



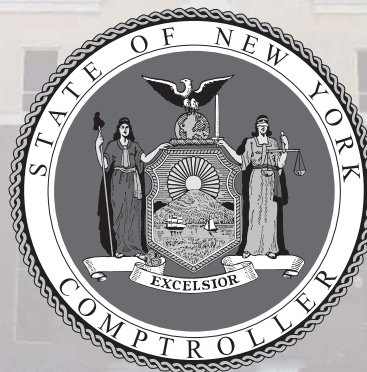
# Herkimer Central School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — November 30, 2007

2008M-38



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

May 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 Herkimer 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

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# EXECUTIVE SUMMARY

The Herkimer 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 District processes payroll and cash disbursements through the Business Office, primarily by the payroll clerk and Treasurer, respectively. The Business Manager is responsible for reconciliations, wire transfers, and journal entries, and is significantly involved in the business transactions of the District. The Board has also appointed a claims auditor to review all claims presented for payment. For the fiscal year ending June 30, 2007, District payroll disbursements totaled \$7.3 million and cash disbursements totaled about \$16.9 million. The District processes these transactions on a computerized financial system.

### **Scope and Objective**

The objective of our audit was to determine if the District's internal controls over selected financial operations are appropriately designed and operating effectively for the period July 1, 2006 to November 30, 2007. Our audit addressed the following related questions:

- Do internal controls over the computerized financial system, cash disbursements and payroll provide for segregation of duties to adequately safeguard District assets?
- Is the District's claims audit function appropriately designed and operating effectively to adequately safeguard District assets?

### **Audit Results**

We found that controls over the computerized financial system, cash disbursements and payroll were not designed appropriately. For example, computer access rights were not appropriately assigned, and the Treasurer's duties were not properly segregated. In addition, the payroll clerk had full access rights to the payroll system, including preparing and processing the payroll and the ability to create, delete or change employee records. District officials had not established compensating controls to mitigate the risk of having employees perform conflicting financial duties. Based on the lack of good internal controls, we examined cash disbursements, payroll, and computer-access rights. Although our audit testing did not identify any material exceptions in these areas, District officials should correct such control deficiencies to reduce the risk of future errors or inappropriate payments.

The Board had not developed defined claims audit procedures to ensure that the claims auditor reviews all claims thoroughly before the claims approved for payment. The claims auditor is not provided the original check or supporting documentation to ensure claims are authorized, legitimate District costs. We also found that the claims auditor reviewed and approved some claims after they were paid. Our tests of 100 cash disbursements did not identify material exceptions. However, District officials should strengthen controls over claims audit to ensure the District pays for only legitimate District costs.

### **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 agreed with our findings and recommendations and plan to initiate corrective action.

# Introduction

## Background

The Herkimer Central School District (District) is located in the Town of Herkimer, 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 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 1,230 students and 113 employees. The District's budgeted expenditures for the 2007-08 fiscal year are \$17.2 million, which are funded primarily with State aid, real property taxes, and grants.

The District processes payroll and cash disbursements through the Business office, primarily by the payroll clerk and Treasurer, respectively. The Business Manager is responsible for reconciliations and is significantly involved in the business transactions of the District. The Board has also appointed a claims auditor to review all claims presented for payment. For the fiscal year ending June 30, 2007, payroll disbursements totaled \$7.3 million and cash disbursements totaled about \$16.9 million. The District processes these transactions on a computerized financial system.

## Objective

The objective of our audit was to determine if the District's internal controls over selected financial operations are appropriately designed and operating effectively. Our audit addressed the following related questions:

- Do internal controls over the computerized financial system, cash disbursements and payroll provide for segregation of duties to adequately safeguard District assets?
- Is the District's claims audit function appropriately designed and operating effectively to adequately safeguard District assets?

## Scope and Methodology

We examined the District's internal controls over the computerized financial system, cash disbursement, payroll processing and claims audit for the period July 1, 2006 to November 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 agreed with our findings and recommendations and 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*.

## Internal Controls Over Selected Financial Operations

One of the Board's managerial responsibilities is the establishment of a system of internal controls that provides reasonable assurance that District assets are properly safeguarded; accounting transactions are authorized, recorded and reported properly; pertinent laws and regulations are complied with; work performed is monitored and reviewed routinely; and operations are efficient and effective. A key tenet of an effective system of internal controls requires segregating financial duties so that no single individual controls all phases of a transaction, or establishing compensating controls. However, we found that a number of District personnel do have conflicting duties, and that the associated risk is not mitigated by management review or other control measures. During part of our audit period, the Business Manager had both administrative rights to the financial system and the ability to process payroll and accounts payable transactions; the Treasurer recorded disbursements, performed wire transfers and prepared journal entries; and the payroll clerk performed all aspects of the payroll process without oversight. While our tests of transactions did not identify any inappropriate payments, District officials should segregate financial duties or establish compensating controls, such as administrative review processes, to reduce the risk that future errors or irregularities could occur and not be detected. The District has already acted to correct a number of these control deficiencies.

### **Computerized Financial System Access**

The computerized financial system should allow users only those access levels they need based on job descriptions and responsibilities. Having access controls in place prevents users from being involved in multiple aspects of financial transactions. A system administrator has the ability to add new users as well as change users' rights. With this ability, administrators are able to control and use all aspects of the software. A good system of controls would segregate the duties of administering access to the computerized financial system from the business office function to reduce the risk that District financial information or resources could be misused.

During a portion of the audit scope period, the Business Manager had administrative access rights to the computerized financial system. The Business Manager also had the ability to process accounts payable and payroll, oversaw day-to-day Business office operations, and was significantly involved in District financial transactions. These duties are incompatible when performed by the same person.

Based on this control weakness, we examined all payments to the Business Manager and other key District officials, including payrolls,

direct payments and personal reimbursements, to determine whether all amounts were properly approved and authorized. We did not note any exceptions or irregularities. During the audit scope period, District officials changed the Business Manager's access rights and appointed a system administrator who is external to Business Office operations.

## Cash Disbursements

Proper segregation of duties should require that the work of one employee be independently checked by another District staff in the course of that staff's regular duties. Although optimal segregation of duties may not always be possible, at a minimum, the duties and abilities of recordkeeping, reconciling bank accounts and making disbursements should be separated. However, the Treasurer is responsible for recording disbursements, performing wire transfers and preparing journal entries without adequate compensating control, such as administrative review by someone outside the Business Office. The performance of all these duties by one person without compensating controls is a significant control weakness.

Because of the Treasurer's conflicting duties, we examined a sample of 100 disbursements totaling \$169,000 for the period July 2006 to November 2007<sup>1</sup> to verify that disbursements were properly authorized and appropriate and that District expenditures were accounted for properly. Further, we reviewed selected wire transfers and journal entries to determine the frequency and appropriateness of the transactions.<sup>2</sup> Our audit testing did not identify any material exceptions. However, unless District officials segregate the Treasurer's duties or provide for compensating controls, the District will be at increased risk of having errors or inappropriate payments occur without detection and timely correction.

## Payroll

The primary objective for internal controls over payroll processing is to ensure that employees are paid the compensation and benefits to which they are duly entitled. Specifically, strong internal controls require that one person not have the ability to authorize, execute and record a transaction or control an entire processing cycle. We found that the payroll clerk could perform all aspects of the payroll process without any other employee's involvement or oversight. During the audit scope period, the payroll clerk was directly responsible for adding, deleting and changing employee information (including salary amounts), and preparing, processing, and maintaining payroll

<sup>1</sup> We judgmentally selected transactions that were deemed higher risk.

<sup>2</sup> We reviewed all wire transfers for the scope period that pertained to bank reconciliations we reviewed and determined that the majority of transfers related to payroll and bond principal and interest. Our review of journal entries determined that, although the Treasurer has the ability to make journal entries, she performs this function on a very limited basis.

records. An employee with these conflicting duties could add fictitious employees or make unauthorized changes to personnel and payroll records without detection. Although the duties of adding, deleting and changing employee information were assigned to the Superintendent's secretary during our field work testing, the payroll clerk still retained full access rights to the payroll system.

Based on the weaknesses, we judgmentally selected 20 employees who posed the greatest risk of being potentially fictitious (e.g., new hires, substitute teachers, staff with unique hire dates) and traced their existence to key supporting documentation in the personnel files. We also judgmentally selected 14 employees who received more than their stated salaries to verify that any additional payments made were consistent with either Board approved contracts or collective bargaining agreements. Despite the internal control weaknesses, our audit testing did not identify any material weaknesses over payroll disbursements. During our audit, District officials addressed this control risk by changing the access rights of the payroll clerk and the Superintendent's secretary to ensure their rights are consistent with their job duties.

## **Recommendations**

1. The Superintendent should continue to monitor computer access rights to District staff and monitor user access right designations to ensure that assigned rights are consistent with job duties.
2. District officials should segregate the duties of the Treasurer or implement sufficient compensating controls over her duties.
3. The Superintendent should continue to ensure that payroll duties are adequately segregated.

## Claims Audit Function

Education Law stipulates that all claims against the District, except for salaries of employees and other rare exceptions, shall not be paid unless an itemized voucher, approved by the officer initiating the claim, is presented to the Board, or to a claims auditor appointed by the Board, for audit and approval. The claims auditor must determine whether each claim is properly authorized and accurate, whether the purchase represents a valid District expense for goods or services, and whether the goods or services were actually received. Audited claims should be included on warrants certified by the claims auditor, and the Treasurer should not pay a claim unless the claims auditor has reviewed and certified the claim for payment. The Board should provide the claims auditor with procedures to follow to help ensure the individual has a clear understanding of his or her responsibilities in performing a competent audit of claims, and knows how to meet specific Board expectations.

We found that the District claims auditor does not properly review. For example, although the claims auditor reviews and approves claims twice per month, the warrants are printed only once per month. Thus, the claims auditor does not always have access to the warrant and supporting documentation when she reviews and approves claims. Further, the claims auditor reviews and approves some claims after they have been paid. When the claim has been paid, she receives only the check stub; she then compares the payee name and check amount to the voucher package. Reviewing claim documentation after the vendor is paid will not prevent the payment of inappropriate costs. We attribute the deficiencies in the District's claims audit function to the fact that the Board has not developed a defined set of procedures to follow to ensure that the claims audit process is consistent and thorough. This deficiency in controls over the audit, approval, and payment of claims increases the risk that improper or erroneous payments could occur and not be detected.

We reviewed claims associated with the 100 disbursements noted earlier in this report to assess whether the District's claim documentation provided sufficient evidence that transactions were processed in accordance with Board purchasing policies and internal control standards. Included in the 100 claims were all personal reimbursements to the Superintendent, Business Manager, and other Business Office staff. We found three claims totaling \$455 were paid by the Treasurer even though there was no evidence of the claims auditor's review and approval; 11 claims totaling \$20,479 were

included on unapproved warrants. We determined that these payments were for legitimate District costs.

Although our testing did not identify any material exceptions, District officials need to strengthen the claims audit function to obtain adequate assurance that the District is paying for only those claims that represent approved legitimate District costs.

**Recommendation**

4. The Board should develop claims audit procedures and monitor the claims auditor's performance to ensure these procedures are consistently followed. At minimum, the claims auditor should compare the actual check to voucher package and warrant during each claims audit process.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# HERKIMER CENTRAL SCHOOL DISTRICT

District Office  
801 West German Street  
Herkimer, New York 13350



CAROL A. ZYGO  
Superintendent of Schools  
315-866-2230, Ext. 1302  
FAX: 315-866-2234

April 17, 2008

Binghamton Regional Office  
Office of the State Comptroller  
NYS Office Building, Room 1702  
44 Hawley Street  
Binghamton, NY 13901-4417

Attn: [REDACTED]

Dear Sir:

This letter is in reply to the draft report regarding the internal controls over selected financial operations that you submitted to the District Audit Committee and the Board of Education on April 17, 2008.

The Board of Education and administrative staff are pleased that after the comprehensive and methodical process, the audit noted only four (4) matters of concern. The District does agree with your recommendations and wishes to thank you for your time and effort involved in this audit. By implementing your recommendations, the Board of Education will be improving the internal controls of the business office.

The following are the corrective actions that have been or will be taken to ensure compliance with the identified items and recommendations.

**Recommendation #1:**

*The Superintendent should continue to monitor computer access rights to District staff and monitor user access right designations to ensure that assigned rights are consistent with job duties.*

The Superintendent now approves the assignment of all user access. The District computer network coordinator is now responsible for the administrative rights controlling the Business Office software. Based on the direction of the Superintendent, the network coordinator issues the appropriate access rights to each Business Office staff member.

**Recommendation #2:**

*District officials should segregate the duties of the Treasurer or implement sufficient compensating controls over her duties.*

To segregate duties, the Treasurer now makes all bank deposits and the Business Manager records the receipt of those deposits in the General Ledger. All warrants are signed and approved by the Internal Claims auditor prior to disbursement of payments.

As a compensating control, copies of all bank statements are now attached to the monthly Treasurer's reports issued to the Board of Education.

**Recommendation #3:**

*The Superintendent should continue to ensure that payroll duties are adequately segregated.*

The Superintendent has made various changes to segregate the payroll duties. All new employees are now entered into the payroll system by the Deputy District Clerk at the time of approval by the Board of Education. The Deputy District Clerk now receives an approved check listing prior to the distribution of all payroll checks. The Business Manager calculates all contract salaries, and the Superintendent now approves all salary revisions prior to each payroll. The payroll process is continuously being reviewed to determine if additional functions can be assigned to other employees.

**Recommendation #4:**

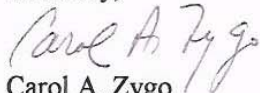
*The District should develop claims audit procedures and monitor the claims auditor's performance to ensure these procedures are consistently followed. At minimum, the claims auditor should compare the actual check to voucher package and warrant during each claims audit process.*

The claims auditor now receives all the actual checks, the voucher packet which includes the supporting invoice and purchase order documentation, a detailed check listing and the warrant for approval.

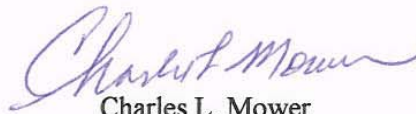
The Superintendent and Board of Education are also preparing a detailed procedure to be followed by the internal claims auditor. This detailed procedure will be completed by May 15, 2008.

Again, we would like to thank the State Comptroller's Office for assisting us in improving our financial systems. As a result of this audit process, we believe the Herkimer Central School District will operate more efficiently and effectively.

Sincerely,



Carol A. Zygo  
Superintendent of Schools



Charles L. Mower  
Business Manager

Pc: Herkimer Central School District Board of Education

## 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 the computer financial system, cash disbursements and claims audit process, and payroll for further audit testing.

We interviewed employees in the District's IT Department and the Business Office concerning the access rights to the computerized financial system. We reviewed user rights and permissions documentation and judgmentally selected users to determine if their user rights were appropriate.

When testing cash disbursements, we focused our testing on the claims audit function and segregation of duties. We judgmentally reviewed various claims for multiple procedures (authorization, reasonableness, compliance and data reliability). We focused on adherence to District policies and procedures, as well as pertinent laws and regulations pertinent to cash disbursements and claims processing. We examined the following records to determine the effectiveness of internal controls pertaining to the cash disbursements function and to identify any associated effect of deficiencies found in those controls:

- Warrants
- Transaction history reports
- Requisition orders
- Claims packets
- Cancelled checks
- Board minutes
- Bank Statements
- System Audit Logs

We examined the following records and reports in an effort to determine if the District had properly designed and implemented internal controls over payroll:

- Employee personnel files
- Collective bargaining agreements and individual employment contracts
- Leave time accrual records
- Payroll registers and employee earnings records generated from the software accounting system
- Salary notification letters
- Board of Education minutes

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.

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