



Marcellus Central School District Internal Controls Over Payroll

Report of Examination

Period Covered:

July 1, 2006 — June 30, 2007

2008M-67



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 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 Marcellus Central School District, entitled Internal Controls Over Payroll. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's Authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Marcellus Central School District (District) is located in the Towns of Marcellus, Skaneateles, Camillus, Onondaga, Spafford, and Otisco in Onondaga 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. The Board has also designated the Superintendent to be responsible for the certification of payrolls.

There are three schools in operation within the District, with approximately 2,080 students and 320 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$24.1 million, which were funded primarily with State aid, real property taxes, and grants. The District reported \$18.8 million in payroll and related fringe benefits for the 2006-07 fiscal year. This amount consisted of \$10.8 million in instructional salaries, \$2.9 million in non-instructional salaries and \$5.1 million in fringe benefits.

Objective

The objective of our audit was to examine the District's internal controls over payroll. Our audit addressed the following related question:

- Are internal controls over payroll appropriately designed and operating effectively?

Scope and Methodology

We examined the District's internal controls over payroll for the period July 1, 2006 to June 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 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*.

Internal Controls Over Payroll

Internal controls over payroll processing must ensure that employees are paid wages and salaries, and provided benefits, to which they are entitled. District officials are responsible for establishing policies and procedures, including an employee manual, to delineate employee responsibilities in preparing and disbursing payroll and provide guidance regarding employee entitlements. Payroll duties must be segregated and carried out with management oversight to ensure that no one person controls all phases of a transaction and to reduce the risk that errors and irregularities could occur.

The District's internal controls over payroll processing were not properly designed and operating effectively. District officials have not established policies and procedures for payroll processing, and the Board has not established policies or resolutions to define the benefits for employees who are not covered by collective bargaining agreements or employment contracts. In addition, there is a lack of segregation of duties and management oversight over the key aspects of the payroll function. As a result, employees may have been overpaid and others may not have been compensated as intended by the Board. In addition, there is an increased risk that employees will not receive all, and only, the benefits intended by the Board, and that errors or irregularities could occur and not be detected and corrected.

Payroll Policies and Procedures — District officials are responsible for adopting written policies and procedures, including specific job descriptions, to provide a framework for employees to understand the Board's objectives and each employee's role in the payroll process, and to ensure that payroll is processed consistently and accurately. Written policies and procedures are particularly important when a separation of duties is necessary to provide for an adequate level of control.

Although the Board designated the Superintendent to be responsible for the certification of payrolls, the Board has not established written policies and procedures for payroll or approved the job description to define the payroll clerk's role, or the other employee's roles in the payroll process. Because of the lack of procedures, the payroll clerk has developed an informal system to process payroll and followed the duties and responsibilities for the Civil Service job classification of personnel aide. These duties and responsibilities describe the work activities expected for the payroll clerk. They do not provide for controls designed to help ensure that the work of the payroll clerk is reviewed and verified by an appropriate District officer or employee.

As a result, there is an increased risk that errors or irregularities could occur and remain undetected.

Salaries and Benefits — The Board must define and authorize salaries and benefits through collective bargaining agreements, individual employment contracts, District-wide policies or Board resolutions to ensure that employees receive only the compensation that the Board intends for them to receive. This must be done for the protection of the employees and the District.

We reviewed the salary and benefits for eight full-time non-union employees who did not have individual employment contracts. Although the Board approved their salaries, there were no District-wide policies or Board resolutions to set forth the benefits they were to receive. District officials told us that three of the employees (the Assistant Superintendent for Business, Assistant Superintendent for Building and Grounds and transportation supervisor) were provided the same benefits as in the administrators' contract, and the remaining five (four Business Office employees and the secretary to the Superintendent) were provided the same benefits as in the office personnel contract.

Although District officials have informally defined the benefits for these employees, the failure to define benefits in writing increases the risk that employees will receive benefits that the Board does not intend for them to receive.

Segregation of Duties — The concentration of key duties (i.e., authorization, recordkeeping and custody) with one individual with little or no oversight weakens internal controls and significantly increases the risk that errors or irregularities could occur and not be detected and corrected. User rights for the District's computerized payroll system must be restricted so that no employee performs all aspects of payroll, including the ability to add new employees, update salary information, and process and distribute checks. In addition, the Treasurer must either directly sign checks or oversee the use of her facsimile signature to ensure that payments are not made without her approval.

If it is not feasible for District officials to adequately segregate duties, compensating controls can be implemented. For example, someone independent of the payroll process could review payrolls for reasonableness, and verify that employees exist, payrolls are based on actual hours worked or authorized leave time used, the Board has authorized the hourly rates or salaries used, and that net payroll checks agree with certified payroll check registers. Someone independent of the process could also perform a payroll payout. A payroll payout

requires employees to pick up their checks in person and produce identification to verify their identity. Another compensating control could be to review computer generated exception/audit trail reports, which detail specific activities, such as new employee additions, changes to pay rates or other predefined criteria, to ensure that additions or changes to the system are authorized.

Policies and procedures have not been developed to ensure that the payroll process is adequately controlled and that the personnel involved do not have incompatible duties. As a result, several internal control weaknesses need to be addressed.

- The payroll clerk has full access rights to the computerized payroll system, and is responsible for adding and deactivating employees, updating employee information, inputting salary detail, setting up withholdings and direct deposits, and preparing and signing manual checks. The Treasurer also has full access rights to the computerized payroll system. Because of this lack of segregation of duties, there is an increased risk that unauthorized payroll disbursements could be made by the payroll clerk or Treasurer and not be detected.
- The Treasurer does not directly affix her facsimile signature to payroll checks or supervise the payroll clerk when she authorizes BOCES to print computer-generated payroll checks with her facsimile signature. Further, although BOCES sends printed checks to the District, the checks are sealed in individual envelopes. As a result, the Treasurer cannot compare payroll checks to approved or certified payroll check registers prior to distribution without opening each individual sealed envelope.
- District payrolls were not certified by the Superintendent or other District official.

Although the District has limited management oversight within the payroll process, District officials have implemented certain compensating controls. The Assistant Superintendent for Business performs a limited review of payroll changes brought to his attention by the payroll clerk, and since June 2007, has begun to review exception/audit trail reports. District officials first became aware of the existence of such reports in June 2007. In addition, the internal auditor has recently conducted an audit of the payroll function.

These compensating controls did not fully address the control weaknesses within the payroll function. We tested wages for 26 employees (\$1,471,079), payrolls for 12 employees (\$447,026),

retroactive payments for six employees (\$37,433), separation payments to three employees (\$45,807), overtime payments to seven employees (\$23,973) and additional payments to six employees (\$67,249) to determine whether amounts paid to District employees were appropriate.

- Two employees who were considered covered by the administrators' contract did not receive matching contributions to their tax sheltered annuities of \$2,310 and \$1,995, respectively.
- One employee who was considered covered by the administrators' contract did not receive a longevity stipend of \$500.
- One recently hired employee covered under the teachers' contract was overpaid by \$4,176 due to a retroactive payment that was not calculated properly.
- Two employees covered under the office personnel contract were overpaid by \$1,201 due to overtime payments that were not calculated properly.¹

The payroll process is not adequately controlled and the payroll clerk has incompatible duties. As a result of these control weaknesses, certain employees may have been overpaid and others may not have been compensated as intended by the Board.

Recommendations

1. District officials should adopt written policies and procedures to provide guidance for processing payroll.
2. The Board should authorize the benefits to be provided to non-union employees and document this authorization, in writing, by employment contracts, policies, and/or by passing Board resolutions.
3. District officials should assign payroll duties so that incompatible duties are segregated.

¹ The overtime rate, one and one-half times the regular hourly rate, applied for hours worked over eight in any day or 40 in any week. The overtime rate was incorrectly applied for hours worked over six per day and 30 hours per week during summer recess, Christmas, winter, and spring vacations and 7 and one-half hours per day and 37 and one-half hours per week when school was in session, resulting in overpayments to the payroll clerk and Treasurer of \$1,030 and \$171, for 109 and 18 hours of work, respectively.

4. The Treasurer should maintain control over the application of her facsimile signature to payroll checks or supervise the signature process for payroll checks.
5. District officials should ensure that someone independent of the payroll process periodically verifies that all persons receiving payments are valid, authorized employees, and reviews completed payrolls.
6. The Superintendent or whoever else the Board appoints should adequately review and certify payrolls.
7. The Treasurer should compare printed checks to certified payroll check registers.
8. District officials should ensure that someone independent of the payroll process reviews payroll changes to verify that the changes are entered into the payroll system as authorized.
9. District officials should consider requiring a periodic payroll payout.
10. District officials should require someone independent of the payroll process to review payroll exception reports, audit logs and financial software permissions to ensure that access rights are compatible with assigned duties.
11. District officials should seek recovery of any amounts overpaid to employees.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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ANTHONY J. CARNEVALE
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673-0206

CRAIG J. TICE, Ph.D.
SUPERINTENDENT OF SCHOOLS

PATRICIA A. MCCARRON
DIRECTOR OF PUPIL SERVICES
673-0203

June 3, 2008

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

Dear Madam or Sir:

Please be advised of the following responses and planned corrective actions regarding the recent examination of the Marcellus Central School District Internal Controls Over Payroll. The following are the written recommendations as outlined in the recent audit report:

Recommendations

1. District officials should adopt written policies and procedures to provide guidance for processing payroll.
2. The Board should authorize the benefits to be provided to non-union employees and document this authorization, in writing, by employment contracts, policies, and/or by passing Board resolutions.
3. District officials should assign payroll duties so that incompatible duties are segregated.
4. The Treasurer should maintain control over the application of her facsimile signature to payroll checks or supervise the signature process for payroll checks.
5. District officials should ensure that someone independent of the payroll process periodically verifies that all persons receiving payments are valid, authorized employees, and reviews completed payrolls.
6. The Superintendent, or whoever else the Board appoints, must adequately review and certify payrolls.
7. The Treasurer should compare printed checks to certified payroll check registers.
8. District officials should ensure that someone independent of the payroll process, reviews payroll changes to verify that the changes are entered into the payroll system as authorized.
9. District officials should consider requiring a periodic payroll payout.

10. District officials should require someone independent of the payroll process to review payroll exception reports, audit logs and financial software permissions to ensure that access rights are compatible with assigned duties.
11. District officials should seek recovery of any amounts overpaid to employees.

The following narrative represents the “Response from District Officials” that should be included in Appendix A of the NYS Comptroller’s Report of Examination for the Marcellus Central School District. This response speaks to the district action plan to address the recommendations as outlined in the report. Accordingly, each recommendation will be addressed individually.

Response/Planned Corrective Actions Regarding Recommendation 1

The Assistant Superintendent for Business and Superintendent of Schools will develop written policies (for approval by the Board of Education) and internal operations procedures regarding payroll processing. Anticipated completion date: August 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 2

Authorization by the Board of Education will be documented via contracts, policies or resolutions as necessary authorizing benefits for non-union district employees. Anticipated completion date: August 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 3

Action has been completed. In October 2007, the District moved payroll duties to another individual in the Business Office. We believe any incompatible duties do not currently exist. The payroll responsibilities will be evaluated at the end of the fiscal year, 6-30-08, and any required adjustments will be accordingly made. We will be asking our internal auditors to assist us with this evaluation.

Response/Planned Corrective Actions Regarding Recommendation 4

The treasurer’s facsimile signature stamp is at OCM BOCES who processes our payroll including affixing the treasurer’s signature to the payroll check. We are comfortable with this arrangement. To increase internal controls over this process we are reviewing payroll data reports that may be used to compare the payroll checks to reports completed by the payroll clerk. We will ask for assistance from our internal auditors to ensure adequate controls are in place for this control procedure that we want to implement. Anticipated completion date: July 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 5

The Assistant Superintendent for Business will verify that individuals receiving payments are valid and authorized district employees. In addition, completed payrolls will be reviewed by this person as well. Anticipated implementation date: July 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 6

Increased scrutiny of the review and certification of payrolls will be accomplished by the Superintendent of Schools or his designee. Anticipated implementation date: July 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 7

The Treasurer or designee will complete comparisons of printed checks to payroll check registers. Anticipated completion date: July 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 8

The Assistant Superintendent for Business will review payroll changes and verify that the changes that appear in the payroll system are corrected and authorized. Anticipated completion date: July 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 9

The District is planning on doing at least one periodic payroll payout for the 2008-2009 school year. Anticipated completion date: October 24, 2008 (at a Staff Development Day). Future periodic payouts will be unannounced.

Response/Planned Corrective Actions Regarding Recommendation 10

The Assistant Superintendent for Business or designee will review payroll exception reports, audit logs and financial software permissions to ensure access rights are compatible with assigned duties. Anticipated completion date: July 1, 2008.

Response/Planned Corrective Actions Regarding Recommendation 11

Action plan is in progress. Of the three individuals that were overpaid, one has already reimbursed the overpayment (\$1,030) to the District. Of the other two employees, one is working on a repayment schedule (\$4,176); the other has indicated her overpayment (\$171) would be re-paid in the near future.

The Marcellus Central School District remains committed to ensuring transparency in its fiscal operations. Should you have any questions regarding this response, please do not hesitate to call me at (315) – 673 – 0206.

Sincerely,



Anthony Carnevale
Assistant Superintendent for Business

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 objective and scope by selecting for audit those areas most at risk. We selected internal controls over payroll for further audit testing.

- We examined Board policies and procedures, employee personnel files, collective bargaining agreements, individual employment contracts, Board minutes, payroll registers, payroll schedules and time cards for hourly employees to determine if the District had properly designed and implemented internal controls and segregated payroll duties.
- We interviewed employees in the Business Office, tested the accuracy of transactions, and verified the authorization for transactions
- We tested wages totaling \$1,471,079 paid to 26 employees (including the Superintendent, Business Administrator, Treasurer and payroll clerk) during the 2006-07 fiscal year. Twenty-one were covered under a written employment agreement with the District, three were considered to be covered by the administrators' contract and two were considered to be covered by the office personnel contract. We compared each employee's Board-approved salary to payroll reports, earning histories, and cash disbursement records to determine whether the benefits received were in accordance with employment contracts.
- We tested payrolls totaling \$447,026 for 12 employees who started employment with the District during the 2006-07 fiscal year to verify that the wages paid agreed with the amounts specified in their Board approved appointments. We also tested retroactive payments totaling \$37,433 for six of these employees to determine if the payments were accurately calculated.
- We reviewed payroll records of five employees who retired or resigned during 2006-07 to determine whether the payments, if any, they received upon separation from the District were

appropriate and accurately calculated. Three payments totaling \$45,807 were made to three employees, which were proper and accurately calculated.

- We tested overtime payments totaling \$23,973 paid to seven employees to verify payments were accurately calculated and approved by appropriate supervisory personnel.
- We tested 10 additional payments exceeding \$6,000 each and totaling \$67,249 to six employees to determine if the payments were proper and accurately calculated.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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