



Eden Central School District Internal Controls Over District Operations

Report of Examination

Period Covered:

July 1, 2005 — May 3, 2007

2007M-165



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

March 2008

Dear School District Officials:

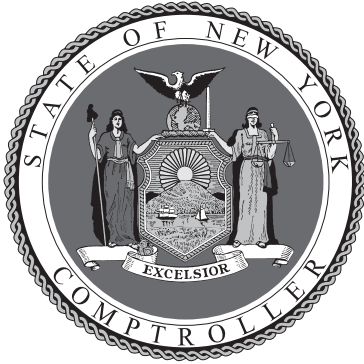
A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, 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 Eden Central School District, entitled Internal Controls Over District Operations. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and to 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 Eden Central 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.

Scope and Objective

The objective of our audit was to evaluate the District's internal control system over its capital projects, Treasurer, and claims processing functions to ensure that assets were properly safeguarded for the period July 1, 2005 to May 3, 2007. However, we extended the scope of our audit in certain instances for capital projects.¹ Our audit addressed the following related questions:

- Did the Board adequately plan the District's capital improvement projects?
- Did the Board adequately manage the Architect² hired by the District?
- Did the Board adequately monitor a contractor that manages the District's energy savings initiatives?
- Are internal controls over the Treasurer's duties appropriately designed and operating effectively?
- Are internal controls over the claims processing function appropriately designed and operating effectively?

Audit Results

The Board and District officials were remiss in their responsibilities to provide adequate planning, monitoring, oversight and management of capital project activities. The Board essentially delegated its duties to plan and monitor the activity of its capital program to its Architect. The District is also not abiding by the terms of a contract with its Architect and providing them with full information or

¹ See Appendix C for additional information.

² Architect refers to the firm that provides the District's architectural services.

a written plan defining the requirements of its capital projects. The Architect has also consistently provided poor capital project budget estimates resulting in increased costs, project scope adjustments and/or individual projects being postponed.

The Board and District officials also do not adequately monitor the contractor that manages the District's energy saving initiatives. For instance, the District entered into a contractual amendment with a contractor to revise its Energy Performance Contract (EPC) and the technical support for Energy Saving Improvements has escalated from \$172,000 to almost \$525,000. District officials do not have adequate information to evaluate the projects' cost effectiveness and make informed management decisions going forward. The District's inadequate monitoring of capital project activity resulted in the District not properly applying for almost \$573,000 in financial aid that it was eligible to receive. The lack of adequate capital project planning and monitoring makes it difficult for District officials to determine the causes for project shortfalls and to identify necessary corrective action.

The Board has not effectively addressed the Treasurer's duties and responsibilities to ensure they are properly segregated. In addition, the Board has not established sufficient compensating controls that would mitigate the risk and provide reasonable assurance that errors or irregularities are detected and corrected. Due to the lack of segregation of duties, we reviewed bank reconciliations and noted that they were not timely. The August 2006 bank statements were not reconciled until January 2007. As a result, errors or irregularities could occur and not be detected and corrected in a timely manner.

The internal controls over the claims processing function are not operating effectively. We identified 22 capital project payments over a four-month period,³ totaling almost \$2.7 million, that were made before the claims auditor approved them. For example, a check to a contractor in the amount of \$269,620 was dated November 15, 2006. However, the claims auditor did not approve the claim until December 15, 2006. We tested 50 claims, paid in 2005 and 2006, aggregating over \$635,000, for authorization, itemization, documentation, reasonableness, and review prior to payment. Our audit indicated that the internal controls over claims processing were not operating effectively since 90 percent of the claims we tested had at least one deficiency. These control weaknesses leave the District vulnerable to making unauthorized or inappropriate payments.

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 have taken corrective action. However, they disagreed with certain audit findings. Appendix B includes our responses to issues raised in the District's response.

³ August 2006 to November 2006

Introduction

Background

The Eden Central School District (District) is located in Erie County and covers an area of approximately 67 square miles. The District has an enrollment of more than 1,800 students and has approximately 250 employees. General fund expenditures totaled \$20.5 million for the 2005-06 fiscal year. The major revenue sources for the District are real property taxes, State aid, sales tax, and Federal aid. The major expenditures are employee salaries and related fringe benefits.

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 Director of Finance is responsible for the administration and supervision of the District's financial activities. As part of these responsibilities, the Director of Finance oversees capital projects. The capital projects fund is used for the acquisition or construction of public improvements such as buildings and equipment. The District finances its capital projects through borrowings and State building aid. Since 2002, the District has incurred expenditures of approximately \$11.3 million for seven capital projects. During our audit period, five of these projects were active. The projects addressed a number of capital improvement activities and two energy savings initiatives.

Responsibilities relating to the District's finances, accounting records and reports are largely those of the District Treasurer, who also serves as the general accountant and Extra-Classroom co-treasurer. The District employs a claims auditor who reviews claims, which normally consist of an invoice, receiving slip and purchase order, and approves them for payment.

Objective

The objective of our audit was to evaluate the District's internal control system over its capital projects, Treasurer, and claims processing functions to ensure that assets were properly safeguarded. We focused our audit on the following questions:

- Did the Board adequately plan the District's capital improvement projects?

- Did the Board adequately manage the Architect⁴ hired by the District?
- Did the Board adequately monitor a contractor that manages the District's energy savings initiatives?
- Are internal controls over the Treasurer's duties appropriately designed and operating effectively?
- Are internal controls over the claims processing function appropriately designed and operating effectively?

Scope and Methodology

During this audit, we interviewed appropriate District officials, examined financial records, and reviewed procedures of the District for the period July 1, 2005 to May 3, 2007. However, we extended the scope of our audit in certain instances⁵ for capital projects.

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 they have taken corrective action. However, they disagreed with certain audit findings. Appendix B includes our responses to issues raised in the District's response.

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 your 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*.

⁴ Architect refers to the firm that provides the District's architectural services.

⁵ See Appendix C for additional information.

Planning and Oversight

The Board is ultimately responsible for the oversight and management of the District's capital projects, even though the responsibility is delegated to the Director of Finance. The Board and the Director of Finance are responsible for designing internal controls to ensure that capital projects are properly planned, managed, and monitored. Proper planning entails establishing a written plan that clearly defines the scope of the project, sources of funding, maximum cost projections, project budget, timeline and other criteria at the onset of the project. District officials are also responsible for monitoring that plan to ensure that the project is progressing as expected. If projects fall short of the District's expectations, it is the Board's responsibility to determine the reasons for those deviations, identify possible corrective action, and take the appropriate action to address the problems.

During our audit period the District had five ongoing projects; we focused on four with considerable expenditures. Although these projects were significant, and in some instances, unusual activities for the District, the Board did not plan and monitor them appropriately. Instead, it delegated its duties to plan its capital program to the District's Architect and a contractor.

Board Oversight of Architectural Services

District officials used the professional services of an architect to assist them in implementing the capital plan. A duly executed written agreement for these professional services should be used to ensure the District's interests are protected. The agreement should clearly indicate the scope of services to be provided, a timeframe for delivery of services, the cost of services, the timing and method of payment and any District responsibilities. District officials should also routinely monitor the services provided by the Architect to ensure that they are in accordance with the terms of the agreement.

We found that the District did not have a signed, executed contract with the Architect, whose services they have been utilizing for over 20 years. District officials did provide us with an unsigned agreement with the Architect that indicates that the Architect is responsible for reviewing the capital program furnished by the District to ascertain the requirements of the projects and arrive at a mutual understanding of such requirements with the District. Among other duties, the Architect is also responsible for providing the District with a preliminary evaluation of the District's program, schedule and construction budget requirements. The Architect is compensated at a rate of 7.5 percent of the lowest bid(s); regardless of actual construction costs or

whether the District needs to reduce the scope of the projects because bid results are significantly more than the Architect's projections.

It is necessary for the Board to establish a plan that defines the District's objectives, schedule, constraints, and other essential criteria for each capital project. The District is also required to establish and update an overall budget for the projects, including the construction cost, the District's other costs and reasonable contingencies related to all of these costs, based on information provided by the Architect. We found the Board did not develop clear plans for the projects, and the Architect's initial assessments for the projects were often inaccurate, resulting in the District's capital plans not achieving their intended objectives. District officials told us that the Architect's projections have consistently been significantly lower than bid results and that the Architect has only completed one project that was within budgetary projections during the last ten years. This has required the District to reduce the scope of services and/or delay parts of projects.

Telephone System — Twice in the past five years, the District has attempted to upgrade its telephone and communication system, but both times, they received inaccurate cost estimates from the Architect. In the first instance, the District discontinued the project. More recently, they attempted to modify the project in order to complete it.

In 2005, the District voters authorized a project to improve the District's telephone and communication systems. The maximum estimated cost of this undertaking was not to exceed \$233,800. District officials could not provide us with any information to show that they complied with their obligation of providing a full plan to the Architect regarding the requirements of the project. Additionally, even though the District established the maximum cost for the project, we could not verify that they completed a detailed budget for the project. Instead, the District relied on the Architect to establish the projections and details for its budget.

The Architect provided the District with an estimate of \$233,800 for the total cost of the new telephone system, including: electrical, equipment, administrative, and incidental costs. However, the total cost based on the lowest bid results was more than \$400,000 or almost double the amount that the Architect projected. There was no indication that the Architect provided the District with any explanation for the cost difference.

Since the bid results were significantly different from the Architect's projections, the District was required to revise the scope of the project.

For example, the original specifications entailed the installation of fiber optic lines that the District would own. However, to ensure that the project stayed within its budget, the District entered into a contractual agreement with a vendor to lease the fiber optic lines at a cost of \$200,000 over the next 20 years.⁶ Once the agreement expires, the District will need to evaluate other technological alternatives and/or renegotiate with the vendor.

In addition to preparing poor project estimates, District officials indicated that:

- The Architect also failed to include 79 drops⁷ in the bidding documentation for the new telephone system. Consequently, the District incurred an additional cost of \$26,000 because of this omission.
- At the inception of the project, the Architect agreed to conduct an appropriate walk-through. However, during the design of the project the Architect failed to do so.
- The Architect did not provide on-site project management as District officials were led to believe at the beginning of the project. Therefore, they were required to deploy their own resources to compensate.

However, because of the lack of an executed contract, District officials did not have anything in writing that defined the Architect's responsibilities with respect to these matters.

When the District's expectations for a project are not specifically defined in a written plan, or communicated at the onset of a project, it makes it difficult for the District to hold the Architect accountable for its actions and/or non-performance.

Other Capital Improvements — During 2005, the voters authorized the District to finance approximately \$6.7 million for the reconstruction, renovation, improvement and equipment of various District buildings and recreational and athletic facilities.⁸ However, District officials did not develop a comprehensive plan regarding the requirements of the overall project.

⁶ The District entered into an agreement with BOCES for fiber optic services for an initial five-year term, with the possibility of three five-year renewals at the District's option.

⁷ Wiring connections

⁸ This was referred to as the Shared Decision Making project. Shared decision making is a process where all members of the educational community at the District and school levels cooperate in identifying educational issues, defining goals, recommending policies; and implementing and assessing activities to help students reach standards of excellence. The group is collectively known as the Shared Decision Making Team.

Subsequently, District officials indicated that they had to amend the scope of the project because of cost estimation increases. During February 2005, the Architect estimated that the total project would cost almost \$7.5 million.⁹ Within this cost projection, District officials anticipated doing various projects ranging from roofing to repaving. However, when bid results were received in June 2006, the total amount for the lowest bidders was nearly \$10 million or 32 percent more than what was estimated by the Architect.

One of the intended projects was to replace the roof at the Grover L. Priess (GLP) Primary School. Implications for delaying this project include the possibility of permanent structural damage to the building and equipment due to water damage. The reason for not going forward with the project was that bid results for the new roof were significantly higher than what the Architect estimated. The Architect also prepared an alternate design to include a peaked roof. However, District officials indicated that the engineer would not approve those designs because the facility would then require a different perimeter design. This increased the bids by \$1 million and was over the District's budget.

Another improvement within the project was to replace the blacktop at various District parking lots. Since the District failed to develop written requirements for the project, there were additional unforeseen costs. For example, according to District officials, the Architect assured the District that the specifications would include sealing and striping as part of the bid package. Again, however, the District does not have any documentation to support this assertion. District officials later learned that the District would have to cover this cost, an estimated additional \$40,000 to \$50,000.

Finally, while reviewing the bidding documentation, we noted that some of the amounts were changed or left blank and then written in. When we attempted to verify that the amount indicated on the bidding documentation agreed with the amount that was recorded in the minutes, we were unable to do so. The Director of Finance stated that the District did not record the opening of the sealed bids. She indicated that the Architect was responsible for opening the sealed bids. This is clearly an internal control weakness, since the Architect is billing the District based on those bid results. In addition, it is the Board's responsibility to ensure that sealed bids are opened at a public meeting and the bid is awarded to the lowest responsible bidder. The Board may not delegate this responsibility to the Architect. Furthermore, when we reviewed the contract, it indicated that the Architect is responsible for assisting the District in obtaining bids

⁹ This projection included approximately \$500,000 for potential alternates.

and is silent on opening bids. Although the Director assured us that there is always a representative present from the District to verify the results, she could not provide us with any documentation.

Energy Saving Initiatives

In 1999, the District entered into an Energy Performance Contract (EPC) with a contractor. The contractor agreed to install, maintain and manage energy systems or equipment to improve the energy efficiency of, or produce energy in connection with, an existing building in exchange for a portion of the energy savings. In July 2002, the District entered into a second EPC with the contractor to construct a Co-Generation Facility¹⁰ so that the District could produce its own electricity fueled by natural gas¹¹ or diesel fuel to realize additional energy savings. This was an innovative approach to energy conservation and we commend the District for its foresight in attempting to become more energy efficient.¹²

The total cost for the project, including financing and technical support, is \$6.4 million. According to the State Education Department (SED), the costs of the EPC (net of financing and technical support) must be recovered by the savings generated by the EPC measures during a period, which shall not exceed 18 years or the useful life of the equipment being installed, whichever is less. We found that the savings guaranteed by the contractor in the 1999 EPC is approximately \$250,000 per year or \$4.2 million over 17 years (the useful life of the improvements).

However, we identified certain areas where the Board did not adequately plan for and monitor these projects.

The Board did not adequately consider all aspects of the project when it began, which has resulted in escalating costs. For example, the contractor initially presented information to the Board to indicate that the cost to the District for technical support for this project would be \$79,000 over the life of the contract. However, when the District actually entered into the agreement with the contractor in June 1999, the cost of technical support aggregated to about \$172,000 for 18

¹⁰ Co-Generation is the simultaneous production of electricity and thermal energy. The Co-Generation system utilizes natural gas engines to turn electric generators thereby producing electricity, which is designed to reduce utility costs. Waste heat captured from the natural gas combustion process can be used to produce domestic hot water, provide space heat in winter or air conditioning in summer when used in conjunction with absorption chillers.

¹¹ For the 2005-06 fiscal year, the District paid \$425,000 for natural gas. We should note that although the District owns three gas wells, the fuel is primarily used to heat only one school because of limitations. Therefore, the District purchases natural gas to heat the other schools and to run the Co-Generation Facility.

¹² The total cost of the Energy Saving Improvements and the Co-Generation Facility projects is \$9.5 million for design, construction, financing and technical support.

years. Since that time, two amendments to the original contract have escalated the cost to almost \$525,000 for on-going technical support. The original contract only included major panel parts and software updates. The amendment covers the replacement of all parts connected to the system and the labor to diagnose and repair problems. Furthermore, District officials did not provide documentation that they performed a cost benefit analysis prior to amending the contract.

A similar situation occurred with the second EPC relating to the Co-Generation Facility. The contractor placed responsibility on the District for an additional two months when the plant was not operational because of parts malfunctioning and replacement needs. According to District officials, the contractor provided assurances at the inception of the project that the contractor would be responsible for all parts, repairs and maintenance as part of their technical support agreement, which totals nearly \$985,000 (or about 60 percent of the cost of the facility) over the life of the contract. However, according to the actual contract, the District is responsible to “Operate, service and maintain all Equipment according to the manufacturer’s recommendation... The CLIENT shall furnish all needed servicing and parts for said ECMs¹³ which parts shall become part of the ECMs...” The Director of Facilities indicated that the contractor has not charged the District in the past for these costs and should not do so now. At the time our field work concluded, the District and the contractor had not reached a resolution.

Finally, the Board has not independently monitored the contractor’s cost savings performance. According to the contractor, the District realized savings from the Co-Generation plant of \$110,033 for the first year of the project (2004-05 fiscal year). However, during February 2006, the District received \$26,452 from the contractor because the annual savings fell short of the guaranteed savings of \$136,485 as specified by the EPC. During the second year of operation, the contractor provided the District with a performance assurance report. This report indicated that the District experienced an annual savings that was \$10,151 less than the guaranteed savings. However, we found that these reports were generated by the contractor and were not verified by District personnel. Consequently, the District is not independently verifying the actual performance of the contractor and whether the District has received its full guaranteed savings.

Financial Assistance

Financial assistance for Expanding our Children’s Education and Learning (EXCEL) was included in Chapter 61 of the Laws of 2006 as a new program to provide additional State funding for certain

¹³ Energy Conservation Measure (ECM) means the equipment, devices, materials and/or software as installed by the contractor at the Facility, or repaired or replaced by the District for the purpose of improving the efficiency of utility consumption.

types of school construction projects.¹⁴ To support this program, the Dormitory Authority of the State of New York (DASNY) was authorized to issue a maximum of \$2.6 billion in bonds and notes. According to the New York State Education Department (SED), the maximum allocation for Eden Central School District is \$572,662.¹⁵

Based on the type of costs associated with the renovation project, we believe that the District would have qualified for the EXCEL aid had the District applied for it. The Director of Finance indicated that although the project costs qualified for the funding, they did not apply for the aid because the required State aid form (SA-139) to SED was submitted prior to the time requirements established by the EXCEL legislation. However, when we reviewed this legislation, we noted that only approved projects for which the SA-139 was received by the State prior to April 1, 2006 are ineligible for EXCEL aid. Further, the EXCEL legislation contains no statutory project application, approval or completion deadlines. Contrary to the Director of Finance's understanding, since the District submitted the SA-139 for this project in June 2006, or well after the filing date, they would have been eligible to receive the EXCEL aid for this project.

Although the District missed an opportunity to use the EXCEL funding for this project, officials indicated that they intend on using the aid in the future to fund the roofing of GLP Primary School. However, when we reviewed the District's Capital Plan, dated June 2006, we noted that the roof for the GLP Primary School would not be completed for another five years. We explained to District officials the opportunity costs associated with not using the funding as soon as possible. For instance, each year that they do not use the aid is an opportunity cost of approximately \$20,000 per year in additional interest costs or \$100,000 for the first five years.¹⁶

District officials were responsive and received approval from the majority of the voters during May 2007 to replace the GLP Primary School roof and they anticipate submitting an application for EXCEL aid. Although District officials are now attempting to secure EXCEL aid, it does not absolve the District of its responsibility to ensure that adequate procedures exist to ensure that all available aid is applied for and secured.

Recommendations

1. The Board should establish internal controls that ensure that capital projects are properly planned by developing a written plan to document the District's criteria for the project.

¹⁴ As defined in Education Law a project qualifies for EXCEL aid as long as the "primary purpose" is for physical capacity expansion, energy, accessibility, health and safety, or education technology.

¹⁵ This apportionment is based on 2005 student enrollment.

¹⁶ Assumes an interest rate of 4 percent.

2. Once a written plan has been established and shared with contractors, architects, engineers and other relevant parties, the District needs to monitor that plan.
3. The District should have contracts for any services obtained that clearly stipulate expectations and responsibilities at the onset of a project.
4. District officials should provide the Architect with necessary information including the appropriate budgetary and financial data needed to establish project scope and cost expectations.
5. District officials should establish monitoring procedures to ensure that the Architect fulfills the terms of written agreements.
6. District officials should ensure that District personnel open bidding documentation and record the bids in the Board's official minutes.
7. District officials should establish adequate procedures to provide assurances that contractor-submitted information is accurate and complete.
8. The Board should require that contractors provide adequate information in order to evaluate their performance and the goals of the projects.
9. The Board should create a monitoring system to ensure that the District is applying for all financial assistance that is available.

Treasurer — Segregation of Duties

A positive control environment provides for the segregation of incompatible duties so that no individual controls key phases of a transaction, and the functions performed by one person are checked by the functions performed by another. One such check is assigning the function of periodic data reconciliations to an employee that is independent of the approval and recordkeeping of the data being reconciled. When it is not practical to segregate duties due to limited staff resources, the Board should establish compensating controls. Compensating controls would include the Board or other administrative staff periodically reviewing the work in question, rotation of duties and mandatory vacations.

The Board has not effectively addressed the Treasurer's duties and responsibilities to ensure they are properly segregated. In addition, the Board has not established sufficient compensating controls that would mitigate the risk and provide reasonable assurance that errors or irregularities are detected and corrected in a timely manner. The Board adopted a policy that noted the Treasurer's job duties, many of which are incompatible, and results in the Treasurer controlling key phases of transactions. According to the policy, the Treasurer is responsible for performing the incompatible duties of cash custodian, cash recordkeeping, reporting, and banking, as well as having the authority to make cash disbursements. The Board did not design or implement any compensating controls such as mandatory vacation scheduling or job assignment rotations. These controls would present opportunities for independent verification of the Treasurer's work and thus mitigate the risk of irregularities occurring without detection.

Due to the lack of segregation of duties, we verified the bank reconciliations prepared for all of the District's bank accounts for the month of August 2006, and we reviewed and performed selected tests of the September 2005 bank reconciliation, as well.

Our audit tests disclosed that the Treasurer's bank reconciliations were not timely. The August 2006 bank statements were not reconciled until January 2007. Board members indicated that they were not aware that timely bank reconciliations had not been performed. Because of check sequencing issues associated with the financial reporting system changeover, the District was also unable to employ a service of the bank that could have mitigated, to some degree, the risk of not performing timely bank reconciliations.¹⁷ The District noted it had

¹⁷ This is a service where the customer sends a list to the bank of all the checks they have issued. The bank matches the check number, payee, dollar amount and account numbers of all inbound checks against the submitted list. Any checks not on this list are not disbursed until further review with the banking customer.

previously experienced check fraud in the 2004-05 fiscal year, and as a result employed the bank service to reduce the risk of this occurring again.

Although our audit tests did not disclose any irregularities, the control deficiencies identified increase the risk that errors or irregularities could occur and not be detected and corrected in a timely manner.

Recommendations

10. The Board should ensure that District policies promote segregation of duties within the Treasurer's office. Minimally, the policy should delineate the separation of recordkeeping, check preparation and reconciling bank accounts.
11. District officials should establish adequate monitoring procedures and controls to mitigate risks when duties are not amply segregated.
12. District officials should ensure that bank accounts are reconciled in a timely manner.

Claims Processing

In general, the objectives of internal controls over claims processing are to ensure that every claim contains enough supporting documentation to determine that it complies with District policies, and that the amounts claimed represent actual and necessary District expenses. Auditing a school district's bills before they are paid is the responsibility of the Board. However, the Board may appoint an individual as claims auditor to assume the powers and duties of the Board with respect to claims auditing. Therefore, the claims auditor must have a clear understanding of the Board's expectations and of his or her responsibilities.

During our risk assessment, we identified 22 capital project payments over a four-month period¹⁸ totaling almost \$2.7 million that were made before the claims auditor approved them. For example, a check to a contractor in the amount of \$269,620 was dated November 15, 2006. However, the claims auditor did not approve the claim until December 15, 2006. Education Law states that districts should not pay claims unless they have been audited and approved for payment by the Board or by a claims auditor appointed by the Board. The District's adopted policy reaffirms this requirement by stating that, "valid claims against the District shall be paid by the Treasurer only upon the approval of the claims auditor."

The claims auditor admitted to us that she has had difficulty auditing capital project claims because she was not involved with the project at the onset. She explained that she frequently finds it necessary to "trust" the judgment of the Director of Finance (Director) to ensure that the claims are appropriate. Essentially, the claims auditor is relying on the Director who also acts as the purchasing agent whose responsibility includes approving requisitions prior to purchase. The Director is also responsible for supervising Business Office staff who record and process the claim package for payment.

The approach used by the claims auditor to review capital projects claims is improper. A good system of internal controls should rely on independent checks and balances among various employees. Specifically, the claims auditing function should be independent of the clerical or professional staff directly involved in accounting and purchasing duties and independent of the direct supervision of the Director of Finance.

¹⁸ August 2006 to November 2006

Due to the internal control weakness noted above, we examined 50 claims paid in 2005 and 2006 aggregating over \$635,000. Our audit indicated that the internal controls over claims processing were not operating effectively since 90 percent of the claims we tested had at least one deficiency:

- The claims auditor approved 45 out of 50 claims, totaling \$572,583, after the payment was made. For example, the District issued a check dated August 15, 2005 to a vendor for approximately \$9,500 for computer equipment. However, the claims auditor did not approve the warrant until September 15, 2005 or one month later. The Director of Finance indicated that sometimes they have to make payments before the audit because of the claims auditor's part-time schedule and limited availability. For the claim cited above, the invoice dated July 6, 2005, had a due date of August 5, 2005. If the District paid the claim immediately following the review and approval of the claims auditor, it would have been paid 59 days after the District received the invoice and 45 days late. The account clerk indicated that the District frequently pays its bills late because of the manner in which the District processes claims and the frequency of its payment cycle.¹⁹
- Although the District uses a purchase order system, we identified nine claims, totaling almost \$285,000 that did not have a purchase order attached to the claim. In addition, four claims, totaling nearly \$28,000, had purchase orders that were dated after the goods were received or service was rendered. For example, the District received an invoice for playground equipment that was dated June 21, 2005. However, the purchase order was not approved until July 27. The benefits of a purchase order system can only be derived if purchase orders are prepared, approved and issued before the acquisition of goods and services. The failure to do so limits management's ability to exercise timely and effective budgetary controls.
- Nine claims, totaling over \$6,000, lacked proper documentation to substantiate the purpose for the purchases. For example, the District reimbursed a Board member over \$1,200 for travel, lodging, and meals to attend a seminar in New York City. However, certificates of attendance, agendas, or other supporting documentation were not attached to demonstrate that the participant attended the seminar.

¹⁹ The District makes payments to vendors twice a month.

- Five claims, totaling \$43,915, were not sufficiently itemized. For example, the District paid \$945 for whirlpool jet boat rides. Although the claim indicated that it was for a business program provided by the company, there was no supporting documentation or indication of what the program entailed other than the jet boat ride. Without additional information, it is difficult to ascertain the purpose, let alone the validity of the business program. Furthermore, the funding of the event was from a grant, but the claim did not attach the details of the grant or indicate how the expenditure complied with the grant requirements. Finally, the claim indicated that 35 students would be participating; however, the claim did not list the names of those students or any certification that all participants attended.

Although the District was able to provide us with additional information²⁰ after our review of the claim, it is unclear how the claims auditor could have approved this claim when sufficient documentation was not originally included in the claim package.

These deficiencies in claims processing could allow errors and irregularities to occur and not be detected and corrected in a timely manner.

Recommendations

13. The Board should establish monitoring procedures to ensure that the claims auditor reviews claims before the Treasurer makes the payment.
14. The claims auditor should ensure that claims are properly documented, itemized, approved and appropriate before approving for payment.
15. To avoid late fees, District officials need to review the claims processing function to ensure that claims are approved and paid by the due date.

²⁰ District teachers and staff provided the additional information.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Eden Central Schools

3150 Schoolview Rd.
Eden, New York 14057



Ronald K. Buggs
Superintendent

Phone: (716) 992-3629
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January 30, 2008

By Hand Delivery and Electronic Mail

Hon. Thomas P. DiNapoli
New York State Comptroller
295 Main Street, Room 1050
Buffalo, New York 14203-2510

Re: Eden Central School District

Dear Comptroller DiNapoli:

The following constitutes the Eden Central School District's response to the Report of Examination issued by your office which is entitled "*Internal Controls Over District Operations.*" The Report of Examination covers the District's fiscal operations during the period July 1, 2005 through May 3, 2007.

The District would first like to express its appreciation for the professional and courteous manner in which your staff conducted its audit responsibilities.

The District's Board of Education and Administration is committed to ensuring that the District's financial operations are conducted with the highest level of integrity and that the interests of the District's taxpayers are properly protected. The District is pleased to note that through this extensive review of District financial operations there was not a single demonstrated instance of any financial irregularity. In addition, the District notes that it has addressed each of the recommendations included in the Report of Examination, and that the great majority of the issues that are the subject of the recommendations had in fact already been addressed either prior to start of the audit or prior to the issuance of the Report of Examination. This underscores the commitment of the Board and the administration to safeguard taxpayer dollars and to ensure cost-effective District programs and operations, and will strengthen the District's already-solid financial operations.

The District does wish to take this opportunity to respond to certain aspects of the Report of Examination, which are as follows:

1) **Planning and Oversight (Report of Examination, pp. 8-14):**

Item: *The Report of Examination noted that the District has not in the past utilized a fully-executed contract with its Architect, and asserts that the Board did not develop clear plans for capital projects and that the Architect's cost projections were often inaccurate (pp. 8-11).*

Response: The District's current administration agrees that the past practice of not utilizing signed contracts with the District's architect was not appropriate. In order to ensure that the District's taxpayers are receiving the best and most cost-effective services the administration has determined to issue a request for proposals for all future architectural services, and in fact has already done so with regard to the current EXCEL capital project. The contract with the architectural firm selected by the District is expected to be finalized and executed in the very near future, and the District will insist that contracts are executed in all cases with District architects.

The Board believes that it has in the past properly communicated capital project budget parameters, goals and other salient information to the District's architect for implementation, consistent with the architect's role as the District's professional representative on the project and consistent with the industry practice. The administration has consistently monitored the progress of the District's capital projects through regular participation in project job meetings, review of project reports and other such activities to ensure implementation of the Board's parameters. However, consistent with industry practice, the District has necessarily relied on the professional capabilities of the architect in the day-to-day undertaking of a capital project. In particular, the Board has appropriately relied upon the architect's professional expertise relating to cost-estimating in order to implement a project within the budgetary parameters established by the Board and the District's voters. Detailed budgets for all capital projects were submitted to the State Education Department for review and consideration. That the architect's estimates may have been inaccurate on occasion is not a reflection on the Board's oversight over such projects, and could also be caused in whole or in part by external factors such as market conditions and fluctuations in the cost of labor and materials. Nonetheless, the

District's taxpayers can be assured that the administration has and will continue to be intimately involved in the planning, undertaking and monitoring of all District capital projects. Finally, the District is not aware of any instance where the architect's compensation was based upon bid amounts that exceeded the project budget as approved by the Board and the District's voters. In the District's view any such claim would be contrary to the clear course of conduct between the District and the Architect.

See
Note 1
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The Report of Examination provides comments relating to the District's efforts to upgrade its telephone and communications systems. The assertion that the District entered into a 20-year, \$200,000 agreement for fiber optic lines is incorrect. The District has entered into an agreement with Erie I BOCES for fiber optic services for an initial 5-year term, with the possibility of three possible five-year renewals at the District's option. If the District determines that the agreement is no longer desirable it will simply decline to exercise the next option and thereby terminate the agreement. In addition, the District will receive an E-rate discount of approximately 40%, and then will receive BOCES aid of approximately 70% of the remaining amount, which means that the actual local share for this fiber optic service will be a fraction of the stated cost.

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Note 2
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Note 3
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The District also believes that it is incorrect to assert that the Board itself is responsible for actually opening capital project bids, and that it may not delegate this responsibility. General Municipal Law § 103(2) is clear that the Board may authorize a designee to open and evaluate bids, and we believe that the practice with regard to school district capital projects throughout the state is that the school district's project representative, such as the architect or construction manager, assists in the receipt, opening and evaluation of bids for purposes of providing a recommendation to the board. In the District's case, District officials were routinely present during the public bid opening to facilitate the opening and evaluation of bids for recommendation to the Board. All bid openings occurred on District property, as noticed in the advertisement for bids. The bid results were publicly tabulated by District officials and the tabulation was provided to the Board. In all instances the Board made the final decision to award contracts, consistent with the General Municipal Law and the best interests of the District.

See
Note 4
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Note 5
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Item: *The Report of Examination asserts that the District did not adequately plan or monitor energy performance initiatives (pp. 11-12).*

Response: It is important to note at the outset that the detailed plans for the District's energy performance projects, including the cost-savings guarantees, were submitted to the State Education Department for review (*see, 8 NYCRR § 150.20[d]*) and in every instance did in fact receive SED approval. The Report of Examination asserts that the cost of on-going technical support with regard to these projects has increased over time. However, the District believes that the cumulative cost for such services is inaccurately overstated in the Report of Examination. Finally, it is the performance contractor and not the District that is contractually required to measure and verify energy savings to ensure that the savings guarantee is met, consistent with the technical methodologies for such evaluation that are set forth in the performance contracts as approved by the State Education Department. This is consistent with the fact that by law it is *the contractor* that is responsible to certify the guaranteed cost savings associated with a performance project (*8 NYCRR § 155.20[d][7][ii]*) and that the measurement and verification techniques used to determine cost savings are in accordance with accepted protocols (*8 NYCRR § 155.20[d][7][iii]*).

See
Note 6
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Note 7
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Item: *The Report of Examination asserts that the District did not effectively utilize EXCEL aid (pp. 12-13).*

Response: The Report of Examination inaccurately describes the District's application for EXCEL aid in relation to the GLP roof project. The District made a considered decision to utilize its allotment of EXCEL aid for the roof project instead of the \$6.7 million capital project. The application of EXCEL aid for the roof project ensured that that project could be completed without any local taxpayer impact. In addition, the District's undertaking of the GLP roof project beginning in 2007 was not in response to the Comptroller's audit as suggested. The need for a new GLP roof was recognized well before the start of the audit, as demonstrated by the fact that the District's capital plan initially indicated that the GLP roof would be replaced during the 2005-06 school year, and that the District had already undertaken review of the use of EXCEL aid to fund the roof project as early as August 2006. Finally, as we have previously explained to your office, the use of EXCEL aid for the roof project instead of the capital project was appropriate given that the State Education Department's guidance for EXCEL funding was not issued until *after* SED had already finalized the

See
Note 8
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District's SA-4 Notice of Building Project Form, and SED had notified districts that it would preclude use of EXCEL aid unless the EXCEL aid was already indicated on the SA-4.

2) **Treasurer – Segregation of Duties (Report of Examination, pp. 15 16):**

Item: *The Report of Examination asserts that the District has not adequately segregated the duties of the District Treasurer.*

Response: The duties and responsibilities assigned to the District Treasurer are in all respects consistent with the Education Law provisions establishing such duties and responsibilities (e.g., Education Law §§ 2122, 2130; 8 NYCRR § 170.2). Although, as noted in the Report of Examination, certain previous bank reconciliations were not performed on a timely basis, this delay was in large part caused by a changeover to new financial software. The software issues were corrected and bank reconciliations are now done on a timely basis. In addition, the District hired an additional employee in the business office in 2006 in order to further strengthen financial controls. That employee now performs bank reconciliations, which serves to segregate that duty from the District Treasurer. Finally, as noted in the Report of Examination, the audit did not disclose a single instance of financial irregularity.

3) **Claims Processing (Report of Examination, pp. 17-19):**

Item: *The Report of Examination included exceptions relating to the District's claims auditor function.*

Response: The District has implemented procedures to ensure the effective audit of claims and the proper protection of taxpayer monies. This includes the mandated use of purchase orders, mandatory approval by the independent claims auditor prior to the issuance of a payment (adopted June 21, 2006), timely payment of properly submitted and reviewed invoices, mandated documentation of authorized travel and conference expenses and the undertaking of a comprehensive review of business office operations, which is expected to be completed during the 2008-09 school year. The District is pleased that the audit did not disclose any instance of financial irregularity, and we are confident that the measures described above will further strengthen the District's financial controls.


See
Note 11
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The Report of Examination asserted that no proof of attendance was provided with regard to a Board member's attendance at the annual New York State School Boards Conference. However, consistent with the District's policy on "*Conferences, Conventions and Workshops*" (Policy # 2320), the Board member at issue reported to the Board following her return from the conference in order to confirm her attendance at the conference and to share the information, recommendations and materials that she had acquired. The Board member's participation in the conference was in all respects consistent with District policies, and the Board member provided full supporting documentation prior to the issuance of expense reimbursement by the District.

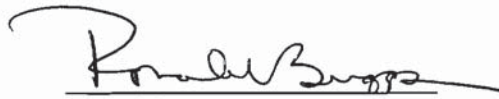
Conclusion

Once again, the District's Board of Education and Administration wish to express their appreciation for the Comptroller's assistance during this audit. Please let us know if your office has any questions regarding the District's response to the Report of Examination, and the District looks forward to future opportunities to work with the Comptroller's office.

Very Truly Yours,



Thomas Gannon, Sr.
President, Board of Education



Ronald K. Buggs
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District's response is misleading in that it oversimplifies the impact that the Architect's inaccurate estimates have had on the District. For example, the Architect waived 60 percent of the fees for the GLP Primary School roofing project and only charged the District for the documents. In a correspondence the Architect indicated that it had "agreed to waive these fees under this project and will include these fees under a new contract for a new capital project to revise and rebid the items eliminated from this project due to the bid results." The total value of the fees for just the GLP roofing section of the project is \$319,000. We should note that if the District elects not to retain the Architect, these designs can only be used as a reference. The District cannot use them for the completion of the project and can only use them as source documents. Consequently, they will likely incur additional architectural fees for this project if they retain another Architect.

Note 2

We have revised the report to clarify the specifics of the contractual arrangement.

Note 3

The Board and District officials are not being fiscally responsible if they are only concerned with what the local share of a project cost is. They should ensure that all taxpayer dollars are spent in a prudent and efficient manner.

Note 4

We have revised the report accordingly.

Note 5

A careful review of General Municipal Law, Section 103 (2) indicates that a Board may, by resolution, designate any officer or employee to open the bids. The Architect is neither an employee nor an officer of the District. At a minimum, it is misleading to use the term 'designee' and then conclude that it was permissible to allow the Architect to fulfill a duty that should be performed by an employee or officer of the District.

Note 6

The District did not provide additional information during the course of the audit or in their official response to support their assertion that the cumulative costs reported in the audit report are inaccurate. Consequently, we have not revised the figure.

Note 7

District officials have a responsibility to ensure that the District is achieving its guaranteed energy savings and, if applicable, receiving contractor subsidies for any shortfall. To fulfill this responsibility District officials need assurances that the contractor reported cost savings data is accurate. They currently do not have those assurances as they are relying upon the contractor exclusively to verify the accuracy of reported data. The contractor's interests may not always align with the District's interests as the contractor has a stake in limiting its need to provide a financial subsidy for any energy savings shortfalls.

Note 8

The District's response is inconsistent with regard to the use of EXCEL aid. District officials indicate that they made a considered decision not to use the EXCEL aid on the \$6.7 million project. Consequently, we can conclude that officials were aware that the aid could have been used on the roof project. However, District officials later indicate that the State Education Department did not provide appropriate guidance until after certain forms were finalized. At the exit discussion, District officials indicated that they strategically delayed the use of EXCEL aid because using it on future projects, could reduce the local share of the projects, and possibly improve the project's chances of receiving voter approval. District officials have a responsibility to ensure that all available aid is applied for and secured. Good business practice dictates that once funding is available it is used in a timely manner. This minimizes the risk of losing the funding or burdening taxpayers with additional interest costs.

Note 9

According to the District's Five-Year Capital Plan dated June 2006, the GLP roof was scheduled to be replaced in year five and the amount budgeted was \$2.95 million. Although the summary section of the plan indicates roof repairs for the 2005-06 school year, a review of the capital budget indicates approximately \$700,000 applies to Eden Elementary and not the GLP Primary School. We believe that the District has inaccurately portrayed this in their response.

Note 10

According to the State Education Department, a school district is eligible to receive EXCEL funding as long as the SA-139 was not approved prior to April 1, 2006. Since the District's SA-139 was approved in June 2006, they were eligible to apply the EXCEL aid to the project at that time. We also contacted the State Education Department and confirmed that the District could have applied for the aid.

Note 11

Although we recognize that it is essential to have a clear policy defining the claims processing procedures, it is even more important for District officials to adhere to those procedures. Our sample included eleven claims that were paid after the District's policy was adopted. However, we found at least one irregularity for each of the seven claims. Additionally, 22 capital project payments, totaling almost \$2.7 million, were paid before the claims auditor approved them. Again, these payments were made from August to November of 2006, after the policy was adopted in June 2006.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by District officials to safeguard assets. To accomplish this, we performed an initial assessment of 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 policy and procedure manuals, Board of Education 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 capital projects, duties of the Treasurer, and claims processing.

We reviewed the following capital projects that were active and had material expenditures during our audit period: Energy Saving Improvements, Co-Generation Facility, Telephone System, and Capital Improvements. In total, seven capital projects incurred expenditures over the last five years. We reviewed historical information relating to each of those projects. We also reviewed pertinent documents including Board resolutions, contractual agreements, and Board minutes to determine authority for the individual projects. We also inspected certain projects to verify their progress and status. We examined accounting records to determine whether projects were accounted for properly and were within authorized amounts. In certain instances, we found it necessary to review information dating back to 1999 as it related to our audit objective.

For duties of the Treasurer, we reviewed key control activities of the Business Office, including the manner in which bank accounts are reconciled, duties are assigned, and checks are signed. We also reviewed District financial records, bank statements, and cancelled checks to verify that bank reconciliations were properly performed for the month of August 2006. We tested 20 bank accounts and seven certificates of deposit. In addition, our review included a judgmental sample of cash disbursements for September 2005. We traced 30 check disbursements of the general fund checking account.

For claims processing, we focused our attention on the approval of purchases and the approval for payment for various types of goods and services acquired by the District. We also focused on claims for reimbursement of expenses for District officials and employees. We interviewed officials, observed transactions and examined vendor history reports, purchase requisitions, conference request forms, purchase orders, claims, and checks.

We conducted our 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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