



Farmingdale Union Free School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — December 31, 2007

2008M-57



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2008

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Farmingdale Union Free School District, entitled *Internal Controls Over Selected Financial Operations*. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Farmingdale 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's audited financial statements for the period ending June 30, 2007 report that expenditures totaled approximately \$118.9 million. Responsibilities relating to the District's finances, and accounting records and reports are largely those of the District's Business Administrator and Chief Accountant, who are also authorized by the Board to sign checks in the Treasurer's absence.

Scope and Objective

The objective of our audit was to examine the District's control environment and internal controls over its reserve funds and information technology for the period July 1, 2006 to December 31, 2007. Our audit addressed the following related questions:

- Has the District established and appropriately maintained the employee benefit accrued liability reserve fund to allow accurate evaluation of fund balance?
- Does the Treasurer maintain adequate control over her signature disk?
- Has the District established adequate internal controls over user access to its financial accounting software and are those controls operating effectively?
- Has the Board established a process for identifying potential conflicts of interest?

Audit Results

The District's employee benefit accrued liability reserve (EBALR) has a balance of \$11 million, which is more than twice the amount of the related liability. Had the District properly accounted for the excess reserve balance of \$6.5 million in the unreserved portion of fund balance, the District could have reduced the real property tax levy by \$1.5 to \$3 million from 2004 through 2007 or used these funds for other District purposes.

We also found that the Treasurer did not maintain adequate control over her signature disk to prevent unauthorized disbursement of District funds. This weakness could lead to errors or irregularities occurring and not being detected.

In addition, although the District has recently begun to revise computer access privileges to better restrict users to only those functions necessary to fulfill their job responsibilities; these revisions have not been completely effective. We found that approximately 30 users had access to both enter and approve requisitions. Users circumvented the access controls by sharing their passwords to gain access to functions they were restricted from under their own usernames. After we brought this to the Superintendent's attention, in January 2008, he issued a memo to District staff reminding them that sharing passwords was prohibited. The District also had not implemented procedures to periodically review audit logs. Failure to establish policies and procedures for the District's computer data systems could result in unauthorized access to sensitive information, manipulation of District records and the loss or destruction of data.

Lastly, we found that a Board member did not disclose his interest in a telecommunications firm that has a contract with the District. Although his interest was not prohibited, disclosure of his interest in the contract is still required by General Municipal Law (GML). The Board's lack of enforcement of the disclosure requirements creates a weakness in internal controls, which increases the risk that prohibited transactions may occur.

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. Except as stated in Appendix A, District officials generally agree with our findings and recommendations, and indicated that they have taken, or have planned to initiate, corrective action. Appendix B contains our comments on issues raised in the District's response.

Introduction

Background

The Farmingdale Union Free School District (District) is located in the Towns of Oyster Bay, Nassau County, and Babylon, 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.

There are six schools in operation within the District, with approximately 6,400 students and 1,000 full-time and part-time employees. For the period ending June 30, 2007, the District spent approximately \$118.9 million. The District's budgeted expenditures for the 2007-08 fiscal year are approximately \$133.3 million, which are funded primarily with State aid, and real property taxes. Responsibilities relating to the District's finances, and accounting records and reports are largely those of the District's Business Administrator and Chief Accountant, who are also authorized by the Board to sign checks in the Treasurer's absence.

Objective

The objective of our audit was to examine the District's control environment and internal controls over its reserve funds and information technology. Our audit addressed the following related questions:

- Has the District established and appropriately maintained the employee benefit accrued liability reserve fund to allow for accurate evaluation of fund balance?
- Does the Treasurer maintain adequate control over her signature disk?
- Has the District established adequate internal controls over user access to its financial accounting software and are those controls operating effectively?
- Has the Board established a process for identifying potential conflicts of interest?

Scope and Methodology

We examined the District's control environment and internal controls over its reserve funds and information technology of the Farmingdale Union Free School District for the period July 1, 2006 to December 31, 2007.

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

**Comments of District
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as stated in Appendix A, District officials generally agree with our findings and recommendations, and indicated that they have taken, or have planned to initiate, corrective action. Appendix B contains our comments on 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 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*.

Financial Operations

District officials are responsible for establishing adequate internal controls to properly safeguard and account for District assets and to ensure compliance with Education Law. A good system of internal controls should be designed to provide reasonable assurance that District assets are properly safeguarded, accounting transactions are recorded and reported properly, pertinent regulations and laws are complied with, and work performed is monitored and reviewed routinely.

We identified weaknesses in the District's financial operations, including the establishment and maintenance of the employee benefit accrued liability reserve. The District has set aside more funds than are necessary which has prevented the District from reducing the real property tax levy by \$1.5 to \$3 million from 2004 through 2007 or using these funds for other District purposes. Additionally, we found a lack of control over the Treasurer's facsimile signature. This weakness could lead to inappropriate payments being made by the District.

Employee Benefit Accrued Liability Reserve

There are two types of fund balance, reserved and unreserved. Reserved fund balance represents moneys that the District has set aside and may only use for specific purposes and, therefore, is not available for the District to use for other purposes.¹ Unreserved fund balance is the amount that is uncommitted and is available for funding District operations. The portion of the unreserved fund balance that is used to help finance the next year's budget is known as appropriated fund balance. The portion of the unreserved fund balance that the District retains and that can be used for cash flow purposes and unanticipated expenditures is known as the unappropriated fund balance. Real Property Tax Law currently limits the unappropriated fund balance to no more than 4 percent of the next year's budget.²

An employee benefit accrued liability reserve fund (EBALR) may be created under General Municipal Law. Moneys from this reserve may be used to make cash payments to employees upon separation

¹ Reserve funds are created under various laws and are used to finance the cost of a variety of objects or purposes. The statutes under which the reserves are established (or sometimes mandated) determine how the reserves may be funded, expended and discontinued.

² In July 2007, legislation was enacted to change the Real Property Tax Law statutory limit of unappropriated fund balance to 3 percent of the 2007-08 fiscal year's budget and 4 percent of the 2008-09 fiscal year's budget. Prior to this the limit was 2 percent.

of service for unused sick leave, holiday leave, vacation time, time allowances granted in lieu of overtime compensation, and any other forms of payment for accrued leave time due. Interest earned on money in the EBALR becomes part of the reserve fund. Should a school district determine that the EBALR is no longer needed, the moneys in the fund may be transferred to certain reserve funds authorized by law, but only to the extent that the moneys in the fund exceed a sum sufficient to pay all liabilities incurred or accrued against the fund, as certified by the fiscal and legal officers of the local government or district.

The District established an EBALR in August 2002 using approximately \$1.3 million of excess fund balance. Since its establishment, the EBALR has not been used. We compared the District's long term liability for compensated absences with the reserve fund. Each year, since establishing the EBALR, the District has set aside more money than is necessary to fund the liability.

Fiscal Year Ended	Amount of Compensated Absences LT Liability³	Amount Reserved for Employee Benefit	Excess Reserve
June 30, 2004	\$658,810	\$3,981,000	\$3,322,190
June 30, 2005	1,168,538	6,116,333	4,947,795
June 30, 2006	4,601,350	7,616,176	3,014,826
June 30, 2007	\$4,484,815	\$11,000,000	\$6,515,185

While the 2006-07 audited financial statements show a long term liability of \$4.5 million for compensated absences, the EBALR in which money to pay this liability was set aside totaled \$11 million, more than twice the amount of the reported liability.

In each of the past four years, the District added to the EBALR thereby reducing the amount of available fund balance despite the reserve being over funded. We recalculated the District's year-end unreserved fund balance by adding the amount that had been transferred to EBALR back to the unreserved fund balance. We then recalculated the percentage of fund balance retained at year-end. Had the District properly accounted for the excess reserve balance each year, the unreserved, unappropriated fund balance would have exceeded the statutory limitation⁴ in each year.

³ Long term liability for compensated absences as reported in the District's audited financial statements.

⁴ In July 2007, legislation was enacted to change the Real Property Tax Law statutory limit of unappropriated fund balance to 3 percent of the 2007-08 fiscal year's budget and 4 percent of the 2008-09 fiscal year's budget. Prior to this the limit was 2 percent.

Fiscal Year Ended	Unreserved Fund Balance⁵	Amounts Transferred to EBALR	OSC Adjusted Unreserved Fund Balance	Ensuing Year's Budget	Percentage of Ensuing Year's Budget
June 30, 2004	\$2,292,000	\$2,726,000	\$5,018,000	\$114,625,481	4.34%
June 30, 2005	2,401,574	2,135,333	4,536,907	122,028,214	3.72%
June 30, 2006	2,137,790	1,499,843	3,637,633	128,116,500	2.84%
June 30, 2007	\$3,622,088	\$3,383,824	\$7,005,912	\$133,252,904	5.26%

In order to reduce the fund balance to an amount compliant with Real Property Tax Law, the Board could have reduced the real property tax levy by \$1.5 million to \$3 million in each year, or used these funds for other District purposes, by appropriating this available fund balance for the subsequent year's budget.

The District is not required to establish a separate bank account for this reserve; however, it must be accounted for separately from other moneys of the District and interest must accrue to the fund. The District has invested the money with the general fund. While it is permissible for the District to invest moneys in this fund together with general fund moneys, the separate identity of the sources of the moneys invested must be maintained and a pro rata share of the interest earned credited to the reserve fund. However, we found that the District had not allocated any of its interest earnings to the EBALR. Had the District properly accounted for the interest earned by the EBALR, we estimate that, based on the District's average interest rate on investments of 4.7 percent, approximately \$630,000 of interest should have been prorated and allocated to the reserve fund during the audit period.

In addition, the District did not establish the EBALR solely for the intended statutory purposes. The resolution establishing the fund contained a statement that "additionally, the reserve shall be for payment of future costs for retiree health insurance or other negotiated benefits." The EBALR may be established and used only to pay for accrued but unused time earned upon separation of service. Retiree health insurance (and possibly certain of the "other negotiated benefits" as intended by the Board resolution) is not a permitted use of this fund. Moreover, currently there is no reserve fund authorized by law for the purpose of paying retiree health care costs.

**Treasurer's Signature
Disk**

Effective control over the disbursement of cash is vital to prevent unauthorized payments and the misuse of District funds. As the District official responsible for signing checks, the Treasurer plays

⁵ As reported in audited financial statements

a critical role in the cash disbursement process. Education Law requires that the Treasurer's actual or facsimile signature be affixed to District checks by the Treasurer or affixed under the Treasurer's direct supervision. The Treasurer must ensure that her signature is not used to make payments that have not been approved.

We found that the Treasurer does not maintain adequate control over her signature disk. The Treasurer's facsimile signature may be produced by the District's computer software program and imprinted on District checks. Checks can only be printed after the Treasurer provides her signature disk. We noted that the Chief Accountant, who was authorized to sign checks in the Treasurer's absence, also had a signature disk containing the Treasurer's signature. This authority has since been moved from the Chief Accountant to the School Business Administrator.

Based on this control weakness, we examined 45 claims totaling \$934,591. Although we did not find any exceptions, the fact that there are two copies of the Treasurer's facsimile signature increases the risk that unauthorized checks could be processed. The Treasurer and anyone authorized to sign checks in her absence must always be in control of any facsimiles of their own signatures.

Recommendations

1. District officials should analyze the balance in the EBALR and transfer funds in excess of the amount certified as necessary to satisfy all liabilities incurred or accrued against the fund to other authorized District reserves.
2. The District should credit the pro rata share of interest earned on invested funds to the EBALR.
3. The District should use the money in the EBALR only for its intended statutory purpose.
4. The Treasurer should maintain control of her signature disk, and should directly oversee the printing of checks. The Treasurer should not share her disk or password.
5. The Board should designate an individual separate from business operations to sign checks in the Treasurer's absence and ensure that individual has a signature disk containing a facsimile of his/her own signature.

Computer Data Safeguards

The use of information technology affects the fundamental manner in which the District initiates, processes, records, and reports transactions. The extent to which the District uses computer processing in significant accounting applications, as well as the complexity of that processing, determines the specific risks that information technology poses to the District's internal controls. The District's widespread use of information technology presents internal control risks that must be addressed. These risks include unauthorized access to data, changes to data in master files, and potential loss of data.

The District did not effectively safeguard its computer data. We determined that approximately 30 users had access to both enter and approve purchase requisitions and that individuals were sharing passwords. In addition, no one was reviewing the audit logs in the District's computer software. The computerized financial system should allow users only those access levels they need based on their job descriptions and responsibilities. Having access controls in place prevents users from being involved in multiple aspects of financial transactions. These weaknesses could result in errors or irregularities occurring and not being detected and corrected in a timely manner.

User Access

The District uses a financial accounting software package (financial software) to process and maintain financial transactions. This financial software consists of modules that segregate various financial recording and reporting processes. Access privileges within the financial software include the ability to add, update, delete, and print transactions within these modules. Having access controls in place helps prevent users from being involved in multiple aspects of financial transactions. The financial software is also capable of generating an audit log.

Although the District has recently begun to revise access privileges to better restrict users to only those computer functions necessary to fulfill their job responsibilities, these revisions have not been completely effective. Approximately 30 users had access to both enter and approve purchase requisitions. In addition, users circumvented access controls by sharing their passwords to gain access to functions they were restricted from under their own usernames. Failure to establish policies and procedures for the District's computer data systems can result in unauthorized access to sensitive information, manipulation of District records and the loss or destruction of data. After we brought the situation to the Superintendent's attention, in January 2008, he issued a memo to District staff reminding them that sharing passwords was prohibited.

Audit Logs

An audit log is a record of all changes a user performs within the software, the location of the computer from which the user made changes, and the times and dates the user made the changes. The District's financial software program is capable of producing an audit log. An appropriate District official should periodically review these audit logs, track the activities of users, and ensure that users are not sharing passwords or performing any duties that are not part of their job descriptions. However, no one reviews the software program's audit logs on a regular or periodic basis. The failure to independently review the audit logs can result in errors or irregularities occurring and not being detected and corrected in a timely manner.

Recommendations

6. District officials should continue to review and revise user access rights to the financial software along with job descriptions to ensure that users have access only to functions within the scope of their responsibilities.
7. District officials should ensure that an individual outside of the business process periodically reviews the audit logs generated by the financial software and reports the results of the review.

Conflict of Interest

The General Municipal Law (GML) limits the ability of municipal officers and employees to enter into contracts in which both their personal financial interests and their public powers and duties conflict. Unless a statutory exception applies, municipal officers or employees may not have an interest in any contract with the municipality of which he or she is an officer or employee, when the officer or employee, individually or as a member of a board, has the power or duty to negotiate, prepare, authorize or approve the contract or authorize or approve payment under the contract; audit bills or claims under the contract; or appoint an officer or employee who has any of the above powers or duties. A municipal officer or employee has an interest in a contract when he or she receives a direct or indirect monetary or material benefit. Municipal officers and employees are also deemed to have an interest in the contracts of their spouse, minor children and dependents (except employment contracts), a firm partnership or association of which they are a member or employee, and a corporation of which they are an officer, director or employee, or directly or indirectly own or control any stock. As a rule, interests in actual or proposed contracts on the part of a municipal officer or employee, or his or her spouse, must be publicly disclosed in writing to the municipal officer or employee's immediate supervisor and to the governing board of the municipality. The written disclosure to the board must be made part of and be set forth in the official record of the proceedings of the board.

GML also mandates that the governing body of every school district in the State must adopt a local code of ethics to guide the district's officers and employees in the standards of conduct reasonably expected of them. A code of ethics that complements and reinforces applicable statutes helps to enhance the control environment of an organization by clearly defining the standard of conduct expected of officers and employees. District records indicate that the Board adopted such a code in 1995. The code requires all members of the Board to "... publicly disclose on the official record the nature and extent of any direct and indirect financial or other private interest he/she has in the adoption of..." resolutions submitted for consideration of the Board.

A Board member is an employee of a telecommunications firm that has a contract with the District. During our audit period, the District paid this company approximately \$40,000 for telecommunication services. In this particular case, the Board member is not deemed to have a prohibited interest in contracts between the firm and the

District, and his powers and duties as a Board member because as an employee of the firm, his remuneration for employment is not directly affected as a result of the contract, and the duties of the employment do not directly involve the procurement, preparation or performance of any part of the contract. However, disclosure of his interest in the contract is still required under the GML.

The Board member told us that he is an installation manager and his compensation is not affected by the company's contract with the District. While disclosure of the interest was required, the Board member did not publicly do so. The District Clerk stated that the other Board members are aware of this interest, but there has not been an opportunity for the interest to be disclosed in the minutes. In addition, we found no indication in the minutes that the Board member abstained from voting on the contract.

The Board's lack of enforcement of the disclosure requirements creates a weakness in internal controls, which increases the risk that prohibited transactions may occur.

Recommendations

8. Board members and any other District official/employee must disclose interests in contracts with the District as required by law.
9. The Board should amend its code of ethics to require all District officers to abstain and recuse themselves from contracts in which they may have a direct or indirect interest.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



education for today..... and tomorrow

F A R M I N G D A L E P U B L I C S C H O O L S

JOHN LORENTZ
Superintendent of Schools

(516) 752-6510 – FAX (516) 847-0363

July 7, 2008

[REDACTED]
[REDACTED] of Local Government
And School Accountability
State of New York
Office of the State Comptroller
110 State Street
Albany, NY 12236

Dear [REDACTED]:

The Farmingdale School District makes every effort to ensure that the public trust that is placed in the hands of school district officials and the Board of Education receives the utmost attention. It is our top priority to ensure that we manage efficiently and effectively the tax dollars that are entrusted to us. We are appreciative of the efforts of the New York State Comptroller's Office to assist us in this venture. It is important to begin our response by including an excerpt from Appendix B of the report; Audit Methodology and Standards, which states the Office of the State Comptroller's Goal:

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 personnel services, and information technology.

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

This report is a significant tool, and we appreciate the comprehensive and thorough process as indicated in the audit methodology and standards.

Four issues are addressed by the Comptroller's report. This response is formatted so as to address those recommendations.

Financial Operations

The District has used significant fund balance amounts to lower taxes as part of the budget development process. Fund balance and reserves used to lower taxes total approximately \$15 million from 2004/05 to present. Appropriated reserves have been used to support anticipated expenses for which each respective reserve has been created. The combination of appropriated reserves and fund balance to lower taxes totals \$4 million for 2008-09 and almost \$3 million for 2007-08.

The Comptroller's suggestion to use additional fund balance to lower taxes must be carefully considered. The use of excess fund balance to fund ongoing expenses can result in future budget gaps. This funding source may not necessarily be available in subsequent years, therefore one shot-revenue sources should not be used to finance recurring operating expenses. District officials closely monitor the use of fund balance so that it is not detrimental to future District operations and takes into account the tax burden of the Farmingdale community.

See
Note 1
Page 22

The Comptroller has also commented that the District did not establish the Employee Benefits Accrual Liability Reserve (EBALR) solely for the statutory purpose. This reserve was established by Board resolution in August 2002. The language used in the resolution references retiree health insurance as it was deemed that statutory financial requirement addressed this potential financial obligation. This resolution shall be revised in 2008/09. Although the reserve was established as per the resolution, it should be noted that the calculation of its value does not consider costs for retiree health insurance. Therefore it is not in violation of the referenced statutory purpose stated in the Comptroller's report. The reserve is supported by a detailed schedule which was provided to the state audit team. The calculation is based upon data and projections that support the \$11 million value of the EBALR.

See
Note 2
Page 22

See
Note 3
Page 22

The District's response to the Comptroller's recommendations with regard to financial operations is as follows:

Recommendation No. 1: District officials should analyze the balance in the EBALR and transfer funds in excess of the amounts certified as necessary to satisfy all liabilities incurred or accrued against the fund to other authorized District reserves.

The District administration will analyze the balance in this reserve and review other authorized District reserves. Adjustments may be made based upon current and future District needs and obligations, including educational, capital and the property tax burden of the community.

Recommendation No. 2: The District should credit the pro rata share on interest on investments to the EBALR.

The District's Business Office has been tasked to generate a mechanism that will allow the interest earned on these invested funds to be credited to the appropriate reserves. This will be accomplished by June 30, 2008.

Recommendation No. 3: The District should use the money in the EBALR only for its intended statutory purpose.

Agreed.

Recommendation No. 4: The treasurer should maintain control of her signature disk and should directly oversee the printing of checks. The treasurer should not share her disk or password.

Although two disks existed containing the treasurer's signature, a process approved by the Board of Education was in place to control the signature and printing of checks. Only three checks were signed by the treasurer, and as indicated in the Comptroller's report, a comprehensive analysis of disbursements indicated no irregularities.

Recommendation No. 5: The board should designate an individual separate from business operations to sign checks in the Treasurer's absence and ensure that that individual has a signature disk containing a facsimile of his/her own signature.

At the annual reorganization meeting (7/9/08), a deputy treasurer will be appointed who has an assignment that is outside the business operations with his/her own facsimile signature disk. This individual will directly oversee the printing of checks that use his/her facsimile signature disk.

Computer Data Safeguards

The Comptroller's report indicates that the district must assess privileges to better restrict users to only those functions necessary to fulfill their job responsibilities. The Comptroller should note that a comprehensive analysis has been accomplished and a process developed so that users have access to the functions necessary to fulfill their job responsibilities only. The system does permit and it is often required that certain users have two or more user names when responsibilities include different budget departments. The Comptroller's office should note that prior to the completion of the audit, the system was revised to properly restrict use. The Superintendent receives a report regularly that allows him to deal with any violations. This has proven effective.

Audit trails will be provided to the superintendent, who has a business background. After review, a permanent recommendation will be made to the Board of Education to address this issue. Until such time, the superintendent and/or an appropriate designee will perform a review.

Recommendation No. 6: District officials should continue to review and revise user access rights to the financial software along with job descriptions to ensure that users have access only to functions within the scope of their responsibilities.

Complete

Recommendation No. 7: District officials should ensure that an individual outside the Business Office periodically reviews the audit logs generated by the financial software and reports the results of the review.

Complete.

Conflict of Interest

In the course of the Comptroller’s audit, an issue has been reported with regard to the district’s code of ethics and conflicts of interest. As a result, there is an appearance of a weakness of internal control; however, there is no risk.

Recommendation No. 8: Board members and any other district official / employee must disclose interest in contracts as required by law.

Annually, as a result of our independent audit, conflict of interest certifications are issued by the district administration and provided to our independent auditors. This is the manner that any potential conflicts are identified. The Board reorganization agenda has been revised to publicly disclose potential conflicts of interest. This meeting is scheduled for July 9, 2008.

Recommendation No. 9: The Board should amend its code of ethics to require all District officers to abstain and recuse themselves from contracts in which they have a direct or indirect interest.

The district’s Policy Committee has been tasked with revising board policy as per the recommendations presented by the Comptroller’s office and will be complete and ready for board action as early as possible in the next school year.

Conclusion

The Farmingdale School District takes its financial responsibilities very seriously. We have addressed all aspects of the Comptroller’s audit. Adjustments have been made in the interest of financial control and separation of duties. The items addressed in this audit have been incorporated into our regular operations. Thank you for your assistance to the District officials in the never ending task that is our fiduciary responsibility to the taxpayers and the students of our community.

Very truly yours,



John Lorentz
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The excess in the District's EBALR over a four-year period constituted amounts that would otherwise have been unreserved, unappropriated fund balance that exceeded statutory limitations. We agree that such excess fund balance should be used to pay off debt or to finance non-recurring expenses, and that one-shot revenue sources should not be used to finance recurring expenses. However, in this case, the excess fund balance was a yearly phenomenon that resulted, in large part, because of District officials' budgeting decisions. Given the consistency of these excess funds, District officials should adjust the tax rates to raise only the amount of property taxes needed to finance ongoing operations.

Note 2

As stated in our report, the long-term liability for EBALR commitments was certified by the independent auditor at \$4.5 million while the District's EBALR fund balance was reported at \$11 million for the fiscal year ended June 30, 2007. Irrespective of whether future retirees' health insurance costs were considered in the calculation of the reserve, the EBALR fund balance was \$5.5 million in excess of the amount the District could legally reserve for compensated absences.

Note 3

District officials provided us with a schedule that showed how District officials calculated the \$5.5 million difference between the long-term liability for compensated absences of \$4.5 million and the reported EBALR fund balance of \$11 million at June 30, 2007. With this calculation, District officials attempted to determine the additional future cost of compensated absences employees would accrue at retirement, which at June 30, 2007, was not yet earned. Under Generally Accepted Accounting Principles, the District may not accrue a liability unless an expense has been incurred.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology.

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

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

The tests for the establishment and appropriate maintenance of the employee benefit accrued liability reserve fund included:

- Obtaining a copy of the Board resolution establishing the reserve.
- Determining whether the District accrues interest on the reserved funds to the reserve.
- Obtaining supporting documentation used by the district to determine the level at which to fund the reserve.

The tests for controls over the Treasurer's signature disk included examining a sample of claims for proper authorizations.

The tests for controls over user access to the financial accounting software included:

- Interviewing district staff to determine the reason for multiple usernames.
- Interviewing district staff to determine why usernames are shared.
- Reviewing user permissions reports to determine whether user access is based upon job functions.

The tests for controls over potential conflicts of interest included:

- Inquiring into what internal controls and procedures were in place to identify and prevent potential conflicts of interest.
- Requesting and obtaining representations from the Superintendent, Business Administrator, Chief Accountant, Purchasing Agent, Treasurer, and Board members indicating their outside employment and business interests and those of their spouses.
- Reviewing records to determine if the District had financial transactions with any business that might constitute a prohibited conflict of interest.

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.

APPENDIX D

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