



# East Hampton Union Free School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — September 30, 2007

2007M-297



Thomas P. DiNapoli

# Table of Contents

|   | <b>Page</b> |
|---|-------------|
| <b>AUTHORITY LETTER</b>   | 3           |
| <b>EXECUTIVE SUMMARY</b>  | 5           |
| <b>INTRODUCTION</b>   | 7           |
| Background  | 7           |
| Objective   | 7           |
| Scope and Methodology   | 7           |
| Comments of District Officials and Corrective Action            | 8           |
| <b>CLAIMS AUDITING</b>  | 9           |
| Recommendations   | 10          |
| <b>TREASURER’S SIGNATURE DISK</b>                               | 11          |
| Recommendation  | 11          |
| <b>APPENDIX A</b> Response From District Officials              | 12          |
| <b>APPENDIX B</b> Audit Methodology and Standards               | 15          |
| <b>APPENDIX C</b> How to Obtain Additional Copies of the Report | 16          |
| <b>APPENDIX D</b> Local Regional Office Listing                 | 17          |

# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

February 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 East Hampton 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

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# EXECUTIVE SUMMARY

The East Hampton Union Free School District (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. The District employs a Business Administrator, part-time Treasurer and three account clerks to carry out its business operations.

### **Scope and Objective**

The objective of our audit was to determine if the District's internal controls over selected financial operations are appropriately designed and operating effectively for the period July 1, 2006 to September 30, 2007. Our audit addressed the following related questions:

- Are internal controls over claims auditing appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the Treasurer's signature disk appropriately designed and operating effectively to adequately safeguard District assets?

### **Audit Results**

The claims auditor audited claims prior to payment. However, she did not report to the Board or sign the warrants and submit them to the Board for approval. Instead, all 47 warrants approved by the Board during our audit period were sent by the accounts payable clerk, and were approved without a review of the underlying claims. Although our testing disclosed no material exceptions, the failure of the claims auditor to report directly to the Board and forward certified copies of warrants to the Board increases the risk that errors or irregularities could occur and remain undetected and uncorrected.

The payroll clerk and accounts payable clerk have access to the Treasurer's signature disk and the ability to print checks even in the absence of the Treasurer. Although the Superintendent informed us that he signs purchase orders for accounts payable checks over \$1,000 and hand signs accounts payable checks over \$5,000, this does not fully compensate for the control weakness. Although our testing disclosed no exceptions, the lack of control over the Treasurer's signature disk could result in the misuse of District funds.

### **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 agree with our findings and plan to initiate corrective action.

# Introduction

## Background

The East Hampton Union Free School District (District) is located in the Town of East Hampton in Suffolk 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. The District employs a Business Administrator, part-time Treasurer and three account clerks to carry out its business operations. For 2006-07, cash disbursements totaled about \$60.8 million.<sup>1</sup>

There are three schools in operation within the District, with approximately 1,950 students and 400 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$50.7 million, which were funded primarily with State aid, real property taxes, and grants.

## Objective

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

- Are internal controls over claims auditing appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the Treasurer's signature disk appropriately designed and operating effectively to adequately safeguard District assets?

## Scope and Methodology

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. Based on that evaluation, we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed.

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<sup>1</sup> This figure includes school lunch, capital projects and other related accounts.

We did determine that risk existed in cash disbursement area, and therefore, we examined internal controls over claims auditing and the Treasurer's signature disk for the period July 1, 2006 to September 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 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 agree with our findings and plan 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, 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*.

## Claims Auditing

In general, the objectives of a good claims processing system are to ensure that the amounts claimed represent actual and necessary expenses, and that every claim contains enough supporting documentation to determine that it complies with District policies. The audit and approval of claims are among the most critical elements of the internal control system. The Board is responsible for auditing claims prior to payment, but may appoint a claims auditor for this purpose. The claims auditor must indicate his or her audit and approval of claims by signing claim warrants (listings of claims) and forwarding the signed warrants to the Board. The claims auditor's independence is compromised if he or she is supervised or controlled by District personnel. It is therefore essential that the claims auditor report directly to the Board rather than to District staff or management. Education Law specifically prohibits appointing clerical staff directly involved in the accounting or purchasing functions, the clerk of the Board, the Treasurer, or the purchasing agent to the position of claims auditor.

The District has appointed a claims auditor who audited claims prior to payment. However, the claims auditor did not sign any of the 47 warrants sent to the Board during our audit period, nor was there any indication that the claims auditor had reviewed them. Instead, we found the accounts payable clerk sent different copies of the warrants to the Board, which the Board approved without examining the underlying claims. The Business Administrator signed the warrants. Further, the claims auditor indicated that she did not appear before the Board or provide the Board with written reports regarding the audit of claims. Instead, she brought any questions or concerns relating to her duties or the propriety of claims to the Business Administrator.

These internal control weaknesses diminished the effectiveness of the claims audit process, and prevented the Board from effectively overseeing the claims audit process. Due to these internal control weaknesses, we judgmentally selected 151 claims totaling \$457,464 for review. Our testing did not disclose any material exceptions. All claims were properly authorized, supported, for proper District purposes and reasonable. However, the failure to ensure that the claims auditor reports directly to the Board and forwards certified copies of warrants to the Board increases the risk that errors or irregularities could occur and remain undetected and uncorrected.

**Recommendations**

1. The Board should require the claims auditor to report directly to the Board and be independent of other District personnel.
2. The Board should require the claims auditor to certify warrants to indicate approval for payment and forward signed copies of the warrants to the Board.

## Treasurer's Signature Disk

The Treasurer is the custodian of all District monies. As such, the Treasurer must sign payroll, accounts payable and other disbursement checks on behalf of the District, and properly secure her signature disk to prevent its misuse.

The Treasurer did not properly safeguard her signature disk. Instead, the payroll clerk had access to the signature disk and printed payroll checks even in the absence of the Treasurer. Similarly, the accounts payable clerk had access to the signature disk and her own password to create computer-generated checks. Although the Superintendent informed us that he signed purchase orders for accounts payable checks over \$1,000 and hand-signed accounts payable checks over \$5,000, the accounts payable clerk could print signed checks of equal to or lesser values without the Treasurer or other District official being aware of the transactions.

Due to this internal control weakness, we reviewed all disbursements made to key officials including the Superintendent, Assistant Superintendent, Business Administrator, Treasurer and payroll clerk and accounts payable clerk. Although our testing disclosed no exceptions, the lack of control over the signature disk can result in the misuse of District funds.

### **Recommendation**

3. The Treasurer should maintain control of her signature disk and specifically oversee its use at all times.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# EAST HAMPTON UNION FREE SCHOOL DISTRICT

4 LONG LANE  
EAST HAMPTON, NEW YORK 11937

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Assistant Superintendent

ISABEL MADISON  
Business Administrator

DEIRDRE HERZOG  
Treasurer

DONNA MARIE RUSSO  
District Clerk

February 4, 2008

[REDACTED]  
Binghamton Regional Office  
Office of the Comptroller  
State Office Building, Room 1702  
44 Hawley Street  
Binghamton, New York 13901-4417

Re: District response to, and corrective action plan for, draft audit report 2007M-297

Dear [REDACTED]

In accordance with Section 35 of the General Municipal Law, Section 2116-a (3) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, we are providing the comments to the draft audit report of East Hampton Union Free School District Internal Controls Over Selected Financial Operations for the period of July 1, 2006 through September 30, 2007. We concur with the recommendations in the Comptroller's Office Audit report and a Corrective Plan has been established to address the findings.

### Recommendation #1

The Board should require the claims auditor to report directly to the Board and be independent of other District personnel.

### District Plan:

The Board of Education now requires a written report from the claims auditor each Regular Board of Education Meeting independent of any district personnel involvement.

### Recommendation # 2

The Board should require the claims auditor to certify warrants to indicate approval for payment and forward signed copies of the warrants to the Board.

Superintendent of Schools 631-329-4104  
Fax: 631-324-0109

Assistant Superintendent 631-329-4133  
Fax: 631-329-7125

District Office 631-329-4100  
Fax: 631-324-0109

Business Manager 631-329-4106  
Fax: 631-329-7550

Page 2

District Plan:

The claims auditor will be signing the warrants starting next Regular Board of Education Meeting; signed copies will be forwarded to the Board.

Recommendation # 3

The Treasurer should maintain control of her signature disk and specifically oversee its use at all times.

District Plan:

The Treasurer maintains control of her signature disk and oversees its use at all times. At the last Regular Board of Education Meeting the district appointed a Deputy Treasurer to cover for the Treasurer in her/his absence.

Please feel free to contact us should you have any questions or need additional information.

Sincerely,



Isabel L. Madison,  
Assistant Superintendent for Business

## 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 our initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board meeting 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 control 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 and limited risk existed in most of the financial areas we reviewed. We then decided upon the reported objective and scope by selecting for audit those areas most at risk. We selected claims auditing and the Treasurer's signature disk for further audit testing. Our procedures included the following:

- We interviewed Board members and District officials to obtain information regarding procedures and internal controls over claims auditing, meals and refreshments, and the Treasurer's signature disk.
- We reviewed all 47 warrants prepared and presented to the Board during our audit scope period.
- We selected 151 cash disbursements (claims) totaling \$457,464 for review. These disbursements included general claims, travel related claims, food and beverage purchases for District sponsored events, credit card purchases and claims that appeared to be to duplicate vendors.
- We tested all payments to key District officials.

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 C

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Steven J. Hancox, Deputy Comptroller  
John C. Traylor, Assistant Comptroller

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