



Highland Central School District

Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — October 18, 2007

2008M-136



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	2
EXECUTIVE SUMMARY	3
INTRODUCTION	5
Background	5
Objective	5
Scope and Methodology	5
Comments of District Officials and Corrective Action	6
PAYROLL PROCESSING	7
Policies and Procedures	7
Segregation of Duties	8
Timesheets	9
Payment Errors	10
Recommendations	12
PURCHASING AND CLAIMS PROCESSING	14
Purchasing	14
Claims Processing	15
Recommendations	16
REQUIRED TRAINING FOR BOARD MEMBERS	17
Recommendation	18
INFORMATION TECHNOLOGY	19
Recommendations	20
APPENDIX A Response From District Officials	22
APPENDIX B OSC Comment on the District’s Response	28
APPENDIX C Audit Methodology and Standards	29
APPENDIX D How to Obtain Additional Copies of the Report	31
APPENDIX E Local Regional Office Listing	32

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2008

Dear School District Officials:

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

Following is a report of our audit of the Highland 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 Highland 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.

There are three schools in operation within the District, with approximately 1,926 students and 330 employees. The District's budgeted expenditures for the 2007-08 fiscal year were \$33,260,777, which were funded primarily with State aid, real property taxes, and grants.

Scope and Objective

The objective of our audit was to review internal controls over selected financial operations for the period July 1, 2006 to October 18, 2007. Our audit addressed the following related questions:

- Are internal controls over payroll appropriately designed and operating effectively to protect District assets against fraud, abuse, and professional misconduct?
- Are internal controls over purchasing and claims processing appropriately designed and operating effectively to protect District assets against fraud, abuse, and professional misconduct?
- Have Board members complied with Education Law requirements for financial oversight training?
- Are internal controls over information technology appropriately designed to adequately safeguard District assets?

Audit Results

District officials need to improve internal controls over the payroll process, purchasing, claims processing, and information technology. The payroll function was not segregated, and a lack of sufficient oversight or other compensating controls allowed numerous overpayments, and some underpayments, to occur. The District did not have an adequate purchasing policy and the claims audit function was not adequately performed or supervised, resulting in the payment of deficient claims. Finally, the lack of sufficient controls places the District's information technology system and financial data at an increased risk of loss from unauthorized access or system failure.

District officials did not establish comprehensive payroll policies and procedures addressing key aspects of the payroll process, including the segregation of duties and controls over the payroll, timesheet approvals, separation payments, and longevity awards. Our testing of the final pay calculations for 31 former District employees found that, due to these control weaknesses, four of the employees were overpaid a total of \$9,572 for unused leave. We found other payment errors due to miscalculation, keying error, and the failure of District management to verify payments against proper time records, authorizations, and employment agreements. Thirteen of 19 employees tested for a four-week period received inaccurate payroll payments: one employee received a \$2,949 salary differential without fulfilling the applicable contractual requirements, 11 employees were overpaid by a total of \$1,656 due to calculation, data entry, and rounding errors, and one employee received a \$1,600 stipend that had not been approved by the Board.

District officials also have not established adequate internal controls over purchasing. The purchasing policy in place during the audit period did not address the specific thresholds for obtaining verbal quotes and written quotes for the procurement of goods and services under the legal thresholds. After we brought this to their attention, the District adopted a purchasing policy that includes criteria for obtaining quotes for items under the legal thresholds.

District officials also did not establish adequate internal controls over, or provide effective oversight of, the claims audit function. During our audit period, the claims auditor did not properly certify or sign claims warrants prior to payment. Of 25 claims we tested totaling approximately \$282,000, seven claims totaling over \$22,000 were either insufficiently documented or not audited before payment. These weaknesses placed the District at an increased risk of paying claims that are unauthorized, erroneous, or inappropriate.

In addition to not providing sufficient policy guidance and oversight of the payroll and claims audit functions, the Board has not fully complied with the law and the regulations of the New York State Education Department (SED) requiring training for board members on their financial oversight responsibilities. Five Board members who were required to obtain such training did not do so, therefore increasing the risk of not being able to properly fulfill their financial oversight, accountability, and fiduciary responsibilities to the District. We will refer this matter to the State Education Department for review.

Finally, internal controls over information technology (IT) are not appropriately designed to adequately safeguard District assets. District officials did not properly restrict users' access to financial data, develop a formal disaster recovery plan, or ensure that backup data was adequately safeguarded. As a result, the District's IT system and electronic data are at an increased risk of loss from unauthorized access or system failure, and the District could incur costly disruptions to its business operations.

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 they plan to initiate corrective action. Our comment concerning the District officials' response can be found in Appendix B.

Introduction

Background

The Highland Central School District (District) is located in the Town of Lloyd, Ulster 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 three schools in operation within the District, with approximately 1,926 students and 330 employees. The District's budgeted expenditures for the 2007-08 fiscal year were \$33,260,777, which were funded primarily with State aid, real property taxes, and grants.

Objective

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

- Are internal controls over payroll appropriately designed and operating effectively to protect District assets against fraud, abuse, and professional misconduct?
- Are internal controls over purchasing and claims processing appropriately designed and operating effectively to protect District assets against fraud, abuse, and professional misconduct?
- Have Board members complied with Education Law requirements for financial oversight training?
- Are internal controls over information technology appropriately designed to adequately safeguard District assets?

Scope and Methodology

We examined the District's payroll, purchasing, claims processing, and information technology operations, as well as Board members' compliance with training requirements, for the period July 1, 2006 to October 18, 2007.

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

**Comments of District
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they plan to initiate corrective action. Our comment concerning the District officials' response can be found in Appendix B.

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, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Payroll Processing

Salaries and wages, overtime, and employee benefit costs comprise a significant portion of the District's budget. Therefore, District officials must establish appropriate controls, including policies and procedures, to prevent and detect errors and irregularities in the District's payroll function. Key components of such controls include the proper segregation of duties and effective management oversight of payroll operations. Sound internal controls also include employment agreements that define conditions and benefits such as hours to be worked, rates of compensation, amounts and method of calculating leave time, and eligibility for health insurance and other fringe benefits, including longevity awards and post-employment benefits.

The District has established employment terms, including pay rates, separation payments, and longevity awards, through various individual employment contracts and through collective bargaining agreements with the Highland Teachers Association (HTA), Highland Essential Personnel Association (HELPA), and Highland Administrators Association (HAA). The Board designated the Superintendent to certify the payroll.

We found that District officials did not establish adequate controls over payroll. The District does not have a comprehensive payroll policy supported by written procedures, and District officials did not ensure a segregation of duties within the Payroll Department. We found errors in payroll payments, timesheets, separation payments, and longevity awards. As a result, the District is at an increased risk of not granting the proper benefits to its employees in compliance with policies and agreements, or of granting benefits the Board did not intend to provide.

Policies and Procedures

Effective internal controls over payroll processing include written policies and procedures to help ensure that the payroll is processed consistently, accurately, and in accordance with applicable employment agreements and contracts. Such policies and procedures help employees understand the Board's objectives and provide them with guidance in carrying out their specific duties and responsibilities. District officials are responsible for establishing procedures that ensure an adequate segregation of duties so that no one individual can control multiple aspects of the payroll process. Payroll calculations should be certified by a designated individual who independently verifies the calculations. Any changes to routine payments require the Board's written authorization.

District officials have not established comprehensive payroll policies and procedures addressing key aspects of the payroll process, including the segregation of duties and appropriate controls over payroll payments, timesheet approvals, and the administration of separation payments and longevity awards. As a result, the District is at an increased risk that errors and irregularities in the payroll process could occur and go undetected and uncorrected.

Segregation of Duties

A strong system of internal controls includes adequate segregation of duties through a combination of organizational restrictions and automated controls over the computerized financial system. Proper segregation of payroll duties is an essential internal control that can be accomplished by assigning payroll functions so that no one employee performs key aspects of payroll such as adding new employees to the system, updating salary information, processing the payroll, and preparing the paychecks. Compensating controls are additional procedures that can limit the risks associated with inadequate segregation of duties. For example, someone independent of the payroll process can be designated to perform a review of the completed payrolls.

District officials did not establish policies and procedures over the payroll function to ensure a proper segregation of duties, and independent monitoring activities were not adequate as a compensating control. The payroll clerk could add and remove employees from the payroll system, keep attendance records, update employee information, input salary detail, and process the payroll, including the preparation of paychecks using the Treasurer's signature disk. Although the Superintendent certified each payroll, he did not provide an independent verification of its information and calculations – for example, by comparing the actual paychecks to the payroll register which lists all employees to be paid.

The lack of policies and procedures, managerial oversight, and effective compensating controls increases the potential opportunity for the payroll clerk to make unauthorized changes. For example, an employee's salary level could be modified to pay the employee more than the Board-authorized level. Because of this risk, we reviewed payments made to 19 employees over two biweekly (two-week) payrolls and compared these payments to District employment contracts and collective bargaining agreements. While we found nothing to indicate fraud, abuse, or professional misconduct, we found several pay rate errors which are detailed in this section. The lack of segregation of duties without adequate compensating controls puts the District at an increased risk of payroll errors or irregularities occurring without being detected and corrected in a timely manner.

Timesheets

Timesheets, a necessary control for accurate payroll processing, are used by individual employees to record the hours they work, including starting and ending times. Sound business practice requires employees to sign their timesheets to certify that the recorded time is correct and reflects the actual time worked on the job, and to submit the timesheets to their supervisors who must also attest to the timesheet's accuracy. Such certified and approved timesheets support payroll entries and may be consulted if errors occur in payroll processing. The absence of formal timekeeping procedures can leave the payroll system susceptible to errors, fraud, or abuse.

The District does not require that timesheets be submitted by all employees, but only by part-time employees, 10-month employees, and those 12-month employees claiming overtime. Various supervisors, such as the food service department heads and building principals, submit "absence reports" which are used to update attendance records and calculate payroll. We tested time records from two pay periods for 19 employees (both 10- and 12-month employees), nine of whom were required to submit a timesheet, and found the following discrepancies in four of the 18 timesheets tested:

- One employee was paid twice for the same 40 minutes worked (for regular time worked and for a kindergarten bus run at the same time).
- One employee was paid twice for the same 1.75 hours worked (for cafeteria time worked and a bus run at the same time). The timesheet also credited the employee with 2.75 hours worked when the supporting documentation showed only 1.75 hours.
- Two employees' timesheets contained information that contradicted other supporting documentation. We found overtime hours on one timesheet for a late bus run when the department daily update sheet indicated "no late bus," and hours submitted for a daily bus run that exceeded the allotted time for that run on the approved route description.

The lack of formal and consistent time reporting procedures for all employees, combined with insufficient management verification of reported time worked, allowed inaccurate timesheets to be processed. These control deficiencies place the District at a risk of payroll errors such as duplicate payments or payments for time not actually worked.

Payment Errors

All compensation and other benefits provided to District employees must be properly authorized. Written documentation of such authorization – by resolution, a policy document approved by the Board, or a negotiated agreement – is an important internal control that communicates the Board’s intent and provides a clear description of benefit terms. The Board is responsible for approving all contracts and agreements, along with any changes that the Board intends to implement, with such approval being part of the official record. For example, an employee stipend that is not in an original agreement must be authorized by Board resolution and this intent documented in the Board meeting minutes. In addition, reviewing payroll registers, certifying the payrolls, checking compensation against applicable agreements, and verifying all calculations are key controls for ensuring that employees are paid in accordance with their respective contracts or other authorizations.

Payroll Payments – Collective bargaining agreements, individual contracts, and memorandums of agreement serve to document authorized pay rates for the District’s employees. We found that, while the Superintendent certified the payrolls, he did not perform an independent verification of pay rates against applicable agreements or Board authorizations, or verify the calculations initially performed. We compared 37 payments issued to 19 employees over two biweekly payrolls against employment contracts and collective bargaining agreements, and found errors or questionable payments to 13 employees.

- Calculation errors, data entry errors, and rounding errors resulted in 11 employees being overpaid \$1,656.
- One employee was paid a \$1,600 stipend that was not approved by the Board.
- One employee was paid a \$2,949 salary differential without meeting contractual requirements for the differential.

The lack of procedures requiring the independent verification of authorized pay rates, payroll calculations, and compliance with applicable contract terms resulted in these errors occurring without detection and timely correction.

Separation Payments – Payments to which the District’s employees are entitled for accrued and unused personal, sick, and vacation leave time when they leave District service are outlined in the District’s employment contracts and collective bargaining agreements. However, the District’s internal controls over payments for unused leave time were not adequate. District managers did not provide

sufficient oversight to ensure that the employees who leave District service receive only the amounts of compensation to which they are entitled, and the District does not perform any independent verification of the separation payment calculations prior to the disbursement of the final paycheck.

We reviewed accrued leave and final pay calculations made to 31 employees reported as having separated from District service during the audit period. Four separation pay calculations, affecting three employees, exceeded employee contract or collective bargaining agreement provisions and resulted in overpayments to the three employees totaling \$9,572:

- Two employees were overpaid \$8,216 and \$883, respectively, for vacation leave that exceeded the maximum accrual allowed by contract. For example, the District paid one employee for 79 days of accrued vacation when the contract limits the amount of vacation days that can be accrued to 40.
- One employee was paid for unused vacation time at a higher rate than stated in the contract. While the memorandum of agreement between the employee and the Board stated the vacation buyout would be calculated on a 260-day basis, the actual calculation was on a 240-day basis, resulting in an overpayment of \$223. The employee was also incorrectly paid \$250 for the proration of health insurance buyback, when there was no provision for a health insurance buyback in the employee's contract.

The lack of policies and procedures, in combination with a lack of management oversight and approvals, allowed these errors to occur and go undetected and uncorrected.

Longevity Awards – Collective bargaining agreements often include provisions to reward employees' length of time worked with a longevity payment. The District contractually provides for cumulative longevity awards to be paid to its 15-year, 20-year, and 25-year employees in addition to their regular pay. During our audit period, the District had six employees who received 25-year longevity payments under the Highland Essential Personnel Association (HELPA) collective bargaining agreement.

Our testing of 19 employees (previously referenced under "Payroll Payments") included four employees who received 25-year longevity awards, one employee who received a 20-year longevity award, and one employee who received a 15-year longevity award. In the course of that testing we found longevity payment errors affecting the four

25-year employees tested as well as the other two 25-year employees covered by the HELPA agreement. A contractual provision for a 25-year longevity payment of \$3,350 was incorrectly entered as \$3,325, resulting in the six 25-year employees covered by the HELPA agreement being underpaid by a total of \$150. In addition, longevity awards were being added to base salary rates for employees covered under the HELPA agreement.¹ These payments increased base rates that were used in the calculation of overtime rates and for payment of additional hours to bus drivers: regular hourly rates for bus drivers receiving 20- and 25-year longevity awards were increased by \$2.88 and \$4.57, respectively, and the overtime hourly rates based on those increased regular rates were therefore increased by \$4.32 and \$6.86. When we brought this to the attention of District officials, they indicated they were not aware that the overtime rates were calculated in this manner. Although the HELPA agreement does not state that the longevity awards are to be added to the employees' regular pay rate, it does not specifically prohibit using that method in place of lump-sum payments. However, the resulting increases in overtime rates may not have been the Board's intent. Without clarification of the Board's intent and management verification of contractual longevity payments, the District is at an increased risk of errors that can result in the overpayment or underpayment of employees and the inappropriate expenditure of taxpayer moneys.

Recommendations

1. District officials should develop a comprehensive payroll policy that provides for an adequate segregation of duties, and written procedures to guide employees in their payroll processing responsibilities. At a minimum, the duties of payroll processing should be separated from entering or modifying employee information and updating salary levels in the computer system. If payroll duties cannot be sufficiently segregated, officials should implement compensating controls.
2. District officials should ensure that employees maintain time records in sufficient detail to support approved timesheets, and that supervisors verify the accuracy of time records before approving timesheets for payment.
3. District officials should implement procedures for the independent verification of payroll calculations and payments.
4. District officials should ensure that managers verify separation payments according to the appropriate employment agreements,

¹ There were 24 District employees eligible for longevity awards under the HELPA agreement, including the four 25-year employees whom we tested. Three of those four employees were bus drivers receiving overtime pay.

and that there is an independent verification of separation payment calculations before payments are made.

5. The Board should seek to clarify contract language to reflect Board intent concerning future longevity payments, specifying whether such payments are to be incorporated into employees' base pay rates for the purpose of calculating overtime pay.

Purchasing and Claims Processing

A good system of internal control over purchasing and claims processing includes policies and procedures to help ensure that an organization is using its resources effectively and complying with applicable laws and regulations. District officials are responsible for designing internal controls that help safeguard District assets, ensure the prudent and economical use of District moneys when procuring goods and services, and protect against favoritism, extravagance, and fraud. A documented procurement process provides guidance to District personnel in obtaining goods and services of the desired quality at the lowest prices. It is also important that the District have appropriate claims processing procedures to ensure that District moneys are expended properly.

We found weaknesses in internal controls over purchasing and claims processing. The District's purchasing policy did not include criteria for District officials to follow when procuring goods and services not required by law to be made pursuant to competitive bid requirements. While claims were audited prior to payment, the claims auditor did not sign warrant certifications authorizing the Treasurer to pay the approved claims. Instead, the accounts payable clerk signed these monthly warrants. We also found deficiencies in certain claims we reviewed which indicated that the claims audit process does not function as intended. Therefore, there is an increased risk that payments could be made for claims that are not legitimate District expenses.

Purchasing

General Municipal Law (GML) and the District's procurement policy require that purchase and public works contracts be publicly advertised for bids and awarded to the lowest responsible bidder when they total \$10,000 and \$20,000 or more, respectively. For purchases below these thresholds, GML requires that the District adopt a policy to provide procedural guidance for obtaining goods and services. Sound business practices include the use of bids and quotes to encourage competition in the procurement of supplies, equipment, and services that will be paid for with public funds.

During our audit period, the District's procurement policies did not provide guidance on the use of written or verbal quotes for purchases that fall below the competitive bidding threshold. This is a significant weakness in internal controls because District staff did not have any clear guidance or criteria for seeking competitive prices for those purchases that fall below the competitive bidding threshold. After we brought this to their attention, the District adopted a purchasing

policy that includes criteria for obtaining quotes for items under the GML thresholds.

Claims Processing

The audit and approval of claims is a critical element of a District's internal control system over non-payroll cash disbursements. Education Law requires school boards to audit claims before they are paid, or to appoint a claims auditor to assume the Board's powers and duties to approve or disapprove claims. A thorough claims audit function determines whether each claim is properly authorized, accurate, and in compliance with contractual agreements and Board policies; whether it represents a valid District expense; whether it contains all necessary supporting documentation; and whether the goods or services were actually received. In addition, Education Law prohibits district treasurers from paying claims without written authorization from either the Clerk of the Board (District Clerk) or the appointed claims auditor. A certified warrant (list of claims) with an attestation that the listed claims have been audited and approved for payment documents this authorization.

We found weaknesses in the District's internal controls over claims processing. The claims auditor did not certify warrants prior to disbursement checks being released; further, because the warrants were signed by the accounts payable clerk instead of the claims auditor as required, they were paid without proper authorization. We reviewed 25 claims packages totaling \$281,781 and found the following discrepancies:

- Four claims packages totaling \$10,504 did not have evidence of the department head's prior approval of the purchase. These claims were for computer equipment, textbooks, and uniforms.
- Three checks totaling \$11,998 for maintenance, chemicals, and athletic supplies were disbursed for claims prior to their review by the claims auditor.
- One claims package was missing a receiving signature for a fuel delivery.

As a result of these weaknesses in the claims auditing process, the District is at an increased risk of making payments for unauthorized purchases, making inaccurate payments, or paying for goods or services it does not actually receive.

After we brought these control weaknesses to the attention of District officials, the claims auditor commenced signing a warrant for each group of audited claims.

Recommendations

6. District officials should follow the provisions of its recently-adopted purchasing policy and obtain the required quotes for the purchase of goods and services.
7. The claims auditor should audit all claims and certify the warrants. The proper audit of claims should ensure that each claims package contains complete and accurate documentation before the claim is approved for payment.
8. The Treasurer should not release disbursement checks until they are authorized by a properly certified warrant signed by the claims auditor.

Required Training for Board Members

School board members are responsible for setting a “tone at the top” that, by example, reflects their commitment to upholding the public trust. This demeanor is the foundation of an internal control environment based on standards and rules that all District staff, as well as Board members, are expected to follow in safeguarding District resources. The Board has an essential responsibility to establish policies and oversee District procedures and practices to ensure that District moneys are expended prudently and in the best interest of the taxpayers.

In 2005, the State Legislature enacted legislation to improve school district fiscal accountability. One of the requirements of this legislation is that each voting member of a school district’s Board who was elected or appointed on or after July 1, 2005 must, within the first year of his or her term, complete a minimum of six hours of training on the financial oversight, accountability, and fiduciary responsibilities of school board members. The law requires the New York State Education Department (SED) to approve the curriculum for meeting this requirement, in consultation with the Comptroller’s Office and training providers. Upon completion of the course, the Board member must file a certificate of completion with the District Clerk. This training is intended to help Board members establish stronger internal controls, improve school district audits, and strengthen their roles in providing appropriate oversight.

Five of nine² Board members serving during our audit period were required to have training on their financial oversight, accountability, and fiduciary responsibilities but chose not to receive the training. Two members indicated the training offered was not convenient, and did not believe it was necessary for them to attend. However, given the lack of Board oversight that we found during this audit, the failure of Board members to attend the required training affects key aspects of the District’s payroll and claims audit processes.

The Board members’ decision to not comply with the law and obtain the training could therefore result in their failure to properly fulfill all of their financial oversight, accountability, and fiduciary responsibilities. Further, the Board members’ lack of commitment to improving their governance skills sets the wrong “tone at the top” which could influence employee attitudes toward rules and regulations that are designed to safeguard District resources and

² Two Board members had completed the required training, two other Board members have left, and the requirement remains for five.

taxpayer moneys. Accordingly, we will refer this matter to the SED for its review.

Recommendation

9. All Board members should receive the required six hours of training on their financial oversight, accountability, and fiduciary responsibilities as soon as possible after they are elected to their Board positions. The five Board members who did not receive this training should attend the next available training.

Information Technology

The District relies on an information technology (IT) system for providing computer education, access to the Internet, email communication, storing student data, maintaining financial records, and reporting to State and Federal agencies. Therefore, the IT system and the data it holds are a valuable District resource. If the IT system fails, or is damaged or destroyed, the problems that could result range from inconvenient to severe. Even small disruptions in electronic data systems can require extensive time and effort to evaluate and repair.

An effective system of internal controls to safeguard computerized data includes policies and procedures to protect vital computer equipment, software, and data, and to provide guidance to District personnel in restoring lost data and resuming operations in the event of a disaster. These essential controls must limit unauthorized access to data, include a disaster recovery plan, and provide for routine backups and secure, off-site storage of computer data so that District personnel can efficiently restore any lost data and resume critical operations with a minimum amount of liability or lost productivity.

We found weaknesses in the District's controls over user access rights, disaster recover planning, and data backup procedures which increase the risk that unauthorized users can access District data or that potentially costly disruptions to the District's business operations will occur and result in system failure or data loss.

Access Rights – It is important for the District to restrict users' access to computer operations to only those functions that are required for individuals to perform their jobs. In addition, user access must be granted to individuals in a manner that maintains a proper segregation of duties.

We found that District officials had not developed policies and procedures requiring users' access rights to be reviewed on a regular basis and have not ensured that users' access rights were appropriately restricted to only those modules required for their job duties. Six employees (the accounts payable clerk, the Treasurer, the secretary to the Assistant Superintendent, the Business Office secretary, the Business Manager, and the payroll supervisor) had the ability to print disbursement checks, a function that should be limited to accounts payable employees only. In addition, the Business Manager had access rights to all modules of the computerized financial system and full editing rights, giving him the ability to initiate and complete all aspects of a transaction. By allowing access beyond that which

is necessary for employees' assigned duties, the District has an increased risk that inappropriate payments could be initiated and remain undetected and uncorrected.

Disaster Recovery – A disaster recovery plan is intended to identify and describe how the District plans to deal with potential disasters. Such disasters may include any sudden, catastrophic event (e.g., fire, computer virus, power outage, or inadvertent employee action) that compromises the integrity of the IT system and data. An effective plan includes precautions to minimize the effects of the disaster, including the routine backup of all critical data, and to enable the District to either maintain or quickly resume its critical functions. Typically, disaster recovery planning involves an analysis of threats to business processes and continuity needs. It may also include a significant focus on disaster prevention.

The District does not have a formal disaster recovery plan. Consequently, in the event of a disaster, District personnel have no guidelines or plan to follow to help minimize or prevent the loss of equipment and data, or guidance on how to implement data recovery and resume operations as efficiently as possible.

Data Backup – Sound business practices require that the District back up (make a duplicate copy of) the data stored on its computers and servers on a routine basis so that it can be restored in the event of loss. Backup data should be kept at a secure alternate location to protect it from loss in the event of a disaster at the server location site. It is also important that the District routinely test the backup data to ensure its integrity.

The District followed procedures to back up its data files, and stored the backup media in a fireproof safe on District premises. However, even though the backup tapes are in a fireproof safe, storing them on-site still subjects them to many of the same risks (disasters) as the original data and defeats the purpose of this control procedure. Further, the District does not have a formal process for testing the backup data by routinely restoring it to the system. As a result of these control deficiencies, the District's financial information and other critical data, such as student and human resource information, are at an increased risk of loss in the event of a disaster.

Recommendations

10. District officials should ensure that users' access rights to the computerized financial system are appropriately assigned and adequately segregated. The District should develop a policy regarding user access rights, and District officials should develop procedures for the routine review of access rights in relation to job responsibilities.

11. District officials should develop a formal disaster recovery plan that addresses the range of potential threats to the District's information technology system and includes the requirement for adequate backup of critical data. District officials should distribute the plan to all responsible parties, periodically test it, and update it as conditions change.
12. District officials should ensure that backup copies of data are stored at a secure off-site location, and that the backup data is periodically tested to verify its integrity.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

HIGHLAND CENTRAL SCHOOL DISTRICT

BELIEVE AND ACHIEVE

John McCarthy, Superintendent

William Toussaint, Assistant Superintendent

September 29, 2008

[REDACTED]
Office of the State Comptroller
22 Computer Drive West
Albany, New York 12205

Dear [REDACTED]

This letter is in response to the "Draft" Report of Examination of the Highland Central School District's Internal Controls Over Selected Financial Operations. As was discussed in the exit conference held on Friday, September 12, 2008 and prior to the State's Auditing Teams' departure, some items identified as concerns were addressed. Many of the areas cited in this report have either already been addressed or are in the process of being addressed.

District's Response Summary:

- While the Audit has identified some areas in need of improvement, no indication of fraud, abuse, or professional misconduct in the Highland Central School District was identified by the Auditors.
- Many of the areas identified as concerns in this report are in regard to unclear contract language. The District is currently in negotiations with the three collective bargaining units in the District. It is through the negotiation process that we intend to clear up language considered vague.
- The District has already taken measures to address the concerns identified with payroll policies and procedures. Steps have been taken to segregate duties within the Business Office, even with limited staffing and some responsibilities have been moved outside the Business Office.
- Procedures have been put in place to make sure that time sheets are accurately reported and verified by supervisors.
- As mentioned in the Audit report, the Board of Education adopted a more stringent Purchasing Policy during the time of the Audit review. All warrants are now signed by the Internal Auditor when checks are issued. Administrators are now following the bidding requirements outlined in the new Purchasing Policy.
- In reference to the Board of Education required training for Fiscal Responsibility, two current Board members have completed the mandated training. Four Board members are scheduled to take the mandated training in November and one Board member is scheduling another date for training.

- In reference to Information Technology concerns, the District currently uses the local BOCES to backup all of the District's electronic data. The District will write a formal Disaster Recovery Plan as recommended. In addition, the District is reviewing user access to Financial Data and will establish levels of access for employees based on their position in the District.

The four major areas covered in the Audit report (Payroll Processing, Purchasing and Claims Processing, Required Training for Board Members, and Information Technology) are addressed in more detail in the District's response below:

Payroll and Processing:

District Response to Recommendation 1:

Currently the District has addressed the issue of adequate segregation of duties by having someone other than the payroll supervisor entering in new and/or modifying new employees. The District is currently developing a Human Resource Matrix which will help delineate/define the roles and responsibilities as it relates to payroll processing.

District Response to Recommendation 2:

During the auditing process, District official were made aware of some issues surrounding the accuracy of timesheets and the need for improved verification by supervisors of the time sheets and records. Each supervisor has put in place additional sign in sheets for their employees to help verify timesheets.

Response to specific audit concerns in this area (Rec.2):

- *The three bullets on the top of page ten in the "Draft Report" are identified errors that should not reoccur with proper oversight and with the established additional checks and balances now in place.*

District Response to Recommendation 3:

The Superintendent has now been provided with additional information that allows for payroll comparisons on each employee. This information can help in the discovery of possible discrepancies or a deviance from previous pay periods. The Business Manager will be the person responsible for the independent verification of the payroll calculations and payments.

The Business Office currently uses [REDACTED] as the computerized operating system. Certain reports now generated in [REDACTED] will help identify potential errors in payments and can provide a history of transactions. Certain stipends are tied directly to salary adjustment based on contract language. The District is currently in negotiations which may help clarify the approval process for salary stipend adjustments. All other stipends that require additional work by the employee require Board approval.

Response to specific audit concerns in this area (Rec.3):

- *The first of three bullets on the bottom of page ten of the “Draft Report” should be addressed by the independent verification of payroll and the increase use of reports from [REDACTED]*
- *The second bullet on the bottom of page ten of the “Draft Report” was an Administrative oversight and should have been included in the agenda of the Re-organization meeting. The person paid for this stipend did the work required for payment.*
- *The third bullet on the bottom of page ten of the “Draft Report” involves the payment for work above the normal responsibilities of the employee. Back up information related to the salary differential/ stipend does exist, but was not reflected on the Board Agenda. In the future, such differentials will be clearly defined and included on Board Agendas.*

District Response to Recommendation 4:

The District will address their procedures for separation of employees in both contract language and administrative oversight.

Response to specific audit concerns in this area (Rec.4):

- *The first bullet on page 12 of the “Draft Report” addresses separation agreements two former employees, in the area of payment for accrued vacation days. In a good faith agreement with former District Administration and with the knowledge of the Board of Education, the first employee was paid for days above the contractual limit because he was not able to take vacation because he had to oversee the building renovation/ addition project. The District believes that the second employee identified was paid in accordance to a legal document separating the employee from the District.*
- *The second bullet on page 12 of the “Draft Report” occurred due to lack of consistency with the application of the denominator used to determine payment calculations. New clear contract language will address this issue in the future.*

See
Note 1
Page 28

District Response to Recommendation 5:

The Board is currently in contract negotiations and is hopeful that the new contract will include clear language as it relates to longevity payments and overtime rates.

Purchasing and Claims Processing:

District Response to Recommendation 6:

The District administration is now following the recently adopted Purchasing Policy.

District Response to Recommendation 7:

The District is currently developing a Purchasing Matrix based on the adopted Purchasing Policy and procedures. This matrix will require administrators to follow consistent steps and appropriate signatures.

Response to specific audit concerns in this area (Rec.7):

- *The District does not dispute the three bullets found on page 14 of the "Draft Report". The District wants to make it clear that all items purchased were budgeted for, approved by administration, and received by the District. The District is committed to implementing safeguards to make sure all purchases follow the District guidelines and procedures.*

District Response to Recommendation 8:

The District took immediate action to have the disbursement of checks released only after the claims auditor's authorization and signature. This action was implemented by the District during the audit process.

Required Training for Board Members:

District Response to Recommendation 9:

During the time period covered for this audit, some Board members were not required to have the Financial Oversight Training. While some members of the Board of Education did not receive the Financial Oversight Training, they did take their fiduciary responsibility very seriously. Some current Board members were not yet elected to the Board during the period covered in the audit.

Two members of the current Board of Education have received the required fiscal training. Four Board members are scheduled for Fiscal Oversight training in November 2008 and one Board member is scheduling another date for the training. In addition, the current Board of Education has held retreats to help clarify their roles and responsibilities.

Information Technology:

District Response to Recommendation 10:

The District is currently reviewing user access to Financial Data and will look to adopt a Policy on User Access to the Board of Education in the near future. Currently the District is looking to limit access rights of employees based on their job responsibilities.

District Response to Recommendation 11:

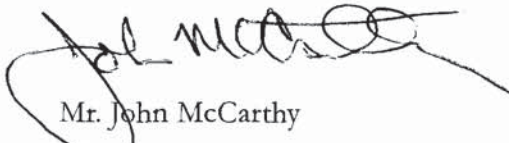
The District will develop a Disaster Recovery Plan and distribute the plan to all key employees. Once the plan is developed, it will be tested, evaluated, and revised accordingly.

District Response to Recommendation 12:

The District is currently utilizing the local BOCES to backup electronic data. Recently the District had an opportunity to test the backup plan in place. The District was able to recover all of the information that was lost. The District is continuing to explore additional ways to backup electronic data which will be incorporated in the Disaster Recovery Plan.

The Highland Central School District would like to thank the members of the State Auditing Team for their fair and comprehensive review of the District, which covered the period of July 1, 2006 through October 18, 2007. The Board of Education and District Officials take their roles and responsibilities very seriously. Together they are committed to addressing the concerns outlined in this report, with the intention of minimizing potential operating risks.

Dedicated to Excellence,



Mr. John McCarthy
Superintendent

cc: Board of Education
Mr. Matthew Metzger, Business Manager
Mr. William Toussaint, Assistant Superintendent

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APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

The separation overpayment for the second employee resulted from noncompliance with terms and conditions of employment relating to prior year vacation leave carryover, not the separation agreement.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

We examined the following records to determine the effectiveness of internal controls pertaining to payroll, claims processing, and information technology to identify any associated effect of deficiencies found in those controls. Additionally, we interviewed Board members to ascertain their compliance with legal requirements for obtaining training in the financial oversight, accountability, and fiduciary responsibilities of school board members.

In the payroll area, we interviewed appropriate District personnel, reviewed biweekly payroll transactions and employee separation and retirement payments, and compared those transactions and payments to approved contracts. We reviewed the following:

- Payroll registers and related documents for employees separating from the District from July 1, 2006 to October 18, 2007
- Payroll registers and related documents for biweekly payrolls of November 17, 2006 and May 18, 2007
- Contracts and collective bargaining agreements for the District with Highland Teachers Association (HTA), Highland Essential Personnel Association (HELPA), and Highland Administrators Association (HAA)

- Individual employment agreements for the Superintendent, Business Administrator, Treasurer, secretary to the Superintendent, and Directors of Buildings and Grounds, Transportation, and Athletics
- Transportation Department assignments, route listings, and daily update sheets
- Minutes of Board proceedings
- Policy manual
- Personnel files, including executed contracts.

For the purchasing area, we focused on adherence to District policies and procedures, as well as pertinent laws and regulations related to purchases. For claims processing, we examined the following records to determine the effectiveness of internal controls over the claims processing function and to identify any associated effect of deficiencies found in those controls:

- Vendor payment history reports
- Purchase orders
- Claim packages
- Warrants
- Policy manual
- Minutes of Board proceedings.

In the information technology area, we interviewed District officials and staff to obtain an understanding of internal controls over the District's computerized financial system, and reviewed reports of employees' access rights to the system in conjunction with their duties and responsibilities. We also inspected the facilities in which the District's IT equipment and storage media were located.

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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