



Solvay Union Free School District Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2004 - November 30, 2005

2006M-60



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State of New York Office of the State Comptroller

Division of Local Government Services and Economic Development

September 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 Solvay Union Free School District — Internal Controls Over Selected Financial Activities.

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

EXECUTIVE SUMMARY

The Solvay Union Free School District (District) is governed by the Board of Education (Board), which comprises five 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 Board's direction. The District employs a Business Manager who also serves as the District's Purchasing Agent responsible for authorizing purchases, and as the District Treasurer responsible for receiving, disbursing, and holding District money.

For the 2005-06 fiscal year, the District expended approximately \$12.1 million for non-payroll claims, excluding debt service payments. District assets that could be inherently vulnerable to theft include a significant investment in technology equipment assets, such as computers and related consumer electronic items, and inventories of food and vending machine supplies stored at the three schools for use by the school lunch department. The consumable food and beverage supplies included products such as frozen meats and bottled beverages.

Scope and Objectives

The objective of our audit was to evaluate the internal controls over selected District financial functions and activities to ensure that District assets were properly safeguarded. Our audit addressed the following related questions for the period July 1, 2004 to November 30, 2005:

- Did the Board exercise its authority and responsibility to ensure that the internal controls over the payment of claims, technology equipment assets, and inventories of bulk food and vending machine supplies were appropriately designed and operating effectively?
- Were separation payments to employees made in accordance with the terms of relevant labor agreements and Board policy?

Audit Results

The Board has not fulfilled its responsibilities to oversee the internal control systems associated with the important business functions we audited. We concluded that the lack of guidance, expectations, and oversight from the Board to District management contributed to a weak control environment and the existence of other internal control deficiencies identified in this report. The Board has not adopted control policies or provided any formal guidance regarding the payments and inventories we audited.

The Board established an audit committee in December 2005 but has not yet defined its roles and responsibilities. In addition, the Board has not provided members with any significant training for their fiscal oversight responsibilities, engaged internal or external auditors to assess risk or test existing internal controls for those areas not included within the scope of the annual financial audit, and has not taken action to address internal control concerns raised by the District's independent auditor in connection with the annual financial audit. Finally, the District has engaged the same audit firm for over 20 years with no record of seeking competitive proposals or considering alternative auditors. The Board's failure to provide strong fiscal oversight and foster a strong control environment increases the District's exposure to preventable losses from illegal acts or errors. Although our audit did not detect fraud or illegal acts, some of the separation payments made to employees were improper and resulted in preventable losses of District funds.

The District inappropriately made eight payments, totaling over \$68,000, for separation benefits that were not authorized under the specific terms of relevant labor agreements or by written Board policy. These unauthorized payments were made to teachers, administrators, and union employees for unused sick leave, unused vacation leave, and in one instance, a retirement incentive bonus. In addition, leave balances credited to two retiring officials were excessive.

The Board is not complying with statutory requirements that it audit claims or appoint an independent claims auditor. Furthermore, the District has vested virtually all control over its fiscal activities in one individual, the Business Manager, without establishing appropriate checks and balances on his work. The Business Manager controls all financial processes and serves as both the Purchasing Agent and Treasurer for the District. Thus, he can both initiate and approve each transaction step leading up to a claim payment without an effective review of his actions.

District managers have not established control policies or procedures to safeguard valuable technology assets from theft or loss. Recordkeeping and custodial duties have not been properly assigned or segregated, inventory records were incomplete, and periodic physical inventories are not being recorded or reported to District management.

Finally, District management has also not established control policies and procedures to safeguard inventories of food and vending machine supplies from theft. Access to inventory is not adequately restricted and food management has not monitored the reasonableness of consumption against production.

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. Except as noted in Appendices A and B, District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

Introduction

Background

The Solway Union Free School District (District) is located in the Towns of Geddes and Camillus, Onondaga County. The District is governed by the Board of Education (Board), which comprises five 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 Business Manager is responsible for recording and reporting the District's financial activity. He also serves as the Purchasing Agent responsible for authorizing purchases and the District Treasurer responsible for receiving, disbursing, and holding District money. He supervises four business office employees who maintain the District's financial accounting records and reports and process the District's cash receipts and disbursement, purchasing, accounts payable, payroll, and personnel transactions. The Business Manager also oversees the buildings and grounds department and the school lunch program.

The District's budgeted expenditures for the 2005-06 fiscal year were \$24.5 million, funded primarily with real property taxes, State aid, tuition charged to other districts, and sales tax. During that fiscal year, the District reported expending \$12.1 million for non-payroll claims, excluding debt service payments. An estimated 1,740 students attend the District's high school, middle school, and elementary school. The District has a workforce of approximately 375 employees including 150 full-time teachers and about 40 substitute teachers.

Objectives

The objective of our audit was to evaluate the internal controls over selected District financial functions and activities to ensure that District assets were properly safeguarded. Our audit addressed the following related questions:

- Did the Board exercise its authority and responsibility to ensure that the internal controls over the payment of claims, technology equipment assets, and inventories of bulk food and vending machine supplies were appropriately designed and operating effectively?
- Were separation payments to employees made in accordance with the terms of relevant labor agreements and Board policy?

**Scope and
Methodology**

During this audit we examined the Board’s internal controls over separation payments, payment of claims and technology asset, food, and vending machine inventories for the period July 1, 2004 to November 30, 2005.

We conducted our audit in accordance with generally accepted government auditing standards. More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

**Comments of District
Officials and Corrective
Action**

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

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, the Board should prepare a plan of action that addresses the recommendations in this report and forward the plan to our office within 90 days. For guidance in preparing 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.

Board Fiscal Oversight

Board members have the overall responsibility for providing effective fiscal oversight of District operations and ensuring that assets are adequately safeguarded. A Board's effective involvement in establishing a good control environment provides the foundation for all other internal control standards.

Our audit concluded that the Board has not fulfilled its responsibilities to guide and monitor the control activities associated with making certain lump sum payments to separating employees, paying claims, and safeguarding investments in technology equipment and consumable food and beverage supply inventories. The Board has not provided significant policy guidance regarding these important business functions and has not communicated related internal control objectives, standards, or responsibilities to District management. Also, the Board's record of past activity demonstrated little involvement in assessing risks to District assets or evaluating the adequacy of existing management control practices. The Board's failure to provide strong fiscal oversight weakens the control environment and increases the District's exposure to losses from illegal acts or errors. We identified the following control deficiencies:

- Board members are required to audit each claim against District funds before it is paid, or appoint an independent claims auditor to perform this essential control function. Claims are not audited either before or after payment. The Board provides a cursory review of paid claims by approving a monthly list of expenditures (warrant report) one or two months after the checks are disbursed. The report is provided to Board members by the business office without any supporting documentation. The importance of the independent claims audit function is discussed further in the section of this report entitled Payment of Claims.
- Board members are responsible for establishing broad District policies that communicate internal control objectives and expectations to responsible District managers and staff. The Board adopted fiscal management policies addressing various budgeting, revenue, and purchasing issues. However, the Board has not adopted policies or provided significant guidance regarding the control of other fiscal activities and physical assets we audited. We concluded that the lack of formal expectations and guidance from the Board to District

management contributed to a weak control environment and the existence of other internal control deficiencies addressed in this report.

- During our audit, the Board had not established an audit committee. In addition, it also did not assess risk or engage internal or external auditors to assess risk or test existing internal controls for those areas not included within the scope of the annual financial audit. Furthermore, the Board took no formal actions to examine or address internal control issues and concerns that the District's independent auditor raised in their annual management letter to the Board or the auditor's verbal recommendations that the Board consider establishing an audit committee and appointing an internal auditor and a claims auditor. After our audit, the Superintendent informed us that the Board appointed an audit committee at its December 2005 meeting. However, the roles and responsibilities for the audit committee have not been established yet.
- The five Board members have each served from between five to 12 years. However, the President of the Board (President) told us that Board members had not received any training for their fiscal oversight responsibilities beyond a finance section presented during a two-day orientation workshop that each Board member attended upon their initial election. After our audit, the Superintendent informed us that two Board members have since attended mandated six-hour training.
- Districts are required to contract for an annual audit by an independent public accountant. These audits are an important component of a district's system of internal controls. Good internal controls, and the Board's own purchasing regulations, require the solicitation of written proposals for professional services contracts. This method of procuring professional services helps to ensure the acquisition of quality professional services at the lowest cost and guards against favoritism, fraud, and corruption. It is also advisable that districts consider periodically changing auditors as a means of maintaining auditor independence and objectivity.

The Board has engaged the same audit firm for over 20 years and recently entered into a new agreement extending the engagement for another three years. District officials told us they were not aware of any past efforts to seek competitive proposals or consider alternative auditors. The President told us that the Board's satisfaction with the audit services was the reason for continuing the long-term engagement.

The Board did not provide sufficient consideration to their fiscal oversight responsibilities because they lacked relevant training and, absent the annual financial audit, there were no external assessments or other mechanisms to raise Board awareness or hold themselves accountable for fulfilling those responsibilities. Although our audit did not detect fraud or illegal acts, some of the separation payments made to employees were improper and resulted in preventable losses of District funds. The control deficiencies and vulnerabilities identified in the rest of this report warrant prompt corrective action by the Board.

Recommendations

1. The Board should develop and maintain an operating style and philosophy that formally recognizes and supports the establishment of a strong control environment with respect to District fiscal controls.
2. The Board should provide oversight guidance to District management by adopting and communicating comprehensive, formal internal control policies.
3. The Board should fully implement all of the reforms contained in the Five-Point School Financial Accountability Plan.¹ Specifically:
 - Obtain necessary training and education for all Board members regarding their financial oversight responsibilities.
 - Establish an audit committee with clearly defined roles and responsibilities designed to help the Board select and oversee external and internal auditors, exercise its financial oversight responsibility, and implement any necessary corrective actions.
 - Use a competitive request for proposal process to select firms for audit services.
 - Establish an internal audit function at the District to assess risk by reviewing financial policies and procedures and testing and evaluating internal controls.

¹ Starting in the fall of 2004, the Office of the State Comptroller (OSC) convened a coalition of school district and accounting stakeholders to address the need for district-level reform. Together with this coalition, OSC drafted the Five-Point Plan legislation and advocated for its successful passage and signing into law in July 2005. Chapter 263 of the Laws of 2005 will strengthen school district financial accountability, require adoption of additional fraud prevention and deterrence measures, strengthen deterrence mechanisms already in place, and increase awareness of these issues among school board members.

- Either assume its statutory responsibility to properly audit claims, or appoint an independent claims auditor.

Separation Payments

Districts establish the salary and benefits for employees in written labor agreements they negotiate with collective bargaining units and individual employees. Boards may also elect to supplement the terms of the agreements with written policies. The documentation, proper implementation, and monitoring of a district's labor contracts are essential aspects of internal control.

Controls over separation payments were not adequate and as a result, the District made unauthorized payments to teachers, administrators, and union employees for unused sick leave, unused vacation leave, and in one instance, a retirement incentive bonus. We examined 16 special lump sum payments to determine whether they were properly supported and correctly calculated, and were authorized by the labor agreements or formal Board policies. Eight payments for separation benefits, totaling over \$68,000, were not authorized under the specific terms of relevant labor agreements or by written Board policy. The eight payments were improper because District management did not have specific contractual justification to support the expenditures. District officials believe that all of the payments were proper based on their understanding of the intent of certain contract provisions and the District's past practices. However, informal understandings of intent do not provide sufficient support for District expenditures totaling over \$68,000.

Improper Retirement Incentive Payment

The District's 2002-04 labor agreement with teachers' union provided a \$23,000 lump sum retirement incentive and a payout for unused accumulated sick leave to teachers who elected to retire within their first year of eligibility under the rules of the Teachers Retirement System, if they had 15 years or more of District service. However, we determined that a teacher who received \$27,130 for this incentive payment did not retire within her first year of eligibility. Her first year of eligibility was in the 2001-02 year but she had not accumulated 15 years of service by that time. She retired in 2004 after she accumulated 15 years but after the initial year of eligibility. Therefore, the \$27,130 payment was not authorized under the specific terms of the labor agreement.

The current Superintendent interpreted the contract to mean that teachers did not have to retire in their first year of retirement eligibility if they had not yet attained 15 years of service to the District. He believed teachers could remain in service until they completed 15 years with the District and became qualified to receive the retirement

incentive payment. However, that is not clearly stipulated in the contract. Furthermore, the Superintendent's interpretation could actually reduce a teacher's incentive to retire. In this case, the teacher had an incentive to delay retirement for two years until she attained 15 years of service.

Improper Payments for Unused sick Leave

District management determined that three other retiring teachers were not eligible for the lump sum payment offered under the retirement incentive option because they had not exercised the incentive option within their first year of eligibility. However, the District still paid these three teachers a total of \$19,302 for unused accumulated sick leave. While there was no separate provision authorizing payment for unused sick leave to other retiring teachers, the current Superintendent and the teachers union felt that the contract language was misleading and that the intent of the contract negotiators was to make the sick leave payout a general benefit for all retiring teachers. District officials noted that the 2005-09 labor agreement contains language specifying that all retiring teachers will receive a payout for their unused accumulated sick leave.

We maintain that these payments were not authorized by the specific written terms of the 2002-04 labor agreement. We reviewed the written terms of several predecessor labor agreements and observed that the sick leave payout had been consistently offered as a retirement incentive designed to encourage teachers to retire at the earliest opportunity. If the District and its teachers union had negotiated a new general benefit for all retiring teachers in the 2002-04 contract, then those terms should have been explicitly stated. Also, the District and union approved written corrections to this section of the contract after it had been signed, but the changes did not alter the language that officials now maintain was misleading. District officials must comply with the express terms of the written contract, rather than perceived intent, when implementing the terms of its labor contracts.

We also found that the former Superintendent was overpaid \$907, upon retirement, for 12.1 unearned sick leave days. The Superintendent's contract authorized a separation payment for unused personal sick leave. On July 1, 2005, in accordance with the contract, the Superintendent rolled over 133.1 unused personal sick leave days from the prior year and was credited with 12 personal sick leave days and five family illness days. However, the labor agreement specified that he received these leave days for each 12 month period of employment. Thus, the 12 personal sick days and five family sick days credited on July 1, 2005 represented the amount the Superintendent would earn if he worked the entire 2005-06 school year. Since he retired effective August 19, 2005, he earned only 1.7 personal sick leave days instead of the full 12 days that was used

for the payout calculation. Furthermore, the Superintendent charged 2.5 days of family illness leave prior to retiring although he actually earned only 0.7 days (pro-rated).

Improper Payments for Unused Vacation Leave

Four employees, upon retirement, improperly received \$22,345 for unused vacation leave because it was not justified by contractual provisions. None of the District’s labor agreements (four with collective bargaining units and 11 with individual employees) contained provisions authorizing payments for unused accumulated vacation leave upon separation. However, the current Superintendent and the Business Manager stated that it was the District’s past practice to pay all retiring employees for unused vacation leave at their current salary level. As a result, four employees, including the former Superintendent, improperly received \$22,345 for unused vacation leave upon retirement.

Position	Unused Vacation Leave Balance (in days)	Amount
Superintendent	15.5	\$8,396
Director of Athletics	28	\$9,877
Maintenance Worker	20	\$2,832
Typist	10	\$1,240
Total	73.5	\$22,345

We also determined that \$6,455 of the \$9,877 paid to the retiring director of Athletics (Director), was for 18.3 days of vacation leave that had been incorrectly credited to her. On July 1, 2005, in accordance with the labor agreement, the Director rolled over 10 unused vacation days from the prior year and was credited with 20 vacation days for the 2005-06 fiscal year. Since she only worked one month and retired effective July 31, 2005, she should have only been credited 1.7 vacation days instead of 20. She charged two days vacation leave during July. Consequently, District officials based her separation payment on 28 unused vacation days. The correct number of days should have been 9.7.

Recommendations

4. The Board and District management should ensure that labor agreements are clearly written and that all terms concerning employee retirement benefits are fully disclosed and documented.
5. District management should establish control procedures to ensure that payments for unused sick leave, unused vacation accruals, and retirement incentive benefits are specifically authorized by written labor agreements and/or Board policy.

6. The board should evaluate the improper payments made to employees and determine whether it should pursue the recovery of these payments.

Payment of Claims

Internal controls over the payment of claims are intended to ensure that every claim has enough supporting documentation to determine that it complies with District policies and that the amounts paid represent actual and necessary District expenses. When internal controls are not designed appropriately or operating effectively, it increases the risk that errors and irregularities may occur and not be detected and corrected. Key elements of a system that accomplishes these internal control objectives are the provision of a careful, independent review of claim documentation prior to payment and the proper segregation of key transaction approval, processing, and cash disbursement duties so that no single individual controls all phases of the claim payment process. If duties cannot be ideally segregated, management must provide increased supervisory review to mitigate specific risks.

The District's system for processing and paying claims does not provide adequate safeguards against fraud, waste, theft, or error. Claims are processed, approved, and paid entirely within the District business office by the Business Manager and two clerks. The District's internal control system does not provide an independent claims audit function and thus, there is no effective review of the Business Manager's actions. The Board's failure to design and enforce strong control over the approval and payment of claims raises serious concerns about the risk that illegal or erroneous payments might occur and not be detected.

Lack of an Independent Claims Audit Function

School boards are, in most instances, required to audit claims against District funds before they are paid, or to appoint an independent claims auditor to assume the Board's powers and duties to approve or disapprove claims. In order to provide an independent and objective audit of District claims it is necessary that the claims auditor report directly and regularly to the Board and not to District management or staff. This control requirement provides a means for the Board to monitor the effectiveness of internal controls over District expenditures and prevent or detect any management abuses or improprieties. The importance of this control is amplified when other significant internal control deficiencies exist, such as the inadequate segregation of key authorization and review duties among District managers.

Board members did not meet their responsibility by auditing the claims themselves or appointing a claims auditor. There was no independent review of claims outside of the business office, except for the Board members' review of a warrant report that was presented, without

supporting documentation, one or two months after the checks were disbursed. The Business Manager told us that he was rarely asked any questions about the warrant report.

Inadequate Segregation of Control Duties

The District has vested virtually all control over fiscal operations in one individual, the Business Manager, without establishing appropriate checks and balances on his work. In addition to supervising and controlling all financial transaction processes, the Business Manager serves as both the Purchasing Agent and Treasurer for the District. Thus, he can both initiate and approve each transaction step leading up to a claim payment without an effective independent check on the propriety of his actions. The concentration of key control duties was illustrated by one of the 47 paid claims we reviewed. The Business Manager initiated and approved a requisition for three computers for \$1,911, approved the purchase order, certified to the receipt of equipment, and approved the payment of the vendor's claim. There were no independent checks on the Business Manager's activity at any phase of the transaction. We found no exceptions with this transaction beyond the lack of an appropriate segregation of duties. However, this illustrates how errors or irregularities could occur and go undetected, placing District resources at risk.

Inadequate Documented Support for Paid Claims

We examined 47 claim payments, totaling \$131,861, to determine if they had been properly authorized, itemized, and documented, complied with District policies, and were a proper District expenditure. We also examined the related disbursement checks and endorsements to verify that the actual payments were consistent with the claim records. All of the disbursements were consistent with claim records and most of the claim transactions were handled properly. However, our audit also identified two instances of lax enforcement of some of the District's procurement and claims processing controls as evidenced by a claim that did not receive prior approval and a claim for a purchase that did not comply with the District policy requiring competitive bids. An effective, independent claim audit function would have identified these transactions so the Board could take appropriate corrective actions.

A teacher ordered an assortment of new and used video production equipment from a local vendor at a total cost of \$8,500. District officials did not submit a purchase requisition or obtain a purchase order for the equipment. District officials could not provide documentation in support of the vendor selection and/or the reasonableness of the prices paid for the items. The Business Manager told us that the prior Superintendent had verbally authorized the purchase.

The District's Technology Coordinator ordered 37 computer workstations from a local vendor, at a total cost of \$27,761, without

obtaining competitive bids. The Purchasing Agent approved the purchases, because he assumed that the computers had been ordered under an existing contract. The Technology Coordinator was not aware of the requirement to obtain bids. There was no evidence that the requirements of the procurement policy had been communicated to District staff and managers.

The lack of an independent audit of claims and adequately segregated duties as well as the lack of supporting documentation for claims approval are weak internal controls that could lead to errors, waste, and irregularities occurring and not being detected and corrected timely.

Recommendations

7. The Board must either assume its statutory responsibility to audit claims or officially appoint a claims auditor that is independent of the business and authorization process.
8. The Board, or the claims auditor if appointed, should ensure the every claim contains adequate itemization and documentation, that it is a proper District charge, approved by the department, certified as received, and complies with District policies, including prior authorization by the Purchasing Agent.
9. The Board should design and implement written procedures to ensure that the claims audit function complies with its policies, statutory requirements, and general standards of good internal control.
10. District management should segregate recordkeeping, transaction approval, and cash disbursement duties to the extent judged to be practical and cost effective. Where incompatible duties cannot be appropriately segregated, they should establish effective supervisory review procedures to mitigate specific risks.
11. The Board should ensure that all relevant District personnel are made aware of policies they have established, or will establish, to safeguard District assets. The Board should ensure that personnel that are responsible for the purchasing of goods and services have a proper understanding of the requirements of the District procurement policy and applicable provisions of State law including those related to competitive bidding.

Technology Asset Inventories

Effective internal controls for equipment typically include assigning specific custodial and control responsibilities, maintaining inventory records to account for individual items, and conducting periodic physical inventories to assess controls, identify losses, and communicate those findings to management for appropriate follow up. Good controls also require appropriate segregation of duties so that the employees responsible for custody of the equipment do not also maintain the inventory records. The risk of loss, misuse or abuse is particularly heightened for equipment that is valuable and portable such as personal computers, laptops, and related electronic items. Therefore, it is especially important that District officials establish effective controls to maintain accountability and guard against misappropriation.

During the fiscal year ended June 30, 2005, the District expended \$246,000 for equipment purchases. A significant portion of this amount was for technology assets such as computers and related consumer electronic items. District managers have not established comprehensive control policies or procedures to safeguard valuable technology assets from theft or loss. The District employs a Technology Coordinator (Coordinator) who is responsible for managing the District's technology inventory, except for items assigned to three departments that are managed by the Business Manager. We found that neither the Coordinator nor the Business Manager maintain effective accountability and control over the technology equipment items they are responsible for. District management has not inventoried capital assets since 2003 when the current record was established. The Business Manager told us that the District intends to conduct a physical inventory during the summer of 2006. The failure to maintain effective control over these valuable and vulnerable assets increases the risk that preventable losses could occur and go undetected.

We tested the accountability for 65 recently acquired technology equipment items with an aggregate cost of \$67,347. We reviewed both the Business Manager's and Coordinator's asset records. We were able to verify the existence of all of the equipment except for one laptop costing \$1,291. The Coordinator told us it had been verbally reported as stolen. The District did not have a formal loss reporting procedure and there was no record that other District officials were informed about the loss. The Business Manager was not notified and the District neither reported the alleged theft to police nor filed an insurance claim.

The failure to maintain effective controls over valuable and vulnerable technology assets increases the risk that preventable losses could occur and go undetected.

Recommendation

12. District management should design and implement an effective system of internal controls to safeguard technology equipment assets. At a minimum, this should include:

- Document control policies and procedures and assign formal control responsibilities and expectations. The responsibilities for recordkeeping and custody of assets should be segregated.
- Establish and maintain a reliable inventory record to account for technology equipment assets.
- Conduct periodic physical inventories to verify the inventory record against the actual assets on hand. Investigate discrepancies and report any adjustments to responsible District managers.
- Establish and communicate procedures to all District staff for reporting the loss or theft of District technology assets.

Food and Vending Machine Inventories

Effective internal controls over consumable supplies generally involve restricting access to storage locations and management monitoring of the reasonableness of consumption against production.

District management has not established adequate controls to safeguard inventories of food and vending machine supplies from theft, or misuse. District management has not documented any control policies or procedures, assigned control responsibilities, or provided formal guidance and expectations for staff regarding the safeguarding food and vending supplies. We were not able to test the propriety of the use of food and vending products because of the pervasive lack of controls over food and vending machine inventories. We identified the following deficiencies:

Access to stored food and vending machine products is reasonably well restricted except all custodial and maintenance staff members have keys to the locked freezers and storerooms. The storage locations are not equipped with any devices such as intrusion alarms, electronic access logs, or security cameras to deter or detect unauthorized access after kitchen operating hours.

Recommendations

13. The Board should develop and adopt policies regarding the monitoring and control of District food and vending machine inventories.
14. District managers should design and implement an effective system of internal controls to safeguard food and vending supplies. At a minimum, this should include:
 - Document control policies and procedures, assign control responsibilities, and communicate control guidance and expectations.
 - Perform periodic analytical reviews of product consumption to detect unusual usage or trends that require further investigation.
15. Restrict or otherwise control custodial and maintenance staff access to stored food and vending machine supplies.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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08 September 2006

Office of the State Comptroller
State Office Building Room 409
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To Whom It May Concern:

The Solvay Union Free School District is in receipt of the Audit Report dated August 10, 2006. Additionally a meeting was held on Thursday, August 17, 2006 at 10:00 A.M. with three members of your staff to discuss the findings of the report. Below please find a response to the recommendations listed in the report. We are pleased that your audit confirmed that there were no fraudulent or illegal acts. The district, however, does not agree with all of the findings, and clearly stated such at the August 17 meeting. We appreciate the efforts of the comptroller's office and certainly recognize the audit findings will provide ways for the Solvay School District to improve its operations. A corrective action plan will be submitted in accordance with the 90-day requirement. Within that document, we will elaborate on the details of our plan to implement the recommendations of the audit as determined by the Board of Education.

The following lists the responses to the recommendations listed in the report dated August 10, 2006.

1. The Board should develop and maintain an operating style and philosophy that formally recognizes and supports the establishment of a strong control environment with respect to District fiscal controls.

The Board of Education will work towards the goal of formally recognizing and supporting the establishment of a strong control environment with regards to fiscal controls.

2. The Board should provide oversight guidance to District management by adopting and communicating comprehensive, formal internal control policies.

Policies have been and will further be developed, adopted and distributed to appropriate district personnel regarding internal control policies and procedures.

3. The Board should fully implement all of the reforms contained in the Five-Point School Financial Accountability Plan. Specifically:

- Obtain necessary training and education for all Board members regarding their financial oversight responsibilities.
- Establish an audit committee with clearly defined roles and responsibilities designed to help the Board select and oversee external and internal auditors, exercise its financial oversight responsibility, and implement any necessary corrective actions.

JAMES A. SHERIDAN, Vice-President/Clerk
KEVIN DWYER, Member

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LENA ROSE ORLANDO, Assistant Clerk

- Use a competitive request for proposal process to select firms for audit services.
- Establish an internal audit function at the District to assess risk by reviewing financial policies and procedures and testing and evaluating internal controls.
- Either assume its statutory responsibility to properly audit claims, or appoint an independent claims auditor.

All aspects of the Five-Point School Financial Accountability Plan have either been, or will be implemented in accordance with the timelines and guidelines of the plan.

4. The Board and District management should ensure that labor agreements are clearly written and that all terms concerning employee retirement benefits are fully disclosed and documented.

Understanding that labor agreements have to be agreed to by both parties in negotiations, the goal of future negotiations on the part of the Board of Education will be to insure that labor agreements are clearly written to outline the intent of the negotiated agreements.

5. District management should establish control procedures to ensure that payments for unused sick leave, unused vacation accruals, and retirement incentive benefits are specifically authorized by written labor agreements and/or Board policy.

Internal control procedures and policies will be established and implemented to address this recommendation.

6. The Board should evaluate the improper payments made to employees and determine whether it should pursue the recovery of these payments.

According to district labor relations counsel, a school district can lawfully commute an employee's unused vacation time into cash upon the employee's separation from service. This is based upon the following legal citations.

See Note 1 Page 28

- a. §92(2) of the General Municipal Law specifically addresses this issue and states: "the government board of each ... school district ... may provide by ... resolution ... that vacations granted to its officers and employees shall be earned by and credited to them for each day, week or month of service and for the payment for such earned and credited vacations prior to the commencement thereof.
- b. In 22 Op.State Compt. 585, 1966 the Comptroller stated, "A school district may not commute and employee's unused vacation time into cash, except at the time of his separation of service."
- c. In 20 Op.State Compt. 76, 1964, "Unused vacation may be commuted into cash payments only upon the employee's separation from municipal service or upon his demise while in such service."

Furthermore, we understand that payments for unused vacation can be made by board resolution. We have determined not to pursue the recovery of past payments, however, all such payments in the future will be made through the adoption of a board resolution.

7. The Board must either assume its statutory responsibility to audit claims or officially appoint a claims auditor that is independent of the business and authorization process.

A claims audit function is in the process of being implemented.

8. The Board, or the claims auditor if appointed, should ensure the every claim contains adequate itemization and documentation, that it is a proper District charge, approved by the department, certified as received, and complies with District policies, including prior authorization by the Purchasing Agent.

See response for #7 above. These items, as necessary, will be included in the implementation process.

9. The Board should design and implement written procedures to ensure that the claims audit function complies with its policies, statutory requirements, and general standards of good internal control.

See response to #7 above. These items will be included in the implementation process.

10. District management should segregate recordkeeping, transaction approval, and cash disbursement duties to the extent judged to be practical and cost effective. Where incompatible duties cannot be appropriately segregated, they should establish effective supervisory review procedures to mitigate specific risks.

The district has three employees, who by civil service requirements, are allowed to record, approve and maintain accounting records. Given the above, segregation of duties is incorporated to the level possible. Additional positions, with civil service titles allowing for accounting duties to be assigned, will be evaluated for cost effectiveness to allow for the additional segregation of duties.

11. The Board should ensure that all relevant District personnel are made aware of policies they have established, or will establish, to safeguard District assets. The Board should ensure that personnel that are responsible for the purchasing of goods and services have a proper understanding of the requirements of the District procurement policy and applicable provisions of State law including those related to competitive bidding.

Any policies in place or established with regard to the safeguarding of assets will be made available to appropriate staff members. The district's procurement policy will be reviewed, modified if necessary, and distributed to appropriate personnel to ensure that it is understood.

12. District management should design and implement an effective system of internal controls to safeguard technology equipment assets. At a minimum, this should include:

- Document control policies and procedures and assign formal control responsibilities and expectations. The responsibilities for recordkeeping and custody of assets should be segregated.
- Establish and maintain a reliable inventory record to account for technology equipment assets.
- Conduct periodic physical inventories to verify the inventory record against the actual assets on hand. Investigate discrepancies and report any adjustments to responsible District managers.

- Establish and communicate procedures to all District staff for reporting the loss of theft of District technology assets.

The District will design and implement an effective system of internal control to safeguard technology equipment as recommended by this audit.

13. The Board should develop and adopt policies regarding the monitoring and control of District food and vending machine inventories.

Policies will be developed, reviewed, and adopted which outline the controls established for monitoring the district food and vending machine inventories.

14. District managers should design and implement an effective system of internal controls to safeguard food and vending supplies. At a minimum, this should include:

- Document control policies and procedures, assign control responsibilities, and communicate control guidance and expectations.

Control policies and procedures are being documented and evaluated for effectiveness. Once finalized, they will be communicated to appropriate staff members and monitored for effectiveness.

- Perform periodic analytical reviews of product consumption to detect unusual usage or trends that require further investigation.

Reviews will be conducted by management to investigate for unusual trends with regard to usage.

15. Restrict or otherwise control custodial and maintenance staff access to stored food and vending machine supplies.

Staff access and the required needs thereof are being reviewed to determine if unnecessary access exists. If this review determines that unnecessary access exists, locks will be changed and keys distributed only to personnel determined to need access to stored food and vending machine supplies.

Sincerely,



J. Francis Manning
Superintendent of Schools

CC: Board of Education

APPENDIX B

OSC COMMENTS TO THE DISTRICT'S RESPONSE

Note 1

We commend management's response that all future payments for unused vacation leave will be made through the adoption of a board resolution. However, their legal citations are irrelevant to the propriety of the payments criticized as improper in this report. We concur that the Board may, by resolution, lawfully commute unused vacation time into cash upon an employee's separation from service. However, the Board had not passed such a resolution and Board-approved labor agreements did not provide for such payments. Absent formal Board action, District management lacked the lawful authority to pay employees for unused vacation leave and the payments we cited were improper. Further, court cases have held that Board resolutions need to be made in advance in order for the payments to be considered proper.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents such as District policies and procedures manuals, Board minutes and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its 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. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected payments for claims, lump sum payments made to separating employees, technology equipment inventories, and food and vending machine supplies inventories for further audit testing. We also examined the Board's oversight activity in order to assess its impact on the identified areas of risk.

For Board fiscal oversight, we reviewed the minutes of the proceedings of the Board of Education for the period July 1, 2004 to September 30, 2005. We interviewed the President of the Board of Education, the Superintendent, and the Business Manager about the Board's oversight activities. We examined audit reports and other communications by the District's independent auditor, but we did not audit the work of the independent auditor.

We focused our attention on the procedures for approving and processing lump sum payments to employees upon separation from the District. We identified 16 such payments made during our audit period. To determine the effectiveness of internal controls and to evaluate the effect of any associated deficiencies in those controls, we examined the supporting records filed in the business office including payroll transaction worksheets, leave accrual records, personnel files, and labor agreements. We also interviewed appropriate District staff and officials and representatives from the teachers union and the Teachers Retirement System to obtain additional information necessary to assess the propriety of some transactions.

We focused our attention on the procedures for approving and processing the payment of claims against the District's general, special aid, and school lunch funds. We based our overall assessment on a judgmental sample of 47 paid claims. To determine the effectiveness of internal controls and to evaluate

the effect of any associated deficiencies in those controls, we examined the supporting records filed in the business office and the paid check facsimiles provided by the bank. The supporting records we reviewed included purchase requisitions, travel authorization forms, employee reimbursement forms, purchase orders, and vendor invoices. We also interviewed appropriate District staff and officials to obtain additional information necessary to assess the propriety of some transactions.

For technology equipment inventories, we focused our attention on the procedures to account for and safeguard equipment assets costing more than \$500. We interviewed the primary equipment custodians about their control procedures and we examined the inventory records that accounted for the assets. We tested the reliability and accuracy of inventory records by tracing in a judgmental sample of 65 recent acquisitions to determine whether they had been recorded. We also physically verified the existence of the sampled equipment items and assessed their security and utilization at their locations.

For food and vending machine supplies inventories, we focused our attention on the procedures to account for and safeguard inventories of frozen meats and vending machine beverages. We interviewed the school lunch manager about control procedures, reviewed inventory, delivery, and production/consumption records, and took physical inventories for a judgmental sample of frozen products and vending beverages on November 29, 2005 at the middle and high schools. We attempted to reconcile our counts with physical inventory reports for the prior month and the receiving reports and food consumption records for the period November 1, 2005 to November 29, 2005. However, we found that these records were incomplete.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and conduct our audit to adequately assess those district operations within our audit scope. Further, those standards require that we understand the district's management controls and those laws, rules and regulations that are relevant to the district's operations included in our scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in accounting and operating records and applying such other auditing procedures, as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for the findings, conclusions and recommendations contained in this report.

APPENDIX D

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