



Wells Central School District Internal Controls Over Payroll

Report of Examination

Period Covered:

July 1, 2004 - March 31, 2006

2006M-131



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State of New York Office of the State Comptroller

Division of Local Government Services and Economic Development

November 2006

Dear School District Officials:

One of the Office of the State Comptroller's top priorities is to identify areas where school districts can improve their operations and provide guidance and services that will assist school district officials in making those improvements. Further objectives are to develop and promote short-term and long-term strategies to enable and encourage school district officials to reduce costs, improve service delivery and to account for and protect their school districts' assets.

The reports issued by this Office are an important component in accomplishing these objectives. These reports are expected to be a resource and are designed to identify current and emerging fiscally related problems and provide recommendations for improvement. The following is our report on the Wells Central School District — Internal Controls Over Payroll.

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

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

Respectfully submitted,

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

Introduction

Background

The Wells Central School District (District) is located in the Towns of Wells, Arietta, Lake Pleasant and Hope in Hamilton 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.

There is one school in operation within the District, with approximately 174 students and 60 employees. The District's expenditures for the 2004-05 fiscal year were \$4.2 million, funded primarily with State aid, real property taxes and grants. The District reported approximately \$2.8 million in payroll and related fringe benefits for the year ended June 30, 2005. This amount consisted of \$1.7 million in instructional salaries, \$400,000 in non-instructional salaries and \$700,000 in fringe benefits.

The District Treasurer (Treasurer) is responsible for the day-to-day functions related to the District's finances and accounting records. As the only full-time employee in the District's business office, the Treasurer controls all parts of the payroll process. She enters salaries and leave time for employees, records bi-weekly payroll information to the accounting records, signs payroll checks and reconciles bank statements. As of May 2006, the Superintendent began reviewing and certifying the payroll.

Objectives

The objective of our audit was to determine whether the District's internal controls over payroll are appropriately designed and operating effectively to adequately safeguard District assets. Our audit addressed the following related questions:

- Has the District adopted policies and procedures for the preparation of payroll?
- Has the District made payments to employees and school officials in accordance with collective bargaining and other contractual agreements?
- Has the District properly accounted for the accrual and use of employee leave time?

**Scope and
Methodology**

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on the areas most at risk. Our initial assessment included evaluations of the following areas: cash receipts and disbursements, purchasing, payroll and personal services, and capital assets and consumable inventories. Based on that evaluation, we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We did determine that risk existed in the District’s payroll processing. Therefore, we examined the internal controls over payroll for the period July 1, 2004 to March 31, 2006.

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

**Comments of District
Officials and Corrective
Action**

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

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

Internal Controls Over Payroll

The primary objective for internal controls over payroll processing is to ensure that employees are paid wages and salaries, and provided benefits, to which they are duly entitled. Internal controls over payroll consist of written policies and procedures that describe employee responsibilities in preparing and disbursing payroll, as well as written Board authorization for salaries, wages and fringe benefits. Two important components of any internal control system are proper segregation of duties that ensure that no one person controls all phases of a transaction, and management oversight.

The District had no written policies and payroll procedures which resulted in the Treasurer developing her own informal procedures. We noted instances where employee pay and leave accruals were inconsistent with their employment contracts. In addition, there was a lack of management oversight and no segregation of duties in the District's business office which allowed errors and irregularities to occur and go undetected.

Policies and Procedures

Written payroll policies and procedures combined with job descriptions help ensure that payroll is processed consistently and accurately, as well as provide a framework for employees to understand the Board's objectives and each individual's role in the process. Written policies are particularly important when a separation of duties is needed to provide an adequate level of internal controls.

The District had not established any written policies and procedures that describe employee responsibilities in processing and distributing bi-weekly payrolls. In the absence of a written policy, the Treasurer has developed an informal system to process payroll. As a result, during the fiscal year ended June 30, 2005, the Treasurer was solely responsible for processing approximately \$2.8 million in payroll and related fringe benefits for 60 employees with virtually no oversight by anyone independent of the process.

The Board's failure to provide specific guidance through well developed policies and procedures could lead to the neglect of key internal control activities or irregular activities occurring and remaining undetected.

Employee Pay and Leave Benefits

Documentation of the Board's authorization of salaries, wages and fringe benefits in writing, by resolution, policy document, negotiated employee contract, or collective bargaining agreement

is an important control over payroll and fringe benefit expenditures; it communicates the Board's intent and provides a framework for compensating officers and employees that is clearly understood by everyone involved in the process. A good system of internal controls over payroll and employee benefits requires that salaries and leave accruals are adequately calculated and agree with Board-authorized pay scales and benefit packages.

The District provided salaries and benefits to employees that were not in accordance with collective bargaining agreements or other employment contracts. Three of ten employees selected in each of the five payrolls tested from July 1, 2004 through March 31, 2006, had inconsistencies between signed contracts, collective bargaining agreements, or Board-authorized pay and the actual salary that was paid. For example, the Superintendent's 2004-05 stated salary according to his employment contract was \$88,400, the Board-approved salary listed in the minutes was \$90,130, while the appointment letter and actual amount paid was \$89,212. There was no explanation for these inconsistencies.

There were no employment contracts in place to support the salaries and benefits paid to three other employees included in our audit test. Although the Board approved the three employees' salaries in the minutes, there was no written authorization covering fringe benefits, such as paid leave and health insurance. The lack of contractual agreements has resulted in payments being made without any evidence of the Board's approval. For example, the Superintendent approved additional payments to the Treasurer for \$2,800 and \$3,000, respectively, for the 2004-05 and 2005-06 fiscal years as compensation for monitoring a Federal grant. However, no documentation existed to substantiate this approval. The Treasurer was also allowed to receive a payment for five vacation days that were not used during the fiscal year ended June 30, 2005. Although these payments were approved in writing by the Superintendent, they were made without evidence of the Board's approval or any supporting written employment contract.

We also noted that six employees' leave accruals did not conform to the benefits authorized in either an employee contract or collective bargaining agreement. For example, we found that the number of hours used to calculate a day of leave for bus drivers fluctuated from three to seven and a half hours. These fluctuations were noted for days used by the same employee. We were unable to reconcile leave hours charged in the accrual records to the method used to calculate leave charged by bus drivers, as explained by the Treasurer. The collective bargaining agreement did not indicate the number of hours that constitute a workday for bus drivers. We also found a teacher that

received an additional 16 days of leave during the 2004-05 fiscal year. The Treasurer stated that an adjustment was made to the teacher's leave records following his complaint that the District's accounting for leave was erroneous. However, there was no documentation presented to warrant the extra 16-day adjustment.

The failure to compensate officers and employees in accordance with the terms of authorized contracts and the absence of written employment contracts for certain employees represent significant weaknesses in internal controls over payroll processing and identify the need for the Board to exercise additional oversight over this function. Accurate leave records are essential in determining termination payments for employees either retiring or resigning from their positions.

Separation of Duties

An important principal of internal control requires that one person not have uncontrolled access to an entire processing cycle. It is important that the Board establish a system of checks and balances over payroll so that one person does not exercise control over all or most of the process. Management should not allow one person to perform the three key payroll duties of authorization (i.e., entering employee records, and changing hourly and annual salary and leave amounts), recordkeeping (i.e., maintaining appointment letters, personnel files and leave records), and asset custody (i.e., signing or distributing checks).

If it is not feasible for the District to adequately segregate duties, the Board should consider mitigating this internal control weakness by having someone independent of the preparation process perform a review of the completed payrolls and accrual records. The review should, at a minimum, include random checks to verify that payrolls are based on actual hours or days worked or authorized leave time; verify that the Board authorized the hourly rates or annual salaries used; compare net payrolls to payroll journals; and to assess the payroll for reasonableness.

The Treasurer was directly responsible for the following payroll duties: creating employee records, inputting all payroll changes, collecting time sheets, entering the hours worked or salaries paid, entering leave records and employee absences, posting expenditures to the subsidiary ledgers, preparing and signing checks and disbursing paychecks. The only segregation of duties included in the District's payroll system occurred when the Superintendent began reviewing and certifying the bi-weekly payroll during May 2006. The Superintendent stated that he performs a meaningful review of the contents of each payroll report, which includes selecting a small sample of employees, reviewing and

tracing their recorded hours worked to their timesheets. However, he does not compare the recorded payment amounts to the actual checks that are being distributed.

The Board is responsible for establishing a system of checks and balances so that one person does not exercise control over all or most of the payroll process. Not having someone independent of the payroll process review the completed bi-weekly payrolls increases the risk that errors and/or irregularities could occur and go undetected.

Recommendations

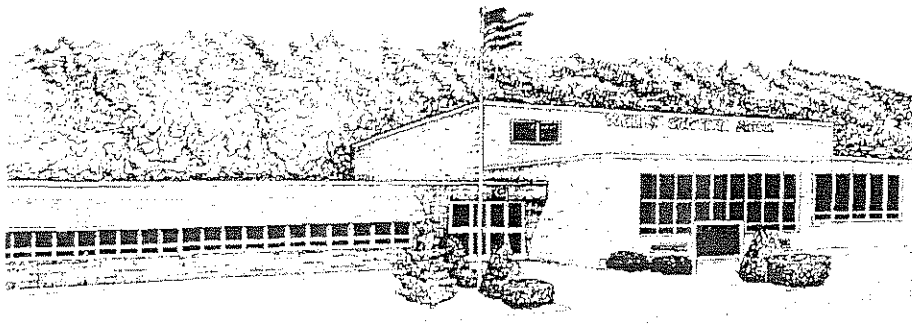
1. The Board should adopt written policies and procedures as guidance for the employees responsible for processing and distributing payroll.
2. The Board should ensure that employees are paid and receive benefits only as authorized by and provided for in its collective bargaining agreements or other employment contracts.
3. The Board should ensure that District personnel calculate leave records accurately for all officers and employees who are entitled to leave benefits.
4. The Board should determine the propriety of the accrual of 16 additional leave days to the teacher.
5. Someone independent of the payroll process should review final payrolls to verify that they are based on actual hours or days worked, or authorized leave charged; check that the hourly rates or annual salaries paid were authorized; compare net payroll checks to the payroll journals; and review the payroll for overall reasonableness.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

The District response letter makes reference to attachments that support the response letter. Because the District's response letter provides sufficient detail of the District's actions, we did not include the attachments in Appendix A.



Paul G. Williamsen
Superintendent

WELLS CENTRAL SCHOOL

P.O. Box 300 • Wells, New York 12190 • (518) 924-6000 • Fax (518) 924-9246

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

October 23, 2006

Dear [REDACTED]:

Please accept this letter as Wells Central School's official response to your preliminary draft findings. We understand your findings and submit the following plan and course of action(s) to you. This letter does not constitute our official corrective action plan (CAP) as contemplated by General Municipal Law.

Has the Wells Central School District adopted policies and procedures for the preparation of payroll?

The Board of Education had its first reading of the new policy on payroll (see attached) on Oct. 18 and will have the second reading on November 15th for approval. Local schools were canvassed for their BOE payroll policy as part of fact finding.

All salaries are computed at the beginning of the fiscal school year and approved by the Superintendent followed by a letter to the employee.

1. payroll will be processed by adding any additional money due employees
2. run payroll report to check all figures, adjust as needed
3. print checks
4. run all current pay period reports and post payroll
5. Superintendent certifies payroll

Has the District made payments for personal services in accordance with collective bargaining and other contractual agreements?

Written contracts approved by the BOE are completed for the District Treasurer and Secretary to the Superintendent (see attached). The Support Staff contract was the document used to monitor benefits, leave time and other contractual issues. The School Nurse is included in the Support Staff contract and will be named as we open contract talks this November.

Due to a clerical error, the Superintendent's salary was readjusted. The District Treasurer will receive, in writing, from the Board Clerk, any and all changes to salary and benefits the Board authorized towards the Superintendent.

The Superintendent was aware of additional payments to the District Treasurer for additional work completed on grants. Compensation for this duty was provided in this fashion for nearly 12 years by different recipients. The Superintendent will make recommendation of any/all grants received by the District and how employees are paid from these grants.

Regarding the payment of unused vacation days for the Treasurer, the contract, under Article 14 Vacations, allows an employee to be paid for any unused vacation days ... not to exceed 1/3 of their total vacation days. The Treasurer now has a written contract which stipulates this benefit.

Calculations for leave time for a bus driver is as follows:

Regular driver has a 3 hour day (1/2 day = morning or afternoon run off)

The formula used to illustrate "pieces" of a day or run taken for leave is:

Sept. 6 – 1.5 hours of leave

Sept. 8 – 1.5 hours of leave

Sept. 15 – 1.5 hours of leave

Sept. 18 – 1.5 hours of leave

Total of 6 hours would reflect two days of leave

The driver would be charged with one day and carry ½ hour until enough time is taken to accumulate another ½ day or a full day.

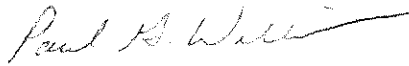
The driver doing the Pre-K run is charged the same as a BOCES run driver except for Friday when the driver only does a morning and afternoon run. Friday would be charged the same as a driver who only does a morning or afternoon run.

The issue of the accrual of 16 additional leave days to the teacher occurred when the District Treasurer thought the total contractual days were 240, when in actuality the count was 400 days allowed to be used. The discrepancy was between the teacher and District Treasurer and worked out according to contract.

Finally, the Superintendent is reviewing and certifying each final payroll and conducting a check to ensure authorized leaves are charged and all salaries are paid.

Thank you for your audit of the Wells Central School District. If I can be of further assistance, please do not hesitate to ask.

Respectfully,

A handwritten signature in cursive script, appearing to read "Paul G. Williamsen".

Paul G. Williamsen, Superintendent of Schools

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by District 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 of Education 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 reviewed. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected payroll and personal services for further audit testing.

- We interviewed appropriate District officials and employees to gain an understanding of the policies and procedures used to process the District's payroll.
- We reviewed, on a test basis, the payroll records for a judgmental sample of 10 of the 60 employees of the District. This sample included management, instructional, and non-instructional support staff. The records of these 10 individuals were traced to the payroll registers, cancelled checks, and other pertinent payroll, personnel and leave documents for five bi-weekly payrolls processed during the period July 1, 2004 through March 31, 2006.
- We reviewed the District's payroll records and reports, tested selected records and transactions, and examined pertinent documents to determine whether the payroll transactions had been properly recorded.

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

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