



Wyandanch Union Free School District Independent Audit Services

Report of Examination

Period Covered:

July 1, 2003 - June 30, 2004

2006M-3



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State of New York Office of the State Comptroller

Division of Local Government Services and Economic Development

June 2006

Dear School District Officials:

One of the Office of the State Comptroller's top priorities is to identify areas where local governments and school districts can improve their operations and provide guidance and services that will assist local officials in making those improvements. Further objectives are to develop and promote short-term and long-term strategies to enable and encourage local government and school district officials to reduce costs, improve service delivery and to account for and protect their entity'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 Wyandanch Union Free School District — Independent Audit Services.

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 the Board of Education.

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 Office of the State Comptroller recently audited the fiscal operations of the Wyandanch Union Free School District (District). A separate report will discuss the results of that audit. This report addresses one phase of that audit, the procurement of quality audit services. The District is required to have an annual financial statement audit, and it contracted with the certified public accounting (CPA) firm Deans Archer & Company to perform this service for the 2003-04 fiscal year.

Scope and Objectives

We reviewed the District's audit service procurement procedures, and the work done by the CPA firm retained by the District to audit the District's general purpose financial statements for the fiscal year ended June 30, 2004. The objectives of our audit were to determine the adequacy of existing practices for the procurement of audit services and the effectiveness of such audit services as a means for the timely detection of errors and irregularities. Our audit addressed the following questions:

- Did the District follow appropriate policies and procedures when procuring audit services?
- Did the audit work of the CPA firm meet the purposes, terms and conditions of the contract of engagement and provide effective oversight for District fiscal operations?

Audit Results

The District did not effectively procure its annual audit services by obtaining requests for proposals. Instead, District officials contracted with a CPA firm that they used in the past without seeking competitive offers from other firms.

We found that the CPA's annual audit of the District did not meet several critical professional standards. For example, the CPA firm did not comply with auditing standard requirements relating to the consideration of fraud. The standardized checklists that the CPA firm used did not contain the CPA's conclusions regarding the risk of fraud. This lack of conclusions brings into question the value of these checklists in planning and performing an audit to obtain reasonable assurance about whether the financial statements are free of material misstatements and fraud. We found no indication that the CPA firm formulated an audit response to the risk of District management overriding controls. Auditing standards mandate such a response, which stems from the many recent instances in which an entity's upper management has overridden internal controls to perpetrate and cover-up fraudulent activity (such as Enron).

In addition, the CPA firm did not comply with the second standard of fieldwork, which states that a sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. The CPA firm failed to obtain an adequate understanding of internal controls relating to the District's use of information technology.

Professional standards require that audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. However, we found that the CPA firm's workpapers contained several instances where the CPAs did not provide conclusions or workpaper references to conclusions.

The CPA firm did not obtain timely written representations from District management for all financial statements and periods covered by the auditors' report, as required by professional standards. In addition, the CPA firm did not disclose all significant instances of the District's non-compliance with laws and regulations. For example, on June 30, 2004, the District's unreserved, undesignated general fund balance was \$2,699,213 and the 2004-05 proposed general fund budget was \$41,950,415 – which created a ratio of 6.4 percent, more than three times the legal limit.

Because of the deficiencies noted, we believe that the CPA firm's audit work did not meet the purposes, terms and conditions of the contract of engagement with the District.

Comments of District Officials

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

Introduction

Background

The Office of the State Comptroller recently audited the fiscal operations of the Wyandanch Union Free School District (District). A separate report will discuss these results. This report addresses one phase of that audit, the District's procurement of quality audit services.

The Board of Education (Board) is ultimately responsible for safeguarding the District's assets. The Board meets this responsibility by establishing internal controls designed to prevent or detect errors and irregularities. It is the Board's duty to make certain that established controls are appropriately designed and operating effectively. Such controls provide the Board with reasonable assurance that the District's assets are adequately safeguarded. The Board ensures the quality of its established controls through timely oversight of the District's fiscal operations.

One aspect of an effective system of internal controls is an annual audit performed by an independent certified public accountant (CPA).¹ Such an audit can be an effective oversight tool for District managers by providing for the timely detection of errors or irregularities. The effectiveness of the annual independent audit as a control is dependent on the scope and quality of such an audit and the resultant communications to management. The scope and quality of this type of audit is governed largely by generally accepted government auditing standards (GAGAS).² Such standards specify the appropriate qualifications and responsibilities of the professionals who will conduct the audit, the quality of the audit work to be performed, and the required communications to management. The CPA's engagement letter³ to the Board should document the audit scope, applicable professional standards, and other audit engagement expectations.

¹ Education Law and the regulations of the Commissioner of Education require that an external audit be conducted by a certified public accountant, in accordance with generally accepted government auditing standards (GAGAS). Although required by legal statute, the District exercises its discretion in choosing a qualified independent auditor. The independent auditor issues an opinion on the District's annual financial statements and its compliance with certain laws and regulations and issues a report on the District's internal controls. The auditor also may issue reports related to federal award programs that the District administers. The report on the District's financial statements must be filed with the New York State Education Department (SED) by October 30 each year.

² Appendix A

³ Appendix B

It is the Board's responsibility, through its established policies and procedures, to ensure that it procures quality audit services. This responsibility is further defined in statute. General Municipal Law⁴ requires political subdivisions, including school districts, to adopt procurement policies and procedures. This statute requires that the District procure goods and services, which are not required by law to be competitively bid, in a manner that ensures the prudent and economical use of public moneys, in the best interests of the taxpayers. The stated purpose of the statute is to ensure that the District acquires goods and services of maximum quality, at the lowest possible cost under the circumstances, and to guard against favoritism, improvidence, extravagance, fraud, and corruption.

Objectives

The objectives of our audit were to determine the adequacy of existing practices for the procurement of audit services and the effectiveness of such audit services as a means for the timely detection of errors and irregularities. Our audit addressed the following questions:

- Did the District follow appropriate policies and procedures when procuring audit services?
- Did the audit work of the CPA firm meet the purposes, terms, and conditions of the contract of engagement, and provide effective oversight for District fiscal operations?

Scope and Methodology

We examined the District's independent audit services for the 2003-04 fiscal year.

We conducted our audit in accordance with GAGAS. More information on such standards and the methodology used in performing this audit are included in Appendix A and Appendix D 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 C, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to take 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

⁴Section 104-b

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.

Procurement of Audit Services

The District did not have any written policies and procedures for the procurement of professional services, including audit services. The District's purchasing policy is silent with regard to the means by which it must procure professional services. As a result, the District did not procure audit services in an effective manner.

District officials did not solicit requests for proposals (RFPs) for auditing services for the District's 2003-04 fiscal year. The associated fees paid by the District for the service amounted to \$30,000. The District retained the Deans Archer & Company (Deans Archer) CPA firm to provide the foregoing audit services, and the firm had performed these same services intermittently over the past several years for the District. The District renewed its contract with this CPA firm for the 2004-05 fiscal year, and the District did not seek RFPs for this contract.

Although the procurement of professional services was not subject to the requirements of the competitive bidding law, alternative proposals secured by RFPs could benefit the District by providing a comparison of the qualifications and fee structure of various firms providing audit services. The State Legislature amended Education Law to require – beginning on July 1, 2005 – school districts to use a competitive RFP process when contracting for the annual audit. In addition, no audit engagement can be for a term longer than five years.

Recommendations

1. The Board should establish policies and procedures relating to the procurement of professional services, including audit services. Such policies and procedures should include RFP guidelines that District personnel must follow when procuring contracts for audit services.
2. District officials should prepare a well-planned written RFP for all subsequent audit services. District officials should refer to the "RFP Template for School Districts Seeking Audit Services" prepared by the Office of the State Comptroller for guidance in preparing the RFP.
3. The District should obtain written proposals, and District personnel should retain and file these proposals at District offices. The District should then award contracts to the best-qualified firm offering the most economic proposal for the services being solicited.

4. The District must issue an RFP for audit services at least every five years.

Effectiveness of Audit Services

The District contracted with Deans Archer to conduct the independent audit of its financial statements for the fiscal year addressed by our audit. As a result of its audit work, the CPA firm issued an unqualified opinion to the District for the 2003-04 fiscal year.

We assessed the effectiveness of the District's engagement of an independent audit as an oversight tool for District managers by determining whether the CPA's contractual audit services met the terms and provisions of the engagement contract,⁵ including professional auditing standards.⁶ Our audit considered requirements under the auditing standards concerning independence, planning the audit, obtaining evidence, and reporting on matters found during the audit, and our audit covered the financial statement audit for the District's 2003-04 fiscal year.

As promulgated by the Government Accounting Office of the United States, GAGAS consist of a series of measures intended to ensure quality audit work. The June 2003 auditing standards — that were applicable to the 2003-04 fiscal year — were structured around four general standards, eight fieldwork standards, and 10 reporting standards. If a CPA firm does not comply with one of these standards, not only should the District be concerned, but the firm could be referred to the State Board of Accountancy.

When reviewing Deans Archer's 2003-04 audit work for the District, we found compliance problems with its auditing fieldwork standards and reporting standards. These standards state that:

- The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.
- A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.
- Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous

⁵ Appendix B

⁶ Appendix A

connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, and recommendations before the auditors issue their report.

- Written representations from management should be obtained for all financial statements and periods covered by the auditors' report.
- Auditors should include in their report on the financial statements either: (1) a description of the scope of the auditors' testing of internal controls over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements, and the results of those tests or an opinion, if sufficient work was performed; or (2) a reference to the separate report(s) containing that information.

Fieldwork Standards — Planning the Audit

Our review of the CPA firm's workpapers that documented their audit planning for the 2003-04 fiscal year revealed several instances where the CPA firm did not meet professional standards.

The planning phase of the audit is critical to the success and quality of the resulting fieldwork and communication to management. The information gathered during the planning phase will help the auditor determine the nature, timing and extent of audit tests needed to accomplish the audit objectives (and adhere to professional standards).

Consideration of Fraud – The American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards (SAS) AU Section 316 requires auditors to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements, caused by error or fraud. SAS 99, "Consideration of Fraud in a Financial Statement Audit," is effective for audits of financial statements for periods beginning on or after December 15, 2002. Our review of the CPA firm's workpapers for the 2003-04 fiscal year audit indicated that the CPA firm did not meet the standards that require consideration of fraud.

The 2003-04 planning section of the CPA firm's workpapers included several standardized forms (checklists) designed to demonstrate compliance with SAS 99, which was effective for the 2003-04 fiscal year. The SAS 99 checklists were:

- GCX-5: Governmental Fraud Risk Assessment Form
- GCX-5a: Fraud Risk Discussion Among Engagement Team Members for Governmental Audit Engagements
- GCX-5b: Inquiries of Management and Others about the Risks of Fraud for Governmental Audit Engagements
- GCX-5c: Considering Fraud Risk Factors for Governmental Financial Statement Audit Engagements
- GCX-5d: Considering Fraud Risk Factors for an Audit of Federal Award Programs.

We noted the following exceptions relating to this set of checklists:

- The checklists did not contain the CPA firm’s documentation of responses to fraud risks, mitigating controls (if any), and the overall conclusion regarding the risk of material misstatements due to fraud. Although form GCX-5 includes sections for the auditors to document these conclusions, the auditors did not complete these sections.
- On form GCX-5, the auditors identified management override of controls as a potential fraud risk and further indicated that an audit response was required for this particular fraud risk. However, the auditors did not identify how the CPA firm planned to respond to this fraud risk. This particular risk is especially important to address, because management is in a unique position to perpetrate fraud through its ability to directly or indirectly manipulate accounting records and prepare financial statements by overriding established controls.⁷
- On form GCX-5a, the auditors identified payroll distribution, physical inventory, and segregation of duties – accountant/ Treasurer as three areas that they should have considered when identifying risks of material misstatements due to fraud. We found no documentation to indicate that the auditors considered the affect that this information would have on their audit plan, development of audit tests, or on the financial statements.

⁷ SAS AU 316.42 states, “Even if specific risks of material misstatement due to fraud are not identified by the auditor, there is a possibility that management override of controls could occur, and accordingly, the auditor should address that risk apart from any conclusions regarding the existence of more specifically identifiable risks.”

- On form GCX-5b, the auditors identified physical inventory and alleged management fraud as two areas that they should have considered when identifying risks of material misstatements due to fraud. We found no documentation to indicate that the auditors considered the affect that this information would have on their audit plan, development of audit tests, or on the financial statements.

Based on these exceptions, we conclude that the CPA firm did not follow auditing standard requirements relating to the consideration of fraud. A partner from the CPA firm stated that the firm uses the checklists as guides for their audit test work, and that the auditors should have prepared a memo summarizing the conclusions reached.

Consideration of Internal Control – SAS AU Section 319 requires auditors to obtain a sufficient understanding of the entity’s internal control to plan the audit and to determine the nature, timing, and extent of tests that they must perform. An auditor should obtain an understanding of the entity’s internal controls that is sufficient to plan the audit by performing procedures to understand the design of controls that are relevant to an audit of financial statements, and by determining whether the entity has implemented these controls. In obtaining this understanding, auditors must consider how an entity’s use of information technology (IT) and manual procedures may affect controls that are relevant to the audit. Our review of the CPA firm’s consideration of the District’s internal controls for the 2003-04 fiscal year audit indicated that the auditors did not meet professional standards.

Internal controls consist of the following five interrelated components: the control environment, risk assessment, control activities, information and communication, and monitoring. An entity’s use of IT and manual procedures may affect any of the five components of internal controls that are relevant to the entity’s achievement of its financial reporting, operations, or compliance objectives. An entity’s use of IT also affects the fundamental manner in which it initiates, records, processes, and reports its financial transactions. If an entity relies on extensive use of complex computer processing in significant accounting applications, auditors should consider: the extent to which the computer is used in each significant accounting application; the complexity of the entity’s computer operations, including the use of outside service organizations; the organizational structure of the computer processing activities; and the availability of data.

The specific risks that IT poses to an entity's internal controls can be extensive, and can include: the entity's reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both; unauthorized access to data; unauthorized changes to data in master files; unauthorized changes to systems or programs; failure to make necessary changes to systems or programs; inappropriate manual intervention; and potential loss of data. However, an entity can use a combination of automated controls (e.g., controls embedded in computer programs) and manual controls to address these risks. As an entity's operations and systems become more complex and sophisticated, it becomes more likely that auditors would need to increase their knowledge of internal control components to obtain the understanding necessary to design tests of controls (when applicable) and substantive tests. Therefore, auditing standards indicate that auditors should consider whether they need specialized skills to determine the affect of IT on the audit, to understand the IT controls, or to design and perform tests of IT controls or substantive tests.

Our review of the CPA firm's workpapers for the financial statement audit for the 2003-04 fiscal year indicated that the CPA firm had not obtained an understanding of the affect of IT on the District's internal controls. We found no consideration in the workpapers of the specific risks associated with using IT, and no indication that the auditor had obtained an understanding of computer controls. A partner in the CPA firm stated that the auditors should have included a memo detailing the strengths and weaknesses of the IT internal control environment in the planning section.

For the 2003-04 fiscal year audit, the CPA firm used the checklist entitled "GCX-3: Governmental Audit Planning Form" to document its understanding of the five components of internal controls. Our review of this form also disclosed several instances where the auditors did not include adequate documentation to explain the answers to the questions provided on the form. The questions that the auditors answered "no," but did not include additional explanations for, are:

- Is management satisfied that all employees are honest?
- Does management commit sufficient resources to address IT risks that might adversely affect internal controls?
- Has management developed and are they appropriately involved in the oversight of a fraud risk management program?

- Is there adequate monitoring of decentralized activities and accounting systems?
- Is approval of a responsible official who is not directly involved in the preparation of the journal entries required for all general journal entries that are not standard entries?
- Is the general accounting/general ledger/journal entry function separate from custody and control over assets such as cash, securities, and inventory?
- Are personnel who perform the general accounting/general ledger/journal entry function not involved in the detail recording functions of accounts receivable, accounts payable, or purchasing?

We found no documentation to indicate whether the auditors had discussions with District management on these issues.

Finally, the auditors checked the question about use of a computer in significant audit areas as “yes.” The form states that if the auditors check this question as “yes,” then they must complete and attach the GCX-3d questionnaire (Financial Reporting System–Computer System) to the checklist form. The auditors did not include this additional questionnaire in the workpapers. The incompleteness of this checklist form and the lack of documented responses from District officials cause us to question the level of understanding that the CPA firm obtained regarding the District’s system of internal controls.

Based on these exceptions, we conclude that the CPA firm did not comply with the second standard of fieldwork, which requires that auditors should obtain a sufficient understanding of internal controls to plan the audit and to determine the nature, timing, and extent of tests that they must perform. The CPA firm failed to obtain an understanding of internal controls relating to the District’s use of IT. Because consideration of an entity’s internal controls guides the entire audit process, the CPA firm’s failure to gain a sufficient understanding of the District’s internal controls system makes the entire audit suspect, including the conclusions reached in the CPA firm’s report. It also significantly reduces the effectiveness of the external audit as an oversight tool for District operations.

Assessment of Control Risk – SAS AU Section 319 provides guidance on the auditors’ assessment of control risk. Assessing control risk is the process of evaluating the effectiveness of an entity’s internal controls

in preventing or detecting material misstatements in the financial statements. Auditors can assess control risk at the maximum level, or below the maximum level for certain financial statement assertions. To assess control risk below the maximum level, auditors must identify specific controls relevant to the assertion and design of controls – and then perform tests of controls and conclude what is the assessed level of control risk. An audit strategy, such as the one previously described, allows auditors to reduce the level of substantive testing needed to meet professional standards – regarding the sufficiency and adequacy of evidential matter – because a greater emphasis is placed on the effectiveness of internal controls. Our review of the CPA firm’s workpapers showed the auditors’ documented assessment of control risk did not agree with the results of their tests of controls. The auditors did not include a conclusion about the effectiveness of the control systems in their test of controls workpapers, even though there was space preprinted on the forms for the documentation of the conclusion.

The CPA firm used the checklists titled “NCX-14a: Tests of Controls Form” and “NCX-14b: Tests of Controls – Sampling Form” to document the tests of internal controls and the results of the tests on the assessment of control risk. NCX-14b includes the following table⁸ for planning the sample size for testing and evaluating the results:

Number of Deviations (Planned or Actual)	Sample Size			
	25	40	60	80
0	Moderate	Low	Low	Low
1	Maximum	Moderate	Low	Low
2	Maximum	Maximum	Moderate	Low
3	Maximum	Maximum	Moderate	Moderate
4	Maximum	Maximum	Maximum	Moderate

The following table shows the planned number of deviations, the actual deviations noted, the documented assessment of control risk, and the actual control risk assessment based on the test results:

⁸ The table on “NCX-14b: Tests of Controls – Sampling Form” includes the evaluation of control risk for the number of deviations ranging from 0-3, and sample sizes of 25, 40, and 60. The auditors achieved the evaluations of control risk for a fourth deviation and the sample size of 80 by using their professional judgment and extrapolating the results of the sample sizes documented in the table.

Test of Controls	Sample Size	Planned Deviations	Actual Deviations	Documented Control Risk Assessment (based on planned deviations)	Actual Control Risk Assessment (based on test results)
Board Expenses	25	0	2	Low	Maximum
Cash Disbursements	60	0 - 1	3	Low	Moderate
Payroll	80	0 - 2	4	Low	Moderate

The CPA firm incorrectly assessed the District’s control risk too low for all three of the audit areas listed in the table. This low assessment increases the detection risk⁹ and does not support the audit strategy of reducing the substantive testing based on strong internal controls. These incorrect assessments increase the risk that the financial information in the District’s financial statements could have material misstatements that were not detected by the auditor.

CPA firm personnel told us that they did not reduce the level of substantive testing due to this assessment. CPA firm personnel should have documented the differences from the preliminary assessment to the actual results, and concluded how the results would have affected the substantive testing. Our review of the workpapers showed that the auditors did not include this documentation in their workpapers.

Fieldwork Standard – Audit Documentation

GAGAS require that audit documentation related to audit planning, conducting, and reporting on the audit contains sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors’ significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report. In our review of the CPA firm’s general audit program for its audit of the District’s 2003-04 fiscal year, and of the firm’s analytical review workpapers, we found that the CPA firm did not meet these standards.

The CPA firm’s Governmental Audit Program (GAP-1) included 13 instances where the auditors did not document a conclusion, or they did not include a reference to a workpaper with a conclusion. The 13 instances included:

- Review the minutes of the Board’s proceedings where the Board adopted the budget, and any budget amendments.

⁹ SAS AU Section 316.42 defines detection risk as the risk that an auditor will not detect a material misstatement that exists in an assertion.

- Scan the budget-to-actual comparison information and consider whether the District violated the budget through over-expenditures.
- Examine journal entries recorded in the general ledger and other adjustments made by District personnel while they were preparing the financial statements.
- In the workpapers, summarize information about significant commitments or contingencies.
- Perform a review for subsequent events that occurred between the date of the financial statements and the date of the auditor's report.
- Consider whether audit procedures performed to achieve other audit objectives have identified conditions that – when considered in the aggregate – indicate there could be substantial doubt about the entity's ability to continue as a going concern.
- Consider whether the financial statements include reasonable estimates for all matters that require estimation, which are material to the client's operating results or financial position.
- Perform a retrospective review of significant accounting estimates reflected in the prior year financial statements.
- Consider the accumulated results of audit procedures in relation to the audit risk assessment made in the planning stage of the audit.
- Consider whether the collective application of significant accounting principles suggests a bias that may be indicative of possible fraud.
- Consider whether audit procedures have detected conditions or circumstances that differ adversely from your expectations, and whether those conditions or circumstances indicate the likelihood of material misstatement.
- Consider whether audit procedures have detected material misstatements resulting from violations of provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts, or other financial data significant to the audit objectives.

- Consider whether any information has come to your attention that indicates there are situations or transactions that could be indicative of abuse.

The following program step – which is critical in the detection of fraud, abuse and professional misconduct – was marked “N/A” in the “Performed By” column:

- Perform a review for related party transactions.

SAS AU Section 329 requires that auditors use analytical procedures in the planning and overall review of financial information for all financial statement audits made in accordance with generally accepted auditing standards (GAAS). Our review of the CPA firm’s workpapers indicated that the auditors did not adequately document their use of analytical procedures applied in both the planning and overall review stages.

Auditors use analytical procedures in the planning stage to assist them in planning the nature, timing, and extent of the audit procedures, and in the final review stage to assist them in assessing the conclusions reached and in evaluating the overall financial statement presentation. In the planning stage, the auditors’ analytical procedures should focus on enhancing their understanding of the audited entity and identifying areas that may represent specific risks relevant to the audit. The overall review would generally include considering the adequacy of evidence gathered in response to unusual or unexpected balances identified in planning the audit or in the course of the audit, and considering unusual or unexpected balances or relationships that were not previously identified. The CPA firm’s analytical review consisted of a material variance report prepared after the District completed its financial statements, and the analytical review did not include any documentation of analysis of the variances. A partner in the CPA firm also stated that the auditors performed a budget-versus-actual review when reviewing the District’s ST-3.¹⁰ However, the auditors did not document this review in the workpapers. The CPA firm’s lack of documentation of analytical review raises questions as to the quality of the work that its auditors performed.

The CPA firm’s lack of documentation for these audit program steps, and lack of documentation of analysis and conclusions on the analytical review workpapers, would prevent an experienced auditor – who has had no previous connection with the audit – from ascertaining from the audit documentation the evidence that supports the auditors’ significant judgments and conclusions on the audited financial statements.

¹⁰ The ST-3 is an annual financial report that all school districts must submit to the New York State Education Department (SED).

**Fieldwork Standard —
Management Representation
Letter**

SASAU Section 333 requires auditors to obtain written representations from management for all financial statements and periods covered by their report. The standard states that “written representations from management ordinarily confirm representations explicitly or implicitly given to the auditor, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations.” For example, management might state in a written representation letter that it provided all financial records and related data, and that there were no unrecorded transactions in the records.¹¹ During an audit, management representation letters are a part of the evidential matter used by auditors to form an opinion on the entity’s financial statements. These representation letters are not a substitute for substantive testing, but compliment the audit procedures performed.

In April 2005, when we asked the CPA firm to provide us with the District’s management representation letter, CPA firm personnel told us that they did not obtain one from the District. In November 2005, the CPA firm provided us with a management representation letter for the District’s 2003-04 fiscal year that was signed by the Director of Finance some time after April 2005. The auditors received the representation letter well after they issued the audited financial statements.

**Reporting Standard —
Compliance With Laws and
Regulations**

GAGAS state that when providing an opinion or a disclaimer on financial statements, auditors should include in their report on the financial statements either: (1) a description of the scope of the auditors’ testing of internal controls over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements, and the results of those tests or an opinion, if sufficient work was performed; or (2) a reference to the separate report(s) containing that information.

As part of our review of the audited financial statements, we found that the District’s June 30, 2004 unreserved, undesignated general fund balance was greater than allowed by law. Real Property Law¹² permits Boards to retain an undesignated fund balance not to exceed 2 percent of the proposed budget for the school year for which the taxes are being levied. On June 30, 2004, the District’s unreserved, undesignated general fund balance was \$2,699,213, while the 2004-05 proposed general fund budget was \$41,950,415 – which created a ratio of 6.4 percent, more than three times the legal limit. The auditors did not document this situation in their audit report.

¹¹ SAS AU Section 333.06

¹² Section 1318

Based on the CPA firm not including this finding in their report, we conclude that the auditors did not include all significant issues of noncompliance with laws and regulations in their report.

Recommendations

5. District officials and Board members should ensure that they understand the scope and limitations of the annual independent audit. If District officials feel that the District periodically needs audit services that are not covered by the annual audit, they should consider expanding the scope of the audit, or contracting for separate engagements.
6. The Board should establish an audit committee whose membership has sufficient financial expertise to successfully accomplish the following activities:
 - a. Provide timely oversight of external and internal audit work.
 - b. Participate in the selection process for external and internal auditors.
 - c. Ensure that the external auditors perform the audit of the District's financial statements in accordance with GAGAS.
 - d. Review the District's financial statements before presentation to the Board.
 - e. Monitor the District's corrective action plans.

APPENDIX A

GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS (GAGAS)

Education Law and Regulations of the Commissioner of Education require that an external audit be conducted by a certified public accountant in accordance with generally accepted government auditing standards (GAGAS).

Generally accepted government auditing standards are promulgated by the Government Accountability Office of the United States. The “Yellow Book,” issued by the Comptroller General, contains guidelines for the conduct of financial statement audits that pertain to auditors’ professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports. The Yellow Book incorporates the standards of the American Institute of Certified Public Accountants (AICPA) and adds additional requirements for government audits. The Yellow Book standards are outlined below.

Government Auditing Standards - 2003 Revision (Yellow Book)

(Effective for financial audits of periods ending on or after January 1, 2004)

This document contains standards for audits of government organizations, programs, activities and functions, and of government assistance received by contractors, nonprofit organizations, and other non-government organizations. These standards, often referred to as generally accepted government auditing standards (GAGAS) are to be followed by the auditors and audit organizations when required by law, regulation, agreement, contract, or policy. The standards pertain to auditors’ professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful reports.

The comprehensive nature of auditing done in accordance with these standards places on the audit organization the responsibility for insuring that:

1. Independence and objectivity are maintained in all phases of the assignment,
2. Professional judgment is used in planning and performing the work and in reporting the results,
3. The work is performed by personnel who are professionally competent and collectively have the necessary skills and knowledge, and
4. An independent peer review is periodically performed resulting in an opinion issued as to whether an audit organization’s system of quality control is designed and being complied with to provide reasonable assurance of conforming with professional standards.

General Standards:

These general standards apply to all audit organizations, government and non-government (for example, public accounting firms and consulting firms), conducting audits of government organizations, programs, activities and functions, and of government assistance received by non-government organizations. GAGAS require the following:

1. In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free both in fact and appearance from personal, external, and organizational impairments to independence.
2. Professional judgment should be used in planning and performing audits and attestation engagements and in reporting the results.
3. The staff assigned to perform the audit or attestation engagement should collectively possess adequate professional competence for the tasks required.
4. Each audit organization performing audits and/or attestation engagements in accordance with GAGAS should have an appropriate internal quality control system in place and should undergo an external peer review.

Fieldwork Standards:

For financial statement audits, GAGAS incorporate the AICPA's three generally accepted standards for field work. AICPA and GAGAS require the following:

1. The work is to be adequately planned, and assistants, if any, are to be properly supervised.
2. A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.
4. Auditors should communicate information regarding the nature, timing, and extent of planned testing and reporting and the level of assurance provided to officials of the audited entity and to the individuals contracting for or requesting the audit.
5. Auditors should consider the results of previous audits and attestation engagements and follow up on known significant findings and recommendations that directly relate to the objectives of the audit being undertaken.

6. Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from violations of provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible violations of provisions of contracts or grant agreements that could have a material indirect effect on the determination of financial statement amounts or other financial data significant to the audit objectives, auditors should apply audit procedures specifically directed to ascertain whether violations of provisions of contracts or grant agreements have occurred or are likely to have occurred.
7. Auditors should be alert to situations or transactions that could be indicative of abuse, and if indications of abuse exist that could significantly affect the financial statement amounts or other financial data, auditors should apply audit procedures specifically directed to ascertain whether abuse has occurred and the affect on the financial statement amounts or other financial data.
8. Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.

Reporting Standards:

For financial statement audits, GAGAS incorporate the AICPA four generally accepted standards for reporting. AICPA and GAGAS require the following:

1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.
2. The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking.
5. Audit reports should state that the audit was performed in accordance with generally accepted government auditing standards.

6. When providing an opinion or a disclaimer on financial statements, auditors should include in their report on the financial statements either: (1) a description of the scope of the auditors' testing of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements and the results of those tests or an opinion, if sufficient work was performed; or (2) a reference to the separate report(s) containing that information. If auditors report separately, the opinion or disclaimer should contain a reference to the separate report containing this information, and state that the separate report is an integral part of the audit and should be considered in assessing the results of the audit.
7. For financial audits, including audits of financial statements in which the auditor provides an opinion or disclaimer, auditors should report, as applicable to the objectives of the audit: (1) deficiencies in internal control considered to be reportable conditions as defined in AICPA standards, (2) all instances of fraud and illegal acts unless clearly inconsequential, and (3) significant violations of provisions of contracts or grant agreements and abuse. In some circumstances, auditors should report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties external to the audited entity.
8. If the auditors' report discloses deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions.
9. If certain pertinent information is prohibited from general disclosure, the audit report should state the nature of the information omitted and the requirement that makes the omission necessary.
10. Government auditors should submit audit reports to the appropriate officials of the audited entity and to appropriate officials of the organizations requiring or arranging for the audits, including external funding organizations such as legislative bodies, unless legal restrictions prevent it. Auditors should also send copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless the report is restricted by law or regulation, or contains privileged and confidential information, auditors should clarify that copies are made available for public inspection. Non-government auditors should clarify report distribution responsibilities with the party contracting for the audit and follow the agreements reached.

APPENDIX B

ENGAGEMENT LETTER

Engagement History – The Board appointed the CPA firm of Deans Archer & Company (Deans Archer) as its independent auditor on July 14, 2004 to perform the District’s annual audit for the fiscal year ended June 30, 2004. A different independent audit firm performed the District’s annual audits for the fiscal years that preceded the District’s appointment of Deans Archer.

The following are our observations concerning the CPA firm’s engagement letters:

The engagement letter for the fiscal year covered by our audit confirmed the understanding of services that the CPA firm would provide to the District. The engagement letter indicated the CPA firm’s agreement to audit the general purpose financial statements of the District for the year ended June 30, 2004, and to audit the District’s extra-classroom activity funds.

Scope – In the July 12, 2004 engagement letter, the CPA firm agreed to conduct an audit of the District’s general purpose financial statements as of, and for the year ended, June 30, 2004. The stated objective of this audit was to express an opinion as to whether the District’s financial statements fairly presented the financial position of the District as of the fiscal year ended June 30, 2004, and on the results of the District’s operations for the year then ended, in all material respects, in conformity with accounting principles generally accepted in the United States of America. In addition, the engagement letter indicated that the audit objectives also included reporting on:

- Internal controls related to the financial statements and compliance with laws, regulations and the provisions of contracts or grant agreements which could have a material affect on the financial statements
- Internal controls related to major programs, including an opinion on the District’s compliance with laws, regulations and the provisions of contracts or grant agreements that could have a direct and material affect on each major program, in accordance with the Single Audit Act and OMB Circular A-133.

Audit Standards – The engagement letter stated that the CPA firm would conduct the audit in accordance with: U.S. generally accepted auditing standards; the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; the Single Audit Act Amendments of 1996; and the provisions of OMB Circular A-133.

District Management’s Responsibilities – The engagement letter also described the responsibilities of the District’s management. Among other things, the letter states that management is responsible for:

- Establishing and maintaining adequate records and effective internal controls over financial reporting and compliance, selecting and applying accounting principles, and safeguarding District assets

- Making all financial records and related information available to the auditors
- Reviewing and understanding the nature of any proposed adjusting journal entries and the impact that they have on the financial statements
- Designing and implementing programs and controls to prevent and detect fraud, and informing the CPA firm about all known or suspected fraud affecting the District
- Establishing and maintaining an adequate system of internal accounting controls, and complying with applicable laws and regulations, including those relating to federal assistance programs
- Following up and taking corrective action reported in the audit findings, and preparing a summary schedule of prior audit findings and a corrective action plan.

CPA Firm's Responsibilities – The CPA firm's various responsibilities also are defined in the engagement letter. The engagement letter states that, among other things, the CPA firm is responsible for:

- Expressing an opinion on the financial statements
- Planning and performing the audit to obtain reasonable — rather than absolute — assurance regarding whether the District's financial statements are free of material misstatements, whether from errors, fraudulent financial reporting, misappropriation of assets, or violations of laws or governmental regulations
- Considering internal controls to a sufficient extent to plan the audit and to determine the nature, timing and extent of auditing procedures that would allow the auditors to express an opinion on the District's financial statements
- Obtaining an understanding of the design of the relevant controls — and determining whether the District has placed these controls in operation — and assessing control risk
- Informing the District of any matters involving its internal controls and their operation that are considered to be reportable conditions under AICPA standards.

APPENDIX C

RESPONSE FROM DISTRICT OFFICIALS

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

WYANDANCH UNION FREE SCHOOL DISTRICT

Central Administration Building
1445 Dr. Martin L. King, Jr., Boulevard
Wyandanch, New York 11798-3997

BOARD OF EDUCATION

Bishop Michael V. Talbert, President
Sister Saldnah Karvem, Vice President
Denise Baines, Trustee
Shirley Baker, Trustee
Samuel Burnett, Trustee
James Crawford, Trustee
Barry White, Trustee

Betty Jo Joynes
District Clerk
631 491-1001
Fax 631 643-3506

DISTRICT MAIN
(AUTOMATED DIRECTORY)
631 491-1013

CENTRAL ADMINISTRATION

Dr. Sherman Roberts
Superintendent of Schools
631 491-1012
Fax 631 491-3032

Dr. Gertrude Karabas
Director of Curriculum & Instruction
631 491-1016
Fax 631 491-1060

Calvin Wilson
Director of Finance
631 491-1002
Fax 631 253-0522

James P. Luff
Director of Human Resources
631 491-1004
Fax 631 643-0527

Sally Neumann
Director of Technology
631 643-0628
Fax 631 491-1060

SCHOOLS

Wyandanch Memorial High School
54 South 32nd Street
Dr. Larry H. Spruill, Principal
631 491-1022
Fax 631 491-1728

Milton L. Olive Middle School
140 Garden City Avenue
Gina Talbert, Principal
631 491-1047
Fax 631 491-1917

Martin L. King Jr. Elementary School
792 Mount Avenue
Dr. Darlene White, Principal
631 491-1041
Fax 631 491-3237

LaFrancis Herdman Elementary School
792 Mount Avenue
Delores Jenkins, Principal
631 491-5640
Fax 631 491-1480

May 11, 2006

State of New York
Office of the State Comptroller

Attn: [REDACTED]
The Powers Building
16 West Main St. - Suite 522
Rochester, New York 14614

Dear [REDACTED]:

The Board of Education for the Wyandanch Union Free School District, along with the Superintendent of Schools, is deeply appreciative of the review of our Independent Audit Services conducted by the Office of the State Comptroller, and the reported results. The work conducted is a most valuable service to the Wyandanch community.

The school district accepts the recommendations contained in the report and pledge to implement the same. The school district does note that many of the six (6) recommendations were not legal requirements during the audit period's scope, but have since become a matter of law.

Sincerely,



Bishop Michael V. Talbert
President, Board of Education



Dr. Sherman Roberts
Superintendent of Schools

APPENDIX D

AUDIT METHODOLOGY AND STANDARDS

To accomplish the objectives of this audit, our procedures included the following steps and procedures:

- We reviewed the District's purchasing policies and regulations.
- We interviewed the District's office personnel.
- We evaluated the process by which the District procured audit services for the 2003-04 fiscal year.
- We considered the requirements under GAGAS concerning independence, planning the audit, obtaining evidence, and reporting on matters found during the audit. The procedures used to carry out the latter part of our audit included, but were not limited to, meeting with pertinent audit firm personnel, reviewing the CPA firm's policies and procedures, and reviewing the District-specific audit workpapers.

We conducted our audit in accordance with 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 E

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APPENDIX F
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