



# Madrid-Waddington Central School District

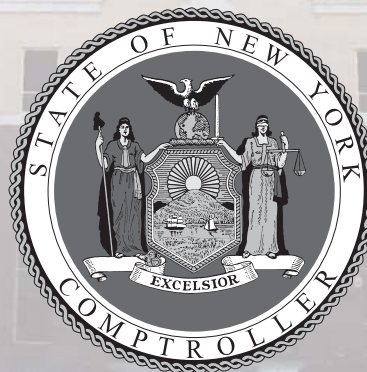
## Internal Controls Over Wire Transfers and Claims Audit

### Report of Examination

Period Covered:

July 1, 2005 — March 31, 2007

2007M-276



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**

January 2008

Dear School District Officials:

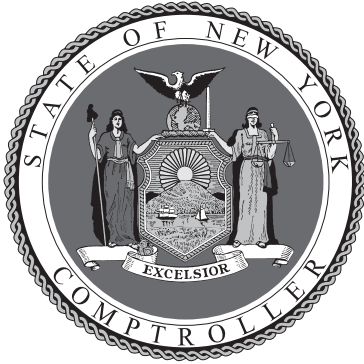
A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished 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 Madrid-Waddington Central School District, entitled Internal Controls Over Wire Transfers and Claims Audit. This audit was conducted pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, 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*



## State of New York Office of the State Comptroller

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# EXECUTIVE SUMMARY

The Madrid-Waddington Central School District (District) is governed by the Board of Education (Board) which comprises nine 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.

### **Scope and Objective**

The objective of our audit was to determine if the District's internal controls over wire transfers and the payment of claims are properly designed and operating effectively for the period July 1, 2005 to March 31, 2007. Our audit addressed the following related questions:

- Are internal controls over wire transfers appropriately designed and operating effectively to safeguard District assets?
- Were internal controls over the audit and approval of claims appropriately designed and operating effectively to safeguard District assets during the 12-month period July 1, 2005 to June 30, 2006?

### **Audit Results**

The Board has not adopted formal policies establishing internal controls related to wire transfers. Additionally, District management has not documented its wire transfer operating procedures. Furthermore, the District does not have a written wire transfer security agreement with the bank handling its checking accounts and District management has not adequately segregated cash disbursement duties for the investment account. As a result, there is an increased risk that the Business Manager could make unauthorized wire transfers from the investment account without detection. We reviewed all wire transfers for the period July 1, 2005 through March 31, 2007 and did not identify any improprieties.

The previous Superintendent also functioned as the claims auditor during his time at the District, which is specifically prohibited by Education Law. Without an independent claims audit and approval function, the District was at risk of loss from the payment of improper or illegal claims approved by the former Superintendent. We reviewed 41 payments, totaling \$98,149, during the 2005-06 fiscal year to ensure that they included supporting documentation and were appropriate District payments. Our testing did not identify any improper cash disbursements.

### **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 planned to initiate corrective action.

# Introduction

## Background

The Madrid-Waddington Central School District (District) is located in the Towns of Lisbon, Louisville, Madrid, Potsdam and Waddington, St Lawrence County. The District is governed by the Board of Education (Board) which comprises nine 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's business affairs are managed by two employees; a Business Manager, who is also the District Clerk, and a Treasurer.

There is one school in operation within the District, with approximately 800 students and 120 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$12.2 million, which were funded primarily with State aid, real property taxes, and grants.

The District has an investment account at one bank and four checking accounts at another. During our 21-month audit period, the District made 64 wire transfers totaling \$12.5 million from the investment account into the checking accounts at the other bank. The District has not utilized wire transfers to pay outside vendors, but the banks do provide that service.

## Objective

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

- Are internal controls over wire transfers appropriately designed and operating effectively to safeguard District assets?
- Were internal controls over the audit and approval of claims appropriately designed and operating effectively to safeguard District assets during the 12-month period July 1, 2005 to June 30, 2006?

## Scope and Methodology

We examined the internal controls related to wire transfers for the period July 1, 2005 to March 31, 2007 and to the audit and approval of claims for the period July 1, 2005 to June 30, 2006.

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

**Comments of District  
Officials and Corrective  
Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

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

## Wire Transfers

The District's wire transfer process is not subject to check writing controls and wire transfers can disburse significant amounts of money. Wire transfers may be initiated by an oral or written payment order from an official authorized to disburse District funds. Banks typically confirm the authenticity of the transfer order with the District prior to disbursing the funds. In order to adequately protect District funds from unauthorized wire transfers, management should have adequate controls in place over the authorization process for transfers and written agreements with the banks setting forth security procedures for authenticating transactions and identifying which officer(s) are authorized to disburse funds. The agreements can further enhance control by establishing limitations on the dollar amount or type of electronic transfer permitted from District accounts. The statutes that authorize district treasurers to utilize wire transfers also require governing boards to have written wire transfer security agreements with the banks. The ability to disburse funds electronically to outside bank accounts can expose District funds to significant risk of loss.

The Board has not adopted formal control policies related to wire transfers and District management has not documented its wire transfer operating procedures. The Business Manager/District Clerk has signed a boilerplate wire transfer security agreement with the bank maintaining the investment account. However, that agreement does not specify who at the District is authorized to issue or confirm payment orders, places no limitations on wire transfers, and states that the bank is only required to verify payment orders above a threshold established by the bank. District officials told us that the bank calls the Treasurer to confirm transfers in excess of \$75,000.

The District also does not have a written wire transfer security agreement with the bank handling its checking accounts. At our request, the bank provided a letter stating that the Treasurer was the only official authorized to sign wire transfers orders; however, the letter did not specify any other wire transfer control policies or procedures, such as a confirmation process for wire transfer requests.

Furthermore, District management has not adequately segregated cash disbursement duties for the investment account. Currently, the Business Manager, who signs all wire transfer orders from that account, also posts all journal entries and reconciles the bank account balance with little effective oversight. As a result, there is a risk that the Business Manager could make unauthorized wire transfers from the investment account without detection.

To address this risk, we identified the transfer recipients for all wire transfers during the period July 1, 2005 through March 31, 2007 and assessed the propriety of each transaction based on the recipient, the amount transferred and the timing of the payment. Our testing did not identify any improprieties. All wire transfers were made to other District bank accounts or were routine payroll remittances to governmental tax authorities, the State Retirement Systems, or the system that distributes net payroll payments into employee bank accounts.<sup>1</sup>

## Recommendations

1. The Board should establish a written internal control policy regarding wire transfers and enter into written wire transfer security agreements for District bank accounts. The written policies and agreements should:
  - require that all wire transfers be authorized by the Treasurer, or another District official who is legally authorized to disburse District funds.
  - establish specific security procedures for authenticating wire transfer orders.
  - establish dual approval controls for non-routine wire transfer transactions.
2. District officials should review the District's system of internal controls over wire transfers and take steps to:
  - segregate wire transfer authority, recordkeeping, and bank reconciliation duties or establish appropriate compensating controls.
  - implement wire transfer control directives issued by the Board.

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<sup>1</sup>The District made 174 electronic payments totaling \$5.8 million to State and Federal tax authorities, the State Retirement System, and a bank system that distributes payroll direct deposits into employee accounts. These payment transactions are originated by electronic funds collection systems administered by those separate entities. Therefore, they provide little, if any, risk for undetected transfer errors or diversion of District funds.

## Claims Audit

The claims audit process is one of the most critical elements of the District's internal control system over non-payroll cash disbursements. Education Law requires school boards to audit claims against district funds before they are paid, or to appoint a claims auditor to assume the board's powers and duties to approve or disapprove claims. An independent claims audit function provides boards with a means to prevent or detect any management abuses or improprieties and provide assurances that funds are expended for authorized purposes and in accordance with board policies. Since superintendents have executive authority over other school district staff and managers, they are in a unique position to override the system of internal controls and order improper payments. For this reason, Education Law specifically prohibits superintendents from serving as the independent claims auditor.

For at least five years prior to his retirement on June 30, 2006, the District's former Superintendent also served as the District's claims auditor, responsible for auditing and approving the payment of claims against District funds. Therefore, the District's system of internal controls was not appropriately designed and did not comply with statutes during this period. The Board President told us that the Board was unaware of the inherent conflict between the duties of Superintendent and claims auditor and that the Education Law prohibited such joint appointments. Several Board Members learned about the conflict at training they attended during May 2006 and the Board took corrective action by appointing another District official as independent claims auditor upon the retirement of the Superintendent in June 2006.

Without an independent claims audit and approval function, the District was at risk of loss from the payment of improper or illegal claims approved by the former Superintendent. To address this concern, we accounted for all checks paid by the bank during the 2005-06 fiscal year and scanned the payee names and amounts to identify questionable vendors and amounts. We identified 30 transactions, totaling \$97,031 that indicated a greater potential for improprieties and 11 payments, totaling \$1,118 that were made to the Superintendent. We examined the supporting documentation for these 41 claims to verify that each transaction was a proper expenditure of District funds. Our testing did not identify any improper cash disbursements.

### **Recommendation**

3. The Board should continue to ensure that the claims audit and approval function is kept sufficiently independent from District management.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# Madrid-Waddington Central School

Lynn M. Roy, Superintendent

P O Box 67  
Madrid, NY 13660

<http://www.mwcsk12.org>

Tel. 315 322-5746  
Fax 315 322-4462

December 27, 2007

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

Dear Sir(s):

This letter is in response to the preliminary draft findings of the Comptroller's audit of the Madrid-Waddington Central School District.

The district believes that the audit procedures were very thorough. The on-site personnel facilitated the entire process by clearly, timely and effectively communicating with district staff. The exit interview, conducted by Comptroller's staff, included members of the Board of Education Audit Committee as well as the District Clerk and myself. All persons involved in the discussion feel the findings as well as subsequent recommendations were fair and appropriate. While no inappropriate use of funds or improprieties were identified, the recommendations for reduction of risks and the safeguarding of district assets are appreciated.

The district's reaction and comments regarding each finding is listed below.

## Wire Transfers

The Madrid-Waddington Central School District has documented accounting procedures that demonstrate the segregation of duties to enhance the security of wire transfers. Although these accounting procedures are not formal policy as adopted by the Board of Education, we at Madrid-Waddington have taken great care with the assignment of functions to various people within the Business Office to enhance the security of district funds by instilling strong internal controls. To supplement our internal controls, the independent internal auditor periodically confirms that wire transfers have the appropriate signatures, verification and authorization of proper personnel, and that all written accounting procedures have been followed. The external auditor also verifies all wire transfer transactions procedures and requests for any areas of weakness as part of their yearly audit. We have developed and are currently reviewing formal written procedures regarding the wire transfer of funds.

Our Board of Education Policy Committee is hereby committed to the **review and adoption of the written policies of Madrid-Waddington Central School's wire transfers**. The review and subsequent adoption by the Board will take place no later than spring of 2008. This review will add procedures ensuring that the **district treasurer authorize all disbursement of funds**.

There now exists a **written security agreement** with the JP Morgan Chase stating that all wire requests faxed by the district clerk will be verified by JP Morgan Chase with the district treasurer before any funds will be released. The dual signatures will enhance the segregation of duties for the cash disbursement in the investment account and yield a higher level of internal controls for the District. The agreement will be reviewed regarding possible limitations on wire transfers and necessary thresholds for payment verifications.

The District will also actively pursue a similar **written security agreement with Community Bank, NA** in order to ensure the appropriate segregation of duties and district treasurer authorization procedures.

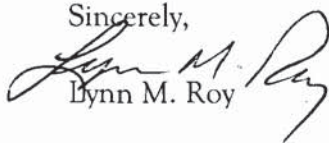
Additionally, effective July 2007, a **deputy treasurer** is now annually appointed by the Board of Education at the District's re-organizational meeting in July. During a period of absence of the treasurer, the deputy treasurer will conduct his/her duties.

### Claims Audit

As stated in the preliminary draft, the Madrid-Waddington Central School Board of Education became aware in May 2006 of the improper practice of allowing the superintendent to serve as the district internal claims auditor. This arrangement was corrected in July 2006 whereby another district official was appointed as independent claims auditor. This **independent claims auditor** reports directly to the Audit Committee of the Board of Education. These reports occur as needed but always at least once on an annual basis. The Audit Committee then reports the findings to the entire Board of Education. The Internal Claims Auditor has received and will continue to receive appropriate training and professional development for the effective execution of the job and responsibilities.

This performance audit was conducted in accordance with generally accepted government auditing standards. No improprieties or unauthorized cash disbursements were found. Therefore, Madrid-Waddington Central School District concludes that, given these revisions and recommendations, the district's fiscal affairs, compliance with necessary statutes or regulations, and observance of good business practices have been substantiated by this comprehensive audit process. The district fully intends to immediately implement the listed recommendations as well as to continue to maintain appropriate internal and external controls in order to effectively and efficiently manage operations to meet the expectations of our constituents.

Sincerely,

  
Lynn M. Roy

## 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 wire transfers and audit and approval of claims for further audit testing.

For internal controls over wire transfers, we focused our attention on procedures for authorizing, processing, recording, and reconciling electronic payments from the District's bank accounts. To determine the effectiveness of internal controls and to evaluate the effect of deficiencies in those controls, we reviewed the recipient, timing, and dollar amount for all wire transfers recorded on the bank statements for questionable transfers. Our review covered all District bank accounts during the period July 1, 2005 to March 31, 2007.

For internal controls over the audit and approval of claims, we focused our attention on procedures for authorizing the payment of claims during the period July 1, 2005 to June 30, 2006. To determine the effectiveness of internal controls and to evaluate the effect of deficiencies in those controls we:

- reconciled checks issued per the Districts disbursement reports to the bank statements.
- reviewed payee names and payment amounts for all 2,181 check disbursements looking for questionable transactions.
- examined the cancelled checks and claim documentation for a risk-based sample of 41 disbursements to verify that the underlying claims were properly supported and represented a proper expenditure of District funds.

We conducted our 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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