



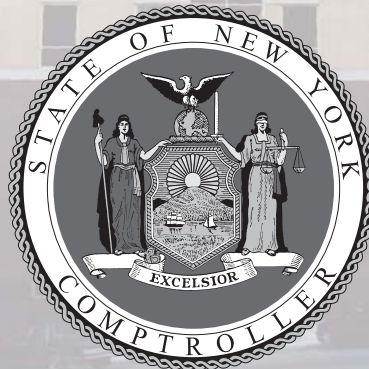
# Wainscott Common School District Internal Controls Over Cash Disbursements and Conflicts of Interest

Report of Examination

Period Covered:

July 1, 2005 — January 31, 2007

2007M-211



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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November 2007

Dear School District Officials:

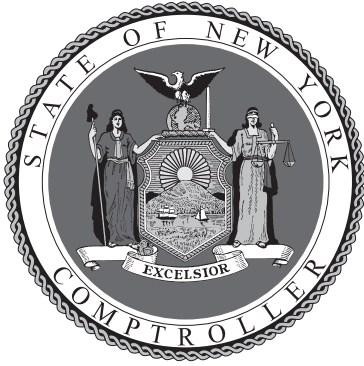
A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, 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 Wainscott Common School District, entitled *Internal Controls Over Cash Disbursements and Conflicts of Interest*. 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

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# EXECUTIVE SUMMARY

The Wainscott Common School District (District) is governed by the Board of Education (Board) which comprises three elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The part-time 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.

All financial transactions of the District are processed by a part-time Business Official, who also is responsible for preparing the District's financial reports. In addition, he presents a budget control report to the Board at its monthly meetings.

### **Scope and Objective**

The objective of our audit was to determine if the District's internal controls over cash receipts and disbursements and for identifying conflicts of interest were appropriately designed and operating effectively to adequately safeguard District assets. Our audit covered the period July 1, 2005 to January 31, 2007 and addressed the following related questions:

- Did the Board and District officials implement and monitor adequate internal controls relating to cash disbursements?
- Has the Board established a process for identifying potential conflicts of interest?

### **Audit Results**

We found that the Board and District officials did not implement and monitor internal controls over cash disbursements to adequately safeguard District assets. As a result, a Board member was appointed as the District's Treasurer, the Board did not audit claims prior to payment, and the part-time Business Official did not include bank reconciliations in his monthly reports to the Board. These internal control weaknesses increase the risk that errors and irregularities will occur and not be detected. We reviewed all 780 District claims totaling approximately \$2.3 million paid during our audit period to determine if they were signed by the Treasurer and had a second signature as required, and to determine if the payees and dollar amounts were in agreement and if all claims were legitimate District expenditures. We found no significant exceptions during our review.

We also found that the District has no formal system in place to identify the outside occupations and/or business interests of District officers and employees. Because District officials cannot identify

these interests, they also cannot determine whether the interests of District employees are prohibited or required to be disclosed. As a result, the District paid \$6,836 to a company in which a District employee's relative had an interest. The District clerk/secretary's husband owned 50 percent of the company's stock, but the District clerk/secretary did not disclose this interest in the District's records.

### **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 take corrective action.

# Introduction

## Background

The Wainscott Common School District (District) is located in the Town of East Hampton, in Suffolk County. The District is governed by the Board of Education (Board) which comprises three elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The part-time 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 eight students and 11 employees. The District's budgeted expenditures for the 2006-07 fiscal year are \$2.1 million, which are funded primarily with real property taxes.

The District's responsibilities related to fiscal affairs rest primarily with the part-time Business Official. The part-time Business Official processes all of the District's financial transactions and is responsible for preparing the District's financial reports. He also presents a budget control report to the Board at their monthly meetings.

## Objective

The objective of our audit was to determine if internal controls over cash disbursements and for identifying conflicts of interest were appropriately designed and operating effectively to adequately safeguard District assets. Our audit addressed the following related questions:

- Did the Board and District officials implement and monitor adequate internal controls relating to cash disbursements?
- Has the Board established a process for identifying potential conflicts of interest?

## Scope and Methodology

We examined the District's internal controls over cash receipts and disbursements and for identifying conflicts of interest for the period July 1, 2005 to January 31, 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 take 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*.

## Cash Disbursements

An effective system of internal controls requires the separation of duties so that no single individual controls most or all phases of a transaction. Concentrating key duties (authorizing payments and signing checks) with one individual weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected. Other important aspects of the District's control environment consist of the Board's legal responsibility to audit claims and the Treasurer's responsibility to include bank reconciliations in the monthly report to the Board to help it properly monitor the District's financial position.

We found that the Board and District officials did not establish policies and procedures over cash disbursements to adequately safeguard District assets. As a result, a Board member was appointed as the District's Treasurer, the Board did not audit claims prior to payment, and the part-time Business Official did not include bank reconciliations in his monthly reports to the Board. These weaknesses increase the risk that errors and irregularities will occur and not be detected.

### **District Treasurer**

Education Law (Law) states that no trustee or member of a board of education can hold the office of treasurer. In addition, the Law states that a school district must not pay claims unless they are signed by the treasurer.

We found that a Board member was the District's Treasurer, in violation of the Law. Due to an emergency situation, the Board elected one of its members as the Board President in November 2005. Subsequently, at the Board's reorganization meeting on July 5, 2006, the Board appointed its President as the District's Treasurer for the period July 1, 2006 through June 30, 2007. Therefore, the Board President had the authority to approve District claims and to sign checks.

While the Board President also holds the title of Treasurer, we note that her duties are limited to being one of two signers of District checks. The Board established a procedure that requires two signatures on each check. Therefore, the checks also are signed by another Board member. The District's part-time Business Official essentially performs all the duties of the District's Treasurer, including processing claims, recording checks, processing all financial transactions, and preparing monthly financial reports for the Board. We reviewed all 780 District claims totaling approximately \$2.3 million paid during

our audit period to determine if they were signed by the Treasurer and had a second signature as required, and to determine if all claims were legitimate District expenditures. We found no significant exceptions during our review.

Although the Board has implemented procedures to mitigate improprieties, when a Board member has the authority to sign checks it significantly increases the risk that inappropriate payments could be initiated and paid.

## **Claims Audit**

The Law requires school boards to audit and approve each claim prior to payment. Auditing claims before the District pays them is an integral part of a District's internal control system. If the Board chooses, it may adopt a resolution to appoint a claims auditor to assume the powers and duties of the Board with respect to auditing claims. If the Board does not appoint a claims auditor, it must conduct a deliberate and thorough review of the District's claims to determine whether proposed payments are proper and valid charges against the District and have been incurred by authorized officials.

We found that the Board neither audited any District claims nor appointed a claims auditor to review claims on its behalf. As a result, we examined all 780 District claims totaling approximately \$2.3 million paid during our audit period to determine if the payees and dollar amounts were in agreement and if all claims were legitimate District expenditures. We found no significant exceptions during our review.

District officials told us that the head teacher/purchasing agent signs an approval section of the claim voucher (which is prepared by the District clerk) that states "the above services or materials were rendered or furnished to the school district on the dates stated and the charges are correct." Although District officials believe that this is a good control, it does not constitute a proper audit of claims by the Board. In addition, the Law precludes the person who is designated as the purchasing agent from being appointed as the claims auditor.

The failure of the Board to fulfill its fiduciary responsibility to audit claims increases the risk that the District may make inappropriate payments and that employee errors and irregularities may occur and go undetected.

## **Bank Reconciliations**

A good system of internal controls over cash management includes the requirement that District staff submit financial reports with complete bank reconciliations to the Board. Timely bank reconciliations are important for the following reasons: to uncover differences that may need further investigation; to detect errors made by the bank and/or

District staff when recording activities in accounts; to create stronger internal control; to identify recording errors and other problems more quickly by being able to isolate problems; and to ensure that account balances are accurate, and reflect the District's true financial position.

The Commissioner of Education's Regulations require that the Treasurer prepare a monthly report of all bank accounts. We found that the Treasurer did not perform bank reconciliations. In fact, this duty was delegated to the District's part-time Business Official. We examined the part-time Business Official's "reconciliation detail" report dated January 13, 2007 and found that five checks totaling \$1,312 (two from 2004, two from 2005, and one from early 2006) had not cleared the bank as of December 31, 2006. We did not find any indication that District officials had investigated or questioned any of these outstanding checks. District officials did not know why these checks were outstanding or why they had not been further investigated.

Without accurate bank reconciliations, District officials cannot have reasonable assurance that the District's accounting records are correct or that monies have been properly accounted for, and the Board cannot properly monitor the District's true financial condition.

## **Recommendations**

1. The Board should appoint an eligible Treasurer in accordance with the Law.
2. The Board should audit all District claims before they are paid in accordance with the Law. If the Board chooses not to audit the claims, it should appoint a claims auditor to perform this duty.
3. The Board should require District officials to perform monthly bank reconciliations and investigate all outstanding checks. The Treasurer should include the reconciliations as part of the monthly financial report.

## Conflict of Interest

Conflicts of interest may occur when a school district official or related party is involved in and financially benefits from business transactions that involve the school district. Article 18 of the General Municipal Law (GML) defines conflicts of interest for most local government entities including school districts and requirements and restrictions regarding contracts and relationships that local officials may have with the municipality or school district. Generally, GML states that municipal officers or employees may not have an interest in any contract with the municipality of which he or she is an officer or employee, when the officer or employee, individually or as a member of a board, has the power or duty to negotiate, prepare, authorize or approve the contract or authorize or approve payment; audit bills or claims of the contract; or appoint an officer or employee who has any of the above powers or duties. A municipal officer or employee has an interest in a contract when he or she receives a direct or indirect monetary or material benefit from a contract with the municipality that the officer or employee serves. Furthermore, GML states that a school district officer or employee also is deemed to have an interest in the contracts of his or her spouse. If a spouse of a municipal officer or employee has an interest in a contract with the municipality, the municipal officer or employee must disclose that interest.

GML also mandates that the governing body of every school district in the State must adopt a local code of ethics to guide the district's officers and employees. A code of ethics that complements and reinforces applicable statutes helps to enhance the control environment of an organization by clearly defining the standard of conduct expected of officers and employees.

The District has not adopted a code of ethics as required by GML. We also found that the District clerk/secretary did not disclose her husband's interest in a landscaping business that provided services for the District. The District clerk/secretary told us that her husband owns 50 percent of the stock of a landscaping company that has performed services for the District for the past 30 years. Therefore, the District clerk/secretary's husband has an interest in the contracts between the company and the District. In January 2007, the District paid this company \$6,836 for landscaping and snow removal services. However, the District clerk/secretary did not disclose the interest as required by GML.

The District's lack of a code of ethics creates a weakness in internal controls, which increases the risk that prohibited transactions may occur.

**Recommendations**

4. The Board should adopt and distribute a code of ethics for District officers and employees.
5. The Board should require the District clerk/secretary, and any other District official/employee, to disclose interests in contracts with the District as required by law.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

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

**WAINSCOTT COMMON SCHOOL DISTRICT**  
**47 Main Street -- PO Box 79**  
**Wainscott, New York 11975**

November 4, 2007

[REDACTED]  
Division of Local Government and School Accountability  
OFFICE OF THE STATE COMPTROLLER  
NYS Office Bldg. 3A10  
250 Veterans Highway  
Hauppauge, New York

Dear [REDACTED]:

I am responding to the examination report of the Wainscott School District entitled "Internal Controls Over Cash Disbursements and Conflicts of Interest" for the period of July 1, 2005 through January 31, 2007. This communication follows the exit discussion between representatives of the State Comptroller's Office and those of the Wainscott School District held on October 30, 2007 at the Wainscott School. This letter represents the directive requiring Wainscott District's response to the preliminary draft findings by November 21, 2007. We also believe the contents of this letter constitute the Corrective Action Plan (subject to modifications) which we must submit to the Commissioner of Education and make available to the general public. Please inform us if we are correct in that assumption.

The Wainscott School District has reviewed your examination and accepts the analysis and recommendations contained therein. We believe it is also noteworthy that the examination of all 780 District claims reviewed during the audit period found that all of the claims constituted legitimate expenditures.

This response attempts to incorporate the audit recommendations in formulating a plan (CAP) to correct deficiencies cited in the report. What follows is a summary of those deficiencies and Wainscott's plan of action to rectify them.

**District Treasurer.** The audit report points out that New York Education Law stipulates that a trustee or board of education member cannot serve as school district treasurer. To correct this deficiency, Wainscott intends to appoint our business official to the position of District Treasurer at our November 28, 2007 meeting. The District Treasurer and one trustee will be signatories of all District checks. The resolution of appointment will read as follows: "Be it resolved, Wainscott's Business Official is hereby appointed District Treasurer effective immediately. The District Treasurer and one Trustee will co-sign all District checks from this date forward."

**WAINSCOTT COMMON SCHOOL DISTRICT**  
**47 Main Street -- PO Box 79**  
**Wainscott, NY 11975**

**Response to Audit Examination**  
**Corrective Action Plan**  
**Page 2**

**Code of Ethics.** The audit examination cites the lack of a Code of Ethics for the Wainscott District. A sample code derived from that used by fire districts has been provided as a model. We will edit this code for use by the Wainscott School District. The newly derived Wainscott School District Code of Ethics will be presented for adoption at the November 28, 2007 Board of Trustees monthly meeting. The resolution for adoption will read as follows: "Be it resolved, the Wainscott School District hereby adopts the attached Code of Ethics. This Code of Ethics establishes standards of ethical conduct for all employees and officers of the Wainscott School District. Every officer and employee of the District will receive a copy of this Code of Ethics and will acknowledge such receipt in writing. Employees' and officers' acknowledgement receipts will be maintained by the District Clerk as a matter of public record."

**Conflict of Interest Disclosures.** The examination report points out that every officer and employee of the Wainscott District must disclose the nature of any personal interest in any contract or services in writing to the Board of Trustees. The report findings indicate that the Wainscott District has not been following this procedure as required by the GML. To correct this deficiency, disclosure of interest's procedures will be included in the Wainscott Code of Ethics. Officers and employees having such contract or services interests will be required to submit a written disclosure that will become part of the public record at a regular Board of Trustees public meeting. The specific citation identified in the report will be addressed in the disclosure procedure noted above at the November 28, 2007 Board of Trustees meeting.

**Internal Claims Auditor.** The audit examination found that the Wainscott School District does not have an internal claims auditor nor a process for conducting a thorough review of District claims to insure charges are valid and payments are proper. To correct this deficiency, the Board of Trustees will approve all warrants and in the process review claims to insure payments are in agreement with purchase orders and approved service contracts. This review of claims will precede any signing and issuance of district payment checks.

**Bank Reconciliations:** The audit examination recommended that the Wainscott School District perform monthly bank reconciliations and investigate more vigorously all outstanding checks. The District will have the Treasurer perform bank reconciliations on a monthly basis. These reconciliations will become part of the monthly financial report presented at each regularly scheduled Board of Trustees meeting and entered into the

**WAINSCOTT COMMON SCHOOL DISTRICT**  
**47 Main Street -- PO Box 79**  
**Wainscott, NY 11975**

**Response to Audit Examination**  
**Corrective Action Plan**  
**Page 3**

public record. The Trustees will review the reconciliation reports, and if they are acceptable, will formally approve them along with the financial report.

I am enclosing a draft of a Code of Ethics for the Wainscott School District. We hope to adopt this Code at our Board of Trustees meeting to be held on Nov. 28<sup>th</sup>. If you have any suggestions for editing this code, please let me know before Nov. 28<sup>th</sup>. Thank you for your consideration.

Cc: Wainscott Bd. Of Trustees  
Greg Hilton, Financial Officer

Sincerely,



Dr. Dominic Annacone  
Superintendent

## APPENDIX B

### AUDIT METHODOLOGY AND STANDARDS

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

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided on the reported objectives and scope by selecting for audit those areas most at risk. We selected cash disbursements for further audit testing.

To accomplish the objective of the audit, our procedures included the following:

- We interviewed appropriate District officials to obtain an understanding of the organization and the District's accounting records, and to identify key personnel.
- We examined paid claims for the purpose of determining whether they were for valid, legal purposes, were sufficiently itemized and included original invoices, and agreed with cancelled checks.
- We inquired into what internal controls and procedures were in place to identify and prevent potential conflicts of interest.
- We requested and obtained representations from the Superintendent, Board members, and the part-time Business Official indicating their outside employment and business interests and those of their spouses.
- We reviewed records to determine if the District had financial transactions with any business that might constitute a prohibited conflict of interest.

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.

## APPENDIX C

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