



Berkshire Union Free School District Financial Condition and Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — August 30, 2007

2008M-9



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	3
EXECUTIVE SUMMARY	5
INTRODUCTION	7
Background	7
Objectives	7
Scope and Methodology	8
Comments of District Officials and Corrective Action	8
FINANCIAL CONDITION	9
General Fund Deficit	9
Comprehensive Plan	11
Recommendations	12
CASH DISBURSEMENTS	13
Recommendation	14
PURCHASING	15
Recommendation	16
PAYROLL AND PERSONAL SERVICES	17
INTERNAL AUDITOR	19
Recommendation	20
APPENDIX A Response From District Officials	21
APPENDIX B OSC Comments on the District’s Response	27
APPENDIX C Audit Methodology and Standards	28
APPENDIX D How to Obtain Additional Copies of the Report	31
APPENDIX E Local Regional Office Listing	32

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

July 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 Berkshire Union Free School District, entitled Financial Condition and 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
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Berkshire Union Free School District (District) is governed by a Board of Education (Board) which comprises four 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 was created by a special act of the State Legislature. One of the Board members is the Executive Director of Berkshire Farm Center and Services For Youth (Farm Center),¹ one is the Residential Director of the Farm Center, one is a voter of the District, and two are required to be appointed by the New York State Commissioner of Education. The District's budgeted expenditures for the 2007-08 fiscal year are nearly \$8 million, funded primarily with charges for services.

Scope and Objectives

The objectives of our audit were to review the District's financial condition and the internal controls over selected financial operations for the period July 1, 2006 to August 30, 2007. Our audit addressed the following related questions:

- What is the financial condition of the District's general fund?
- Has the District established adequate internal controls over cash disbursements to protect District assets against fraud, abuse, and professional misconduct, and are those controls operating effectively?
- Has the District established adequate internal controls over purchasing to protect District assets against fraud, abuse, and professional misconduct, and are those controls operating effectively?
- Has the District established adequate internal controls over payrolls and personal services to protect District assets against fraud, abuse, and professional misconduct, and are those controls operating effectively?
- Does the District's internal auditor meet the independence requirements stated in Education Law?

¹ A not-for-profit organization that operates a private residential facility for youth

Audit Results

The District's financial statements show that its general fund balance declined from a total of \$263,580 at June 30, 2004 to a deficit of \$1,793,223 at June 30, 2007. This decline in fund balance of \$2,056,803 represents a significant weakening of the District's overall financial condition. This deficit is due primarily to a shortfall in budgeted tuition revenue. District officials contend that the District's delay in the receipt of final tuition rates from the State Education Department (SED) and the New York State Division of Budget (DOB) resulted in a shortfall in budgeted tuition revenue. The District has also seen a decline in its student population. Although the Board has taken some steps to correspondingly reduce expenditures to match the lowered revenue amount, expenditures have remained in excess of revenues. The District has applied to the State Education Department for an additional \$2.2 million in reimbursements. As of February 2008, the District has not received any of the additional reimbursements.

The District has also been unable to maintain adequate cash flow, requiring the issuance of short-term borrowings, in the form of revenue anticipation notes, ranging from \$1.7 million at June 30, 2006 to \$3 million at June 30, 2007. In addition, the District has not developed a comprehensive plan to address the deficit, if the additional aid is not received. As a result, the District faces further deterioration of fund balance and greater financial stress.

The District's system of internal controls did not adequately segregate the duties of the Business Administrator to provide for an effective system of checks and balances over safeguarding District assets. Although our audit of cash disbursements disclosed no significant errors or irregularities, the concentration of key duties with one individual weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected and uncorrected.

Although internal controls over purchasing were appropriately designed and generally operating effectively, our scan of the records for possible bid items and review of three larger contract expenditures found that controls may not be operating as designed. The three contracts we tested required bid solicitation. However, the District did not competitively bid any of these three contracts, valued at total of \$282,010. As a result, the District cannot be sure that it is securing goods and services in the most economical manner.

Although the District is exempt from the requirement to establish an internal audit function because it has fewer than 300 enrolled students, in an effort to strengthen fiscal oversight and improve internal controls, the District entered into an inter-municipal agreement with their regional BOCES. However, we found that the BOCES employee serving as the internal auditor is not independent in performing the internal audit function. The District's current arrangement may put this BOCES employee in the position of evaluating significant District services or programs that are provided by the BOCES, the individual's employer.

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 disagreed with certain findings and recommendations contained in this report. Our comments on the District's response can be found in Appendix B.

Introduction

Background

The Berkshire Union Free School District (District) is located in the Town of Canaan in Columbia County. The District was created by a special act of the State Legislature and is governed by the Board of Education (Board) which comprises four members — one the Executive Director of Berkshire Farm Center and Services For Youth (Farm Center)², one the Residential Director of the Farm Center, one is a voter of the District, and two are required to be appointed by the New York State Commissioner of Education. There is currently a vacancy in one of the appointed positions. The District is seeking a fifth Board member to fill that vacancy. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There is one school building in operation within the District, with approximately 155 students and 103 employees. The District's facilities are located on the grounds of the Farm Center where students reside in upper and lower campus cottages. The District provides educational services for its residents. In addition, other students are bused in from area school districts.

Generally, a school district is governed by a Board that is elected by the residents of the area that the district encompasses. In addition, those residents vote on the district's annual budget. However, this is not the case in this District. Its budget is not voted upon by the public and real property taxes are not raised to fund its operations. The costs incurred by this District are reimbursed by the students' home school districts, and counties and the State, based on tuition reimbursement rates calculated by the SED. The District's budgeted expenditures for the 2007-08 fiscal year are nearly \$8 million, funded primarily with charges for services.

Objectives

The objectives of our audit were to review the District's financial condition and internal controls over selected financial operations. Our audit addressed the following related questions:

- What is the financial condition of the District's general fund?

² A not-for-profit organization that operates a private residential facility for youth

- Has the District established adequate internal controls over cash disbursements to protect District assets against fraud, abuse, and professional misconduct, and are those controls operating effectively?
- Has the District established adequate internal controls over purchasing to protect District assets against fraud, abuse, and professional misconduct, and are those controls operating effectively?
- Has the District established adequate internal controls over payrolls and personal services to protect District assets against fraud, abuse, and professional misconduct, and are those controls operating effectively?
- Does the District’s internal auditor meet the independence requirements stated in the Education Law?

Scope and Methodology

We examined the District’s financial condition and internal controls over cash disbursements, purchasing, payroll and personal services, and the internal audit function for the period July 1, 2006 to August 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. District officials disagreed with certain findings and recommendations contained in this report. Our comments on the District’s response can be found in Appendix B.

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*.

Financial Condition

Healthy financial condition in a special act school district can be defined as the district's ability to remain fiscally viable while providing diversified and quality educational programs. Fiscal viability, as referenced in the New York State Education Commissioner's Regulations, means the district's balance sheet should show a positive fund balance, a ratio of current assets divided by current liabilities of 1:1 or greater, and sufficient working capital (current assets minus current liabilities) to demonstrate solvency. Fiscal viability also includes a district's ability to maintain adequate program levels while surviving economic disruptions, identify the ability to and adjust to long-term changes, and anticipate future problems.

Financial condition and cash flow concerns are inherent in special act school districts due to the reimbursable cost methodology utilized. A special act district seeks approval to be reimbursed with public funds for the costs of educating students. These include administrative, direct care, and facility costs. Costs must be reasonable, necessary, directly related to the education program and have adequate substantiating documentation. These costs are reimbursable through the calculation of maximum tuition rates for approved programs and additional reimbursements for unforeseen expenditures. Tuition rates are determined and approved by SED. Districts are required to have access to sufficient capital or lines of credit to cover all operating, property maintenance, leasing or purchase costs during the period of reimbursement approval. The board of education should review periodic fiscal reports and financial statements to assess fund balance, operating deficits and the adequacy of revenues to fund budgeted appropriations. In addition, the board should immediately address any fund balance deficits, operating deficits or revenue shortfalls and implement remedial action to deal with any financial condition issues.

General Fund Deficit

Operating deficits occur when total expenditures exceed total revenues. Persistent and recurring operating deficits are usually indicative of a structurally imbalanced budget and financial stress. The District's general fund actual expenditures exceeded revenues for fiscal years 2004-05, 2005-06 and 2006-07 creating operating deficits and contributing to the deterioration of the District's accumulated fund balance from \$263,580 at June 30, 2004 to a deficit of \$1,793,223 at June 30, 2007. This decline in fund balance of \$2,056,803 represents a significant weakening of the District's overall financial condition.

General Fund				
Year	Fund Balance - Beginning of Year	Revenues	Expenditures	Fund Balance - End of Year
2004-05	\$263,580	\$6,651,938	(\$7,124,766)	(\$209,248)
2005-06	(\$209,248)	\$6,190,462	(\$6,611,055)	(\$629,841)
2006-07	(\$629,841)	\$5,780,062	(\$6,943,444)	(\$1,793,223)

The deficit is due primarily to a shortfall in budgeted tuition revenue. District officials contend that the District's delay in the receipt of final tuition rates from SED's rate setting unit and the DOB resulted in the corresponding shortfall in budgeted tuition revenue. This delay creates an inherently unstructured budget where revenues are not available to fund budgeted expenditures within a school year. As a result, the District has been paid at tuition rates which are below current expenses. This has subsequently resulted in cumulative operating deficits. For example, During the 2006-07 fiscal year, the District was billing tuition based on a non-final 2005-06 tuition rate, since SED's rate setting unit had not issued final rates for 2005-06. The District is currently waiting for final tuition rates for the 2004-05, 2005-06 and 2006-07 fiscal years.

In addition to the delay in rate setting, the Business Administrator also stated that the tuition rate set by SED is not high enough to produce the necessary level of revenues to sustain expenditures. As of November 15, 2007, the District had applied to SED for approximately \$1 million in additional reimbursements attributable to the 2004-05 and 2005-06 fiscal years because the Business Administrator believes the maximum allowable tuition reimbursement was not sufficient to cover total costs. The Business Administrator is in the process of applying for approximately \$1.2 million in additional reimbursements attributable to the 2006-07 fiscal year. District officials do not know how much of the \$2.2 million in additional reimbursements will be approved by SED to help offset the deficit fund balance, or when the approved moneys might be available. As of February 2008, the District had not received any of the additional reimbursements.

In addition, the District has experienced a decline in the student population. As a result of the decline in enrollment, the District has taken some steps to reduce expenses. However, District officials have not adjusted spending sufficiently to maintain expenditures within the limits of these reduced revenues. The total student enrollment, reported at 270 students for the 2004-05 fiscal year, declined to 185 for the 2005-06 fiscal year, and was reported at 155 students as of September 2007. The operations of the residential program at the related Farm Center have a direct impact on the operation of the school. The

enrollment decline at the school occurred because the Farm Center's residential capacity was reduced as a result of environmental, safety, and structural renovation initiatives. For example, one cottage is no longer used as a residential unit due to environmental and structural problems. An Independent Living program, which was housed in one on-campus cottage, was moved to an off-site location and the cottage was not redesignated for use as a residential unit due to staffing limitations. Also, to provide safer and more secure living arrangements, the Farm Center eliminated the use of dormitory style rooms and reduced the number of students residing in each cottage, thus further decreasing the residential capacity of the Farm Center, and the related enrollment at the school.

As a result of these factors, the District has taken steps to reduce expenses to levels which still allow it to maintain programs and remain compliant with students' Individualized Education Plans (IEPs). However, the District has not been able to sufficiently reduce expenses to meet the current revenue stream. In September 2005, 16 program staff were laid off to adjust budgeted expenditures as a result of the enrollment decline from the 2004-05 to the 2005-06 fiscal year. District officials indicated that administrative and contractual costs were reduced beginning in the 2005-06 fiscal year, and that further reductions in contracted services were also achieved in 2006-07. For the 2007-08 fiscal year, the District is working with the office of Vocational Educational Services for Individuals with Disabilities (VESID) to adjust staffing to offer a VESID approved program which is supported by the SED's rate setting unit.

The significant operating deficits and exhaustion of the District's positive fund balances have resulted in insufficient cash flow to pay bills as they come due. To alleviate the cash flow difficulties in the general fund, the District issued revenue anticipation notes (RANs) totaling \$1.7 million in 2004-05, \$1.7 million in 2005-06 and \$3 million in 2006-07. The RANs represent a temporary source of cash borrowed on the pending collection of State aid. Although necessary to ensure the continued operation of District programs, the issuance of temporary cash flow financing places an additional burden on the District due to the incurrence of legal and interest costs associated with such indebtedness. For example, the \$3 million RAN issued in 2006-07 cost the District \$67,633 in interest and legal fees. This strategy should not be long-term in nature and its termination is dependent upon the Board's future actions to adopt a comprehensive financial plan.

Comprehensive Plan

Good management practice dictates that when a district experiences significant fiscal stress resulting in a large cumulative deficit fund

balance, the district should develop a comprehensive plan to address the fiscal stress and deficit both on a short-term and long-term basis. The plan should include actions such as increasing sources of revenue or reducing the level of services; adopting structurally balanced budgets with realistic estimates of available fund balance; conservatively estimating revenues; and keeping expenditures within budgetary appropriations.

Although Board members indicate that they have taken steps which they hope will address these operating deficits, they have not developed a formalized, written plan to provide direction on resolving the deficit in the general fund. The failure to develop such a financial plan may lead to further deterioration of fund balance and greater financial stress to the District.

Recommendations

1. The Board and District officials should monitor both revenues and expenditures throughout the year, and take corrective action when necessary to avoid incurring expenditures in excess of available revenues.
2. District managers should monitor the rate-setting proceedings, including the status of proposed additional reimbursements and be prepared to take action if the final SED reimbursements are insufficient to remedy the District's deficit fund balance.
3. The Board should develop a comprehensive, written plan for resolving the deficit fund balance and cash flow deficiencies. This plan should also attempt to reduce or eliminate the general fund reliance on RANs.

Cash Disbursements

An effective system of internal control requires the separation of duties so that no single individual controls most or all phases of a transaction. Concentrating key responsibilities (i.e., authorizing transactions, recording transactions and having access to assets) with one individual significantly increases the risk that errors and/or irregularities may occur and go undetected and uncorrected. For example, bank reconciliations should be prepared by someone other than the individual who receives, records, deposits and expends moneys, and fund transfers should be approved by someone independent of the process. When circumstances do not permit for an adequate segregation of duties, mitigating controls should be implemented. Such compensating controls could include increased supervision and oversight by District officials, including the periodic review of the work in question.

The District's system of internal controls did not adequately segregate the duties of the Business Administrator to provide for an effective system of checks and balances over safeguarding District assets. Without any additional oversight provided by other District officials, the Business Administrator deposited cash, disbursed cash (by signing checks), posted entries to the accounting records, and performed bank reconciliations. The Business Administrator also has the ability to open and close bank accounts, and transfer funds between bank accounts. There were no written policies and procedures for cash disbursement controls and responsibilities and no mitigating controls to compensate for the control weaknesses, such as a routine review by another employee or increased management oversight.

As a result of these control deficiencies, we reviewed all bank statements, cash transfers, cash disbursement schedules, cancelled checks, and cash disbursement transactions for the 2006-07 fiscal year to ensure they were supported and represented proper charges against the District. We also reviewed all bank account activity for unidentified or unusual withdrawals, transfers or charges for the 2006-07 fiscal year. In addition, we tested the May and June 2007 bank reconciliations to ensure they were prepared timely and properly, and agreed with accounting records. Although our examination did not disclose any significant errors or irregularities within the accounting records or among cash transactions, the Board should be aware that a lack of oversight and segregation of financial duties increases the risk of undetected errors, irregularities, fraud and abuse. In situations where it is not possible to segregate financial duties, it is incumbent

upon District officials to establish compensating controls and provide oversight, such as reviewing the monthly bank reconciliation to ensure it is timely and accurate.

Recommendation

4. District officials should establish and implement written procedures to either segregate the cash authorization, recordkeeping, disbursing, and custodial duties of the Business Administrator or implement appropriate compensating controls and provide sufficient oversight. Controls should be monitored to ensure that they are operating effectively.

Purchasing

A good system of internal controls over purchasing consists of policies and procedures that allow an organization to provide reasonable assurance that it is using its resources effectively and is complying with applicable laws and regulations. District officials are responsible for designing internal controls that help safeguard the District's assets and ensure the prudent and economical use of its moneys when procuring goods and services. The objectives of a procurement process are to obtain services or materials, supplies, and equipment of the desired quality, in the quantity needed, and at the lowest price in compliance with applicable Board and legal requirements. This helps ensure that taxpayer dollars are expended in the most effective manner.

Overall, the internal controls over purchasing were appropriately designed and generally operating effectively. However, our review of purchases subject to competitive bidding found that controls over those purchases were not operating as designed. While the District has adopted policies that reinforce the Law's requirements for competitive bidding, compliance with the policies was poor for purchases tested because District officials did not enforce them.

Competitive Bidding — General Municipal Law (Law) requires school districts to advertise for bids when a purchase contract exceeds \$10,000 or a public works contract exceeds \$20,000. The purpose of obtaining bids is to encourage competition in the procurement of supplies, equipment and services which will be paid for with public funds. The appropriate use of competition provides taxpayers with the greatest assurance that goods and services are procured in the most prudent and economical manner; goods and services of desired quality are being acquired at the lowest possible price; and procurement decisions are not influenced by favoritism, improvidence, extravagance, fraud or corruption.

To test adherence to competitive bidding requirements, we scanned the records for possible bid items and reviewed three contracts, totaling \$282,010, paid in fiscal year 2006-07, and found that the District did not competitively bid any of these contracts. The contracts included: janitorial services (\$130,883), security cameras (\$105,145), and electric services (\$45,982). The Business Administrator could not explain why these contracts were not publicly advertised for bid.

Without proper adherence to competitive bidding laws and established policies and procedures, the District cannot be sure that it is securing goods and services in the most economical manner.

Recommendation

5. The Board should monitor and enforce compliance with adopted policies and regulations relating to competitive bidding requirements.

Payroll and Personal Services

As with all school districts, payroll and fringe benefits represent a large portion of the District's annual budget. Internal controls over payroll consist of written policies and procedures that describe employee responsibilities in preparing and disbursing payroll, as well as written Board authorization for salaries, wages and fringe benefits. District policies, collective bargaining agreements and/or individual employee contracts should stipulate an employee's entitlement to the accrual, use and payment of leave time. Payments for unused leave upon separation from employment should occur only as authorized by the Board in policies, agreements or contracts, or by separate Board resolutions. The significant costs associated with payroll and personal services highlight the importance of good internal controls in this area. When internal controls are not designed appropriately or operating effectively, there is a significant increase in the risk that fraud, abuse, or errors may go undetected and uncorrected.

The District has established an adequate internal control structure over its payroll processing. Our audit included reviews of agreements, contracts, timesheets, employees' earning records, leave time records and payroll registers, and discussions with District officials and employees.

We found that salaries and benefits are governed by collective bargaining agreements or individual employment contracts. We verified that five new hires during our audit period were authorized by the Board. We reviewed personnel files of 15 employees to confirm that they were legitimate employees and that appropriate supporting documentation was on file. We also reviewed payroll records of 25 employees to ensure that they were paid in accordance with their respective agreements, that withholdings were properly authorized and calculated for 15 employees, and that earnings and withholdings were properly reported for 10 employees. Additionally, we tested the records of nine employees to verify leave time was allotted as authorized by agreement, and reviewed 25 occurrences of leave time to ensure leave request forms were completed and approved, and that the leave time was appropriately deducted on the employee records. We traced a selection of 10 paychecks to payroll records to verify that the paychecks were correct and in agreement with the authorized pay amounts. We examined payroll account reconciliations for August 2007 and September 2007 to ensure that reconciliations were performed, and done correctly. Lastly, we reviewed two separation payments made during our audit period to ensure they were appropriate and in accordance with collective bargaining agreements.

We found no significant deficiencies in the payroll records we examined. We determined that, except for minor deficiencies that we discussed with District officials, internal controls over payroll and personal services were adequate.

Internal Auditor

Generally, all school districts were required by law to have an internal audit function in operation no later than December 31, 2006, which includes, at a minimum, the development of a risk assessment for district operations. The risk assessment should include, but not be limited to, a review of financial policies, procedures and practices; an annual review and update of such risk assessment; and annual testing and evaluation of one or more areas of the district's internal controls taking into account risk, control weaknesses, size and complexity of operations; and the preparation of reports (at least annually) which analyze significant risk assessment findings, recommend changes for strengthening controls and reducing identified risks, and specify timeframes for implementation of such recommendations.

A district may use its own employees, inter-municipal cooperative agreements, shared services to the extent authorized by Education Law, or independent contractors to fulfill the internal audit function. The internal auditor must have professional auditing qualifications and be independent of other district functions. The internal auditor must have no other responsibilities related to district business operations, and cannot be a close or an immediate family member of an employee, officer, or contractor providing significant or material services to the district. In addition, an individual or consultant hired for the internal audit function may not have a significant or material interest in any other contract with the district.

The District is exempt from the requirement to establish an internal audit function because it has fewer than 300 enrolled students. However, in an effort to strengthen fiscal oversight and improve internal controls, the District entered into an inter-municipal agreement with the Rensselaer, Columbia and Greene Counties Board of Cooperative Educational Services, Questar III (BOCES) to perform the internal audit function for the period July 1, 2006 through June 30, 2007. The agreement states that the internal auditor shall be considered an employee of Questar III for purposes of payroll administration and benefits.

In 2006-07, the District spent \$105,190 on general fund services provided by the BOCES. Based on the material nature of these payments, we conclude that the BOCES employee serving as the internal auditor would not be independent in performing the District's internal audit function. This arrangement is likely to put the BOCES employee in the position of evaluating significant District services or

programs that are provided to the District by BOCES, the individual's employer.

Recommendation

6. The Board should terminate the internal audit relationship with the BOCES and replace this position with an internal auditor who meets the independence requirements in Education Law and guidance provided by SED.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



BERKSHIRE UNION FREE SCHOOL DISTRICT

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Canaan, NY 12029
518-781-3500
Fax 518-781-4890

James Gaudette
Superintendent
ext. 3545

Bruce Potter
Asst. Superintendent
ext. 3576

David Hodgkinson
Business Administrator
ext. 3574

June 17, 2008

State of New York
Office Of The State Comptroller
110 State Street
Albany, NY 12236

Re: Response letter for draft audit report

Dear Office Of The State Comptroller:

Thank you for meeting with the BOE members and district administration on May 6, 2008 to review the draft audit report of our school district for the period July 1, 2006 to August 30, 2007. The district values the Comptroller's Office assessment of the district's operations and we would like to thank your staff for the professional and courteous manner in which the audit was conducted.

The district would like to take this opportunity to address certain sections of the audit report that need clarification. The audit report states, "This deficit is due primarily to the District's decline in student population, and a shortfall in budgeted tuition revenue. In addition, the District has not developed a comprehensive plan to address the deficit, if the additional aid is not received." The deficit is not a result of the decline in student population. The primary reason for the deficit is the failure to receive timely final tuition rates from SED's rate setting unit and the New York State Division of Budget. For example, the district is currently waiting for final tuition rates for the 04-05, 05-06, and 06-07 school years. Further, as a result of this delay in receiving final tuition rates, the district must borrow money using revenue anticipation notes to fund the deficit until such rates are received.

See
Note 1
Page 27

The district also has developed a comprehensive plan to address the deficit. In fact, the BOE has taken significant steps to reduce expenditures to acceptable levels to correspond with the reduction in student population. Any further reductions would jeopardize the districts ability to meet the students Individualized Education Plans (IEP's). In September 2005, 16 program staff were laid off as a result of the enrollment decline from 04-05 to 05-06 to adjust the budget to the appropriate level. In addition, administration was reduced by \$255,222 in 05-06. Various contracts for services were reduced in 05-06 for a savings over the prior year of \$302,930. Many of these reductions were maintained for 06-07 and further reductions in contracted services were also achieved in 06-07.

See
Note 2
Page 27



BERKSHIRE UNION FREE SCHOOL DISTRICT

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David Hodgkinson
Business Administrator
ext. 3574

A new day program was developed and started in September 2006 to reduce the dependence on the Berkshire Farm Center student population as the primary source of tuition revenue. This resulted in \$238,346 in new revenues from local area public schools for the 06-07 school-year above and beyond Berkshire Farm enrollment revenues. The school is working with rate setting to get final and prospective tuition rates issued which the district is aggressively pursuing. For the 07-08 year the district has been working with VESID (the office of Vocational Educational Services for Individuals with Disabilities) to adjust staffing to offer a VESID approved program which is supported by SED's Rate Setting Unit.

Additionally, the district is pursuing offering an Alternative education program with Albany City School district which will assist in obtaining additional revenues if successful. The district's long range plan will be to expand the alternative education plan to other school districts. The district has secured the support of the Board of Directors of the Berkshire Farm Center and Services For Youth to loan the district money from their endowment funds if needed until finalized tuition rates can be received. The district also has reduced and continues to reduce expenses where necessary.

The audit report states, "The District has not been able to sufficiently reduce expenses to meet the current revenue stream." The objective of the school is not to stay within the current revenue stream as the revenue stream is not enough to maintain adequate educational programs for the students. For example the district is currently billing with a non-final 05-06 tuition rate in the 07-08 school year. This rate is not enough to maintain programs and therefore the district must borrow funds until SED's rate setting unit issues a higher corresponding rate for 07-08.

The audit report also discusses fund balance and that the district should be "adopting structurally balanced budgets with realistic estimates of available fund balance." The rate setting methodology used by SED does not allow special act districts to have a positive fund balance and tuition rates are only issued to cover expenditures.

The audit report states "Without any additional oversight provided by other District officials, the Business Administrator deposited cash, disbursed cash (by signing checks), ... performed bank reconciliations, and transfer funds between bank accounts." There was and is oversight provided by other district officials and routine reviews by other employees.

All incoming cash receipts are received first by the purchasing agent and logged into a cash receipts journal. The cash receipts are then given to the business administrator to deposit and record. The internal claims auditor approves all claims invoices to be paid as well as the purchasing agent before they are paid. Further, the claims auditor and the purchasing agent review and

See
Note 3
Page 27



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approve the final warrant before checks are mailed out. All transfers of cash between bank accounts are made with checks and also follow this procedure. All bank statements are reviewed by the claims auditor.

Recommendation 1. The Board and District officials have monitored both revenues and expenditures for the 06-07 and 07-08 school years. District officials monitor revenue and expenditure reports on a monthly basis internally and these reports have been presented and reviewed monthly at the Board meetings throughout the year. Corrective action is taken when necessary to avoid incurring expenditures in excess of available forecasted revenues. However, due to the delay in receiving final tuition rates to support programs, the district will continue to have expenditures exceeding revenues operating from a deficit until the final rates can be issued and billed.

Recommendation 2. District managers have been and continue to monitor the rate-setting proceedings, including the status of proposed additional reimbursements and are prepared to take action if the final SED reimbursements are insufficient to remedy the District's deficit fund balance.

Recommendation 3. Although the Board and district officials have unwritten plans mentioned above, the Board will develop a comprehensive written plan for resolving the deficit fund balance, cash flow deficiencies, and attempt to reduce or eliminate the general fund reliance on RANs. This plan will be submitted in our corrective action plan letter within the 90 day timeframe.

Recommendation 4. In regards to cash disbursements, the district has implemented additional compensating controls. For the 07-08 year the internal claims auditor also reviews all treasurer's report/bank reconciliations and journal entries in addition to the 05-06 year procedures of reviewing the bank statements, bills for payments, and warrants. The treasurer's reports are approved by the BOE. The purchasing agent will verify cash receipts have been deposited and recorded. Controls will be monitored by the internal claims auditor.

Recommendation 5. Purchasing, the district has hired a Business Official and competitive bidding requirements will be monitored by the Business Official to insure compliance. Bids will be awarded thru the BOE to insure proper monitoring. The janitorial services contract will be put out for bid upon its expiration. The BOE approved the district to participate in the OCM BOCES electric bid. The district's electric account will be changed over to the OCM BOCES vendor on May 6, 2008.

The contracts for janitorial services and security cameras were not bid because the district had no Business Administrator at the time these contracts were signed and other district personnel were not aware of these regulations.



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The electric contract was not bid as the provider referenced it was the only provider in the area upon contract renewal and at the time was therefore believed to be exempt from the bidding requirement.

Although the district did not bid these three contracts the district participated in an RFP for the camera purchase with Berkshire Farm Center. The choice was based on the vendor that offered the specific camera technology the district needed. The janitorial services contract was negotiated with the existing vendor for a lower fee. The electric contract was changed to a lower cost plan with the same vendor.

Recommendation 6. The district acknowledges your recommendation to terminate the internal audit relationship with the BOCES and replace this position with an internal auditor who meets the independence requirements in Education Law and guidance provided by SED. However, the district respectfully recognizes a difference of opinion with the Comptroller’s Office, and our reasons are provided below.

See
Note 4
Page 27

Ed Law §2116-b states, “a district shall be permitted to use (a) inter-municipal cooperative agreements...” Article 5-G of General Municipal Law empowers municipal corporations which, includes school districts and boards of cooperative educational services, to enter into agreements “for the performance among themselves or one for the other of their respective functions, powers and duties on a cooperative or contract basis.” We have an inter-municipal agreement with Questar III BOCES and other school districts for our internal auditor.

Ed Law §2116-b states, “personnel or entities performing the internal audit function...meet professional auditing standards for independence between the auditor and the district.” The generally recognized governmental accounting standards are issued by the Comptroller General of the United States and are referred to as the “Yellow Book Standards.” Section 3.27 of the Yellow Book Standards addresses governmental entities that employ auditors, thereby forming an internal audit organization. Such an organization is free from impairments to independence provided the accounting organization is: “(a) accountable to the head or deputy of the governmental entity, (b) required to report the results of the audit organization’s work to the head or deputy head of the government entity, and (c) located organizationally outside the staff or line management function of the unit under audit.” Our auditor reports directly to the BOE and is outside any other line of management of the school.

SED has recently issued a question and answer memo regarding the Internal Audit Function posted on the educational management services website. Specifically, the memo states, “The individual appointed as the internal auditor must be independent and have no other responsibilities related



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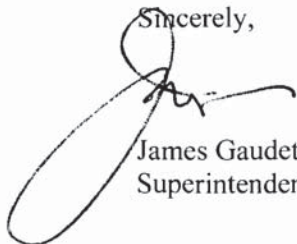
to business operations of the district or BOCES, and can not be a close or an immediate family member of an employee, officer, or contractor providing significant or material services to the district or BOCES.” We believe our level of services from BOCES is not significant or material to the overall level of services being provided to the district or by BOCES to all districts and this issue of significant or material has not been clarified in law. In 2006-2007 \$47,972 of the \$105,190 spent on general fund services was from a prior school year that was not paid previously. The remaining \$57,218 represents 0.82% of the total expenditures for the 2006-2007 year.

Further section 3.30 of the Yellow Book standards provides that an “audit organization’s independence is enhanced when it also reports regularly to the entity’s independent audit committee and/or the appropriate government oversight body.” Our internal auditor reports to the audit committee which is also our school board.

The district also believes it has selected the best internal audit service for many reasons. It is the most cost effective way as the auditor has no profit motive, the internal auditor has experience with internal audits as opposed to financial audits, and has experience in the educational industry. The district is also aware of a legal opinion that differs from the interpretation of the position taken by the Comptroller’s Office.

We are pleased to have the opportunity to respond to the Comptroller’s findings and recommendations and appreciate the assistance in improving controls over the district’s operations. Although the district has a difference of opinion in regards to the internal auditor, all of the remaining recommendations were implemented as described above. This quick response is evidence of the district’s commitment to efficiently manage school district resources. Thank you.

Sincerely,



James Gaudette
Superintendent



Harith Flagg
Board of Education President

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

For the reasons cited in our report, we believe that the decline in student population has had a significant impact on the District's financial condition. We acknowledge that delays in rate setting may have also had an impact and have included the District's views in our report.

Note 2

As stated in our report, and acknowledged by the District in its response to Recommendation 3, our concern was that the Board had not developed a formal written plan to address the deficit.

Note 3

Our concern was with the lack of segregation of duties in the area of cash disbursements. District officials are citing controls in the areas of cash receipts and deposits, and claims processing.

Note 4

The internal auditor is a BOCES employee, and the arrangement must be viewed from that perspective when considering State Education Department (SED) guidelines and audit independence standards. When a Board of Education implements the internal audit function by contracting with a BOCES, the BOCES and its employees should comply with SED guidelines and professional auditing standards (including independence). SED guidelines state that there would be a lack of independence if a BOCES employee audited material and significant goods and services provided by the BOCES, or the claims for such goods or services. SED guidelines point out that the Government Accountability Office (GAO) suggests that limits of materiality/significance may need to be set lower for public sector audits, and therefore we conclude that the District should not contract with the BOCES for the internal audit function.

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 condition, 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 objective and scope by selecting for audit those areas most at risk. We selected financial condition, cash disbursements, purchasing, and payroll and personal services for further audit testing.

To assess the District's financial condition, we examined the Treasurer's and Business Administrator's records and reports for the period June 30, 2004 to June 30, 2007. Our procedures included the following steps:

- We interviewed appropriate District officials to obtain an understanding of the organization and the District's accounting system, and to identify key personnel.
- We reviewed the District's financial records and reports to ensure that transactions were properly recorded.
- We reviewed District's policies and procedures and evaluated their adequacy.
- We analyzed the changes in fund balance of the District's funds for the 2004 through 2007 fiscal years to determine the combined fund deficit trends, and we evaluated major factors contributing to operating deficits for the applicable years.
- We compared budget estimates to actual revenues, expenditures and fund balances to determine whether the revenue and expenditure estimates were reasonable, and whether sufficient fund balances were available.

For cash disbursements we focused on the approval and recording of payments. We examined the following records to determine the effectiveness of internal controls for cash disbursements:

- Bank statements
- Bank reconciliations
- Wire and/or cash transfers
- Cash disbursements schedules (Warrants)
- Cancelled checks.

For purchasing, we focused our attention on the approval of purchases and approval of payment for various types of goods and services acquired, including purchase packets for reimbursement of expenses for officials and employees and credit card charges. We also focused on adherence to District policies and procedures, as well as pertinent laws and regulations related to purchasing. We interviewed appropriate District officials to learn about procedures used to prepare and approve purchase packets for payment. We reviewed 27 purchase packets prepared during the 2006-07 fiscal year to determine if payments were properly supported, approved, and recorded in accordance with management's directives and legal requirements. We also examined the following records to determine the effectiveness of internal controls for the purchasing and claims processing functions, and identify any associated effect of deficiencies found in those controls:

- Purchase orders
- Cash disbursement schedules (Warrants)
- Bid files
- Purchase packets
- Budget status reports
- Lists of board members and administrators
- Policy and administrative manuals
- Treasurer's reports
- Minutes of the proceedings of the Board of Education.

Our review of payroll included the following:

- We reviewed District policies, procedures, and records pertaining to payroll.

- We interviewed and observed District officials and employees to learn about procedures used to process payrolls.
- We tested employee leave accruals and District payroll records for accuracy by comparing payment and benefits to corresponding employment contracts and collective bargaining agreements.
- We reviewed payroll records to ensure that employees were being paid the appropriate amounts of money and payrolls were being certified.
- We reviewed separation payments to ensure that they were appropriate and supported by contractual provisions.

When reviewing the internal audit function, we reviewed the independence of the contractual relationship between the BOCES and the District, total expenditures between the District and BOCES, and potential independence issues.

We conducted our 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 D

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