



Briarcliff Manor Union Free School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — October 22, 2007

2008M-52



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

May 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 Briarcliff Manor 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
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Briarcliff Manor 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.

Responsibilities relating to the District's finances, and accounting records and reports are largely those of the District's Assistant Superintendent for Business and Technology, who also acts as the Purchasing Agent. The District's budgeted expenditures for the 2006-07 fiscal year were \$47.1 million, funded primarily with real property taxes, State aid, tuition, sales tax and interest revenues.

Scope and Objective

The objective of our audit was to examine internal controls over selected financial operations for the period July 1, 2006 to October 22, 2007. Our audit addressed the following related questions:

- Did District officials properly use encumbrance accounting procedures to allow for accurate evaluation of the District's financial condition?
- Were District purchases made according to District policies, procedures and applicable laws?

Audit Results

District officials inappropriately used encumbrances rather than appropriately setting up a reserve fund for capital projects and repairs. District officials created and encumbered 25 purchase orders, totaling \$2 million, in June 2007, for which no actual commitments existed at the time of encumbrance. As a result, the reserve for encumbrance account was overstated and the unreserved, unappropriated fund balance in the general fund was understated by \$2 million. After adjusting for the amount encumbered, the unreserved, unappropriated fund balance retained in the general fund for the 2007-08 fiscal year was more than twice the amount allowed by Real Property Tax Law.

Although the purchasing agent generally complied with the Board's policies, we found instances where competitive bids for purchases over \$10,000 and public works contracts over \$20,000 were not always sought as required by General Municipal Law (GML). In addition, the District did not consistently document quotes for public works contracts under the GML threshold. We reviewed the purchases and public works contracts for 20 vendors totaling \$1.3 million and found that \$168,892 was not in

accordance with the Board's procurement policy. As a result, District officials cannot be certain that they are procuring goods and services at the lowest possible costs.

Comments of District Officials

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

Introduction

Background

The Briarcliff Manor Union Free School District (District) is located in the Towns of Ossining and Mt. Pleasant, Westchester 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 three schools in operation within the District with 1,781 students and approximately 400 employees, including substitutes. The District's budgeted expenditures for the 2006-07 fiscal year were \$47.1 million, funded primarily with real property taxes, State aid, tuition, sales tax and interest revenues. Responsibilities relating to the District's finances, and accounting records and reports are largely those of the District's Assistant Superintendent for Business and Technology, who also acts as the District's purchasing agent.

Objective

The objective of our audit was to determine if internal controls over selected financial operations were appropriately designed and operating effectively. Our audit addressed the following related questions:

- Did District officials properly use encumbrance accounting procedures to allow for accurate evaluation of the District's financial condition?
- Were District purchases made according to District policies, procedures and applicable laws?

Scope and Methodology

We examined internal controls over selected financial transactions and purchasing for the period July 1, 2006 to October 22, 2007. For encumbrances, we expanded our scope and examined financial records for the period July 1, 2005 to January 7, 2008.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials

generally agreed with our recommendations and indicated they had initiated corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, the Board must approve a corrective action plan that addresses the findings in this report, forward the plan to our office within 90 days, forward a copy of the plan to the Commissioner of Education and make the plan available for public review in the District Clerk's office. For guidance in preparing the plan of action, the Board should refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*.

Encumbrances

A school district's financial condition determines its ability to provide public educational services to its students. The responsibility for effective financial planning and management of the District rests with the Board, the Superintendent, and the Assistant Superintendent for Business. One of the primary responsibilities of the Board and the Superintendent is to ensure that District budgets are accurate. The Board and District management must make sure that budgets are prepared, adopted, and amended based upon reasonable and accurate assessments of resources that can be used to fund appropriations. They must also make sure that policies and procedures are in place to ensure that financial information is recorded correctly and timely.

An important aspect of budget preparation includes a reasonably accurate estimate of fund balance at the end of the fiscal year. There are 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 purposes and, therefore, is not available for the District to use for other purposes. Unreserved fund balance is the amount that is uncommitted and is available for the reduction of real property taxes in the next fiscal year. 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 the unappropriated fund balance. The amount of unappropriated, unreserved fund balance at the end of any given fiscal year has a direct impact on the amount of the tax levy needed to fund the ensuing fiscal year's budget. Current Real Property Tax Law limits the unappropriated fund balance a school district can retain to no more than 3 percent of the next year's budget.¹

Encumbrances are commitments for payments related to unperformed contracts for goods or services. Encumbrance accounting is intended to guard against a district creating liabilities in excess of approved appropriations. In order for school district officials to maintain budgetary control and to arrive at an accurate estimate of its uncommitted appropriations, it is necessary to encumber all of its known obligations when contracts are approved or purchases are

¹ In July 2007, legislation was enacted to change the Real Property Tax Law statutory limit of unappropriated fund balance to 3 percent of the 2007-08 fiscal year's budget and 4 percent of the 2008-09 fiscal year's budget.

authorized. At the end of the fiscal year, a portion of the unreserved fund balance is set aside for the payment of goods, materials, and services that have been ordered but not received. This restricted amount of fund balance is known as the reserve for encumbrances and the following year's budget is increased by this amount.

District officials improperly encumbered fund balance for purchase orders that did not exist and thereby purposely overstated encumbrances and understated the resulting unreserved fund balance with the goal of reserving funds for future repair and capital project expenditures.

We reviewed all of the District's 106 open purchase orders with encumbrances totaling \$3.2 million at June 30, 2007, and we found that 25 purchase orders totaling \$2 million had no documentation showing that District officials had placed orders with vendors. At January 7, 2008, District's records still listed these encumbrances. District officials indicated that they were setting money aside to pay for repair and capital projects in the next year, and they added that reserve funds were not mandatory for repair or capital projects when funded from the general fund. District officials also said that they encumbered the funds based on professional advice provided by their independent auditors. The officials further stated that the establishment of reserves and the subsequent release of funds required voter approvals, obtained through a costly and time-consuming voting process and, therefore they believed setting up official reserves was not an efficient method to appropriate funds.

Encumbrances should be used to set funds aside to pay orders placed in the current year, not to carry funds over to pay for future repairs or capital projects. As a result, the reserve for encumbrance was overstated and the unappropriated fund balance for the 2006-07 fiscal year was understated by \$2 million.

The District's accounting practices for encumbrances distorted its financial situation and technically circumvented the Real Property Tax Law. According to District records, unreserved, unappropriated fund balance in the general fund at June 30, 2007 totaled \$1.4 million representing 2.8 percent of the \$50.8 million of budgeted appropriations for 2007-08 fiscal year, slightly less than the 3 percent limit. However, because the District had manipulated its fund balance using encumbrances, its actual fund balance exceeded the 3 percent limitation. We recalculated the District's year-end unreserved fund balance and determined that the District actually retained almost \$3.5 million, more than twice the amount allowed by law.

By improperly encumbering funds, District officials reduced the amount of unreserved fund balance that would be available for

appropriation for the subsequent fiscal year. As a result, the funds could not be used as a financing source in the subsequent year's budget, which resulted in a higher tax rate for District residents.

Recommendations

1. The purchasing agent should not approve purchase orders until known obligations exist or contracts are approved.
2. District officials should establish a reserve fund to properly appropriate funds for future District repairs or capital expenditures.
3. District officials should use encumbrances to set funds aside to pay for orders placed in the current year, not to carry funds over to pay for future repairs or capital projects.

Purchasing

General Municipal Law (GML) requires that bids be solicited when the cost of an item or commodity group exceeds established dollar limits. All contracts for public works in excess of \$20,000 and purchase contracts in excess of \$10,000 must be awarded, after advertising for sealed bids, to the lowest responsible bidder who furnishes the required security. There are exceptions to the competitive bidding requirements. One exception occurs when there is only one possible supplier or source from which to procure goods or services. When a school district invokes this exception, officials should be prepared to offer proof that the goods and/or services in question were available from only one source. GML also requires the Board to adopt written policies and procedures for the procurement of goods and service that are not subject to competitive bidding requirements. These policies and procedures should indicate when District officials need to obtain competitive quotations or bids; the procedures for determining which method will be used and that adequate documentation of the actions taken is retained on file for verification.

The purpose of obtaining bids is to encourage competition in the procurement of supplies, equipment and services purchased 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, that goods and services of desired quality are being acquired at the lowest possible price and that procurement is not influenced by favoritism, improvidence, extravagance, fraud or corruption.

The District's procurement policy requires sealed bids in conformance with GML for purchases greater than \$10,000 and public works contracts greater than \$20,000. The procurement policy requires that quotations be obtained for supplies and equipment that are not required by law to be procured through competitive bidding. For purchases with an estimated cost of \$3,001- \$5,000 documented telephone quotes from at least three separate vendors (if available), or a Request for Proposal must be obtained. For purchases with estimated costs of \$5,001 to less than \$10,000 formal written quotes from at least three separate vendors (if available) are required. The Board adopted similar dollar limit procedures for public works contracts. Public works contracts with estimated costs up to \$7,000 may be procured at the discretion of the Purchasing Department and public works contracts from \$7,001- \$19,999 require formal written quotes from at least three separate vendors (if available).

Although the purchasing agent generally complied with the Board's policies, we found that the District did not always use the competitive bidding process for purchases over \$10,000 and public works contracts over \$20,000 as required by GML and the District's own policy. In addition, the District did not consistently document quotes for public works contracts under the bidding threshold.

We reviewed the purchases and public works contracts for 20 vendors totaling \$1.3 million and found that payments made to four vendors and totaling \$168,892 were not in accordance with GML or Board policy.

- The District paid a vendor a total of \$69,342 for maintenance of District playing fields and lawns with environmentally friendly, "green" products during fiscal year 2006-07 without seeking competitive bids. District officials stated that they considered this vendor to be a sole source. However, our research identified multiple landscapers and lawn care experts that also used "green" products in the Mid-Westchester area.
- District officials did not solicit competitive bids for bathroom counter tops and plumbing supplies for bathroom renovations. They paid a total of \$14,135 to a single vendor for the total bathroom renovation project. District Officials said that they had not anticipated that costs would exceed \$10,000.
- The District purchased trees and plants from a local nursery at a cost of \$10,765 without solicitation of competitive bids.
- The District paid a local construction company a total of \$74,650 under six different purchase orders for unrelated public works contracts including excavation, concrete work and sidewalk replacement, all costing under \$20,000 each. A review of the vendor file revealed that five of the six payments that required quotes did not contain any documentation that quotes were obtained.

Without proper adherence to laws and established policies and procedures, the District cannot ensure that they are procuring goods and services at the lowest possible costs.

Recommendations

4. The purchasing agent should comply with the Board's procurement policy by using State or local government contracts or seeking competitive bids when required by General Municipal Law.
5. If sole source purchases are made, District officials should document proof that the goods and/or services in question were available from only one source.

6. The purchasing agent should ensure that public works contracts under the \$20,000 threshold for competitive bidding are obtained following the Board's procurement policy.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Briarcliff Manor Union Free School District

45 Ingham Road
Briarcliff Manor, New York 10510
914-941-8880, Ext. 301 Fax: 914-941-6613

April 17, 2008

[REDACTED]
Newburgh Regional Office
Office of the State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, NY 12553

Dear [REDACTED]:

Re: Briarcliff Manor UFSD Audit Response

The Briarcliff Manor UFSD acknowledges receipt of the Report of Examination for the audit period of July 1, 2006 through October 22, 2007 (2008M-52). The Report identifies two areas of improvement within the District's internal controls--encumbrances and purchasing. The District accepts the recommendations made within the report. In this audit response letter, we wish to describe the corrective actions that have already been taken.

Response to recommendations:

1. The purchasing agent will not approve purchase orders until known obligations exist or contracts are approved.
2. District officials will establish additional reserve funds with Board approval.
3. The District will use encumbrances to set aside funds to pay for orders placed in the current year, and will not carry over funds to pay for future repairs or capital obligations. On May 20, voters will be asked to approve a proposition authorizing the transfer of fund balance to the capital account for current improvements and/or repairs.
4. The Assistant Superintendent for Business and Technology has disseminated and reviewed the policies and procedures with staff to ensure that purchases are in compliance with District policy and General Municipal Law.
5. District officials will document sole source providers.
6. The Purchasing Agent has reviewed policy with the Director of Building and Grounds to ensure that public works contracts, under the \$20,000 threshold for competitive bidding, are obtained following the Board's procurement policy.

We commend the professionalism and thoroughness of your auditors who worked with us during this period and appreciate the opportunity to identify ways to improve upon our practices and procedures to promote responsible stewardship. Thanks for your help and guidance.

Best regards,



Charles K. Trainor
Briarcliff Manor UFSD, Board President

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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, 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. Based on that evaluation, we determined that controls appeared to be adequate but risk existed within the purchasing process including encumbrances. Therefore, we decided upon the reported objectives and scope by selecting encumbrances and the purchasing process for further audit testing.

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

- We interviewed personnel involved in the preparation and approval of purchase orders and the subsequent release of purchase orders to vendors.
- We reviewed purchase orders, purchase order detail reports, open purchase order analysis reports and the recording and liquidation of encumbrances in District files.
- We tested procurement transactions for compliance with statutory bidding requirements and the District's procurement policy including the review of vendor payment files, invoices.
- We examined and compared paid claims to contractual agreements to confirm rates and services.
- We examined bid, quote and RFP documentation to determine if the lowest cost, responsible vendor was selected.
- We examined purchase agreements and contracts for evidence of authorized signatures and proper dates.

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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