



Brookfield Central School District Internal Controls Over Claims Auditing and Cash Disbursements

Report of Examination

Period Covered:

July 1, 2006 — June 30, 2007

2008M-172



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government 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 Brookfield Central School District, entitled Internal Controls Over Claims Auditing and Cash Disbursements. 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 Brookfield Central School District (District) is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The Board appoints a Business Manager who also serves as the District's Treasurer and purchasing agent. He is responsible for the District's daily financial operations and for some disbursement activities. The District contracts with the Oneida-Herkimer-Madison Board of Cooperative Educational Services (BOCES) Central Business Office (CBO) for the services of two account clerks who work, under the direction of the Business Manager/Treasurer, with cash receipts, cash disbursements, payroll and financial records of District operations. The District, as a public employer, enrolls its eligible employees in the New York State and Local Employees' Retirement System (ERS).

Scope and Objective

The objective of our audit was to examine the District's internal controls over claims auditing, cash disbursements, and classification of employees for the period July 1, 2006 to June 30, 2007. Our audit addressed the following related questions:

- Are internal controls over the claims audit process appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the processing of cash disbursements appropriately designed and operating effectively to adequately safeguard District assets?
- Did the District's process for classifying workers ensure that the persons the District enrolls in ERS are valid public employees?

Audit Results

The District's internal controls over claims auditing, cash disbursements, and classifying workers for ERS are not adequate. The Board does not have an acceptable claims audit function and District officials have not developed guidance for cash disbursements or classifying workers. As a result, claims were not properly audited nor were the financial duties of the Business Manager/Treasurer segregated. In addition, we noted weaknesses in the classification of workers for ERS.

For example, the Board failed to establish adequate and appropriate controls over the audit of claims. The Board elected to retain its authority to audit District claims rather than appoint a claims auditor. However, instead of having the entire Board audit claims in concert, they appointed two members to audit, which is not permissible by Education Law.¹ The Board members did not ensure that they audited every claim appearing on the warrants provided to them. We found that claims paid with 113 manually-prepared checks, totaling over \$1.7 million, processed by the Business Manager/Treasurer showed no indication that the claims were audited by the Board, even though they appeared on the warrants. In addition, we identified 69 claims, totaling over \$96,000, that were paid by computer-printed checks listed on warrants that were not provided to the Board for audit. While we did not find any of these claims to be improper, the Board and District management were not aware of these claims. Because the Board did not account for and audit every claim, there is an increased risk that the District may have paid inappropriately for purchases that were not necessary or cost effective.

Also, the Business Manager/Treasurer performed the incompatible duties of recordkeeping, cash custody, check processing, making wire transfers as well as initiating and updating payroll information in the computerized system. In addition, there is no effective oversight of the Business Manager/Treasurer, increasing the risk that inappropriate payments could be initiated and concealed. Finally, there was no routine review of computer-generated activity reports by District management to monitor this employee's activity in the accounting system. While we did not find any inappropriate payments, when duties are not properly segregated or there is not effective oversight, there is an increased risk that the District's funds could be expended for unauthorized purposes.

Lastly, we noted weaknesses in internal controls over the District's process for classifying workers whom the District enrolls in the ERS. Although we did not find any material exceptions, these weaknesses increase the risk that the District could improperly enroll non-employees (independent contractors) in ERS.

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 that they plan to initiate corrective action. Appendix B includes our comments on issues raised in the response letter.

¹ Section 1724

Introduction

Background

The Brookfield Central School District (District) is located in the Towns of Brookfield, Hamilton and Madison in Madison County, the Towns of Bridgewater and Sangerfield in Oneida County and the Town of Columbus in Chenango 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 is one school in operation within the District with approximately 275 students and 80 employees. The District's budgeted expenditures for the 2006-07 fiscal years were \$5.5 million which were funded primarily with State aid, real property taxes and grants. The District disbursed approximately 1,300 non-payroll checks totaling approximately \$2.7 million and approximately 1,800 payroll checks/direct deposits totaling approximately \$1.4 million.

The Board appoints a Business Manager who also serves as the District's Treasurer and purchasing agent. He is responsible for the District's daily financial operations and for some disbursement activities. The District contracts with the Oneida-Herkimer-Madison Board of Cooperative Educational Services (BOCES) Central Business Office (CBO) for the services of two account clerks who work, under the direction of the Business Manager/Treasurer, with cash receipts, cash disbursements, payroll and the financial records of the District. The District, as a public employer, enrolls its eligible employees in the New York State and Local Employees' Retirement System (ERS).

Objective

The objective of our audit was to examine the District's internal controls over claims auditing, cash disbursements, and classification of employees. Our audit addressed the following related questions:

- Are internal controls over the claims audit process appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the processing of cash disbursements appropriately designed and operating effectively to adequately safeguard District assets?

- Did the District's process for classifying workers ensure that the persons the District enrolls in ERS are valid public employees?

Scope and Methodology

We examined internal controls over the District's claims auditing, cash disbursements, and classification of employees 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. District officials generally agreed with our recommendations and indicated that they plan to initiate corrective action. Appendix B includes our comments on issues raised in the response letter.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the GML, 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.

Claims Auditing

Conducting a proper audit of claims before the District pays them is an integral part of any internal control system. Before the District can pay a vendor, the corresponding claim must be audited and approved for payment either by the Board or by a claims auditor appointed by the Board. It is not permissible to assign the claims audit duty to a single Board member, a rotation of different Board members, or a subcommittee of the Board, because the Board acts in concert; it is a single entity. Whenever a board of education audits bills and passes a resolution approving the schedule of claims, which orders the Treasurer to pay, it is presumed that each board member has inspected each of the claims and found them to be in order. A claim must contain enough detail and documentation so that the Board has sufficient information concerning the nature of the claim to enable it to determine whether the claim represents actual and necessary District expenses.

The District's process for auditing claims does not comply with Education Law requirements. The Board has elected to retain its authority to audit District claims rather than appoint a claims auditor. However, rather than the entire Board auditing claims, it appointed two members to do the audit. One of the Board members appointed to audit claims resigned effective February 28, 2007, and the Board did not appoint another member to review claims until July 1, 2007. This practice does not substitute for the legal requirement or the important internal control that the entire Board audit and approve every claim. Although approved in the Board minutes, the warrants are not formally certified as audited and approved for payment.

In addition, the District did not have control procedures to ensure that all claims presented on the warrants were audited and approved for payment before issuing checks. For example:

- The Board member charged with auditing claims informed us that he did not compare the number of claims that he received to the number of claims listed on the warrant to ensure that every claim appearing on the warrant was accounted for and audited.
- We found that 113 manual checks, totaling over \$1.7 million, processed by the Business Manager/Treasurer had no indication they were audited by the Board although most appeared on warrants that had been approved by the Board member. The Board and District management were not aware

of the informal process for manual check payments and the Business Manager stated that he was under the impression that the Board was receiving all the claims associated with the warrants. However, the account clerk was unaware that the claims for manually-prepared checks were required to be provided to the Board for audit. Manual checks were written for monthly BOCES billings, cell phones, credit card payments, insurance premiums, postage, and employee expense reimbursements among other things.

- We reviewed all 57 warrants issued during the audit period and found seven warrants with 90 claims totaling approximately \$150,000 were not provided to the Board for audit.² The Board and District management were not aware that these claims and warrants had not been presented for audit. They were also unable to provide an explanation as to why this occurred.

Based on the risks resulting from the Board's failure to ensure that all claims appearing on the warrants presented to them were audited, we reviewed the reasonableness of the payees and amounts for the unaudited payments made with 113 manually-prepared checks and 69 computer-printed checks listed on the warrants that were not presented to the Board. We also examined the associated cancelled checks and endorsements to verify that the information agreed with the printed warrants and scanned the supporting claim documentation to assess whether it appeared to be complete. We selected 21 of the unaudited claims totaling \$11,716 and an additional 31 audited claims totaling \$38,052,³ which we deemed higher-risk claims for a more thorough review of the supporting documentation and the propriety of the expenditure. We found minor discrepancies with four claims, which were discussed with District officials.

When all claims appearing on warrants provided to the Board have not been audited, there is an increased risk that the District may have paid inappropriate expenses for purchases that were not necessary or cost effective. In addition, there is no assurance that goods or services were actually received.

² The seven unapproved warrants included 21 manual checks totaling \$53,488 and 69 computer-printed checks totaling \$96,438.

³ We selected the 31 higher-risk claims from the computer-printed checks listed on the 50 warrants approved by the Board during the audit period. The 31 claims were presented to the Board for audit. We selected the claims based on payment amounts and whether or not we considered the payee name to be odd or unusual for school districts. The claims included reimbursements to key administrative officials.

Recommendations

- 1. The Board should conduct a proper audit of claims, or ensure that a Board-appointed claims auditor conducts a proper audit of claims, in accordance with applicable laws, regulations and policies.

- 2. The Board and District officials should ensure that no claims are paid until they have been audited and properly certified.

Cash Disbursements

An effective system of internal controls over cash disbursements requires that key duties be segregated so that no one employee controls all the transaction steps related to expenditures. Assigning key duties (such as transaction approval, accounting, and asset custody) to the same individual, particularly when there is very little or no supervisory review, weakens internal controls and increases the risk that inappropriate payment transactions could be initiated and concealed. For example, the same individual should not receive and deposit cash, record receipts and disbursements, sign checks, make cash and wire transfers, prepare and post journal entries, and update employee salaries. Proper segregation of duties helps to prevent and detect errors, and reduces the potential opportunities for employees to initiate and conceal improper payments or make unauthorized changes to the accounting records. When it is not practical to adequately segregate duties because of limited staff resources, it is important for District officials to institute compensating controls such as independent review of the accounting records by someone who is not involved in key transactions. The periodic review of computer-generated reports, such as exception/change reports and audit logs, can also help District officials monitor employees' work on the computerized accounting system.

District officials have not established an adequate system of internal controls to properly segregate the duties of the Business Manager/Treasurer. The Business Manager/Treasurer's duties include receiving and depositing cash, recording and processing disbursements, signing District checks, making cash and wire transfers and initiating and approving all payroll changes. This control deficiency is compounded by the lack of compensating controls such as a periodic review of the Business Manager/Treasurer's work by someone independent of the Business Office. Furthermore, District officials stated that no one periodically reviews computer-generated exception/change reports and audit logs to monitor employees' activities on the accounting system. As a result, District cash assets are not adequately protected and there is an increased risk that errors and irregularities could occur and go undetected.

Wire Transfers — Wire transfers provide a means of direct access to the moneys held in the District's name. Appropriate controls over wire transfer activity include policies and procedures that require management authorization of a transaction before the transaction is initiated; itemized documentation to support the purpose, source, destination and amount of the transaction; and documentation to

appropriately account for and record the transaction. District officials are responsible for ensuring the segregation of duties involved in wire transfer activity or providing compensating controls. For example, if the individual who executes wire transfers also records them in the accounting system, an independent review of the ledger entry by a District official can verify the accuracy of the transfers and help prevent errors or the improper use of funds. District officials do not require the bank to confirm transfers made by the Business Manager/Treasurer with someone independent of the process before the transfer can be made.

District bank statements recorded \$4 million of wire transfers during the audit period. Because of deficiency in control over the Business Manager/Treasurer's wire transfer authority, we reviewed all wire transfer activity for District bank accounts during the audit period and assessed the propriety of each transaction based on the recipient, the amount transferred and the timing of the payment. We did not identify any improprieties.

Non-Payroll Cash Disbursements — The Business Manager/Treasurer has the ability to prepare and sign manual checks, and post journal entries to record disbursements without a periodic, supervisory review of his work. Therefore, the Business Manager/Treasurer has the ability to conceal an improper payment.

Without an independent review of the Business Manager/Treasurer's work over non-payroll cash disbursements, there is a significant risk that fraud, abuse, and professional misconduct could occur and not be detected and corrected in a timely manner. Our testing of 113 manually-prepared checks (see the Claims Auditing finding) did not disclose any improper or inappropriate payments.

Payroll Cash Disbursements — The Business Manager/Treasurer can also initiate and approve changes to payroll records without oversight of District management. We verified that the salaries paid to the Superintendent and Business Manager/Treasurer agreed with their Board-approved contracts. We also reviewed the payroll records of 11 employees to verify they were legitimate District employees and that the salaries paid to them were authorized by formal Board action or collective bargaining agreements.

Although our audit did not identify any improper or inappropriate payments in the District's payroll cash disbursements, the fact that someone independent of the Business Office does not periodically review the work of the Business Manager/Treasurer increases the risk that improper payments could occur and go undetected and uncorrected in a timely manner.

Recommendations

3. District officials should ensure wire transfers are properly authorized by someone independent of the wire transfer process and that someone is reviewing computer-generated exception/change reports and audit logs to monitor data modifications and financial transactions.
4. District officials should evaluate the Business Manager/Treasurer's duties and responsibilities and, where practicable, assign them to other Business Office staff to better segregate duties. Where it is not practicable to segregate duties, compensating controls, including routine reviews by other District officials, should be established.

Classification of Employees

Local governments and school districts obtain services from both public employees and independent contractors and consultants. It is important that public employers enroll only public employees, elected officials and public officers in ERS to ensure that only persons entitled to ERS membership receive ERS service credit. The Office of the State Comptroller's *Financial Management Guide for Local Governments*⁴ provides information to help distinguish between independent contractors and employees. The New York State and Local Employees' Retirement System (ERS) provides its own checklist of indicators⁵ that can help localities and school districts make this determination correctly. In addition, as of April 3, 2008, the Office of the State Comptroller (OSC) made enhanced regulations available that more clearly define how local governments and school districts can determine whether providers of professional services are employees or independent contractors. These regulations are posted on the OSC website.⁶

For the period July 1, 2006 to June 30, 2007, we audited the status of persons the District enrolled in ERS to determine whether these individuals met the criteria for employee classification as established by the *Financial Management Guide for Local Governments* and ERS indicators. Although we did not find any material exceptions, we identified weaknesses in the District's controls over the classification process. For example, District officials have not formally designated an individual or department who is responsible making a determination of whether individual(s) providing professional services should be classified as an employee or independent contractor and they have not established any guidelines or procedures for determining employee/contractor classifications. Unless District officials correct these control weaknesses, they are at increased risk of improperly enrolling non-employees in ERS.

Recommendation

5. District officials should strengthen controls over worker classification processes to help ensure that they correctly determine the status of individuals who work for the District in compliance with the Guide and the regulations posted on the OSC website.

⁴ *Financial Management Guide for Local Governments*, Subsection 8.4020, page 1, issued December 1992

⁵ The ERS Checklist, entitled "Distinguishing Between an Employee and an Independent Contractor", is available from ERS.

⁶ www.osc.state.ny.us

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

BROOKFIELD CENTRAL SCHOOL

P.O. Box 60, Fairground Road
Brookfield, NY 13314
Telephone (315) 899-3323
Fax (315) 899-8902

Superintendent

Sherri G. Morris

Clerk

Judith Van Duren

Business Manager

James Plows

Board Members

Bernard C. Whitacre, President

Jeffrey Beehm, Vice President

Cara Goedeker

Melinda Johnson

Kevin Kupris

October 8, 2008

Office of the State Comptroller
Syracuse Regional Office
State Office Building, Room 409
333 East Washington Street
Syracuse, NY 13202

Re: Response and Corrective Action Plan to Findings from the Comptroller Audit

This letter serves as the school district's response and corrective action plan to the Comptroller's Audit Report that your staff reviewed with the Brookfield Central School district officials.

The district is pleased to note your comments in your report as follows: "we did not find any of these claims to be improper" and "we did not find any inappropriate payments". We also appreciate your findings, as noted below, that are designed to reduce the risk, while not entirely eliminating such risk, that an error could occur. Our response to your findings is designed to reduce the risk that an error may occur while at the same time being cost effective so as not to result in an unreasonable financial burden to the district.

Finding: Claims should be audited by the entire Board of Education or the district should employ a claims auditor.

Claims for payment will be made available to all members of the Board of Education prior to Board of Education meetings. Board members will indicate their agreement with the claims as presented by initialing a copy of the district warrant that will become a part of the official meeting minutes.

See
Note 1
Page 17

Finding: Manual checks did not contain evidence of being audited by the Board of Education.

When auditing claims board members will verify that all claims appearing on a warrant have been presented for audit.

Finding: The Business Manager performs incompatible duties.

The duties of the business manager will be reviewed to determine if incompatible duties should be assigned to another employee in order to reduce the level of risk that an error may occur.

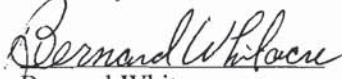
See
Note 2
Page 17

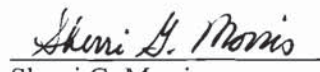
Finding: Weaknesses in internal controls when enrolling individuals in the Employee Retirement System.

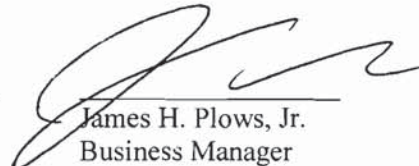
The district will follow the procedures recommended by the NYS Comptroller when determining if employees are eligible to participate in the Employees Retirement System.

Thank you for your assistance in this matter.

Sincerely:


Bernard Whitacre
Board President


Sherri G. Morris
Superintendent of Schools


James H. Plows, Jr.
Business Manager

JHP/j

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District's response indicates that the Board prefers to retain its statutory responsibility to audit claims. However, the response does not address the manner and extent of the Board audit and could define an audit process that continues an environment of weakened Board oversight of expenditures. As discussed in our report, a proper audit of claims requires that each Board member inspect each individual claim and approve its acceptability for payment.

Note 2

The District's response only commits to determining if incompatible duties of the Business Manager should be assigned to another employee. Wherever a determination may be made that it is not practicable or cost effective to segregate incompatible duties, we reiterate our recommendation that compensating controls, including routine reviews by other District officials, should be established.

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, and payroll and personal services.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

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

For claims auditing, we examined the Board's claims audit function for the period July 1, 2006 to June 30, 2007. To accomplish the objectives of this audit and to obtain relevant audit evidence, our procedures included the following:

- We conducted interviews with District officials, personnel and Board members to gain an understanding of procedures in place and the nature of internal controls.
- We reconciled all of the 57 paid warrants recorded in the District's accounting system to cash disbursements listed on bank statements.
- We compared warrant approvals recorded in the Board minutes to the printed warrants to determine whether all warrants had been approved and all paid claims had been accounted for on warrants.
- We identified 113 manually-prepared checks, totaling over \$1.7 million, and 69 computer-printed checks, totaling over \$96,000 that were issued to pay claims but had not been audited or approved by the Board. We examined the associated cancelled checks and endorsements to verify that the information agreed with the printed warrants and we reviewed the claim documentation for reasonableness. We selected 21 of these claims, totaling \$11,716 based on the payee or amount or supporting documentation and applied additional procedures to assess

the transaction and verify that the payments were for proper District purposes. The procedures included reviewing purchase requisitions, purchase orders, claim forms, invoices, receiving reports and packing slips and interviewing appropriate District staff and officials to obtain additional information about certain transactions.

- We examined cancelled checks and supporting documentation for a sample of 31 higher-risk audited claims totaling \$38,052 based on payee or amount to verify that the payments were for proper District purposes. Our procedures included reviewing purchase requisitions, purchase orders, claim forms, invoices, receiving reports and packing slips and interviewing appropriate District staff and officials to obtain additional information about certain transactions.

For cash disbursements, we examined the District's procedures for authorizing wire transfers and non-payroll and payroll cash disbursements. To determine the effectiveness of internal controls and to evaluate the effect of deficiencies in these controls, our procedures included the following:

- We examined six warrants and verified that the listed payees and dollar amounts agreed with accounting system records and cancelled checks.
- We examined all non-check disbursements recorded on the District's bank statements during the audit and assessed the propriety of each transaction based on the recipient, the amount transferred and the timing of the payment.
- We compared the Superintendent's and Business Manager/Treasurer's Board-approved salaries to payroll reports and earnings histories.
- We reviewed personnel folders for 11 employees selected from the District's payroll to verify their existence and compared their earnings records to salary agreements to verify they were being paid correctly.
- We selected a sample of claim payments (see the Claims Auditing section) during our audit period based on a review of the electronic data, and examined the transactions to ensure that they contained proper support and authorization, and were for valid District purposes.
- We examined detailed activity reports for all general ledger cash accounts for unusual adjustments during the audit period that could conceal improper cash disbursements.

For classification of employees, we reviewed the District's process for classifying workers to ensure that the persons the District enrolls in ERS are valid public employees rather than independent contractors.

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

APPENDIX D

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APPENDIX E

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