



Copenhagen Central School District Internal Controls Over Non-Payroll Cash Disbursements

Report of Examination

Period Covered:

July 1, 2006 — February 29, 2008

2008M-228



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 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 Copenhagen Central School District, entitled Internal Controls Over Non-Payroll 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*

Introduction

Background

The Copenhagen Central School District (District) is located in the Towns of Champion, Rutland and Watertown in Jefferson County and Denmark, Harrisburg and Pinckney in Lewis County. The District is governed by the Board of Education (Board) which comprises seven 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 600 students and 90 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$8.3 million, which were funded primarily with State aid, Federal aid and real property taxes. The Business Office is staffed by the Treasurer and a Business Office clerk. The Board has appointed the Treasurer to manage the District's financial resources and has appointed a claims auditor to audit claims. In addition, as a post audit function, the Board formally approves warrants at meetings. The Treasurer's authority to make payments originates with the warrants approved by the claims auditor.

The District's accounting system consists of combined manual and computerized accounting systems. Most general fund and payroll checks are generated and printed by the Madison-Oneida Board of Cooperative Educational Services (BOCES) at the Mohawk Regional Information Center (MORIC) using a computerized accounting system. The District maintains a manual accounting system as the sole recordkeeping system for the special aid and capital funds and keeps records with both the computerized accounting system and manual accounting system for the general and school lunch funds.

Objective

The objective of our audit was to determine if District officials were properly safeguarding their financial resources. Our audit addressed the following related question:

- Are internal controls over non-payroll cash disbursements appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

We examined internal controls over cash disbursements for the period July 1, 2006 to February 29, 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 planned to initiate 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, 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.

Non-Payroll Cash Disbursements

Timely, accurate, and complete recording and reporting of financial transactions are essential for the District's ability to monitor the financial activities of the District. These activities should be performed in such a way so that no individual controls most, or all, phases of a transaction. Also, claims should be audited either by the Board or by a Board appointed claims auditor prior to payment.

We identified internal control weaknesses in the District's cash disbursements operations that could lead to errors or irregularities occurring and not being detected. Specifically, we found that the detailed computerized records for non-payroll cash disbursements were not accurate, the duties of the Treasurer were not adequately segregated, and payments were made prior to claims audit.

Recordkeeping

An accounting system should provide for timely, accurate, and complete recording and reporting of financial transactions. Information generated from accounting records provide the basis for decision making. Therefore, it is essential that the District maintain sufficient accounting records to document the disbursement of District monies. However, District officials do not use the computerized accounting system to account for all non-payroll check disbursements.

The District produces approximately 40 percent of the general fund checks and 100 percent of all other funds' checks manually (manual checks) rather than using the computerized accounting system. Therefore, the District has not been optimizing available technology. All computer-generated checks are processed at MORIC and are for claims approved by the claims auditor on a regular monthly warrant. Other general fund checks and other funds' non-payrolls checks are manual checks. District staff does not enter manual checks in the computerized accounting system for the special aid fund or the capital fund. These two funds have manual accounting records. For the general fund and school lunch fund, manual checks are sometimes entered in the computerized accounting system as detailed individual check disbursements, but at other times are grouped together and summarized in a journal entry. These journal entries did not include adequate detail information, making it difficult to identify and explain individual payments. When check disbursements are recorded in a summarized journal entry with insufficient detail in the accounting records, it reduces District management's ability to monitor transactions.

We tested 156 checks totaling \$1.8 million and we found 60 manual checks totaling \$1.1 million that were not entered in the computerized accounting system accurately, as follows:

- We examined 20 special aid fund checks totaling \$30,734 and ten capital fund checks totaling \$738,540. These checks were all listed on manual warrants. Because special aid fund checks and capital fund checks are only recorded in supplemental manual records, none of these disbursements was reflected in the District’s central records by entry in the computerized accounting system.
- All of the school lunch fund checks are manual checks. Of the 22 checks totaling \$14,261 that we examined, 18 checks totaling \$12,863 were entered in the computerized accounting system by journal entries, summarizing the warrants. The other four checks, totaling \$1,398, paid to four different payees, were recorded as manual check disbursements in the computerized accounting system; however, they were erroneously recorded as paid to “CCS.”¹ Although these four checks were erroneously recorded, we determined that they were issued for legitimate purposes.
- We reviewed 56 manually prepared checks totaling \$652,271 from the general fund. While most were recorded directly as check disbursements in the computerized accounting system, four manual checks totaling \$121,397 were recorded in journal entries, summarizing the warrants. Four other manual checks totaling \$212,820 were recorded in part through manual check disbursements and in part through other entries, and the issued check amounts did not equal the amount of the recorded checks in the computerized accounting system. Three of these checks were written to the trust and agency fund for \$207,859 to cover payroll costs. When these three manual checks were issued, they were recorded in the computerized accounting system as \$15,480, which was the District’s share of Social Security and Medicare that the general fund paid the trust and agency fund. The difference between \$207,859 and \$15,480 is \$192,379, which was recorded through routine payroll accounting entries in the computerized accounting system. The fourth check for \$4,961 in legal services was recorded as \$4,388. The \$573 difference was recorded by a journal entry, reflecting the amount due from the capital fund for its share of the legal services.

¹ CCS stands for Copenhagen Central School (District).

Although these checks did not include any inappropriate payments, a significant risk exists when checks are disbursed and not correctly recorded. By producing manual checks instead of computer-generated checks, there is also a greater risk for data input errors. When checks are not accurately recorded, inappropriate payments may be more easily concealed and managers do not have accurate information for monitoring operations.

Segregation of Duties

To have effective internal controls, duties must be adequately segregated so that no single individual controls most, or all, phases of a transaction. The work of one employee should be routinely verified in the course of another employee's regular duties. This reduces the risk that errors and irregularities could occur and go undetected and uncorrected. When it is not practical to segregate all duties because of limited staff resources, District officials should establish compensating controls, such as managerial review of an employee's work.

District management has not established adequate internal controls over the cash disbursement activities of the Treasurer. The duties of the Treasurer include making and recording inter-account bank transfers and wire transfer payments, preparing and posting journal entries and preparing and signing checks. Although the Business Office clerk routinely prepared checks for the general fund, the Treasurer has the ability to write and sign checks out of the general fund and has complete control over the check writing functions for the special aid, school lunch, capital, and trust and agency funds.

The District's internal auditor recommended internal controls over bank reconciliations and journal entries be improved. The Treasurer and Business Office clerk told us that around October 2007, the Business Office clerk began reconciling the bank statements to the book balance, reviewing all cancelled checks and reviewing journal entries. However, the Business Office clerk does not document her review of the journal entries, and the clerk's bank reconciliation and review of journal entries does not include the appropriateness of electronic banking transfers. In addition, the Business Office clerk is also involved in the preparation of check disbursements, which reduces the effectiveness of having her review journal entries, and prepare bank reconciliations.

Assigning key duties to one individual with little oversight weakens internal controls and increases the risk that inappropriate transactions could be initiated and go undetected and uncorrected. The Treasurer could issue an improper check or make an improper electronic banking transfer, alter records and manipulate the accounting records to prevent detection. District officials told us that they did not believe

there was any specific consideration as to who should do which duties, but that they try to incorporate suggestions for improvement.

Because of the risk identified, we examined 11 inter-account and 11 external wire transfers, 111 canceled checks and 129 journal entries to determine whether payments were proper. The Treasurer had no supporting documentation and could not explain one “correcting entry” crediting (reducing) cash by \$251, but believed it was related to a payroll accrual of the prior year. Except for the unsupported write down of cash by \$251, we did not find any improper disbursements in our testing.

Disbursements Prior to Claims Audit

Education Law requires the Board to audit claims against District funds before they are paid, or to appoint a claims auditor to assume the Board’s powers and duties to approve or disapprove claims. With few exceptions,² Education Law prohibits school district treasurers from paying claims without written authorization indicating that the claim was audited by the Board or the claims auditor. This authorization is usually documented by a certified listing of claims attesting that the claims listed have been audited and approved for payment.

District officials told us that manual checks are routinely released to vendors prior to being audited by the claims auditor. This lack of internal controls over the cash disbursement function increases the risk that the District could make inappropriate payments without detection. District officials told us that they have customarily paid claims in a very timely manner. For example, they do not like to hold money for staff mileage reimbursement checks. In addition, on occasion claims are paid in advance of audit due to the timing of the invoice due dates and when the claims auditor is scheduled to audit the claims next.

To address this risk, we examined 106 checks and related claims totaling \$1,349,345 to determine whether payment was made after the claims auditor had audited and approved the claims for payment. We identified 48 checks that were paid prior to audit and approval by the claims auditor. Of these 48 checks, 15 checks were not subsequently audited by the claims auditor. As a result of these deficiencies, District officials do not have adequate assurance that the purchases were properly approved and comply with District policies and regulations, or that the goods and services were actually received by the District. We found no improper payments in our testing.

² Education Law authorizes the Board to authorize by resolution the payment of certain claims in advance of audit, including those for public utility services, postage and freight, and express charges. However, all such claims must subsequently be presented to the Board or claims auditor for audit.

Recommendations

1. District management should establish procedures that ensure accounting records are accurate, and complete, and to document all disbursements. The procedures should include verifying that detailed records such as check listings agree with the actual check disbursements. This should include more fully utilizing the computerized accounting system to account for financial activities.
2. District officials should segregate recordkeeping and treasury duties to the extent practical. Where incompatible duties cannot be appropriately segregated, District officials should establish effective supervisory review procedures to mitigate specific risks with appropriate documentation of such reviews. The Business Office clerk should report any significant concern from her review of journal entries and preparation of bank reconciliations to the Board.
3. The Board should consider directing the internal auditor to review operations that involve incompatible duties as an added mitigating control.
4. If the Treasurer needs to make a correcting journal entry, all relevant information as to the reason for the journal entry should be documented and approved. Such documentation should be retained on file.
5. With the exception of those claims allowed by law to be paid prior to audit, all claims from all funds should be submitted to, audited, and approved by the claims auditor before payment. Claims allowed by law and authorized by Board resolution for the Treasurer to pay prior to audit should subsequently be presented to the claims auditor for audit and approval.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

COPENHAGEN CENTRAL SCHOOL DISTRICT

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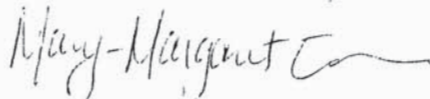
December 9, 2008

Eugene A. Camp, Chief Examiner
Office of the State Comptroller
Division of Local Government and School Accountability
State Office Building, Room 409
333 E. Washington Street
Syracuse, New York 13202-1428

Dear Mr. Camp,

The Copenhagen Central School District has reviewed the Report of Examination regarding internal controls over non-payroll cash disbursements for the period covering July 1, 2006-February 29, 2008. The school district accepts the recommendations and findings of the report.

Sincerely,



Mary-Margaret Zehr
Superintendent

"Equal Opportunity / Affirmative Action Employer"

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, 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 cash disbursements for further audit testing.

- We interviewed appropriate District officials and employees and reviewed Board policies and procedures in order to obtain an understanding of the District's cash disbursements process.
- We selected 106 non-payroll checks from bank statements and compared them to the approved warrants, and examined the claim for reasonableness.
- We selected 111 non-payroll checks from bank statements and traced them to the actual canceled checks and inspected the endorsements.
- We selected one month of transfers from bank statements for review. We examined the 11 external wire transfers from the bank statements and reviewed the supporting documentation to verify that transfers were appropriate. We also reviewed the 11 inter-account transfers among District bank accounts and verified that these transfers were deposited to other District accounts.
- We examined March 2007 journal entries for entries that reduced cash to related records to verify the legitimacy of entries posted and to gain an understanding of the routine entries. We scanned the remaining nineteen months of activity for non-routine journal entries and unusual payments to confirm that the payments were proper and authorized.

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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