



Hadley-Luzerne Central School District Internal Controls Over Extra-Classroom Activity Funds and Payroll

Report of Examination

Period Covered:

July 1, 2006 — January 31, 2008

2008M-113



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	3
INTRODUCTION	5
Background	5
Objective	5
Scope and Methodology	5
Comments of District Officials and Corrective Action	6
EXTRA-CLASSROOM ACTIVITY FUNDS	7
Recommendations	9
PAYROLL	10
APPENDIX A Response From District Officials	12
APPENDIX B Audit Methodology and Standards	15
APPENDIX C How to Obtain Additional Copies of the Report	17
APPENDIX D Local Regional Office Listing	18

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 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 Hadley-Luzerne Central School District, entitled Internal Controls Over Extra-Classroom Activity Funds and Payroll. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in and 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 Hadley-Luzerne Central School District (District) is located in the Towns of Day, Edinburg, Hadley, Lake Luzerne, Stony Creek, and Warrensburg in Warren and Saratoga Counties. The District is governed by the Board of Education (Board) which comprises five 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 three schools in operation within the District, with approximately 930 students and 250 employees, 186 of which are full time. The District's budgeted expenditures for the 2006-07 fiscal year were \$17.9 million, which were funded primarily with State aid, real property taxes, and grants.

The District's extra-classroom activity fund reported approximately \$227,900 in receipts and disbursements during the 2006-07 fiscal year. During the same year, the District's gross payroll was approximately \$8.4 million, which comprised approximately 47 percent of the District's annual expenditures.

The District's Business Office experienced significant changes in key personnel during our audit period. In June 2007, the District hired a new Business Manager and added a Treasurer's position to create better internal controls within the Business Office.¹

Objective

The objective of our audit was to determine if the District had established effective internal controls over extra-classroom activity funds and payroll. Our audit addressed the following related questions:

- Are internal controls over extra-classroom activity funds adequate?
- Are internal controls over payroll appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

We examined extra-classroom activity funds and the payroll function of the District for the period July 1, 2006 to January 31, 2008.

¹ Refer to the Payroll section for further information.

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 have initiated, or 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*.

Extra-Classroom Activity Funds

Extra-classroom activity funds are raised through charges for, by, or in the name of organizations whose activities are conducted by students. Students raise and spend these funds to promote the general welfare, education, and morale of all students, and to finance the normal and appropriate extracurricular activities of the student body. The District's 46 accounts in the extra-classroom activity fund (activity fund) recorded more than \$319,000 in receipts and disbursements during the period July 1, 2006, to January 31, 2008, and had a combined cash balance of approximately \$55,000 as of January 31, 2008.

The Regulations of the Commissioner of Education (Regulations) require the Board to establish policies and procedures that describe the records that District personnel and students must maintain, and the duties and control procedures that they must follow for the safeguarding, accounting and auditing of all monies received and derived from extra-classroom activities. The Regulations require the Board to appoint a central treasurer who is responsible for the activity fund receipts and disbursements. The Board must also appoint a faculty advisor (advisor) to oversee each activity and to assign a student treasurer to maintain a ledger for each activity. Regulations also require the Board to appoint a faculty auditor to oversee management of the activity fund. Having these controls in place helps to ensure that activity fund monies are properly accounted for, and it minimizes the risk that errors or irregularities could occur and remain undetected.

The Board has established policies to govern the operations of the activity fund and has appointed a central treasurer to be responsible for receipts and disbursements. However, the Board appointed faculty advisors to oversee only 10 of the 46 activities. Further, the Board did not appoint a faculty auditor to oversee the management of the activity fund. As a result, neither the Board nor District officials could be assured that activity fund monies were being accounted for properly in compliance with the Regulations, and there was an increased risk that errors or irregularities could have occurred and gone undetected.

We requested the financial records of eight extra-classroom activity accounts and found that the advisors did not ensure that any records were maintained for six of the eight accounts. The records maintained for the remaining two accounts were inadequate. For example, the available records maintained for these two activity accounts lacked

detailed receipt and disbursement ledgers. District officials told us that all eight advisors relied on the central treasurer to maintain their ledgers.

District procedures require advisors to deposit monies received in the bank. Good business practices dictate that such deposits be made in a timely manner to reduce the risk that cash could be lost or misused. We attempted to review the deposit receipts for each activity account to determine if the advisors deposited monies in a timely manner. However, we could not perform this review because only one of the two advisors maintained bank deposit receipts, and neither advisor had records to show when the monies were received. Therefore, we could not determine whether deposits were made promptly to properly safeguard cash deposits.

During the 2006-07 school year, the advisor of one of the two activities that had financial records maintained documentation to support the composition² for each of her deposits. We reviewed 36 bank deposit receipts totaling \$16,968 to verify that the activity fund's receipt documentation matched the receipts posted to the central treasurer's ledger and found that they did not agree. The central treasurer's ledger included eight additional posted receipts totaling \$4,343 that were missing from the advisor's deposit documentation. Our review later determined that these funds were accounted for. We were unable to review the second activity account's deposit composition because the advisor did not maintain records of bank deposit receipts.

Finally, we examined the central treasurer's ledgers and supporting documentation to verify whether checks and cash receipts contained proper approvals, were issued sequentially, and could be accounted for. We found that during our audit period, the central treasurer disbursed checks and maintained receipts in a proper sequential manner, and we could account for all checks disbursed and recorded receipts. We also reviewed 40 payments totaling \$40,502 that the central treasurer made from 19 activities funds accounts to determine if payments were appropriate and authorized by the faculty advisor and student treasurer, as required by District policy. All purchases appeared appropriate; however, 21 of the 40 payments lacked the student treasurer's signature to indicate that it was an approved activity purchase. We also reviewed 85 cash receipts posted by the central treasurer to her ledger during the audit period and found that the amounts of all 85 cash receipts agreed to corresponding bank deposits. However, we also found that 44 of the 62 deposits did not have the required signature of the student treasurer on deposit documentation.

² Amount of cash and the actual checks

The District's failure to comply with the Regulations and with its own policies governing controls over these funds increases the risk that errors and irregularities could occur and remain undetected and that activity fund monies could be lost or misused.

Recommendations

1. The Board and District officials should ensure that all District personnel maintain activity fund monies in accordance with District policy and the Regulations of the Commissioner.
2. The Board should appoint faculty advisors for all extra-classroom activities, and District officials should provide the faculty advisors with appropriate guidance on their duties.
3. Faculty advisors should assign a student treasurer to maintain a student ledger for each activity account that records all receipts and disbursements, and displays a running account balance.
4. The Board should appoint a faculty auditor to oversee the management of extra-classroom activity fund monies.
5. District officials should ensure that each faculty advisor sufficiently documents and deposits cash and checks collected for extra-classroom activities.
6. District officials should ensure that deposit and payment notification forms include the faculty advisor's and student treasurer's signatures.

Payroll

As with all school districts, payroll and fringe benefits represent a large portion of the District's annual budget. Internal controls over payroll consist of written policies and procedures that describe employee responsibilities in preparing and disbursing payroll, as well as written Board authorization for salaries, wages and fringe benefits. District-wide policies, collective bargaining agreements and/or individual employee contracts must stipulate each employee's entitlement to the accrual, use and payment of leave time. When employees leave District employment, it is important that payments for unused leave should occur only as authorized by the Board in policies, agreements or contracts, or by separate Board resolutions. Further, it is imperative that the District establish solid internal controls over the payroll process because of the significant costs involved to the District and taxpayers. When internal controls are not designed appropriately or operating effectively, there is an increased risk that fraud, abuse, or errors may go undetected and uncorrected.

We found that the District established appropriate internal controls over its payroll process for the 2007-08 fiscal year. The District hired a new Business Manager and added a Treasurer's position to segregate key duties and provide a stronger system of internal controls. District officials designed the oversight of the payroll process to decrease the risk that improper transactions could occur and go unnoticed. For example, the Treasurer is responsible for adding new employees to payroll, and the payroll clerk is responsible for processing payroll. The Treasurer or Business Manager regularly review payroll transactions and timesheets before the Superintendent reviews and certifies the payroll. Finally, the payroll clerk prints the checks, and the Treasurer signs the checks. The Treasurer performs timely bank reconciliations that the Business Manager subsequently reviews.

We found that the payroll process for the 2006-07 year was significantly different from the current process. During that period, the District had not segregated key duties over the payroll process and did not compensate this weakness with sufficient management oversight, which increased the risk that payroll errors could have occurred and gone undetected. Because of these weaknesses, we examined payroll records and related employment contracts for 24 employees during the audit period. We examined payrolls to determine if the employees' pay rates and health insurance deductions were appropriate, made in accordance with employment

contracts, calculated correctly, and agreed with each employee's annual income tax remittances (W-2 forms). We reviewed payroll records of nine newly hired employees to ensure that they were legitimate employees, and we reviewed payroll records of eight retirees/resignees to ensure that they were removed from the payroll. Additionally, we reviewed 20 employees' leave records to determine if time and accrual records were being maintained and were made in accordance with employees' contract provisions. We found no significant exceptions.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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EARL SUSSMAN

SUPERINTENDENT

July 29, 2008

[REDACTED]
Office of the State Comptroller
Glens Falls Regional Office
One Broad Street Plaza
Glens Falls, NY 12801-4396

[REDACTED]

This letter is in response to your *Internal Controls Over Extra-Classroom Activity Funds and Payroll Report of Examination*. The examination took place at the Hadley-Luzerne Central School District - Central Office, from December 2007 through March 2008. Please note that this narrative includes the steps taken for our corrective action plan regarding the Extra-Classroom Activity Funds.

We would like to commend your department for the professionalism and courtesy displayed by your staff. A stressful process was made less so thanks to [REDACTED]. Through this process, we have established a relationship with your office that will be beneficial to the district for many years to come. The expertise and assistance provided by your office is deeply appreciated, and will certainly be utilized in the future.

As noted in the report, the District has undergone significant personnel changes in the Business Office. When the audit began, our Business Manager had been in place for slightly less than six months. Through restructuring and re-assigning duties, the District Treasurer's position was created, while the part-time Tax Receiver's position was consolidated with the Accounts Payable Clerk/Secretary position. This restructuring has allowed the District to implement controls and segregation of duties to enhance accountability. Starting this month, the District Treasurer is now a full-time position, allowing for continued enhancements in control procedures and accountability. The Hadley-Luzerne Central School District is committed to safeguarding the assets of the District, ensuring complete compliance with state and federal regulations, and maximizing potential, while providing an excellent educational opportunity for all students.

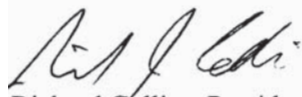
The Central Office staff has been working diligently to improve all aspects of the financial operations of the District. The initial focus was on major risk areas, such as tax receipts, payroll and disbursements. As those areas procedures were strengthened, other areas moved up the ladder. Extra-classroom Activities had not progressed very far up the ladder prior to your visit. Since your visit, we are pleased to report that this area has been and is continuing to receive the attention and scrutiny it deserves. Once Administration was aware of the lack of a student signature, that deficiency was immediately rectified. Policy/procedure manuals have been distributed to all advisors. Prior to the beginning of the school year, we will provide mandatory training for all advisors, and will not allow clubs to operate without Board appointed advisors. All clubs will have student officers, including

Student Treasurers. Additionally, the Board of Education has appointed a Faculty Auditor to oversee the operations of the activities. With the assistance of the Faculty Auditor, we will enhance procedures to ensure the timely and accurate deposit of funds. We are confident that all recommendations will be fully implemented and active for the new school year.

Payroll was one of the first areas to be addressed after the change in personnel. The establishment of internal controls, especially utilizing segregation of duties, was a high priority. Current staff worked diligently to effect the changes, and the addition of the Treasurer position facilitated the process. We continue to look to improving our procedures and controls, and will continue to enhance security, control and compliance procedures whenever possible. We are pleased that even in the previous year (06/07) the audit revealed no significant exceptions, and feel it is a testament to the quality of the staff we have here at Hadley-Luzerne Central School.

We would like to extend our thanks to the staff of the Glens Falls Office, and express our appreciation for their professionalism and assistance. As noted before, the Hadley-Luzerne Central School District has now developed an additional resource to utilize with financial, accounting and legal questions.

Sincerely,



Richard Collins, President
Board of Education
Hadley-Luzerne Central School District

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 objectives and scope by selecting for audit those areas most at risk. We selected extra-classroom activity funds and payroll for further audit testing.

To accomplish the objectives of our audit, we performed the following procedures:

- We reviewed Board minutes for our audit period and all District policies, procedures and guidelines relating to extra-classroom activities and payroll processing.
- For extra-classroom activities, we reviewed financial documentation kept by two activity clubs, which represented records kept by three faculty advisors. We interviewed the central treasurer, and reviewed the central treasurer's ledger, cash receipt and disbursement documentation, bank statements, bank reconciliations, and bank-processed deposit slips to determine the effectiveness of internal controls over extra-classroom activity fund functions and any associated effects of deficiencies in those controls.
- We interviewed pertinent District officials and employees involved in the payroll process.
- We reviewed collective bargaining agreements, employment contracts, appointment and resignation letters, and Board resolutions to verify employee salary and fringe benefit compensation, and dates of employment.
- We examined employee leave accruals and payroll records for accuracy and appropriateness by comparing employment contract salary, leave and health insurance benefit information to payroll registers, leave time records, timesheets, bank statements, employee earnings reports, cleared checks, direct deposit transaction reports, and W-2s.

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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