



Frankfort–Schuyler Central School District

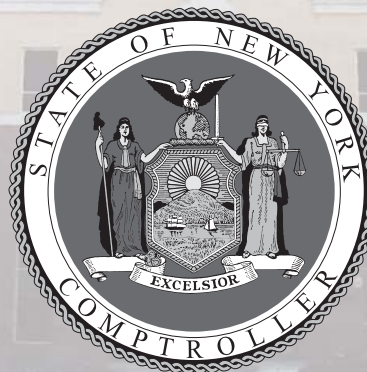
Internal Controls Over Cash Disbursements

Report of Examination

Period Covered:

July 1, 2005 — April 30, 2007

2008M-23



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

April 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 Frankfort-Schuyler Central School District, entitled Internal Controls Over Cash Disbursements. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

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

Respectfully submitted,

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

Introduction

Background

The Frankfort-Schuyler Central School District (District) is located in the Towns of Frankfort and Schuyler, Herkimer County. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The Business Office staff consists of the Business Administrator, the Treasurer, a payroll clerk and a transportation/health insurance clerk. They are responsible for maintaining the District's financial accounting records and reports, and for processing the District's cash receipts and disbursements, purchasing, accounts payable and payroll. The Board appoints a claims auditor on an annual basis.

There are three schools in operation within the District, with approximately 1140 students and 130 employees. The District's budgeted expenditures for the 2005-06 fiscal year were \$14.5 million, which were funded primarily with State aid, real property taxes, and grants.

Objective

The objective of our audit was to examine the District's internal controls relating to cash disbursements. Our audit addressed the following related question:

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

Scope and Methodology

We examined the District's internal controls over cash disbursements for the period July 1, 2005 to April 30, 2007.

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

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials

generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, 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*.

Cash Disbursements

District managers are responsible for designing internal controls over cash disbursements to ensure that cash is disbursed only upon proper authorization. This includes designing and documenting appropriate operating policies, practices and procedures, and properly delineating employee responsibilities. Duties must be segregated so that no single individual controls all phases of a transaction. In addition, the Treasurer and Superintendent must control use of their signatures in the check signing process and all checks must be posted to the accounting records. When internal controls are not designed appropriately or operating effectively, it increases the risk that errors or irregularities may occur and not be detected and corrected.

We identified internal control weaknesses in the District's operations relating to the segregation of duties, check signing and accounting records that could lead to inappropriate or incorrect payments occurring and not being detected and corrected timely.

Segregation of Duties – The concentration of key duties with one individual, with little or no oversight, weakens internal controls and significantly increases the risk that errors or irregularities could occur. Therefore, an effective system of internal controls must provide for the segregation of duties so that no single individual controls all or most phases of a transaction. When it is not practical to segregate duties due to limited staff resources, District officials must establish compensating controls.

Cash disbursement duties were not properly segregated and compensating controls were not established. The Treasurer maintained the accounting records, and with the exception of the payroll bank account, prepared and made deposits, signed checks, initiated bank wire transfers, made cash transfers between funds and reconciled bank accounts. Although the Business Administrator reviewed bank reconciliations, he also made transfers between bank accounts and recorded journal entries. Further, although the Business Administrator and Treasurer informed us that the Business Administrator had not signed any checks, he was authorized to do so. Our testing, as discussed later in the report, did not identify any checks that were signed by the Business Administrator.

Signature Stamps – An important aspect of internal control over the treasury function involves the direct supervision of the check signing process. Education Law provides that all checks must be signed by

the Treasurer or in the Treasurer's absence, by the Deputy Treasurer or a Board member if so authorized by the Board. The Board may also authorize a second individual to sign checks to enhance internal control. The Treasurer or other individual must either personally sign checks or control the signing of checks with the use of a mechanical check-signer if authorized by the Board. There is no provision in the statutes to authorize the use of a hand stamp to sign checks. Further, given the relative ease with which hand stamps can be replicated, the risk of unauthorized disbursements is increased when hand stamps exist and are allowed to be used.

Our review of disbursement procedures disclosed that payroll checks bear the signature of the Treasurer¹ and accounts payable checks bear the signature of the Treasurer and Superintendent. We found hand stamps are used to affix their signatures and neither the Treasurer, nor the Superintendent, properly controls the use of their signature stamps. Both stamps are stored in the District safe, which is accessible to all Business Office staff. The payroll clerk uses the Treasurer's signature stamp to sign payroll checks with no oversight from the Treasurer. Although the Treasurer signs accounts payable checks by hand or with her stamp, she uses the Superintendent's signature stamp to apply his facsimile signature with no oversight from the Superintendent. We also found that the Business Administrator was made an authorized signatory for payroll and accounts payable to ensure that someone could sign checks in the Treasurer's absence. However, only a Deputy Treasurer² or Board member can do this, and then, only with Board authorization.

Check-Processing Software – Internal controls must ensure that all checks are posted to the accounting records and that the person with signatory authority directly supervises the check signing process. We found the District software used to print checks allows for the reprinting of checks and that the reprinted checks are not recorded in the accounting records. Although the reprinted checks lack the Treasurer's and Superintendent's facsimile signatures and pre-printed check numbers, given the ease with which the Treasurer's and Superintendent's facsimile signatures can be applied, this is a serious control weakness. The ability to reprint checks provides an opportunity for unauthorized payments to be made. Further, because the check-printing software does not record information in the computerized accounting system, any such unauthorized payments may not be detected promptly.

¹ The Board adopted a policy on October 11, 2005 which authorized the "single signature of the Treasurer on all District checks" and use of the Treasurer's "signature stamp to stamp school district checks."

² A Deputy Treasurer has not been appointed.

Due to these control weaknesses, we performed tests of disbursements to ensure they were properly authorized. We traced 94 claims totaling \$32,663 and 67 payroll and payroll-related claims totaling \$73,261 from bank statements to check images to authorizations on warrants signed by the claims auditor or payrolls certified by the Superintendent. We also performed tests to identify unrecorded disbursements. Although our testing did not identify any checks that were signed by the Business Administrator or other exceptions, the failure to properly segregate duties, restrict check signing authority, control the use of facsimile signatures and ensure that all checks are posted to the accounting records significantly increases the risk that inappropriate payments could be processed and concealed.

Recommendations

1. District officials should assign financial related duties so that the work of one individual is independently verified in the course of another employee's regular duties. This could include having a staff member independent of the cash receipts or disbursements processes perform or review bank reconciliations.
2. The Treasurer should personally sign all District checks or control the signing of all checks with the use of a mechanical check-signer.
3. Only if the Board chooses to require a second signature by the Superintendent, should the Superintendent sign checks. In that case, the Superintendent should either personally sign or control the signing of applicable checks, such as with the use of a mechanical check-signer. If the Board chooses not to require a second signature by the Superintendent, District officials should direct the bank to remove the Superintendent's signature as an authorized signatory.
4. District officials should direct the bank to remove the Business Administrator's signature as an authorized signatory. If the Board chooses to authorize another individual to sign checks the Treasurer's absence, it may appoint a Deputy Treasurer or authorize a Board member to do so.
5. District officials should request that the accounting system software vendor make the necessary program changes to prevent the creation of re-printed checks without being recorded in the accounting records, or develop alternative controls to compensate for this weakness.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Administrative Offices
605 Palmer Street
(315) 894-5083 Superintendent
(315) 895-7781 Business Office
(315) 895-7011 Fax

Middle-Senior High School
605 Palmer Street
(315) 895-7461 Principal
(315) 895-4032 Fax
(315) 895-7733 Special Education



**Frankfort-Schuyler
Central School District
Frankfort, NY 13340**

Reese Road Elementary School
Reese Road
(315) 895-7491 Principal
(315) 895-4102 Fax

West Frankfort Elementary School
160 School Lane
(315) 735-8336 Principal
(315) 735-9231 Fax

March 17, 2008

[REDACTED]

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

Dear [REDACTED]:

On March 4, 2008, an exit interview was held, with associate examiners from your office, regarding preliminary draft findings of the recent examination of the Frankfort-Schuyler Central School District.

Please be advised that the Frankfort-Schuyler Central School District is in agreement with the findings, and recommendations, that are included in this report.

As a result, the following changes will be implemented:

1. Segregation of Duties:
 - A staff member, with responsibilities independent of the cash receipts or disbursements processes, will review bank reconciliations.

2. Signature Stamps
 - The practice of utilizing signature stamps will be discontinued; and, the stamps destroyed.

 - The District will begin implementation of an electric check-signing process.

 - The Treasurer will control the signing of all checks.

2. (Continued)

- The bank will be directed to remove the Superintendent's signature as an authorized signatory.
- The bank will be directed to remove the Business Administrator's signature as an authorized signatory.
- The Board of Education will create a Deputy Treasurer's position. This person shall be authorized to sign checks in the Treasurer's absence.
- The Board of Education will annually appoint a Board of Education member as second alternate check signer, in the event that the Treasurer and Deputy Treasurer are unavailable.

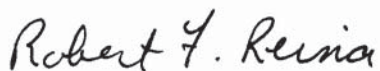
3. Check-Processing Software

- The District will request the accounting system software vendor to make the necessary program changes to prevent the creation of re-printed checks without being recorded in the accounting records.

The District is in the process of preparing the corrective action plan and, upon completion, will submit it as required.

Thank you for your department's assistance during this process. Please do not hesitate to contact me if additional information is needed.

Sincerely,



Robert F. Reina
Superintendent of Schools

RFR:clf

cc: Frankfort-Schuyler Central School Board of Education
Christopher Abdoo, Business Administrator

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

During 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 objective and scope by selecting for audit those areas most at risk. We selected cash disbursements for further audit testing. To accomplish the objective of this audit, our procedures included the following:

We examined the following records to determine the effectiveness of internal controls pertaining to cash disbursements and to identify any associated effect of deficiencies in those controls:

- Bank statements
- Cancelled checks
- General ledger accounts
- Claim packets
- Warrants
- Payroll registers.

We also used ACL (an audit testing program) to verify check sequence integrity, look for duplicate check numbers or payments, examine non-payroll checks to employees and test for certain other check transactions.

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

objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C

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