



Avon Central School District Internal Controls Over Payroll and Information Technology

Report of Examination

Period Covered:

July 1, 2005 — January 21, 2007

2007M-168



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2007

Dear School District Officials:

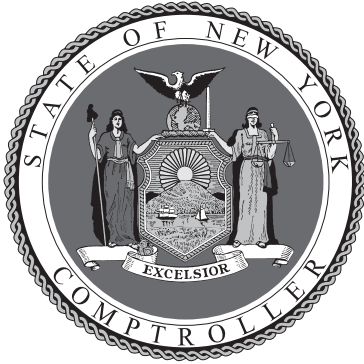
A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Avon Central School District, entitled Internal Controls Over Payroll and Information Technology. 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.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Avon Central 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.

There are two schools and a transportation building in operation within the District, with approximately 1,100 students and 189 employees. The District's budgeted expenditures for the 2005-06 fiscal year were approximately \$13.9 million, funded primarily with State aid, real property taxes, and grants. The District's payroll expenditures for the 2005-06 fiscal year totaled \$9.1 million.

The District's Treasurer, School Business Administrator and two account clerks maintain the District's financial records. The Board approves new hires and sets wages and salaries. The payroll clerk performs payroll processing and maintains the personnel records.

The information technology (IT) department comprises a Director and two support staff. The District has five servers and approximately 600 individual computers, and uses financial software administered by a local regional information center (RIC).

Scope and Objective

The objective of our audit was to assess the District's internal controls over its payroll function and information technology for the period July 1, 2005 to January 21, 2007. Our audit addressed the following related question:

- Are internal controls over payroll and information technology appropriately designed and operating effectively to safeguard district assets?

Audit Results

The District's controls over payroll processing and information technology were not appropriately designed or operating effectively. As a result, District assets are not properly safeguarded.

We identified internal control weaknesses in the business office because there was not adequate segregation of the payroll clerk's duties. We also identified internal control weaknesses in the

computerized financial system. Several users of the accounting software had access rights that exceeded the requirements of their duties. The Treasurer's electronic signature was not password-protected and was widely available to staff. In addition, management did not monitor system use or activity.

Comments of District Officials

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

Introduction

Background

The Avon Central School District (District) is located in the Towns of Avon, Caledonia, Lima, and York in Livingston County and Rush in Monroe 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 Board's direction.

There are two school buildings in operation within the District, with approximately 1,100 students and 189 employees. The District's budgeted expenditures for the 2005-06 fiscal year were approximately \$13.9 million, funded primarily with State aid, real property taxes and grants. The District's payroll expenditures for the 2005-06 fiscal year totaled \$9.1 million.

The District's Treasurer, School Business Administrator, and two account clerks maintain the District's financial records. The Board approves new hires and sets employee wages and salaries through resolutions, individual employee contracts, and collective bargaining agreements. The payroll clerk adds and removes employees in the payroll system, inputs salary detail, maintains employee information and time records, and processes the biweekly payroll.

The information technology (IT) department comprises a Director and two support staff. The District has five servers and approximately 600 individual computers, and uses financial software administered by a local regional information center (RIC). The RIC assigns user access based on information from the Business Administrator.

Objective

The objective of our audit was to assess the District's internal controls over its payroll function and information technology. Our audit addressed the following related question:

- Are internal controls over payroll and information technology appropriately designed and operating effectively to safeguard district assets?

Scope and Methodology

We examined internal controls over selected financial operations of the Avon Central School District for the period July 1, 2005 to January 21, 2007.

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, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, the Board must approve a corrective action plan that addresses the findings in this report, forward the plan to our office within 90 days, forward a copy of the plan to the Commissioner of Education, and make the plan available for public review in the District Clerk's office. For guidance in preparing the plan of action, the Board should refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*.

Payroll

The Board is responsible for establishing an effective system of internal controls to ensure that District officials safeguard the District's assets; that District personnel properly authorize, record, and report accounting transactions; that staff complies with pertinent laws and regulations; that District officials monitor and review the work of District staff; and that District operations function efficiently and effectively. An effective system of internal controls separates incompatible duties so that no single individual controls most or all aspects of a transaction, reducing the risk of errors or irregularities. When it is not practical to segregate duties because of limited staff resources, compensating controls can mitigate this risk. For example, the Board or other administrative staff can periodically review the work in question, or duties can be rotated among staff members. The District's accounting software should produce reports for monitoring financial activity, and Board policies and procedures should require District officials to review these reports independently.

Policies and Procedures

School boards are required by law and good business practice to establish policies governing a district's operations, and also to designate an official to certify the payrolls (usually the Superintendent of Schools). Districts should ensure that the payroll is examined, that the employees regularly perform their duties in accordance with the terms of their employment, and that any changes to routine salary payments comply with the District's bylaws and are based on District-maintained records. Any salary changes should require written authorization. Well-designed policies and procedures should ensure that key duties and responsibilities are segregated, so that the work of one individual routinely verifies the work of another in the course of their duties. Written policies containing such checks and balances over a district's financial operations reduce the risk that errors and/or irregularities will occur and go undetected, and not be corrected.

The Board had not established a payroll policy, nor had the District developed formal written procedures to guide the payroll process. The absence of policies and procedures, with an associated lack of departmental oversight, led to clerical errors resulting in incorrect payments to District employees. These errors were minor and we discussed them with District officials.

Segregation of Duties

A good internal control system requires the segregation of incompatible duties, where no single person controls most or all the key aspects of a transaction. For example, transaction authorization,

accounting, reconciliation, and asset custody should be separated among employees.

District officials did not adequately segregate the duties of the payroll clerk or establish sufficient compensating controls, nor did Board policies and procedures require them to do so. The payroll clerk performed all phases of payroll processing and leave accruals without sufficient administrative oversight. Her duties included maintaining manual and computerized employee records; entering the hours worked, salaries paid, payroll changes, leave records and absences; posting expenditures to the subsidiary ledgers; collecting timesheets; and preparing and disbursing paychecks.

In addition, due to the lack of written Board policies and procedures, District officials had no guidance for addressing this issue. Without adequate segregation of incompatible duties within the payroll area, the District is at risk for processing payroll transactions that may be inaccurate, unauthorized, or inappropriate.

Employee Time Records

An important component of internal controls over payroll expenditures is individual time records, which enable supervisors and payroll processing staff to determine employees' regular and overtime hours. The District's internal controls should require employees to maintain daily records of hours worked, accounting for the entire workday including start and end times, leave charges, and meal times. The time records should be approved by the employee's immediate supervisor to certify that services were performed.

Due to the lack of adequate segregation of duties, combined with the deficient policies and procedures governing payroll, we selected 39 (21 percent) of the 189 employees paid on the January 19, 2006 payroll to determine if they were paid properly. Our tests identified minor errors while reviewing the payroll of hourly employees from the Buildings and Grounds and Food Service Departments, which we discussed with District officials.

Recommendation

1. District officials should adopt policies and procedures that separate the duties of personnel records maintenance, payroll processing, and paycheck distribution among employees.

Information Technology

The District uses information technology to initiate, process, record, and report transactions. The pervasive use and complexity of these computerized functions produces internal control risks such as unauthorized access to data, unauthorized changes to master files, and the potential loss of data.

The District can mitigate these risks through a combination of automated and manual controls including policies and procedures, adopted by the Board, limiting user access to protect data from loss by intentional or unintentional manipulation. The system of internal controls should include a disaster recovery plan and systematic backup procedures to restore lost or damaged data as quickly and easily as possible. Disasters include sudden, unplanned catastrophic events (e.g., fires, computer viruses, or inadvertent employee actions) that compromise the integrity and data of the information technology system.

The Board had not established adequate control policies and procedures to safeguard the District's financial computer data, which is essential to its operations. The following are specific areas where internal controls should be strengthened.

Access Rights to Financial Software

Access to computer operations should be restricted to only those functions required by individual employees' job description(s) and/or official duties and, when granted, should preserve proper segregation of duties. Such access controls prevent users from handling mutually incompatible aspects of financial transactions. The regional information center that administers the software sets user access rights based on information from the Business Administrator. While eight individuals had appropriate access to the purchasing module, in other cases access was not restricted to just those modules required by individual employees' job descriptions and/or official duties. Specifically, three individuals (the Business Manager, the Treasurer, and the payroll clerk) had full access to all modules of the accounting software, enabling them to prepare journal entries, record cash receipts and disbursements, and add, delete, or modify employee information in the payroll module. By allowing access beyond that necessary for an individual's assigned duties, the District increases the risk that errors and irregularities could occur and remain undetected and uncorrected.

Signature Disk

The Treasurer is the custodian of all District monies. District checks require the Treasurer's actual or facsimile signature, affixed by the Treasurer herself or under her direct supervision. Both the Treasurer and payroll clerk controlled disks containing the Treasurer's signature. These disks were not password-protected, but were only physically secured in the locked business office. Except for occasional manual checks, the payroll clerk generated the District checks on the computer and applied the Treasurer's electronically stored signature to all the checks when processing the District's payrolls. Because the Treasurer does not directly supervise the signature process, District officials have no assurance that signed checks are for legitimate District purposes.

Financial Software Reports

A computerized financial system should routinely identify the individual accessing the system and the transactions that are processed. Specifically, an audit log is an automated mechanism for tracing individual accountability, reconstructing events, and monitoring problems. It maintains a record of activity by system or application, identifying each person who accesses the system; recording the time and date of the access; identifying the activity that occurred; and recording the time and date of logoff. Ideally, management reviews this audit log to monitor users' activity. However, management's ability to detect and address unauthorized activities was limited because they did not review the audit logs available.

These weaknesses could result in errors or irregularities occurring and not being detected in a timely manner, and should be corrected.

Recommendations

2. District officials should ensure that users of the financial software have access only to those modules required for their job duties.
3. District officials should ensure that only the Treasurer can control the use of her electronic signature on District checks.
4. District officials should routinely review users' activities using audit logs and payroll change reports.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Avon Central Schools

191 Clinton Street • Avon, New York 14414-1495

(585) 226-2455

Bruce D. Amey, Superintendent
David E. Green, Business Administrator
Christopher A. Salinas, High School Principal
Jennifer K. Miller, Middle School Principal
Robert T. Lupisella, Primary School Principal
Kerstin Wheeler, Director of Pupil Services,
Curriculum, and Instruction

www.avonesd.org

Rodney George, Board of Education President
Russell Leberman, Vice-President
David Cushing
Robert DeBruycker
William LaBine

October 9, 2007

Office of the State Comptroller
The Powers Building
16 West Main Street – Suite 522
Rochester, New York 14614

Dear Sir or Madam:

The Board of Education and Administration of the Avon Central School District extend their appreciation for the professionalism, dedication, and collaboration by the representatives of the New York State Office of the Comptroller during the audit process. The entire audit process was deemed an opportunity to assess the policy and practice of internal controls to safeguard the investment that the Avon community has made in their school system.

The Board of Education and Administration are pleased that after the comprehensive and methodical process undertaken by your office, the audit noted only four (4) matters of concern. This gives the Avon Central School Board and public a level of assurance that the business operations of the Avon Central School District are fiscally sound and that the business office structure and internal controls are functioning properly.

The following are the corrective actions that will be taken to ensure compliance with identified items and recommendations:

Recommendation #1:

District officials should adopt policies and procedures that separate the duties of personnel records maintenance, payroll processing, and paycheck distribution among employees.

The District has plans to work with its internal auditor and an outside consultant to formalize its policies and procedures with respect to the above items.

Recommendation #2:

District officials should ensure that users of the financial software have access only to those modules required for their job duties.

Learning for a Lifetime

As of October 2, 2007, all permissions for the Accounting, Payroll, and Human Resources functions with the Financial Management Software have been updated to ensure that users of the software have access only to those modules required for their job duties.

Recommendation #3:

District officials should ensure that only the Treasurer can control the use of her electronic signature on District checks.

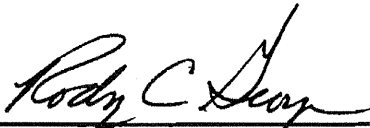
The District has secured a lockbox in which to store the disks that contain the Treasurer's Electronic Signature. The lockbox is kept in the vault; the Treasurer has control of the key for the lockbox. As of October 2007, when checks are printed by the payroll clerk, the Treasurer hands the disk to the payroll clerk so the payroll clerk can actually print the checks, thus controlling the use of her (i.e., the Treasurer's) electronic signature..

Recommendation #4:

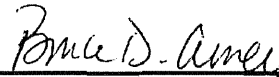
District officials should routinely review users' activities using audit logs and payroll change reports.

Since July 2007, audit logs and payroll change reports are being reviewed. The Business Official is reviewing Permissions Change Reports, Vendor Change Report, Manual Check Reports and Human Resources Audit Trail Reports. The Superintendent is reviewing Payroll Change Reports.

Thank you for the opportunity to respond to this report. The Board of Education, Administration and Business Office personnel benefited from the Office of the State Comptroller's examination of Avon Central School's business operations.



Rodney C. George
Board of Education President



Bruce D. Amey
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 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: financial oversight, cash receipts and disbursements, purchasing, and payroll and personal services.

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 databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. 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 information technology for further audit testing.

- We reviewed payroll records for authorizations, approvals, verifications of employee status and pay rate changes, documentation of employees' existence, proper appropriation codes, and documentation supporting employees' benefits.
- We reviewed payroll job duties, Board minutes, and employee contracts.
- We traced pay rates to supporting documentation.
- We traced timecards to payroll records for both regular and overtime hours.
- We reviewed overtime documentation for authorizations and approvals.
- We compared W-2 forms with other payroll documentation to ensure proper deductions were being taken.
- We reviewed bank reconciliations for payroll accounts.
- We reviewed payroll records for unauthorized termination and/or separation payments and benefits.

- We reviewed employees' access rights to the financial software.
- We reviewed District policies and procedures related to payroll processing and information technology, and verified employee adherence to selected policies and procedures.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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