



Bay Shore Union Free School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — June 30, 2007

2008M-138



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	2
EXECUTIVE SUMMARY	3
INTRODUCTION	5
Background	5
Objective	5
Scope and Methodology	5
Comments of District Officials and Corrective Action	6
EBALR FUND	7
Recommendations	8
PURCHASING	10
Professional Services	11
Competitive Bidding	13
Recommendations	14
INFORMATION TECHNOLOGY	16
Recommendations	18
APPENDIX A Response From District Officials	19
APPENDIX B OSC Comments on the District's Response	25
APPENDIX C Audit Methodology and Standards	28
APPENDIX D How to Obtain Additional Copies of the Report	30
APPENDIX E Local Regional Office Listing	31

State of New York Office of the State Comptroller

Division of Local Government Services and School Accountability

October 2008

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, in part, 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 Bay Shore Union Free School District, entitled Internal Controls over Selected Financial Operations. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in 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 Services
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Bay Shore Union Free School District (District) is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The District maintains several reserve funds, including an Employee Benefit Accrued Liability Reserve (EBALR). General Municipal Law dictates that an EBALR fund may be established and used only to pay for accrued but unused time earned upon separation from service. At June 30, 2007, the EBALR fund had a balance of \$20,487,930.

Scope and Objective

The objective of our audit was to examine the adequacy of the District's internal controls over selected financial operations for the period July 1, 2006 to June 30, 2007. Our audit addressed the following related questions:

- Did the District establish and account for the EBALR properly?
- Has the District established adequate internal controls over the procurement of goods and services and are those controls operating effectively?
- Are internal controls over the District's information technology system designed appropriately and operating effectively to adequately protect electronic data?

Audit Results

The District did not properly establish and account for the EBALR fund. District officials planned to use EBALR monies to pay for legally non-permissible costs. The Board resolution that created the EBALR fund stated that the money set aside would be used to pay accumulated or accrued compensated absences due to a District employee upon separation from service, and to pay the future costs for retiree health insurance or other negotiated benefits. Therefore, the District did not establish this fund solely for the intended statutory purposes, since expenditures for retiree health insurance or other post employment benefits are not permitted uses of EBALR fund monies. Moreover, currently there is no reserve fund authorized by law for the purpose of paying retiree health care costs.

Further, District officials put far more money than necessary into the reserve. At June 30, 2007, the EBALR had a balance of \$20,487,930, while the District reported a liability for accrued compensated absences of only \$10,503,284. However, our review revealed that \$4,331,035 of the \$10,503,284 in stated liabilities were for costs that cannot legally be paid from this reserve fund. Therefore, the District's total liability representing compensated absences at June 30, 2007 was \$6,172,249. In addition, District officials have not used any money from this reserve; instead, they have paid for compensated absences costs from the general fund. District officials said that they would use the \$14.3 million excess fund balance to pay for retiree health insurance benefits, which are not allowed by law. The District will require legislative approval to remove these funds from the reserve and use them for productive purposes, such as paying off debt or financing non-recurring District expenses. We also found that the District failed to credit \$410,000 in interest earned on EBALR monies to the reserve, as required by GML.

The District's procurement process was not functioning appropriately and as a result, goods and services may not have been obtained at the lowest possible price, and the District may have paid professionals for services that were not properly authorized. Policies for procuring professional services were not adequate; therefore, the District continued to use the same professionals year after year without competition. District officials paid 10 vendors \$979,681 for professional services without soliciting competitive proposals. In addition, Board resolutions to hire three professionals who were paid a total of \$46,260 were insufficient because they did not indicate the services that the professionals were expected to provide. We also found that four professionals did not submit sufficiently itemized invoices to support payments totaling \$70,613. While the District's purchasing policies clearly outline when and how to use competitive bidding when purchasing goods or services, District officials did not always follow these policies and solicit competition when required. We found that the District entered into three purchase contracts totaling \$86,232 and seven public work contracts totaling \$293,260 without following competitive bidding requirements. As a result, the District may have paid more than necessary for these goods and services.

The District's information technology system was not designed appropriately or operating effectively to adequately protect electronic data. District officials have not developed comprehensive policies and procedures to protect critical computerized financial data from unauthorized access or potential loss in the event of a disaster. As a result, there is an increased risk that critical financial data could be lost or misused.

Comments of District Officials

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B contains OSC comments on issues raised in the District's response.

Introduction

Background

The Bay Shore Union Free School District (District) is located in the Town of Islip, Suffolk County. The District is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are seven schools in operation within the District, with approximately 5,800 students and 1,600 employees. The District's actual expenditures for the 2006-07 fiscal year were approximately \$109 million. The District's budgeted expenditures for the 2007-08 fiscal year are over \$124 million, which are funded primarily with State aid, real property taxes, grants and appropriated fund balance.

The District maintains several reserve funds, including an Employee Benefit Accrued Liability Reserve (EBALR). General Municipal Law dictates that an EBALR fund may be established and used only to pay for accrued but unused time earned upon separation from service. At June 30, 2007, the EBALR fund had a balance of \$20,487,930.

Objective

The objective of our audit was to examine the adequacy of the District's internal controls over selected financial operations. Our audit addressed the following related questions:

- Did the District establish and account for the EBALR fund properly?
- Has the District established adequate internal controls over the procurement of goods and services and are those controls operating effectively?
- Are internal controls over the District's information technology system designed appropriately and operating effectively to adequately protect electronic data?

Scope and Methodology

We examined the internal controls over selected financial operations of the District for the period July 1, 2006 to June 30, 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 C of this report.

**Comments of District
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B contains OSC comments on issues raised in the District's response.

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, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

EBALR Fund

School districts have two types of fund balance: reserved and unreserved. Reserved fund balance represents moneys that the District has set aside and may only use for specific legal purposes; therefore, it is not available for the District to use for other purposes. Unreserved fund balance is the amount that is uncommitted and may be added to the next fiscal year's budget to reduce real property taxes. The portion of the unreserved fund balance that is used to help finance the next year's budget is known as appropriated fund balance. The portion of the unreserved fund balance that the District retains and that can be used for cash flow purposes and unanticipated expenditures is known as unappropriated fund balance. For the period covered by our audit, Real Property Tax Law limited the unappropriated fund balance to no more than three percent¹ of the next year's budget.

Reserve funds are created under various laws and are used to finance the cost of a variety of objects or purposes. The legal statutes under which the reserves are established (or sometimes mandated) determine how the reserves may be funded, expended and discontinued. An Employee Benefit Accrued Liability Reserve (EBALR) fund may be created under General Municipal Law (GML). Moneys from this reserve may be used to make cash payments to employees upon separation from service for unused sick leave, holiday leave, vacation time, time allowances granted in lieu of overtime compensation and any other forms of payment for accrued leave time due. Interest earned on money in the EBALR fund becomes part of the fund. Should the District determine that the EBALR fund is no longer needed, the moneys may be transferred to certain reserve funds that are authorized by law.

The funds that school districts may accumulate in an EBALR must pertain only to employees' compensated absences and not to any other salary-related payments (non-permissible costs, such as FICA, Medicare taxes, and contributions to the retirement system). Although school districts must measure and report the total liabilities on their financial statements, they cannot legally accumulate funds in an EBALR for non-permissible payroll-related costs.

The Board formally established the EBALR fund by resolution on July 3, 2002 with an opening balance of \$8,281,444. The Board

¹ In July 2007, legislation was enacted to change the Real Property Tax Law statutory limit of unappropriated fund balance to three percent of the 2007-08 fiscal year's budget and four percent of the 2008-09 fiscal year's budget.

resolution that created the EBALR fund stated that the money set aside would be used to pay accumulated or accrued compensated absences due to a District employee upon separation from service, and to pay the future costs for retiree health insurance or other negotiated benefits. Therefore, the District did not establish this fund solely for the intended statutory purposes. GML dictates that an EBALR fund may be established and used only to pay for accrued but unused time earned upon separation from service. Using EBALR monies to pay for retiree health insurance and other negotiated benefits is not permitted. Moreover, currently there is no reserve fund authorized by law for the purpose of paying retiree health care costs.

Further, District officials put far more money than necessary into the reserve. While the District's 2006-07 audited financial statements show a liability of \$10,503,284 for compensated absences, the EBALR fund totaled \$20.5 million. In addition, our review revealed that \$4,331,035 of the \$10,503,284 reported for compensated absences cannot legally be paid from this reserve fund. Furthermore, although the balance in the reserve represents 16 percent of the District's entire operating budget, reserve funds are not being used to pay for compensated absences when employees separate from service; instead, the District used general fund money to pay for these costs. District officials stated that the \$14.3 million excess fund balance would be used to pay for post retirement benefits – expenditures which cannot legally be made from an EBALR fund. The District will require legislative approval to remove these funds from the reserve and use them to pay for retiree health insurance benefits, or for other productive purposes, such as paying off debt or financing non-recurring District expenses.

The District is not required to establish a separate bank account for the EBALR fund; however, EBALR funds must be accounted for separately from other District moneys, and interest must be accrued to the reserve. The District has invested the EBALR moneys commingled with its general fund moneys. While the District is permitted to invest moneys in the EBALR with general fund moneys, the District must maintain the separate identity of the sources of the moneys invested and must credit a pro rata share of the interest earned to the EBALR fund. However, we found that the District had not allocated any of its interest earnings to the EBALR fund. Had the District properly accounted for the interest earned, we estimate that approximately \$410,000 of interest earned should have been prorated and allocated to the EBALR fund during the 2006-07 fiscal year.

Recommendations

1. District officials should evaluate the balance in the EBALR fund and transfer excess funds to other authorized District reserves.

2. The District should use the money in the EBALR fund only for its intended statutory purpose.
3. District officials should credit the pro rata share of interest earned on invested funds to the EBALR fund.

Purchasing

An effective purchasing process helps to obtain necessary goods and services at a reasonable cost and in compliance with all applicable legal requirements to ensure that taxpayer dollars are spent in the most efficient manner. Such a process helps the District guard against favoritism, improvidence, extravagance, fraud, and corruption. It is also important for the District to have comprehensive purchasing policies and procedures to purchase goods and services. These policies and procedures must provide guidance to District officials before they contract with a vendor for purchases. Contracts should clearly describe the vendors' responsibilities, and District officials should ensure that vendors adhere to contract terms so that taxpayer money is spent in an economical manner.

The District's policies to procure professional services are not adequate; therefore, the District continues to use the same professionals year after year without the benefit of competition. We found that District officials paid 10 vendors \$979,681 for professional services without soliciting competitive proposals. In addition, Board resolutions to hire three professionals whose services totaled \$46,260 were insufficient because they did not indicate the services that the professionals were expected to provide. We also found that four professionals did not submit sufficiently itemized invoices to support payments totaling \$70,613. As a result, goods and services may not have been obtained at the lowest possible price, and the District may have paid professionals for services that were not properly authorized.

The District's purchasing policies clearly outline when and how to use competitive bidding and when to obtain quotes when purchasing goods or services. However, the District's purchasing function is not centralized, and officials do not always monitor aggregate purchase and public work contracts. As a result, officials did not always follow the District's purchasing policy, and they did not solicit competition when required. We tested payments to 15 vendors totaling approximately \$840,000 that were subject to competitive bidding requirements and found that the District made purchases from three vendors totaling \$86,232 and entered into seven public work contracts totaling \$293,260 without seeking competitive bids. As a result, the District may have paid more than necessary for these goods and services.

Professional Services

Competitive bidding is not required for the procurement of professional services that involve specialized skill, training and expertise; use of professional judgment or discretion; and/or a high degree of creativity. GML requires the District to adopt internal policies and procedures governing the procurement of goods and services when competitive bidding is not required. An effective and comprehensive purchasing policy would require the District to request written proposals from professional service providers whenever such services are needed. A request for proposal (RFP) process is one method that could help ensure that the District receives the desired service for the best price.

The District's purchasing policies do not require officials to solicit competitive proposals, such as RFPs, prior to issuing a contract with a professional service provider. Instead, the policy states that the Board may decide if soliciting RFPs is in the best interest of the District. Therefore, the District generally used past experience in selecting professionals rather than selecting professionals based on a competitive process. For example, the District has been using the same legal firm for over 12 years and the same physical therapists for over 20 years without seeking competition.

Request for Proposals – During the fiscal year ended June 30, 2007, the District paid 74 professional service providers approximately \$3.2 million. We tested payments that were made to 12 professional service providers totaling \$1.1 million during the audit period and found that the District made payments totaling \$979,681 to 10 of the 12 professionals whose services were procured without soliciting RFPs. The professional services included:

- One firm that provided architectural services totaling \$581,833
- One firm that provided legal services totaling \$72,522
- Eight firms that provided various consulting, medical and therapeutic services totaling \$325,326.

The District's failure to solicit competition prior to procuring professional services increases the risk that these services were not obtained at the lowest possible price.

Payments to Professionals – A written agreement for professional services provides both the District and the individual or firm furnishing services to the District with a clearly-defined and mutually agreed-upon basis for determining entitlement to payments. It is

necessary that the agreements indicate the services to be provided and the basis for compensating those services. In addition, the District must require that all professional service providers submit properly itemized invoices to allow for a proper audit of claims. Every claim must contain enough supporting documentation to determine that it complies with the contracted agreement and the amounts claimed are in accordance with Board-approved contracts.

We examined claim vouchers that were submitted by the 12 professionals indicated above and found that vouchers totaling \$70,613 submitted by four of the professionals did not indicate the services they provided to the District. In addition, the Board resolutions to hire three of the four professionals who received payments totaling \$46,260 did not specify the services they were expected to provide to the District. Although these claims did not contain proper documentation to ensure they were legitimate District expenditures, they were authorized by the purchasing agent and approved for payment by the claims auditor.

For example, the District paid \$34,412 for the services of two school physicians. The physicians were each paid on monthly claim vouchers that did not indicate the days or hours worked each month or the services provided. In July 2006, a Board resolution approved the appointments of both physicians. The resolution indicated the total amount to be compensated to each physician for the fiscal year, but it did not indicate the services that the physicians would provide.

The District also paid a human resources consultant \$11,848 during the 2006-07 fiscal year. While the consultant submitted claim vouchers that indicated the days worked and number of hours worked each day, they did not include a description of the services provided. The Board hired the consultant by resolution in January 2007 at the rate of \$750 per day, not to exceed \$30,000 for the year. However, the resolution only stated that the consultant would be “working on human resources projects” without elaborating further.

Finally, during the audit period, the District paid a capital projects consultant \$24,353. In June 2005, the District entered into an agreement with the consultant to provide various oversight services regarding the District’s capital projects at the rate of \$700 per day. While the consultant submitted claim vouchers that indicated the days worked and number of hours worked each day, they did not include a description of the services provided.

The District cannot be assured that they are receiving desired services at approved rates unless they enter into written agreements

with professionals that clearly define the services to be provided. In addition, District officials must require professionals to submit claim vouchers that indicate the services they provided. The failure to enter into adequately prepared written agreements or require adequately itemized claim vouchers can result in the District receiving unnecessary services or services at excessive prices.

Competitive Bidding

Competitive bidding helps ensure the prudent and economical use of public moneys. GML and the District's procurement policy require that purchase and public work contracts be publicly advertised for bids and awarded to the lowest responsible bidder when they exceed \$10,000 and \$20,000 during a fiscal year, respectively. School districts may also use certain contracts awarded through the New York State Office of General Services (OGS) or a county, or may participate in cooperative bidding with other governmental entities such as a Board of Cooperative Educational Services (BOCES). Generally, items or services of a similar nature which are customarily handled by the same vendor should be aggregated and treated as a single item for determining whether the dollar threshold will be exceeded. Competitive bidding is not required in the case of an emergency that necessitates immediate action to restore public buildings, public property, or the life, health, safety or property of inhabitants of the District.

During our audit period, the District purchased approximately \$3 million in goods and supplies from 57 vendors. We found that the District did not solicit competitive bids for purchases made from three of eight vendors that we tested. The District paid these three vendors \$86,232 for goods and supplies that should have been competitively bid. For example, the District purchased approximately \$300,000 of flooring materials from a vendor who participated in a Suffolk County contract. In August 2006, the District paid this vendor \$66,159 for the purchase and installation of approximately 37,000 square feet of flooring materials which were not included in the County contract. Although District officials informed us that this was an emergency purchase, there was no Board resolution declaring an emergency, and no indication on the purchase order or the claim voucher that this was an emergency purchase. During the same period, the District paid two vendors a total of \$20,073 for floor care products without soliciting competitive bids. Although District officials thought the vendors were included in a BOCES contract for floor care products, they were not, and no one at the District checked the BOCES contract to verify the vendors' inclusion.

The District also entered into approximately \$11.5 million of public work services from 49 vendors during the fiscal year ended June 30, 2007. We found that the District did not solicit competitive bids from

seven of eight vendors that we reviewed. The District paid these seven vendors \$293,260 for work that was subject to competitive bidding requirements but was not bid. The failure to follow the Board's procurement policy and GML increased the risk that goods and services were not obtained at the lowest possible price.

For example, during the fiscal year ended June 30, 2007, the District paid a firm \$105,605 for security guard services without publicly advertising for competitive bids. Officials claimed they were not aware that security guard services were subject to competitive bidding requirements. For the same period, the District paid three vendors a total \$81,954 for printing District forms, letterheads, calendars and newsletters, etc., without first publicly advertising for competitive bids. While the District had publicly advertised for bids for certain printing contracts and had used BOCES contracts for other printing services, the above payments were not included in either District or BOCES contracts. District officials did not routinely review printing contracts to determine which services were available in existing contracts.

The District also paid a vendor \$38,918 for refinishing wood floors. Rather than publicly advertising for competitive bids, the District used the same vendor that it awarded a contract to for the purchase of flooring materials (tile, carpet, etc.). Another vendor was paid \$42,985 for the purchase and installation of doors and door accessories. Although the District used a BOCES contract for the labor to install the doors (at a cost of \$8,398), it did not follow competitive bidding requirements for the purchase of the doors and accessories totaling \$34,587. The District purchased the items from the same vendor that had been awarded the installation contract. Finally, the District paid a vendor a total of \$32,196 to recondition sports uniforms without soliciting competitive bids.

Because the District did not solicit competitive bids as required by GML and its own procurement policy, it may have paid more than necessary for goods and services.

Recommendations

4. The Board should revise the District's procurement policy to require the District to solicit requests for proposals prior to awarding all professional service contracts.
5. The Board should enter into written agreements with all professional service providers that clearly stipulate the services to be provided and the basis for compensation.
6. District officials should require that all professional service providers submit claims that indicate the work performed.

7. District officials should ensure that the District complies with the provisions of its purchasing policy and General Municipal Law by soliciting competitive bids when necessary.
8. District officials should ensure that vendors are included in approved State, County or BOCES contracts before procuring goods or services.

Information Technology

The use of information technology (IT) affects the fundamental manner in which the District processes, records, and reports financial transactions. Therefore, the IT system and the data it holds are a valuable District resource. The District uses a financial accounting software package (financial software) to process and maintain the District's financial transactions. The District's widespread use of information technology presents a number of internal control risks such as unauthorized access to data and the potential loss of data. Therefore, District officials must design an effective system of internal controls to safeguard computerized data from loss and misuse. It is important that this system include policies and procedures to control and monitor access to financial data and a formal disaster recovery plan (DRP) to minimize the damage that a disaster would cause to operations if the IT system fails.

We examined controls over the District's computerized financial operations and found that District officials have not developed comprehensive policies and procedures to protect critical financial data. The District has a Technology Use Policy that addresses unacceptable uses of the District's computer system, but it does not adequately address all major areas of the District's IT operations. Specifically, District officials have not: effectively addressed the safeguarding of computerized financial data from unauthorized access or potential loss in the event of a disaster; ensured that audit trail logs were monitored; adequately controlled remote access; or ensured that employees were given proper access rights. As a result, critical financial data is subject to an increased risk of loss or misuse.

Disaster Recovery – The District's internal control system should include a formal DRP to address the possible loss of computer equipment and data and establish procedures for recovery in the event of such a loss. The plan should detail the precautions to be taken to minimize the effects of any disaster and enable the District to either maintain or quickly resume its mission-critical functions. It is important that the plan include a significant focus on disaster prevention.

We found that District officials have not established a formal DRP. Consequently, in the event of a disaster, District personnel have no guidelines or plan to follow to help minimize or prevent the loss of equipment and data or guidance on how to implement data recovery procedures. This could negatively impact the District's ability to resume normal operations.

Audit Trail Logs – A well-designed information technology system should be capable of generating an audit log that provides a means of determining, on a constant basis, who is accessing the system and what transactions are being processed. Audit logs maintain a record of activity that includes the identity of each person who has accessed the system, the time and date of the access, and what activity occurred. Ideally, a manager should review these logs on a routine basis to monitor the activity of users who access the District’s applications and data.

Although the financial software has the ability to track system activity, District officials did not implement procedures to periodically produce and review relevant reports such as logs, audit trails, and exception and change reports. As a result, there is an increased risk that unauthorized activity could go undetected.

Remote Access – Remote access is the ability to access the District’s computer system from the internet or other external source. Remote access must be controlled, monitored, and tracked so that only authorized individuals are allowed to access the District’s computer system. Policies and procedures should address how remote access is granted, who is given remote access, as well as how remote access will be monitored and controlled.

The District has not implemented policies or established procedures that address remote access issues. We found that the District’s financial software manufacturer has total unrestricted access to the financial application within the system in order to provide updates and maintenance to the financial software. This remote connection is always open and not adequately monitored to determine when and who has accessed the system remotely.

Internal controls are compromised when remote access is not monitored and controlled. Accordingly, there is an increased risk that financial data could be manipulated, and errors and irregularities could occur and go undetected. These internal control weaknesses could lead to the loss of important financial data and cause serious interruption to the District’s operations.

User Permissions – To ensure proper segregation of duties and internal controls, the District must grant users of the computer system only the access that is required to perform their job duties and responsibilities. Access controls are intended to provide reasonable assurance that computer resources are protected from unauthorized use and modifications. Having access controls in place prevents users from being involved in multiple aspects of financial transactions and ensures that users are restricted from unauthorized areas where

they can intentionally or unintentionally destroy or change critical financial data. A system administrator has the ability to add new users as well as change users' rights. With this ability, administrators are able to control and use all aspects of the software. A good system of controls would segregate the duties of administering access to the computerized financial system and the functions of the Business Office to reduce the risk that District financial information or resources could be misused.

District officials have not established formal policies or procedures outlining how computer system user permissions should be established and have not established any policies or procedures to routinely review computer system user permissions. We found that the District's Assistant Superintendent for Business has administrative access rights to the computerized financial system. This individual is involved in the day-to-day Business Office operations and is significantly involved in financial transactions. Additions, deletions and modifications to user permissions are normally performed by the District's IT Department. Therefore, it is important that the Assistant Superintendent for Business does not have the ability to control access to the system and only has the rights necessary to perform her job duties.

The failure to establish and monitor comprehensive policies and procedures relating to user access of computerized data increases the risk that errors and irregularities can occur and not be detected and/or corrected in a timely manner.

Recommendations

9. District officials should develop a formal disaster recovery plan to address the possible loss of computer equipment and data in the event of a disaster.
10. District officials should implement procedures to have an individual whose responsibilities are outside of the daily Business Office functions periodically review audit trail logs.
11. The District should adopt policies and establish written procedures to control and monitor remote access to financial computer data.
12. District officials should compare users' access rights to the financial software with their job descriptions, and revise if necessary, to ensure that users only have access to transactions that are within the scope of their responsibilities.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials' response to this audit can be found on the following pages. Part of the officials' response included confidential District information that was omitted from the report because of its sensitive nature.



Bay Shore Union Free School District

DISTRICT ADMINISTRATIVE OFFICES
75 West Perkal Street, Bay Shore, N.Y. 11706
Phone (631) 968-1117 Fax (631) 968-4131
E-mail holman@bayshoreschools.org

Board of Education

Mary Louise Cohen, President
Jerry G. Berka, Vice President
Andrew A. Arcuri
Guy Leggio
Gregory Nardone

Evelyn Blose Holman, Ph.D.
Superintendent of Schools

September 29, 2008



Office of the State Comptroller
250 Veterans Highway, Ste. 3A10
Hauppauge, NY 11788

Dear 

This audit response is in reference to the Office of the State Comptroller's Report of Examination number 2008M-138 *Bay Shore Union Free School District Internal Controls Over Selected Financial Operations* for the July 1, 2006 – June 30, 2007 period. We appreciate your interest in this matter and look forward to working with you and your staff as we move forward.

EBALR Fund

This section of our response serves to inform the Comptroller's Office regarding the genesis and evolution of the EBALR Fund. We seek to clarify the Bay Shore Union Free School District's actions and intent, both in the establishment, funding and anticipated utilization of the EBALR. We understand that it is the position of the Comptroller that your audits are based upon facts and law, and not a district's objectives; however, your express exclusion of our motives may result in media and taxpayer assumption of ill-intent by district officials which is simply not the case. In constructing this audit response, we seek to continue an open dialogue with your office and to address any necessary corrective actions based upon constructive recommendations.

School Districts strive to shore up reserves for the purpose of prudent financial planning by identifying obligations well in advance of their occurrence. Clearly, the avoidance of the financial impact on the taxpayer of unplanned costs remains a laudable goal. Planned funding of the reserve in question was based on the following:

- We acted on the advice of our external auditors: public accounting firms who were aware of and approved the establishment and funding of the EBALR.
- We relied on Governmental Accounting Standards Board Statement No. 16, July 1994, and Office of the State Comptroller documents, also from July of 1994, indicating liabilities must be calculated for expenditures associated with compensated absences, including FICA, Medicare, retirement system contributions, and other employee benefits.

See
Note 1
Page 25



- Municipal Law 6-p reserve funds can be used to save for “the payment of any accrued employee benefit due an employee upon termination of the employee’s service.” This seminal document was the cornerstone of the establishment and funding of our reserve that is now being criticized in the draft audit statement which is the subject of this response. (See attached SED document and Bay Shore UFSD Board of Education resolution for the establishment of the reserve). See
Note 2
Page 25
- Upon learning of Office of the State Comptroller’s alternative interpretation of General Municipal Law 6-p, we discontinued our use of the EBALR to fund “Other Post Employment Benefits” liabilities (OPEB) (Office of State Comptroller Opinion 2006-8) pending the adoption of proposed legislation. See
Note 3
Page 25
- We presently continue to fund compensated absences due upon separation of service via the EBALR (the Comptroller’s comment that “...reserve funds are not being used to pay for compensated absences when employees separate from service;...” is incorrect, although we grant that the fund was not used for same during the period covered by the audit report referenced in this response letter.) See
Note 4
Page 25

Many public accountants and the State Education Department had, for years, advised districts that General Municipal Law Section 6-p authorized a reserve fund for payment of benefits due upon termination of employment and that this reserve is financially prudent. Recommendations to prepare for and/or fund this future liability were commonplace prior to the Comptroller’s 2006 Opinion. **We lament that clarification was not given earlier by prior Comptrollers.** See
Note 5
Page 25

The Office of the Comptroller received a copy of our annual external audit for years; yet there was never any question of the establishment, calculation methods used or funding with respect to the EBALR. Prior communications with the Comptroller’s Office reveal that this is, in fact, a widespread issue and that a minimum of 250 school districts across New York State have more money in their EBALR than their total liability for compensated absences. Clearly, a statewide remedy to the problem is necessary. See
Note 6
Page 25

As you know, Governmental Accounting Standards Board Statement No. 45, June 2004, now requires that districts conduct actuarial studies of the cost of retiree health insurance premiums, calculations which the Bay Shore UFSD had been making for many years. Henceforth, districts will be required to report this liability on their annual financial statements. This single post employment benefit imposes a liability many times greater than our present reserve balance. This liability will continue to grow. The failure of the New York State Legislature to advance pending legislation in recent years has left New York’s school districts in this quandary. See
Note 7
Page 26

The Office of the State Comptroller is currently advocating to the Governor and Legislature a legal framework for funding other post employment benefit liabilities. In fact, a May 8, 2008 press release urges state and local governments to begin managing escalating health care costs by proposing the establishment of a structure for creating trusts that can be used to help fund these liabilities. We support the Comptroller’s call for legislation allowing the use of trust funds for the wide variety of future liabilities currently not expressly permitted under General Municipal Law, Section 6-p.

Reserves allow districts to level spending over time. In fact, last year Bay Shore UFSD reduced our unappropriated, unreserved fund balance below 1% in an effort to stabilize the tax rate. Taxpayers simply cannot handle large spikes in taxes from one year to the next. Bay Shore UFSD's reserves were carefully built and designed to avoid dramatic increases that might otherwise occur in the absence of available resources.

Purchasing

Professional Services

Subsection entitled "Request for Proposals" – As the audit report does explicitly state, "Competitive bidding is not required for the procurement of professional services that involve specialized skill, training and expertise; use of professional judgment or discretion; and/or a high degree of creativity." There is no express legal requirement or precedent under General Municipal Law that school districts must conduct annual, or even periodic, RFP's for such services (with the exception of external/internal auditing services). The audit report goes on to state that, "The District's purchasing policies do not require officials to solicit competitive proposals, such as request for proposals (RFP), prior to issuing a contract with a professional service provider. Instead, the policy states that the Board may decide if soliciting RFP's is in the best interest of the District." As such, the District properly procured said services in accordance with both existing law and District procurement policies and procedures, and has been in full compliance at all times. We respectfully disagree with the Comptroller's position on this issue. A policy that "...would require the District to request written proposals from professional service providers whenever such services are needed" is not an appropriate solution to this issue. In addition to the obvious cost implications, the disruption to the educational process, in particular as it relates to special education services and their efficient/timely procurement, necessitates a certain amount of professional discretion, which our present policy permits. Although RFP's were not solicited for the services cited in the audit report, the Bay Shore Board of Education does, in fact, often require that same be produced.

See
Note 8
Page 26

Subsection entitled "Payments to Professionals" – The District does concur that in general "The Board should enter into written agreements with all professional service providers that clearly stipulate the services to be provided and the basis for compensation." And further, that "District officials should require that all professional service providers submit claims that indicate the work performed." However we do take exception to the examples cited. Requiring that our school physicians "...indicate the days or hours worked each month or the services provided" is unnecessary as all work is performed in cooperation with school officials who are fully aware of the medical services provided and the time commitment necessary to complete same. In the case of both the human resources consultant and the capital projects consultant, all services were provided in cooperation with and under the supervision of the District's Central Office administration. Although we feel that the above are poor examples of internal control weaknesses, we do understand the spirit of the recommendations in general and will endeavor to comply with same going forward.

See
Note 9
Page 26

Competitive Bidding

We concur with the Comptroller's recommendations that "District officials should ensure that the District complies with the provisions of its purchasing policy and General Municipal Law by soliciting competitive bids when necessary." We also agree that "District officials should ensure that vendors are included in approved State, County or BOCES contracts before procuring goods and services." We take exception, however, to a few of the examples cited. For example, the "\$66,159 for the purchase and installation of approximately 37,000 square feet of flooring materials..."; although we did indicate to the Comptroller's office that this was an emergency purchase (the delay of which would have had an adverse impact on the opening of a school building), the pricing we received matched the price for same awarded by Educational Data Services, Inc. as part of a formal cooperative bid.

See
Note 10
Page 26

In the case of the "...\$38,918 for refinishing wood floors", the "...\$42,985 for the purchase and installation of doors and door accessories" and the "...\$32,196 to recondition sports uniforms..."; it is the District's belief that each of these purchases falls under the category of cooperatively bid, from one source or another. While we understand that the Comptroller's Office would like to see copies of the bids highlighting each of the items purchased attached to their respective purchase orders, this can quickly become both a costly and time consuming venture. We agree that it represents an 'ideal' control, but practically speaking, it simply is not always possible.

See
Note 11
Page 26

The balance of purchases were, we believe, accurately reported upon and the District will take the Comptroller's advice into consideration and apply appropriate corrective action to similar purchases in the future. Although we feel that a few of the above are poor examples of internal control weaknesses, we do understand the spirit of the recommendations in general and will endeavor to comply with same going forward.

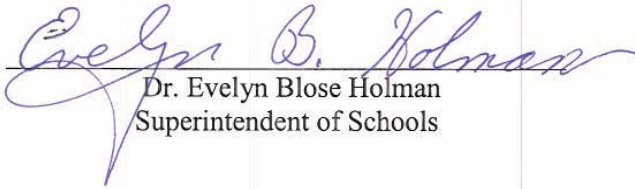
Information Technology

Subsection entitled "Backing up Data" – The Bay Shore Union Free School District's tape backup process has been gradually phased out over the past year. We now backup live data sets to a hard disk. Financial data is backed up nightly and then copied to a replica data drive on another server located within our secured network operations center. The first live backup to hard disk began on or around May of 2005. Since then, we began to mirror that same set of data off-site to an auxiliary network operations center located at the Bay Shore Middle School. Then, in October of 2007, we began to host yet another replica on a third tier server located in one of our elementary buildings. All of the backup data is live and current. Normal operations can be resumed within an estimated two hour time frame.


See
Note 12
Page 27

Subsection entitled "User Permissions" – We concur with the Comptroller's recommendations in this regard and, in fact, took steps to correct this particular weakness prior to the conclusion of the audit.

The Bay Shore Union Free School District wants to express how seriously we take the Comptroller's report and recommendations on these matters. Again, we thank you for your efforts to ensure the appropriate use of school district funds. **You can be assured that fiscal matters are our primary interest as well.** We will review the audit conclusions with our external accountants and legal counsel and will take all necessary actions based upon their advice and our appropriate business judgment.



Dr. Evelyn Blose Holman
Superintendent of Schools



Mary Louise Cohen
President, Board of Education

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District is correct in stating that the liability for compensated absences can include additional costs such as Social Security contributions, Medicare, and retirement system contributions. However, an Employee Benefit Accrued Liability Reserve (EBALR) can only be used to make payments to employees upon separation of service for accrued leave time due.

Note 2

The District did not follow the provisions of General Municipal Law when the Board resolution establishing the EBALR indicated the fund would be used to pay post employee benefits. The law is clear on this issue, EBALR funds can only be used for the payment of accrued benefit due upon an employee's separation of service. There are no provisions in the law to allow for payments for other employee benefits or post employment benefits.

Note 3

The District's statement that the State Comptroller's Office offered an "alternative" interpretation of General Municipal Law 6-p is incorrect. The State Comptroller's interpretation of the law and the wording of the law are the same; there are no provisions that allow EBALR funds to be used to pay other post employment benefits.

Note 4

Although District officials claimed, after our audit was completed, that they had used EBALR funds to pay for compensated absences when employees separated from service, they did not provide adequate documentation to support such a statement. They merely forwarded to us a copy of a journal entry dated June 30, 2005, showing that \$1,500,000 was removed from the fund. No documentation was provided detailing what that money was used for.

Note 5

Our Office has always been clear on this matter; EBALR funds can only be used for the payment of accrued leave due upon an employee's separation of service.

Note 6

In July 1994, OSC issued guidance for the implementation of GASB Statement 16. This guidance specifies what should be included in the liability and offers suggestions for calculating it. It also, however, clearly states that funding of the liability is not required. There is a distinct difference between what should be included in the liability and what is permitted to be funded by the EBALR. According to the GML 6-p, "employee benefits" means the value of accrued and unliquidated time

earned by municipal and school district employees and payable to those employees upon termination of service. This clearly does not include salary-related payments or Other Post Employment Benefit (OPEB) costs. The Comptroller has not issued additional guidance because no changes have occurred in the requirements of Statement 16 or the parameters set by the GML 6-p.

Note 7

Currently, there is no legal mechanism to allow school districts to reserve monies for OPEB costs, including payment of retiree health insurance premiums. The Comptroller's Office, in performing this audit, held the District accountable for adhering to General Municipal Law 6-p(7)(a) requirements for EBALR funds. The Comptroller has advanced proposals for a remedy in the State Legislature, and has vigorously supported the creation of OPEB trusts that will allow districts to save for OPEB costs. We are also recommending that districts be allowed to perform a one-time transfer of monies "stranded" in EBALR accounts to an OPEB trust, once it is legally established.

Note 8

The cost of soliciting RFPs is not significant. However, the cost of failing to solicit RFPs can be significant if the District does not receive the services it desires, or if those services cost the District significantly more money than necessary.

Note 9

In order to verify that the District pays for only those services that were delivered, at the agreed upon rates, it is essential that all professionals submit itemized invoices to the District, indicating the hours and days worked and specifying the services that were provided.

Note 10

When we asked District officials in the fall of 2007 why they did not solicit competitive bids for the purchase and installation of flooring in the spring of 2006 costing \$66,159, they informed us that it was an emergency purchase. However, there was no documentation to support that assertion. The Board minutes did not contain an emergency declaration and the claim voucher in support of the payment did not indicate that it was an emergency. In fact, the purchase order prepared for this expenditure included other purchases and installations, totaling approximately \$95,000, that were not characterized as an emergency either.

Note 11

Although District officials claimed that contracts for the refinishing of floors, the purchase and installation of doors, and the reconditioning of sports uniforms were all "competitively bid from "one source or another", they did not provide us with documentation to support this assertion. Supporting documentation provided included contracts with other vendors, contracts not in force during the time purchases were made, or contracts that listed prices that did not agree with amounts charged by the vendors used by the District.

Note 12

This subsection was deleted from the audit report.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

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. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected financial condition, purchasing and information technology for further audit testing.

We accomplished the audit objectives by evaluating internal controls over the areas of financial condition, purchasing and information technology to determine whether the controls were appropriately designed and operating effectively.

Our audit procedures included the following:

- We reviewed the calculation of the District's long-term compensated absences for reasonableness and accuracy.
- We compared the fund balance reserved in the EBALR fund to the District's liability for compensated absences.
- We added the excess fund balance in the EBALR fund to the unreserved unappropriated fund balance at June 30, 2007 to determine the revised percentage of fund balance retained.
- We determined approximately how much interest the reserve earned during the audit period.
- We reviewed the District's procurement policy to determine if it adequately addressed the procurement of goods and services.
- We examined public bids, quotes and RFP documentation to determine whether such procurements were made in accordance with Board policy and legal requirements.

- We examined purchase agreements and contracts for evidence of authorized signatures and proper dates.
- We examined bid, quote and RFP documentation to determine if the District selected the lowest-priced responsible vendor.
- We examined claims for evidence of audit and approval for payment.
- We compared paid claims to contractual agreements to confirm rates and services.
- We scanned vendor payment history reports for evidence of multiple purchases/services from the same vendor in amounts just below bid limits and for indication of duplicate payments.
- We reviewed the District's computer access and security protocols and procedures.
- We reviewed user permission reports to determine if permissions were properly segregated based on job descriptions.
- We reviewed the District's computer data back-up and recovery protocols 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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