



Fredonia Central School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2005 — September 14, 2007

2007M-299



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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

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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 Fredonia Central 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 Fredonia 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. The Business Administrator is appointed annually to serve as the District's Treasurer and purchasing agent. Additionally, the Board has appointed a claims auditor annually to fulfill its obligations under Education Law. The District's general fund operating expenditures for the 2005-06 fiscal year were \$21 million, which were funded primarily with State aid, real property taxes, and grants.

Scope and Objective

The objective of our audit was to evaluate the District's internal controls over selected financial operations for the period July 1, 2005 to September 14, 2007. Our audit addressed the following related questions:

- Are internal controls over claims processing appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over payroll processing for new hire employees, separating employees, and employees of the District's Business Office and information technology (IT) department appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over cash receipts and disbursements appropriately designed and operating effectively to adequately safeguard District assets?

Audit Results

We found that the Board had not established a sufficient internal control framework that provided adequate and clearly communicated oversight and periodic monitoring of payroll, claims processing, and cash receipt and disbursement transactions. Deficiencies in the District's internal controls have resulted in errors or irregularities occurring and going undetected.

Two former Superintendents received improper health insurance coverage valued at \$92,425. There was no Board authorization for this coverage. The Business Administrator/Treasurer told us that when he worked under the former Business Administrator, he was informed by him that lifetime health insurance benefits were to be provided for the two former superintendents; however, he did not

provide us with any documentation to support this statement. Both of the former Superintendents have agreed to repay the District for coverage through June 2007 totaling \$92,425. This repayment will be made over a period of years, with the first payments received in September 2007 for \$11,952 from one former Superintendent, and \$6,000, received in May 2008, from the other former Superintendent.

We examined 53 claims totaling \$1,210,465 and found that the claims auditor had not audited 20 manual checks, and 19 claims were paid after the invoice due date (12 claims), were for late fees for previously late payments (3 claims), or were both paid after the invoice due date and for late fees for previously late payments (4 claims). In addition, the Superintendent did not pre-approve five travel-related claims as required by District policy, and District managers did not sign 24 of the 53 claims to indicate that they were approved for payment.

The Superintendent did not certify payrolls as required by the Board, and the Business Administrator/Treasurer does not provide adequate oversight of the payroll clerk's duties. We reviewed 56 timesheets for three District employees and found 59 errors on 25 of the timesheets. District managers did not pre-approve overtime hours on all 56 timesheets, and the payroll clerk could not locate 20 timesheets for three Business Office employees and one IT employee. We also reviewed separation payments for eight former employees and found that the Superintendent directed the Business Administrator/Treasurer to pay \$10,876 to two former employees without authorization from the Board. District officials could not provide us with personnel files for three of 20 new employees hired by the District. We also reviewed the salary schedules for these 20 employees and found that two employees had salaries that were a combined \$1,231 more than what the Board had authorized.

The District had not established internal controls within the Business Office to ensure that critical financial and payroll duties are segregated, and user access rights to the financial software were not adequately assigned. The Business Administrator/Treasurer was consistently two months late in providing his monthly reports to the Board, and he did not adequately supervise the use of his signature disk. We also found that nine non-resident students had outstanding tuition balances totaling \$8,918, and the Board was aware of this situation but took no documented action to enforce payment.

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 that they either have initiated or plan to initiate corrective action.

Introduction

Background

The Fredonia Central School District (District) is located in the Towns of Arkwright, Dunkirk, Pomfret, Portland and Sheridan in Chautauqua 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 two schools in operation within the District, with approximately 1,760 students and 300 employees. The District's general fund operating expenditures for the 2005-06 fiscal year were \$21 million, which were funded primarily with State aid, real property taxes, and grants. Salary and wages, overtime and employee benefit costs comprise the most significant portion of the District's budget, totaling approximately \$14.9 million dollars in 2005-06, which is 71 percent of the District's operating expenditures.

Objective

The objective of our audit was to evaluate internal controls over selected financial operations. Our audit addressed the following related questions:

- Are internal controls over claims processing appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over payroll processing for new hire employees, separating employees, and employees of the District's Business Office and information technology (IT) department appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over cash receipts and disbursements appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

We examined the internal controls over payroll, claims processing, and cash receipts and disbursements of the Fredonia Central School District for the period July 1, 2005 to September 14, 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 that they either have initiated or plan to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, the Board must approve a corrective action plan that addresses the findings in this report, forward the plan to our office within 90 days, forward a copy of the plan to the Commissioner of Education, and make the plan available for public review in the District Clerk's office. For guidance in preparing the plan of action, the Board should refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*.

Claims Processing

Education Law generally requires that the Board, or a Board-appointed claims auditor, audit and approve District claims before directing the Treasurer to pay the claims. When the Board appoints a claims auditor, the claims auditor assumes the Board's powers and duties of reviewing, approving, and/or denying all claims against the District. The claims audit function ensures that payments have appropriate supervisory approval, are for valid and legal District purposes, are in proper form, mathematically correct, paid in a timely manner, in agreement with supporting purchase orders, and are in compliance with statutes, regulatory requirements, and District policies. Education Law and District policy require the claims auditor to affirm that he has audited claims by including a certification¹ on each claim schedule or warrant (list of claims) before presenting it to the Treasurer. Education Law also requires the claims auditor to report directly to the Board, which allows for appropriate oversight of this critical function.

Although the Board appointed a claims auditor, he told us that the Board did not provide him with a job description or any other form of guidance; for example, he was not aware of the District's purchasing policy. The Business Administrator/Treasurer paid claims even though the claims auditor had not audited and approved them for payment. The claims auditor told us that he routinely audited claims after the checks had been mailed out for payment, he had no authority to reject payments, and he did not report directly to the Board.

Due to these deficiencies, we examined 53 claims totaling \$1,210,465 and found that there was no Board or Superintendent approval for \$92,425 in health care coverage payments for two former superintendents, the claims auditor had not audited 20 manual checks, and 19 claims were paid after the invoice due date (12 claims), were for late fees for previously late payments (3 claims), or were both paid after the invoice due date and for late fees for previously late payments (4 claims). In addition, the Superintendent did not pre-approve five travel-related claims as required by District policy, and District managers did not sign 24 of the claims to indicate that they were approved for payment. As a result, the District is at risk for processing other unauthorized transactions that are inappropriate District expenditures.

¹ By signing claims schedules or warrants after he has audited them

Authorization

Board-authorized contracts and employment agreements provide guidance regarding employee entitlements. It is important for the minutes of the Board's proceedings to clearly indicate the Board-authorized compensation and benefits for administrators and staff. This authorization can be described in detail in the minutes, or the minutes can refer to attached or bound original documents that provide necessary detailed information. It is the functional manager's² responsibility to confirm that payments for continued health insurance coverage are authorized and accurate by reviewing contracts and agreements before approving claims for payment. Also, to perform a proper audit of claims, the claims auditor must confirm that payments for continued health insurance coverage have proper approval and are accurate. This review helps the claims auditor ensure that the District pays only what it should.

We found that the District improperly paid health insurance premiums for two former superintendents totaling \$92,425. There was no Board authorization for these continuing payments. The Business Administrator/Treasurer told us that when he worked under the former Business Administrator, he was informed by him that lifetime health insurance benefits were to be provided for the two former superintendents; however, he did not provide us with any documentation to support this statement. In addition, the Business Administrator/Treasurer did not review the employment agreements for either of these two individuals and provide appropriate approval for these claims, and the claims auditor did not audit the claims before the Business Administrator/Treasurer paid them.

Documentation at the District indicated that the health insurance coverage for one of the former Superintendents was to end when he reached age 55, which occurred in August 1999. Shortly after we brought this to the District's attention, the former Superintendent agreed to repay the District the improper payments, totaling \$72,778, which the District had paid through June 30, 2007. This repayment will be made over a period of seven years, with the first payment received in September 2007 for \$11,952.

The other former Superintendent was appointed by the Board as an Interim Superintendent in October 1995. His employment agreement was signed by himself and the President of the Board, and it was included in the minutes for the Board's regular meeting. In addition to a monthly salary, this agreement states that "health insurance will be paid for a period of ten (10) years commencing on October 1, 1995."

² A functional manager is a manager who oversees a specific functional area, such as the information technology (IT) manager, transportation manager, or the Business Administrator/Treasurer. These individuals are familiar with the specific needs and requirements of their particular functional area.

However, we found that the 10-year period expired in 2005. As a result, the District has paid this individual \$19,647 in unauthorized health insurance coverage through June 30, 2007.

District officials later gave us a document that was identical to the agreement contained in the Board minutes except that the sentence noted above that limited coverage to a 10 year period was replaced with the following, "Health insurance will be paid commencing on October 1, 1995." The Business Administrator/Treasurer told us that he received this document from the former Interim Superintendent. We found no indication that this change was discussed by the Board or that the Board took any action to authorize changes to the terms of the Interim Superintendent's agreement. Moreover, the changed sentence does not state that the District will provide this individual with lifetime health insurance coverage; it simply indicates when coverage was to begin.

Subsequent to the completion of our fieldwork, the former Superintendent agreed to repay the District the improper payments. This repayment will be made over a yet to be determined period of years, with the first payment received in May 2008 for \$6,000.

Manual Checks

When preparing manual (handwritten) checks, it is important for District personnel to generate claim forms to document and support the handwritten checks. Also, manual checks must be listed on warrants and audited by the claims auditor before they are mailed out. During the 2006-07 fiscal year, the District processed 370 payments representing approximately \$3.6 million in expenditures using manual checks.

Of the 53 claims that we examined, we found that 20 claims (20 manual checks) totaling \$293,240 had not been audited by the claims auditor. We found that the claims auditor generally did not review manually generated checks and did not list them on a warrant. Instead, the account clerk accounted for manual checks on a spreadsheet. Also, checks that are prepared manually often do not have claim forms to support them. Examples of the types of expenditures paid with manual checks include capital project expenditures, reimbursements of overpayments, and late fees.

Oversight and Approval

Because the Superintendent is responsible for the day-to-day management of the District, it is important for him to exercise sufficient oversight and monitoring of the work of the Business Administrator/Treasurer to help ensure that transactions are properly recorded and reported, and moneys are properly accounted for. In addition, the District's purchasing policy requires Board members and employees to have their travel expenditures pre-approved to

ensure that they are necessary and legitimate District expenditures. The Board annually appoints the Superintendent to pre-approve travel expenditures for Board members and employees. District policy also requires functional managers to sign claims acknowledging receipt of goods and/or services and providing necessary approval for the Business Office to process payments.

We reviewed 53 claims to determine whether District personnel adequately processed the claims and found that the Superintendent and other District officials did not provide appropriate oversight and claims approval, which resulted in the following deficiencies:

- 19 claims were paid after the invoice due date (12 claims), were for late fees for previously late payments (3 claims), or were both paid after the invoice due date and for late fees for previously late payments (4 claims). The three claims that were for late fees for previously late payments were payments made to the Internal Revenue Service (IRS) for interest and penalty payments totaling \$24,722. The late payments to the IRS occurred because the Business Administrator/Treasurer did not file IRS forms remitting District payroll withholdings in a timely manner. The Superintendent did not provide adequate oversight of the Business Administrator/Treasurer and was unaware that these payments had been late. We found no evidence that the three IRS claims were reviewed or approved by any other District official prior to payment.
- Seven claims, totaling approximately \$4,500, were travel-related. Of these seven claims, we found that the Superintendent did not pre-approve five of the claims, totaling \$2,391, as required by District policy.
- 24 of the 53 claims totaling \$102,763 were not signed by a functional manager. For example, the appropriate functional manager did not sign two claims for refunds of overpaid school taxes totaling \$4,193. When functional managers do not sign claims, District officials have no assurance that these payments were properly reviewed and approved for payment.

When District personnel write handwritten checks without including claim forms with the checks, when the claims auditor does not audit purchases, and when District officials do not provide proper oversight and approval for claims, it increases the risk that the District may process unauthorized transactions.

Recommendations

1. The claims auditor should report directly to the Board.
2. The Board should provide the claims auditor with Board policies, a job description, and other necessary guidance.
3. The Business Administrator/Treasurer should only pay the claims that the claims auditor has audited and approved, including those to be paid by manual checks.
4. The Board should seek to recover improperly paid health insurance premiums.
5. Administrators should establish procedures to clearly articulate responsibilities and assignments with regard to the management of health care for retirees.
6. The Superintendent should ensure that the Business Administrator/Treasurer remits payroll withholdings and pays claims in a timely manner.
7. District officials should ensure that employees and Board members adhere to District policy by having their travel pre-approved by the Superintendent.
8. Functional managers should review supporting documentation, including claim vouchers and applicable authorized contracts and agreements, before signing claims and approving them for payment.
9. District officials should ensure that the claims auditor checks claims for a functional managers' signature before approving claims for payment.

Payroll

The primary objective for internal controls over payroll processing is to ensure that employees are paid wages and salaries and provided benefits to which they are entitled. District officials and administrators must ensure that appropriate controls are established to prevent and detect errors or irregularities in the District's payroll and personnel procedures and practices. Controls, such as segregation of duties and supervisory review of transactions, help ensure that compensation is in accordance with Board action, employment contracts, and District policies. Employment contracts and policies generally address matters such as hours to be worked, rates of compensation, amount and type of leave time to be granted, eligibility for health insurance and other fringe benefits, and post-employment benefits to be granted.

We found that the Superintendent does not certify District payrolls as required by the Board, and the Business Administrator/Treasurer does not provide adequate oversight of the payroll clerk's duties. We reviewed 56 timesheets for three District employees and found 59 errors on 25 of the timesheets that we reviewed. District managers did not pre-approve overtime hours on all 56 timesheets, and the payroll clerk could not locate 20 timesheets for three Business Office employees and one information technology (IT) employee. We also reviewed separation payments for eight former employees and found that the Superintendent directed the Business Administrator/Treasurer to pay \$10,876 to two former employees without authorization from the Board. District officials could not provide us with personnel files for three of 20 new employees hired by the District. We also reviewed the salary schedules for these 20 employees and found that two employees had salaries that were a combined \$1,231 more than what the Board had authorized.

Payroll Certification and Oversight

It is important for the Superintendent to certify (review and sign) the District's payroll before the payroll department disburses the checks. This certification serves as an important oversight control within the payroll process and helps the District ensure that it does not under or overpay its employees. In addition, it is important for the Business Administrator/Treasurer to adequately oversee and review timesheets to ensure that the payroll clerk is properly performing her duties, functional managers are providing adequate oversight of regular and overtime hours worked, and to ensure that employees receive their proper wages and salaries. Timesheets for employees serve as a basis for District officials to authorize salary payments and to ensure employees are paid only for time worked. It is important for

District officials to approve timesheets before the payroll department processes payroll checks. Also, according to employee contract requirements, overtime hours must be pre-approved before District employees work overtime.

The Board annually appoints the Superintendent to certify (review and sign) each payroll, and the Business Administrator/Treasurer is responsible for supervising the District's payroll processing function. Because the payroll clerk performs many incompatible duties within the payroll processing system,³ the Business Administrator/Treasurer must provide adequate oversight of the performance of her duties.

Although the payroll clerk reports to the Business Administrator/Treasurer, we found no evidence that he reviewed her processing of the payroll or that the Superintendent certified the payroll. Therefore, the payroll clerk was performing all aspects of the payroll process without any other employee's involvement or oversight.

We examined 56 timesheets for two Business Office employees and one former IT employee and found 59 errors on 25 of the 56 timesheets that we reviewed. For example, on the 14 timesheets that we reviewed for one of the IT employees, we found 13 inaccurate tabulations of hours worked, totaling an overpayment of \$183 to the employee. We also found that District managers did not pre-approve overtime hours on all 56 timesheets that we reviewed. In addition, the payroll clerk could not locate 20 timesheets for three Business Office employees and one IT employee, which represented pay totaling \$21,447.

These timesheet errors, missing overtime approvals, and missing timesheets were due to the Business Administrator/Treasurer's lack of supervisory oversight and review. We found that the Business Administrator/Treasurer approved the account clerk's⁴ timesheets one or more days after the pay date. For example, we found that 10 of the account clerk's timesheets for the pay periods September 15, 2006 through January 5, 2007, were all dated as having been signed by the Business Administrator/Treasurer on January 23, 2007. Because the Business Administrator/Treasurer does not adequately oversee and review timesheets, the District has an increased risk of under or overpaying employees.

Separation Payments

Any changes to pay or benefits, including separation payments, that are not part of a collective bargaining agreement or

³ Refer to the Segregation of Duties finding under the Cash Receipts and Disbursements section for further information.

⁴ The account clerk was one of the two business office employees whose timesheets we examined.

individual employee contract must be authorized by the Board. Also, this authorization must be documented in the minutes of the Board's proceedings. Without such authorization, the Business Administrator/Treasurer has no authority to execute any related payments.

We reviewed separation payments for eight former employees and found that the Superintendent directed the Business Administrator/Treasurer to pay \$10,876 to two former employees without authorization from the Board, as follows:

- A former network coordinator was paid \$7,021 in unauthorized compensation. At a Board meeting on November 14, 2006, the Board accepted the network coordinator's resignation effective December 31, 2006. Although the network coordinator had a settlement agreement that was signed by him and the Superintendent, we found no indication that the Board authorized the agreement. The agreement awarded him regular payroll payments from November 14 through December 31, 2006, despite his not working for the District after October 27, 2006.
- A former part-time grants administrator was paid \$3,855 in unauthorized compensation. On November 14, 2006, the Board accepted his resignation for retirement purposes effective November 3, 2006. However, the District continued to process regular payroll payments totaling \$3,855 for this employee through December 21, 2006, based on unused vacation leave that he had not accrued. The part-time grants administrator did not have any unused vacation leave from the prior year, and he was eligible to have earned only about three days of vacation leave before he retired.

New Hire Employees

The Superintendent is responsible for ensuring that complete and accurate personnel files are maintained for each employee and that all Board directives are implemented. It is important for the Business Administrator/Treasurer to ensure that employees are paid at the rates authorized by the Board by matching the salary rates indicated in the minutes of the Board's proceedings with the actual paychecks. Also, because the Superintendent is responsible for certifying the payroll, the Superintendent also is responsible for ensuring that employees are being paid at the correct rates.

We attempted to review the personnel files for 20 employees and found that District officials could not provide a personnel file for three of them. However, District officials were able to locate employment applications for these three employees, and their

employment and salaries were authorized in the minutes of the Board's proceedings. We also reviewed the salary schedules for these 20 employees and found that two employees had salaries that were a combined \$1,231 more than what the Board had authorized. District officials could not provide us with supporting documentation for these variances.

Without complete and accurate personnel files, proper authorization of timesheets and separation payments, and without adequate review and approval of payrolls, the District may make payments that are not authorized by the Board.

Recommendations

10. The Superintendent should certify payrolls.
11. The Business Administrator/Treasurer should routinely supervise the payroll process including, but not limited to, periodically reviewing timesheet tabulations and separation payment calculations.
12. District officials should ensure that functional managers pre-approve overtime hours for employees.
13. The Superintendent should ensure that personnel files are maintained for all District employees.
14. The Business Administrator/Treasurer should ensure that the payroll clerk processes payroll-related payments only with evidence of Board authorization.

Cash Receipts and Disbursements

District officials must establish, implement and periodically monitor controls to ensure that District assets are safeguarded and accounting records are complete, accurate, and up-to-date. An effective system of internal controls over the District's financial operations provides for the distribution of duties so that no one individual controls all phases of a transaction. In general, it is important that the transaction-approval function, the accounting function, and the asset custody function be separated. The proper division of responsibility requires independent oversight of the work performed by those involved in financial operations. To ensure adequate internal control over computer access, users must have access only to those computer functions needed to fulfill their job responsibilities. Regular reporting of the District's financial status helps the Board stay informed about the District's financial condition and allows the Board to ensure that expenditures remain within budgeted amounts.

Another important internal control over financial transactions includes the Business Administrator/Treasurer's control and supervision over the use of his signature disk. In addition, it is important for the Board to have adequate procedures in place to ensure tuition is collected for non-District students attending its schools. The lack of adequate procedures for tuition collection increases the risk that the District is not collecting the revenues to which it is entitled to help it offset the additional costs of educating non-District students.

We found that the District had not established internal controls within the Business Office to ensure that critical financial and payroll duties are segregated, and user access rights to the financial software were not adequately assigned. The Business Administrator/Treasurer was consistently two months late in providing his monthly reports to the Board, and he did not adequately supervise the use of his signature disk. We also found that nine non-resident students had outstanding tuition balances totaling \$8,918, and the Board was aware of this situation but took no documented action to enforce payment.

Segregation of Duties

Strong internal controls over financial transactions and payroll require that duties be adequately segregated so that no one individual has the ability to add, update, or delete employee information, process and distribute payroll payments, or control a transaction from beginning to end. In cases where there is a limited number of staff, duties must be separated to the extent possible, and other compensating controls put into place to reduce the risk that errors or irregularities

could occur and not be detected and corrected. Such compensating controls could consist of, among other things, documented reviews of activity by supervisory personnel not directly involved in that function.

There are four employees in the Business Office: the Business Administrator/Treasurer, a payroll clerk, account clerk, and a switchboard/account clerk. The Business Administrator also serves as the District's Treasurer, purchasing agent, and payroll supervisor. The account clerk performs substantially all aspects of disbursement transactions and has the opportunity to collect cash, while the switchboard/account clerk performs most cash collections and processes employee attendance cards and purchase transactions. The payroll clerk performs the regular day-to-day payroll processing and related personnel functions, such as tabulating timesheet data and entering new employees, pay rates, deductions, and timesheet data into the payroll system. The payroll clerk also is responsible for adding, updating, and deleting employee information, entering payroll changes, collecting timesheets, entering hours worked and salaries paid, and preparing, signing, and distributing payroll checks. The Business Administrator/Treasurer has the ability to receive, record, reconcile and report cash transactions for the District, without adequate compensating controls. When performed by one individual, these duties are incompatible.

When the District does not segregate critical financial and payroll duties involving recordkeeping, authorization and custody of funds, and adequately restrict employees' access to payroll records, there is increased risk that payroll records could be subject to unauthorized changes, staff could receive pay and benefits to which they are not entitled, and the District could make inappropriate payments. Also, because the Business Administrator/Treasurer performs bank reconciliations and is involved in the cash receipt and disbursement functions, this increases the risk that errors or irregularities could occur and not be detected in a timely manner.

User Access Rights

It is important that user access rights for the financial software applications be assigned to District personnel based on the requirements of their job responsibilities. Access controls prevent a user from being involved in multiple aspects of financial transactions. The financial software used in the District's Business Office has the capability for access rights to be set at different levels for each user. The payroll clerk, account clerk, and Business Administrator/Treasurer have system administration user access to the financial software that includes the payroll, purchasing, and budget reporting functions.

We found that three of the four Business Office employees had user access rights to the financial software in excess of what was required for their job responsibilities. This software did not have audit trail reporting capability.⁵ In addition, these three employees had the ability to change the access rights of other District users. Also, the Business Administrator/Treasurer was the only employee who had access to the financial software for the District's general ledger. This software also did not have audit trail reporting capability.

Failure to restrict access rights to accounting functions based on a person's job requirements can increase the risk of unauthorized changes to data or unauthorized changes in other employees' access rights. These control deficiencies expose the District to an increased risk that errors and irregularities could occur and go undetected.

Monthly Reports

It is important for the Business Administrator/Treasurer to provide the Board with monthly reports. These reports include a list of District bank accounts and they provide the Board with the information necessary to monitor District assets. It is also important for the Business Administrator/Treasurer to include a copy of the bank reconciliations with the monthly report. This allows District officials to compare reconciled bank balances to the general ledger cash account balances, which helps District officials to safeguard these assets by allowing them to detect errors or irregularities on a routine basis.

We reviewed the minutes of the Board's proceedings during our audit period and found that the Business Administrator/Treasurer was consistently two months late in providing his reports to the Board. For example, the June 2006 report that was due at the July 2006 Board meeting was provided to the Board in September 2006. In addition, we found that the Business Administrator/Treasurer did not list all of the District's bank accounts on his monthly reports. Of the District's 18 bank accounts, nine accounts (with balances aggregating \$548,000) were not listed on the Treasurer's monthly reports. The Business Administrator/Treasurer also did not include a copy of the bank reconciliations with his monthly reports. Therefore, the Board did not have adequate information to monitor all of the District's cash assets.

Check Signing

The Business Administrator/Treasurer plays a critical role in the cash disbursement process because this individual is responsible for signing checks and must ensure that his signature is not used to make payments that have not been authorized. Education Law requires

⁵ Audit trail reports document all user activity related to use of the financial accounting software.

that the Treasurer's actual or facsimile signature be affixed to District checks by the Treasurer or under the Treasurer's direct supervision.

The Business Administrator/Treasurer did not directly supervise the use of his facsimile signature⁶ and did not always review checks prior to distribution. The Business Administrator/Treasurer, along with the payroll clerk, the account clerk, and the switchboard operator/account clerk, all have access to and can print computer-generated checks or create manual (handwritten) checks. The Board had appointed an account clerk in the Business Office as the Deputy Treasurer. According to District policy, in the absence of the Business Administrator/Treasurer, and with the Superintendent's authorization, the Deputy Treasurer may affix the Business Administrator/Treasurer's signature to checks using the signature disk. However; all members of the Business Office told us that they had access to the signature disk and had printed checks and affixed the Business Administrator/Treasurer's signature to checks using the signature disk without the Business Administrator/Treasurer's supervision and without the Superintendent's authorization.

Because all of the Business Office employees were able to create and sign checks without supervision, we examined 25 manual checks to ensure that all payments were legitimate. Although we did not find any material exceptions, when employees can create and sign checks without appropriate supervision, it increases the District's risk that it may make inappropriate payments and that those payments may not be detected and corrected in a timely manner.

Tuition Receipts

The Board adopted policies for an out-of-district tuition program in which students who do not live within the District's boundaries may attend District schools. These non-resident students must have a contract that requires tuition payments, and the policy states that the children will not be allowed entry to the school if tuition is not paid. The Business Administrator/Treasurer is responsible for overseeing this activity, and the program is accounted for by an account clerk.

We reviewed the tuition payments for 47 non-resident students and found that nine students had outstanding balances totaling \$8,918 as of July 30, 2007. In addition, District officials could not provide us with the signed contract agreements for these nine students. The Business Administrator/Treasurer also told that it was very difficult for him to manage and enforce this activity. For example, on two occasions he had presented these delinquent payments to the Board, but the Board did not take action to enforce payment and these

⁶ The Business Administrator/Treasurer's facsimile signature was contained on a signature disk.

students were allowed to continue attending school without paying tuition.

Because the Board took no action to enforce payment of tuition, students who resided outside of the District were allowed to attend classes without contributing to the cost of providing those classes.

Recommendations

15. The Business Administrator/Treasurer should ensure that no one person can perform all aspects of the payroll process. In particular, the duties of payroll processing should be separate from entering new employee information, deleting employees, and updating salary and benefit levels in the financial software.
16. District officials should ensure that someone who is independent of the cash receipt and disbursement functions performs the District's bank reconciliations.
17. The Board should identify an employee who is independent of Business Office operations to be responsible for assigning user access rights to the financial software.
18. The Board should establish a policy to ensure that all user rights are properly approved and granted only to those who need them based on their job duties.
19. The Business Administrator/Treasurer should provide timely monthly reports to the Board that include the balances of all District funds.
20. The Business Administrator/Treasurer should maintain control of his signature disk or supervise its use.
21. The Board should support the Business Administrator/Treasurer's efforts to enforce the Board's policy regarding out-of-district tuition.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Mr. Paul J. DiFonzo
Superintendent of Schools

Mr. John A. Forbes
Business Administrator

Mr. Joseph P. Reyda
Interim Admin. for Grants Mgt.
& Prof. Development

Mrs. Amy S. Piper
CSE Chairperson

Fredonia Central School District
425 East Main Street • Fredonia, New York 14063 • Phone (716) 679-1581



Mr. James G. Detwiler
Lead Elementary Principal

Mrs. Danielle M. Grimm
Elementary Principal

Mr. Andrew T. Ludwig
Middle School Principal

Mr. Todd A. Crandall
High School Principal

Mrs. Paula J. Troutman
Interim Assistant High School
Principal

May 19, 2008

[REDACTED]
Office of the State Comptroller
295 Main Street Room 1050
Buffalo, NY 14203-2511

Dear [REDACTED]:

On behalf of the Fredonia Central School Board of Education and Administration, I would like to express my gratitude to the NYS Comptroller's staff for conducting a thorough review of the District's finances, specifically the internal controls over selected financial operations. We have taken all recommendations very seriously and have begun the implementation of changes to our internal control policies, as necessary.

As it relates to the specific findings of the New York State Office of the Comptroller (NYSOC) audit, the District would like to offer the following responses:

Recommendation No. 1

The claims auditor should report directly to the Board.

District Response to Recommendation No. 1

As a result of the NYSOC audit report, the District will require the claims auditor to issue a report quarterly to the Board of Education for its review.

Recommendation No. 2

The Board should provide the claims auditor with Board policies, a job description and other necessary guidance.

District Response to Recommendation No. 2

The current District Claims Auditor has tendered his resignation effective June 30, 2008. As a result, in part due to the recommendations of the NYSOC audit report, the District will be providing all future claims auditors with pertinent Board policies, job descriptions and other necessary guidance. The job description of the claims auditor will be reviewed and modified as appropriate. In addition, the District is currently in the process of having all Board Policies reviewed by the Erie 1 BOCES Policy Review Service and will make changes to the District's fiscal policies, as appropriate.

"The Fredonia Central School District and community will maintain a continuing partnership to provide an educational environment for the children of the community which will insure that all children are valued, all children learn and all children possess the knowledge and attitudes needed to reach their full potential intellectually, personally, socially and productively".

| | | | | | |
|---------------------------------------|---------------------------------------|-----------------------------------------|-------------------------------------|-----------------------------------|---------------------------------------|
| Business Office Fax (716) 673-9449 | Wheelock School Fax (716) 672-4802 | Elementary School Fax (716) 679-9043 | Middle School Fax (716) 672-2686 | High School Fax (716) 672-8687 | District Office Fax (716) 679-1555 |
|---------------------------------------|---------------------------------------|-----------------------------------------|-------------------------------------|-----------------------------------|---------------------------------------|

Recommendation No. 3

The Business Administrator/Treasurer should pay only claims that the claims auditor has audited and approved, including those to be paid by manual checks.

District Response to Recommendation No. 3

The Business Administrator/Treasurer has already made adjustments to the scheduling of the release of checks from the Business Office to accommodate the review by the Claims Auditor. In addition, the duties of the Claims Auditor will be expanded to include review of all checks issued by the District.

Recommendation No. 4

The Board should seek to recover improperly paid health insurance premiums.

District Response to Recommendation No. 4

The separation agreements of the two former employees that mistakenly received the health insurance benefits were Board approved twelve years ago (1995). The Board members that approved these agreements and the administrators that worked on them are no longer with the District. There were no specific directives left by the former administration regarding the timetable of these benefits. The current Business Administrator/Treasurer, who was in a subordinate position at that time, was directed to pay these benefits as part of lifetime coverage for these past employees. He had no reason to question that directive.

The District acknowledges that mistaken payments for health insurance benefits for these two individuals have occurred for a number of years. Both former employees have met with the current administration of the District, have made initial payments toward the repayment of these benefits and have developed repayment plans. Both former employees have agreed to repay all monies owed to the District in full.

No past independent audit reports have brought this particular situation to our attention. We will discuss at the Board level an administrative procedure or policy for periodic review of separation agreements for future safeguards.

Recommendation No. 5

Administrators should establish procedures to clearly articulate responsibilities and assignments with regard to the management of health care for retirees.

District Response to Recommendation No. 5

The District will discuss at the Board level an administrative procedure or policy for periodic review of separation agreements for future safeguards regarding the management of health care and/or other benefits for retirees.

Recommendation No. 6

The Superintendent should ensure that the Business Administrator/Treasurer remits payroll withholdings and pays claims in a timely manner.

District Response to Recommendation No. 6

The District is an electronic filer of Federal and State withholding taxes. The District has begun processing the electronic filings as soon as the payroll information is finalized.

Recommendation No. 7

District officials should ensure that employees and Board members adhere to the District policy by having their travel pre-approved by the Superintendent.

District Response to Recommendation No. 7

The Superintendent and District Clerk have put procedures in place that will assure pre-approval of travel by Board members. In addition, the District is currently in the process of having all Board Policies reviewed by the Erie 1 BOCES Policy Review Service, and will make changes to the District travel policies and procedures, as appropriate.

Recommendation No. 8

Functional managers should review supporting documentation, including claim vouchers and applicable authorized contracts and agreements, before signing claim forms and approving them for payment.

District Response to Recommendation No. 8

The District had no on-going policy to have payments for such items as refunds of over-paid taxes or other non-expenditure items reviewed by the Claims Auditor. The District has already made that change, and will further review expansion of the duties of the Claims Auditor prior to the hiring process for this position.

Recommendation No. 9

District Officials should ensure that the claims auditor checks claims for a functional manager's signature before approving claims for payment.

District Response to Recommendation No. 9

The District will be reviewing the job description of the Claims Auditor and will make adjustments as needed to address this recommendation. The new/revised job description will be reviewed with all applicants as part of the hiring process.

Recommendation No. 10

The Superintendent should certify payrolls.

District Response to Recommendation No. 10

The need for the certification of payroll was brought to the attention of the District by the NYSOC auditor early in the audit fieldwork. It was addressed immediately by the Superintendent, who now is certifying each payroll.

Recommendation No. 11

The Business Administrator/Treasurer should routinely supervise the payroll process including, but not limited to, periodically reviewing timesheet tabulations and separation payment calculations.

District Response to Recommendation No. 11

The Business Administrator/Treasurer has already met with the Building Level Administrators to direct them to carefully check the calculation of hours on each timesheet prior to signing them. In addition, the Business Administrator/Treasurer has met with the staff of the Business Office regarding the tabulation of hours on timesheets, and will be reviewing each of those on a bi-weekly basis.

Recommendation No. 12

District Officials should ensure that functional managers pre-approve overtime hours for employees.

District Response to Recommendation No. 12

The District will discuss at the Board level the need for modification of the contract language that addresses pre-approval of overtime hours for employees.

Recommendation No. 13

The Superintendent should ensure that personnel files are maintained for all District employees.

District Response to Recommendation No. 13

The District Office maintains personnel files for each District employee. The employees who the auditor found not to have complete personnel files were temporary/seasonal and/or long-term substitute employees. The District is in possession of employment applications for these three employees and these were given to the auditor. However, the auditor was not satisfied with just the applications in lieu of formal personnel files. The District will insure that the employment applications, fingerprint clearance records and other pertinent information for all temporary and substitute employees are filed together in the future.

Recommendation No. 14

The Business Administrator/Treasurer should ensure that the payroll clerk processes payroll-related payments only with the evidence of Board authorization.

District Response to Recommendation No. 14

The Superintendent directed the Business Administrator/Treasurer to make payments to two former employees who had their resignations officially approved by the Board of Education. Due to the sensitivity of these two resignations (personnel issues), discussion was held in executive session regarding the specifics of each separation agreement. The Board members at that time were fully aware of the separation agreements for these two employees, including the benefits to be paid. The Board of Education should have approved each separation agreement independently, along with the resolution accepting each employee's resignation. Four of the current Board of Education members were on the Board at the time these resignations were approved and were aware of the details of the separation agreements for these employees. Pending legal advice, they will consider passing a retroactive resolution to officially approve these two separation agreements at a future Board meeting. This issue had not been mentioned in past independent audit reports as a potential concern.

Recommendation No. 15

The Business Administrator/Treasurer should ensure that no one person can perform all aspects of the payroll process. In particular, the duties of payroll processing should be separate from entering new employee information, deleting employees, and updating salary and benefit levels in the financial software.

District Response to Recommendation No. 15

Due to the small number of staff within the Business Office, in some cases the segregation of duties cannot be maximized. However, the District is looking at several options to improve segregation of duties including: joining a consortium of local districts looking at the creation of a Central Business Office; changing the district software from ██████████ to ██████████; and extra review of any payroll changes by the Business Administrator/Treasurer.

Recommendation No. 16

District officials should ensure that someone who is independent of the cash receipt and disbursement functions performs the District's bank reconciliations.

District Response to Recommendation No. 16

The District shifted the processing of the bank reconciliations to an account clerk within the Business Office as a result of a concern expressed by an external auditor. As part of that change, the account clerk is also signing off each reconciliation as well as the Business Administrator/Treasurer. The Business Administrator/Treasurer is currently doing the reconciliations without the account clerk present once a year as a double check. In addition, as a result of the NYSOC audit, the Board has now requested to see copies of the bank reconciliations on a monthly basis, and the Superintendent is getting a copy of the monthly balance sheets and reconciliations for review.

Recommendation No. 17

The Board should identify an employee who is independent of Business Office operations to be responsible for assigning user access rights to financial software.

District Response to Recommendation No. 17

The assignment of access rights is currently the responsibility of the Business Administrator/Treasurer. As a result of the NYSOC audit, the District will shift this responsibility to someone outside of the Business Office.

Recommendation No. 18

The Board should establish a policy to ensure that all user rights are properly approved and granted only to those who need them based in their job duties.

District Response to Recommendation No. 18

The Business Administrator/Treasurer has reviewed the current access to the financial software. An account clerk currently has update capabilities for payroll, but functions as the "emergency" back-up payroll clerk. A previous external audit had suggested the need for a back-up payroll clerk. In addition, the Business Administrator also has update capabilities as part of his overseeing the Business Office operation. While the District understands the concern of the state auditor, the District will maintain its present procedures regarding these assignments based on the external auditor's recommendations and until an alternative procedure is possible.

Recommendation No. 19

The Business Administrator/Treasurer should provide timely monthly reports to the Board that include the balances of all District funds.

District Response to Recommendation No. 19

As a result of comments made by the NYSOC auditor during the fieldwork, the Business Administrator/Treasurer has amended the monthly Treasurer's reports to include all funds. In addition, due to the age of the current financial software for General Ledger, the District cannot work in two separate fiscal years. At the end of the fiscal year, the books must be kept open until the conclusion of the external audit, in case any adjusting entries are required by the auditors. The Board is aware of this issue and procedure.

The Business Office is scheduled to change over to the [REDACTED] system in early 2009, which should alleviate this issue.

Recommendation No. 20

The Business Administrator/Treasurer should maintain control of his signature disk or supervise its use.

District Response to Recommendation No. 20

The signature disk is kept in a locked cabinet and the Business Administrator is notified by his staff when the disk is needed. The Business Office will maintain its present procedures regarding these assignments pending further review.

Recommendation No. 21

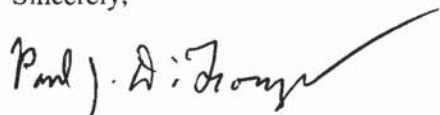
The Board should support the Business Administrator/Treasurer's efforts to enforce the Board's policy regarding out-of-district tuition.

District Response to Recommendation No. 21

The Board will be reviewing this matter with appropriate legal officials in regards to collection of delinquent balances. The District is currently in the process of having all Board Policies reviewed by the Erie 1 BOCES Policy Review Service, and will make changes to the District out of district tuition policy and procedures, as appropriate.

Overall, we appreciate the efforts of the NYSOC auditors. Completing the audit process will allow the Fredonia Central School District to make recommended changes to strengthen our fiscal operations.

Sincerely,



Paul J. DiFonzo
Superintendent

PJD:wlh

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

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

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

Within claims processing, we focused our attention on the approval of purchases and payments for various types of goods and services acquired. We interviewed officials, observed transactions and examined financial records such as vendor history reports, warrants, claims, District policies, Board of Education minutes and regulations, and conflict of interest representations to determine the effectiveness of internal controls and any effects of deficiencies in those controls.

For payroll and separation payments, we interviewed District officials, observed transactions and examined employee earnings records, contracts, payroll registers, Board of Education minutes, employee attendance records, personnel files, W-2 forms, and worksheets prepared by the payroll clerk and Business Administrator/Treasurer.

We examined cash receipts and disbursements documentation such as policies, job descriptions, Board of Education minutes and regulations, bank statements, warrants, cancelled and voided checks, journals, receipts books, and work papers of the Business Office. Additionally, we interviewed officials and observed transactions to determine the effectiveness of internal controls and any effects of deficiencies in those controls.

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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