund by almost \$3.6 million. The effect of these understated liabilities, along with the \$1.5 million increase in liabilities due to the accounting change, resulted in a \$5 million overstatement in the general fund balance.

External Audit — Audited annual financial statements are designed to allow District officials, the Board and taxpayers to monitor public funds and to provide information on current performance that is needed to make future financial plans. The financial statements for the 2003-04 fiscal year were audited by the now-defunct firm of Miller,

Lilly & Pearce, LLP. However, these statements misrepresented the financial condition of the District. It was not until November 2005, when the Board received the report from a new public accounting firm it hired to audit the District's 2004-05 financial statements, that the errors in the 2003-04 financial statements were discovered. To correct the errors in the District's general fund balance sheet, the new firm had to make the following decreases in the unreserved fund balance for June 30, 2004:

Unrecorded Accounts Payable	(\$1,809,121)
Change in Accounting on Retirement Systems Contributions ¹	(\$1,435,878)
Unrecorded Retirement Obligation	(\$1,407,325)
Unrecorded Accrued Payroll	(\$ 304,718)
Net Effect of Other Miscellaneous Adjustments	(\$ 58,847)
 Total Decrease in General Fund:	 (\$5,015,889)

As a result of these adjustments, the unreserved fund balance of the general fund was restated from a positive balance of \$2.1 million to a fund deficit of \$3 million. The Superintendent and the Assistant Superintendent for Business claimed they were not aware that general fund liabilities were significantly understated at year end June 30, 2004.

District officials are entrusted with the District's fiscal management and are primarily responsible for recording transactions timely and accurately. They should possess sufficient knowledge in financial matters to enable them to evaluate financial issues and understand how such issues ultimately affect the District's financial condition. District management cannot afford to wait until an external audit is performed to make informed decisions about budgets and other fiscal matters affecting the operation of the District. The failure of District

¹ This change in the District's financial statements was made to comply with a new Government Accounting Standards Board (GASB) requirement, and was not made to correct an error. In December 2004, the GASB issued a technical bulletin that required school districts that prepare financial statements in accordance with Generally Accepted Accounting Principles (GAAP) to recognize an expenditure for required pension contributions attributable to the financial reporting period, and a liability for any of those contributions that remain unpaid at the end of the period. Previously, the District had recognized this expense at the time it paid its pension bill. Now the District was required to change from the cash basis of accounting to an accrual basis for this expense. This GASB guidance required the District, and many other districts, to restate the beginning 2004 fiscal year fund balance using a prior period adjustment to recognize the appropriate amounts of pension-related expenditure and liability for the prior fiscal year.

officials to prepare accurate financial statements and the failure of the external auditor to properly audit those statements resulted in District officials' preparing, and the Board's approving, budgets for the 2004-05 and 2005-06 fiscal years that did not address the general fund deficit.

General Fund Deficit

The general fund's unreserved fund balance deteriorated from a positive balance some time prior to the 2003-04 fiscal year to an unreserved fund deficit at June 30, 2005 of \$4.6 million — 6 percent of the \$82 million budget for the 2004-05 fiscal year. Due to the unreliability of financial statements audited prior to 2005, we did not try to determine the year the general fund fell into a deficit position. The causes of the fund balance deterioration were shortfalls in estimated unclassified revenue and appropriation of unavailable fund balance. During the 2004-05 fiscal year alone, the fund balance deteriorated by approximately \$1.6 million due primarily to a shortfall of almost \$900,000 in estimated unclassified revenue and the appropriation of \$1 million of non-existent fund balance in the 2004-05 budget. Prior period adjustments to financial statements indicate that the District may also have over-expended appropriations.

Budgeted Revenues — An annual budget must provide for sufficient financing sources to fund all expenditures included in the budget. Accurate estimates of revenue reduce the need to use unreserved fund balance at year end to compensate for shortfalls in revenue and ensure the property tax levy will be sufficient to meet operating expenses.

We analyzed the District's revenue trends for the 2002-03 through 2004-05 fiscal years and reviewed the estimated revenue for 2005-06. The following chart shows that District officials significantly overestimated unclassified revenue² during this period and included higher than historically realized amounts in the 2005-06 budget.

Overestimates of Unclassified Revenue			
Fiscal Year	Budget	Actual	Revenue Shortfall
2002-2003	\$1,051,000	\$85,336	\$965,664
2003-2004	1,000,000	131,622	868,378
2004-2005	1,000,000	108,410	891,590
2005-2006	\$625,000	\$60,530 *	NA

* Actual revenue through May 12, 2006 per unaudited District records

² Unclassified revenue included miscellaneous District revenue from a variety of sources (e.g., a BOCES reimbursement; a receipt from the Long Island Science Center; and a receipt from the South Country Little League).

The budget for 2006-07 includes \$525,000 as estimated revenue from unclassified sources. Since unclassified revenue never reached \$132,000 in any of the four prior years, there is no reasonable basis for including a \$525,000 figure for estimated revenue. Thus, the District's shortfall in unclassified revenue in 2005-06, and the likeliness of a shortfall again in 2006-07, will only add to the District's worsening financial condition.

Budgets consistently overestimated revenue because District officials did not include data about the actual revenue raised in prior years or current year operating results in preparing the budget for the upcoming year. In budgeting, it is essential to review actual revenue data for prior years and up-to-date financial data for the current year to accurately estimate revenues and appropriations for the next fiscal year. However, the District's proposed budget for the 2005-06 fiscal year, prepared by the Assistant Superintendent for Business, included only estimated revenues and appropriations for 2004-05 and actual expenditures for 2002-03 and 2003-04; it did not include actual revenues for 2002-03 or 2003-04, or actual revenues and appropriations for 2004-05 through March 31, 2005.

Appropriation of Fund Balance — School districts are permitted to maintain an unreserved fund balance (not to exceed 2 percent of the upcoming year's budget appropriations) as a cushion against unforeseen circumstances, such as revenue shortfalls and over-expenditure of appropriations. Districts can appropriate a portion of that unreserved fund balance in the subsequent year's budget to help finance operations and reduce the need for tax increases.

The District's proposed budget for the 2004-05 fiscal year included an appropriation of \$1 million of fund balance to help finance District operations for that fiscal year. The Board approved this budget based on audited financial statements indicating sufficient fund balance was available. However, as the restated financial statements for June 30, 2004 disclosed, the general fund had no fund balance to appropriate; instead, it had an unreserved fund deficit of \$3 million. Thus, the appropriation of \$1 million that was not available simply increased the deficit in the general fund.

The contingent budget for the 2005-06 fiscal year, adopted by the Board in the fall of 2005, included \$830,000 of appropriated fund balance to help finance District operations for that fiscal year. Once again, District officials were not aware that the District had no fund balance until the restated financial statements were completed on November 15, 2005. As a result, financing for 2005-06 expenditures

was short by \$830,000 because District officials did not possess sufficient knowledge of accounting and reporting requirements to know that the District had a deficit.

Tax Anticipation Notes

Local Finance Law allows school districts to issue tax anticipation notes (TANs) to raise cash needed for District operations prior to the collection of taxes levied for that fiscal year. It has been the District's practice to issue these notes in June of one year to help finance operations of the next fiscal year beginning July 1. We found that, as a result of cash flow problems, TAN proceeds were improperly spent prior to the year's operation for which they were intended:

- On June 21, 2004, the District received \$25 million from the issuance of a TAN. Audited financial statements show the general fund cash balance at June 30, 2004 was only \$21.9 million. Therefore, in June 2004, the District spent at least \$3.1 million of TAN proceeds intended for the 2004-05 fiscal year.
- On June 23, 2005, the District received \$22.7 million from the issuance of a TAN. Since the cash balance at June 30, 2005 was only \$20 million, the District used at least \$2.7 million intended for the 2005-06 fiscal year to pay costs from the 2004-05 fiscal year.

We found that the District has been using TAN monies prematurely since the 2000-01 fiscal year. The fact that the District was having cash flow problems at the end of the fiscal year when all tax moneys had already been collected should have been an indication to Board members and District officials that there were financial problems.

Recommendations

1. The Board should develop comprehensive policies and procedures for good financial planning and, with the assistance of District officials, implement such plans to eliminate the general fund deficit and cash flow problem.
2. The Board must establish criteria to ensure that those responsible for the financial operations of the District, specifically the Assistant Superintendent for Business and District Treasurer, possess the business knowledge and expertise to competently perform the duties of their positions and effectively manage a multi-million dollar operation.

3. The Board should require the Assistant Superintendent for Business and District Treasurer to provide the periodic reports and timely financial information the Board needs to properly monitor revenues and expenditures.
4. District officials should prepare reasonable estimates of revenues and appropriations for future budgets, and the Board should review the reliability of the estimates, to help avoid future fund deficits.
5. The Board and District officials should revise the future budget format to include the actual revenues for prior completed years of operations and the actual-to-date revenues and expenditures of the current fiscal year.
6. Proceeds from the issuance of Tax Anticipation Notes should be used only for expenditures in the fiscal year for which the tax levy is imposed.

Procurement

An effective procurement process helps the District obtain necessary goods and services at reasonable cost in compliance with Board and legal requirements. The District has adopted sound purchasing policies that clearly outline responsibilities for purchasing activities, require the use of a purchase order system and define when and how competitive bidding will be used to purchase goods and services. However, we found these policies are not consistently enforced. Of 33 purchases we reviewed that required purchase orders, 5 purchases totaling \$10,344 had no purchase orders, and 3 purchases totaling \$37,582 had purchase orders that were dated later than the related invoices. The District also paid \$31,000 for sports clothing and a \$17,960 installment payment for copiers without soliciting bids, and obtained certain professional services without Board-approved contracts. Because District officials did not adequately monitor the operation of the procurement process, District personnel were able to make unauthorized payments to vendors, avoid using purchase orders and circumvent competitive bidding rules. As a result, the District may have spent too much money for the above goods and services.

Purchase Orders

A purchase order system typically requires the fiscal officer to certify that funds are available before the goods can be ordered from the vendor. When working properly, a purchase order system can be effective in controlling expenditures. The District's purchasing policy requires using purchase orders for purchases of goods and services where a budgetary appropriation has been made.

We reviewed 18 claims paid between July 2004 and December 2005. Of the 33 purchases on these claims that required purchase orders, 28 purchases had purchase orders, but the remaining 5 purchases (15 percent) lacked them. For example, no purchase order was issued for procuring the services of an administrative consultant at the high school (\$4,750) in September 2005, or for tutoring services (\$4,332) in March 2005.

We also identified three instances in which District personnel prepared purchase orders after they had purchased the goods. This practice involves a District staff member placing a verbal order with a vendor, and then filling out a purchase order afterward to "confirm" the purchase was made. The District's purchasing policy is silent with regard to this practice. However, since "confirming" purchase orders circumvent review and approval by a fiscal officer before goods are

ordered, they should be used only to make emergency purchases. Confirming purchase orders should also be clearly identified as such, so the emergency nature of the purchase can be verified.

The following three non-emergency purchases, totaling \$37,582, included invoices and purchase orders with dates that implied they were confirming purchase orders:

- A payment of \$18,842 was made in September 27, 2004 to an equipment company for partition panels. The invoice was dated August 31, 2004 but the purchase order was dated September 1, 2004.
- On November 9, 2004, the District purchased sporting goods equipment and uniforms costing \$12,215, which was billed to the district on October 4, 2004. The purchase order was dated October 27, 2004.
- On August 31, 2005, the District paid an invoice dated July 25, 2005, totaling \$6,525, for van service in a summer program. The purchase order was dated August 25, 2005.

Since none of these purchases met the criteria for emergency items or repairs, they could have been made in conformance with the District's purchase order system. Circumvention of the purchase order system can result in purchasing unnecessary or overpriced goods and services.

Competitive Bidding

The District's procurement policy and the General Municipal Law (Law) require competitive bidding for goods or services that cost more than \$10,000 and for all contracts for public work in excess of \$20,000. Written quotes are required for purchases under \$10,000 but more than \$1,501. Lease-purchase agreements constitute installment purchases when rental payments are payments toward the purchase of the item. As such, lease-purchase contracts for amounts specified in the Law must be competitively bid. The Law also requires that contracts for similar items from the same vendor that aggregate more than \$10,000 and \$20,000, respectively, during a fiscal year be competitively bid.

We tested significant payments made to seven vendors during the 2004-05 fiscal year. We found that payments to two of the seven vendors, as described below, were not advertised for bids in accordance with the Law and District policy.

Lease-Purchase Agreements — During the 2004-05 fiscal year, the District paid a total of \$17,960 to lease eight photocopy machines. The terms of the lease-purchase agreements provided for monthly payments ranging from \$113 to \$396, depending on the type of photocopier. Since the agreements stated that, at the expiration of the lease term, the copier could be purchased (at either its fair market value or for \$1), these agreements were actually installment purchase contracts subject to competitive bidding requirements. The cost of each machine over its lease term ranged from \$7,144 to \$23,753, or a total of \$92,320 for all eight machines. Since these lease-purchase agreements were awarded without solicitation of competitive proposals, the District could have paid too much for this equipment. District officials said they were unaware that installment purchase contracts were subject to competitive bidding requirements.

Aggregate Purchases — The District paid a local sporting goods store approximately \$51,000 between July 1, 2004 and June 30, 2005 for uniforms and sporting equipment, including more than \$31,000 for sports clothing. We examined the 20 purchase orders affixed to claim vouchers in support of District payments for these clothes. The purchases, made at different times throughout the period from the same sporting goods store, were for amounts ranging from \$88 to \$10,730. Therefore, the District failed to comply with the requirement to competitively bid aggregate purchases. In addition, 18 of the 20 purchase orders were not approved by the purchasing agent or other District official. As a result, the District spent more than \$31,000 for sports clothing without ensuring it was getting the best price for these goods, or ensuring these purchases had been authorized and approved.

Professional Service Contracts

A written agreement for professional services gives the District, along with the provider, a clearly defined and mutually agreed-upon basis for determining payments. All significant contracts require Board approval. We tested four professional service providers, who were paid a total of \$65,500 during the fiscal year ended June 30, 2005, and found that two of these professionals did not have a written Board-approved contract.

The Board did not authorize contracts with two firms that provided tutoring services to the District during the 2004-05 fiscal year. During that year, the District paid these two firms a total of \$59,489: \$46,220 to one firm and \$13,269 to a second firm. In both cases, written agreements for at-home or facility-based tutoring services were signed by the tutoring firm and the District's Director of Student Services.

However, neither agreement was authorized or approved by the Board. The Director of Student Services, who signed the agreements, was not aware that contracts with service providers required Board approval.

Recommendations

7. The Board should take steps to ensure that the District's policy requiring the issuance of purchase orders is followed.
8. The use of confirming purchase orders should be limited to emergency situations. Individuals initiating such purchase orders should mark "confirming" on the purchase order and justify the reasons for using a confirming order.
9. The Board should follow provisions of its purchasing policy and General Municipal Law by soliciting competitive bids when purchases of goods and services, including aggregate purchases, fall within established dollar guidelines.
10. The claims auditor should review all relevant contract purchase information and verify that purchases were authorized and approved before paying vendor claims.
11. The Board should approve written agreements with all firms and individuals that provide professional services to the District.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

BOARD OF EDUCATION

PRESIDENT
BARBARA SCHATZMAN

VICE PRESIDENT
ELLIE M. MAHONEY

TONI HUFFINE
KEVIN KIRK
MARIAN MCKENNA
GREGORY C. MIGLINO, JR.
CARL MOODT
JAMES VAUGHAN
FRANK ZAMPARIELLO

South Country Central School District

TOWN OF BROOKHAVEN - COUNTY OF SUFFOLK

ADMINISTRATIVE OFFICES
189 DUNTON AVENUE
EAST PATCHOGUE, NEW YORK 11772

SUPERINTENDENT
OF SCHOOLS

DR. SUSAN A. AGRUSO
631-730-1510
FAX 631-286-6394
saagruso@southcountry.org

October 10, 2006

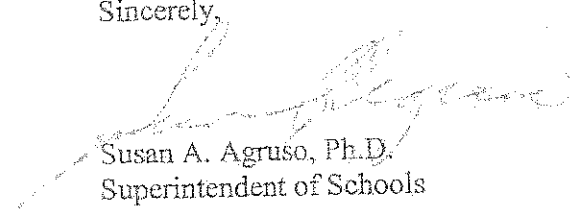
[REDACTED]
[REDACTED]
State of New York
Office of the State Comptroller
110 State Street
Albany, NY 12236

Dear [REDACTED]:

Enclosed, please find our response to your preliminary draft findings of your recent examination of our school district finances.

Please do not hesitate to contact me if you require any additional information.

Sincerely,


Susan A. Agruso, Ph.D.
Superintendent of Schools

saa:mmb

Enclosure

cc: Board of Education
[REDACTED]

Mr. James Koronkiewicz, Audit Committee
Mr. Larry Ryder, Audit Committee
Mr. Wesley F. Springhorn, Audit Committee
Dr. William J. Fanning, Interim Assistant Superintendent for Business

South Country Central School District
Response to Recommendations
Report of Examination of Financial Condition and Purchasing

The Board of Education for the South Country Central School District is committed to the long term financial health of the district. The Board appreciates the urgency of this situation and has taken strong measures to address the financial problems faced by this district.

The Board appointed an Internal Auditor on July 5, 2006, and established the District Audit Committee in December 2005. The District also has an External Auditor and an Internal Claims Auditor. The information, evaluations and recommendations provided by these individuals and groups is reviewed and used to revise fiscal practices and reporting.

The Board hired a new superintendent, who began her tenure on July 1, 2006. An interim Assistant Superintendent for Business was appointed by the Board and began working in the district on June 26, 2006. They share the board's commitment to financial health and are adamant that all expenditures and revenues will be accounted for accurately.

Together this team (Board and District officials) has already begun to address many of the issues raised in this report. They will continue their ongoing oversight of the budget processes for the district and are developing a long term plan to ensure the financial stability of South Country. That plan will be reported in the Action Plan the District will submit to the Comptroller within 90 days after the official report is released.

Financial Condition Recommendations

1. The Board should develop comprehensive policies and procedures for good financial planning and, with the assistance of District officials, implement such plans to eliminate the general fund deficit and cash flow problem.

The Board has hired an Interim Assistant Superintendent for Business who has significant experience in the area of school district finances. District officials are carefully reviewing all budget expenditures and revenues and creating a transparent line-item budget. This process will ensure that all budgeted items are listed under the appropriate codes, all planned expenditures are clearly indicated prior to budget approval, and all expenses are aligned to the approved budget. Recognizing that failure to account for and record accounts payable and accruals contributed to our current financial crisis, steps have been taken to assure against this oversight.

The Board has retained an internal audit firm which is currently reviewing internal controls. The firm's report will assist the Board and Administration in developing the recommended comprehensive policies.

Trend data is being reviewed so that the creation of the 2007-08 budget will be based on factual past expenses and anticipated increases due to contract provisions and cost increases.

Detailed written procedures are being developed so staff will have clear information to follow for all financial activities. Specific procedures are being established so that proper accounting of all expenses takes place. Staff will be held accountable for following established procedures and appropriate disciplinary action will be taken if procedures are violated.

The Board's Policy Committee will review all financial policies and make any necessary changes to ensure procedures are established and followed.

2. The Board must establish criteria to ensure that those responsible for the financial operations of the District, specifically the Assistant Superintendent for Business and District Treasurer, possess the business knowledge and expertise to competently perform the duties of their positions and effectively manage a multi-million dollar operation.

The Board and District officials will analyze the current job descriptions for the Assistant Superintendent for Business and the District Treasurer. Specific criteria will be established describing the expectations and the requisite knowledge and skills for each position which exceed the minimal business and finance training and experience mandated by SED certification and/or Civil Service requirements. Staff will be expected to attend training sponsored by the State Education Department, by the New York State Association of School Business Officials, and by related professional associations to ensure everyone is up-to-date on all requirements.

An annual review of each person's job performance will be reported to the Board. Any deficiencies will be addressed by establishing specific job performance goals.

The interim Assistant Superintendent for Business began training district business staff in July 2006 to manage specific job functions. He established clear lines of responsibility to ensure proper oversight and check and balances. Cross training is also ongoing to provide the district with additional expertise and backup.

3. The Board should require the Assistant Superintendent for Business and District Treasurer to provide periodic reports and timely financial information the Board needs to properly monitor revenues and expenditures.

At each business meeting of the Board, the following reports are currently provided:

- a. Treasurer's and Cash Flow Reports.
- b. Budget Status Report
- c. Budget Transfer Report
- d. Budget Transfer Request
- e. Revenue Status Report

The Internal Auditor has suggested the district also provide a semiannual report of the estimate of fund balance to the Board. This report will be presented beginning January 2007. The Internal Auditor will continue to review these reports and may make additional suggestions in this area.

The Assistant Superintendent for Business and the Treasurer are required to attend business meetings and to respond to questions. In addition, the Assistant Superintendent for Business will be providing quarterly updates to the Board that include an analysis of the current status of the district's finances.

The Interim Assistant Superintendent for Business has initiated a process of reporting specific findings to the Board based on his analysis of each budget code and the items assigned to that code. These reports describe the current financial status, highlight issues that need to be addressed, and outline corrective actions that must be taken.

4. District officials should prepare reasonable estimates of revenues and appropriations for budget, and the Board should review the reliability of the estimates, to help avoid future fund deficits.

For the 2007-08 budget, trend data for actual revenues and expenditures for two years and estimates for the current year (including actual-to-date expenses and revenues) will be the basis for the budget estimates and will be clearly shown in a table provided to the Board and the public. In addition, detailed line item budgets for 2006-07 and 2007-08 will be produced and reported.

5. The Board and District officials should revise the future budget format to include the actual revenues for prior completed years of operations and the actual-to-date revenues and expenditures of the current fiscal year.

District officials are currently revising the 2005-06 budget format to show actual revenues and expenditures. Similarly, they are revising the 2006-07 budget format to show anticipated revenues and expenditures and actual-to-date revenues and expenditures. This information will be provided along with the 2007-08 budget request.

6. Proceeds from the issuance of Tax Anticipation Notes should be used only for expenditures in the fiscal year for which the tax levy is imposed.

The Board and District officials recognize that all expenditures must be assigned to the budget year in which they occurred. To this end, District officials severely limited allowable expenditures for the 2006-07 school year the first week in July. That limit continues today as they continue their analysis of anticipated revenues and expected expenditures. Careful planning is underway to create the next annual budget request so that it fully addresses the anticipated expenses. The regular review and reporting of actual-to-date expenses will enable the Board and District officials to anticipate any revenue shortfalls and adjust spending immediately.

The Board and District officials are committed to sound fiscal management. Tax Anticipation Notes will only be used for the fiscal year in which the tax levy is imposed.

Procurement Recommendations

7. The Board should take steps to ensure that the District's policy requiring the issuance of purchase orders is followed.

The Board and District officials are adamant that purchase orders will be issued prior to orders being placed. The only exception will be for rare emergencies for which confirming purchase orders with proper documentation will be issued. District staff has been informed in writing and in person (during staff orientation in September) that purchase order procedures must be followed.

District officials are developing written step-by-step procedures for staff to follow. The Interim Assistant Superintendent for Business conducts monthly reviews for purchase orders with his staff and informs the Superintendent if the process has been violated. For violations, the Superintendent then follows up with staff and takes appropriate disciplinary action.

The Board is provided with a list of all warrants indicating purchase order numbers at the monthly business meeting. The claims auditor provides a report to the Board which includes the identification of warrants without required purchase orders.

At the September 27 meeting, the Board asked that the Board's Finance Committee review all financial reports prior to their being presented to the full Board for approval.

8. The use of confirming purchase orders should be limited to emergency situations. Individuals initiating such purchase orders should mark "confirming" on the purchase order and justify the reasons for using a confirming order.

Staff has been informed of the procedure for purchase orders and that confirming purchase orders are permitted in emergency situations only. Since July 1, District officials have permitted very few confirming purchase orders and only in true emergency situations (e.g., cesspool problem). The practice has been to identify them as emergency purchase orders, but the term confirming will be used from now on.

9. The Board should follow provisions of its purchasing policy and General Municipal Law by soliciting competitive bids when purchases of goods and services, including aggregate purchases, fall within established dollar guidelines.

Staff has been informed of the procedures to follow based on dollar limits for competitive bids. District officials are developing step-by-step procedures for staff to follow. The Purchasing Agent is charged with following up with staff on this process and ensuring that the procedures have been followed. Appropriate disciplinary action will be taken for all violations of this process.

10. The claims auditor should review all relevant contract purchase information and verify that purchases were authorized and approved before paying vendor claims.

The Claims Auditor reviews all contract purchase information. He notifies the Board and District officials if the procedures for purchase orders have been violated.

11. The Board should approve written agreements with all firms and individuals that provide professional services to the District.

The Board is provided with copies of written agreements with all firms and individuals providing professional services. These agreements are also reviewed by Board counsel prior to being presented to the Board. The Board must approve the agreements prior to the individual or firm beginning work.

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

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

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. Based on that evaluation we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we review. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected Financial Condition and Procurement for further audit testing.

Our examination included the following:

- We examined recent annual audit reports prepared by the District's public accounting firms for objective, scope, methodology and findings.
- We analyzed changes in fund balances.
- We reviewed and verified the deficit balance in the general fund.
- We obtained information regarding Administrators understanding of and input into the preparation of financial statements.
- We analyzed the affect of Tax Anticipation Notes proceeds on cash flow.
- We reviewed budget preparation procedures.
- We reviewed revenue trends and their use in budget projections.
- We reviewed the formal policy for purchasing and determined if it adequately addressed the procurement of goods and services.
- We verified that purchases were made, that goods were received and claims were processed as authorized.
- We examined paid claims to contractual agreements to confirm rates and services.
- We examined bid, quote and RFP documentation to determine if the lowest responsible vendor was selected.
- We examined purchase agreements and contracts for evidence of authorized signatures and proper dates.

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

HOW TO OBTAIN ADDITIONAL COPIES OF THE REPORT

To obtain copies of this report, write or visit our web page:

Office of the State Comptroller
Public Information Office
110 State Street, 15th Floor
Albany, New York 12236
(518) 474-4015
<http://www.osc.state.ny.us/localgov/>

APPENDIX D
OFFICE OF THE STATE COMPTROLLER
DIVISION OF LOCAL GOVERNMENT SERVICES
AND ECONOMIC DEVELOPMENT

Mark P. Pattison, Deputy Comptroller
Steven J. Hancox, Assistant Comptroller
John Clarkson, Assistant Comptroller

LOCAL REGIONAL OFFICE LISTING

BUFFALO REGIONAL OFFICE

Robert Meller, Chief Examiner
Office of the State Comptroller
295 Main Street, Room 1050
Buffalo, New York 14203-2510
(716) 847-3647 Fax (716) 847-3643
Email: Muni-Buffalo@osc.state.ny.us

Serving: Allegany, Cattaraugus, Chautauqua, Erie,
Genesee, Niagara, Orleans, Wyoming counties

ROCHESTER REGIONAL OFFICE

Edward V. Grant, Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street – Suite 522
Rochester, New York 14614-1608
(585) 454-2460 Fax (585) 454-3545
Email: Muni-Rochester@osc.state.ny.us

Serving: Cayuga, Chemung, Livingston, Monroe,
Ontario, Schuyler, Seneca, Steuben, Wayne, Yates
counties

SYRACUSE REGIONAL OFFICE

Eugene A. Camp, Chief Examiner
Office of the State Comptroller
State Office Building, Room 409
333 E. Washington Street
Syracuse, New York 13202-1428
(315) 428-4192 Fax (315) 426-2119
Email: Muni-Syracuse@osc.state.ny.us

Serving: Herkimer, Jefferson, Lewis, Madison,
Oneida, Onondaga, Oswego, St. Lawrence counties

BINGHAMTON REGIONAL OFFICE

Patrick Carbone, Chief Examiner
Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton, New York 13901-4417
(607) 721-8306 Fax (607) 721-8313
Email: Muni-Binghamton@osc.state.ny.us

Serving: Broome, Chenango, Cortland, Delaware,
Otsego, Schoharie, Sullivan, Tioga, Tompkins
counties

GLENS FALLS REGIONAL OFFICE

Karl Smoczynski, Chief Examiner
Office of the State Comptroller
One Broad Street Plaza
Glens Falls, New York 12801-4396
(518) 793-0057 Fax (518) 793-5797
Email: Muni-GlensFalls@osc.state.ny.us

Serving: Clinton, Essex, Franklin, Fulton, Hamilton,
Montgomery, Rensselaer, Saratoga, Warren, Washington
counties

ALBANY REGIONAL OFFICE

Christopher J. Ellis, Chief Examiner
Office of the State Comptroller
22 Computer Drive West
Albany, New York 12205-1695
(518) 438-0093 Fax (518) 438-0367
Email: Muni-Albany@osc.state.ny.us

Serving: Albany, Columbia, Dutchess, Greene, Orange,
Putnam, Rockland, Schenectady, Ulster, Westchester
counties

HAUPPAUGE REGIONAL OFFICE

Richard J. Rennard, Chief Examiner
Office of the State Comptroller
NYS Office Building, Room 3A10
Veterans Memorial Highway
Hauppauge, New York 11788-5533
(631) 952-6534 Fax (631) 952-6530
Email: Muni-Hauppauge@osc.state.ny.us

Serving: Nassau, Suffolk counties