



# Margaretville Central School District

## Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2005 — June 28, 2007

2008M-44



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# State of New York Office of the State Comptroller

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## 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 Margaretville Central School District, entitled Internal Controls Over Selected Financial Activities. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

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

Respectfully submitted,

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



## State of New York Office of the State Comptroller

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### EXECUTIVE SUMMARY

The Margaretville Central School District (District) is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Superintendent also serves as the District's purchasing agent. The District Treasurer (Treasurer) is responsible for recording and reporting financial activities and disbursing District funds. The Board appointed a claims auditor whose responsibility is to review and approve District claims prior to payment. The Board adopted a purchasing policy that establishes requirements for District staff to follow prior to making a purchase, such as obtaining quotes or bids.

The District uses one networked computer system to process and store financial and non-financial data, supported by seven servers located at the school. Financial data is stored on a dedicated network server. The Information Technology (IT) administrator oversees the network system and is an employee of the Broome-Tioga Board of Cooperative Educational Services (BOCES).

#### **Scope and Objective**

The objective of our audit was to determine if District officials were properly managing District operations to safeguard District assets for the period of July 1, 2005 to June 28, 2007. Our audit addressed the following related questions:

- Did the Board ensure that duties related to cash receipts and disbursements were adequately segregated?
- Did the Superintendent ensure that District personnel sought competition for the purchase of goods and services as required by the District's procurement policy?
- Did the claims auditor properly audit and approve all District claims?
- Did the cafeteria manager ensure that cafeteria moneys were properly recorded and deposited in a timely manner?
- Did the Board establish comprehensive policies and procedures to safeguard computerized data and assets?

- Did the District’s process for classifying workers ensure that the persons the District enrolls in the Employees Retirement System (ERS) are valid public employees?

### **Audit Results**

The Board did not ensure that the duties related to the District’s cash receipts and disbursements were properly segregated. The Treasurer performed all aspects of the cash receipt and disbursement processes which included collecting receipts, preparing deposit slips and making deposits, recording journal entries, preparing purchase orders, performing wire transfers, and signing District checks. The Treasurer also reconciled all District bank accounts with no independent review. Although our testing did not reveal any material discrepancies, the concentration of key financial duties with the same individual significantly increases the risk that errors or irregularities could occur without being detected and corrected in a timely manner.

District officials did not ensure compliance with the District’s procurement policy, and the District’s Superintendent, as purchasing agent, approved purchases without first soliciting or ensuring that District staff solicited the required competition. District officials could not demonstrate that they solicited verbal or written quotes, as required by District policy, for 14 claims totaling almost \$44,000. Additionally, for seven claims totaling over \$39,000, District personnel obtained quotes from only one vendor for each purchase instead of three vendors as required. Without the benefit of competition in the procurement process, the District is at an increased risk of purchasing goods or services that are not of the best quality at the lowest price.

We also found that, although the Board had established policies and procedures defining the duties of the claims auditor, District officials did not properly monitor the claims auditor’s work. The claims auditor did not audit and approve all claims before payment, did not provide a certified warrant to indicate approval of claims for payment, and did not report deficient claims to the Board. Further, District officials allowed the Treasurer to pay claims based on the Clerk’s signature. Thirty-eight claims totaling \$95,865 were not audited in accordance with District procedures and had one or more deficiencies. As a result of these control weaknesses, District officials do not have assurance that the District’s payments are accurate and that they are for legitimate goods or services that the District actually received.

Additionally, District officials did not develop policies and procedures to ensure that cafeteria moneys were properly recorded, accounted for, and deposited intact. The cafeteria manager did not ensure that the cashiers recorded all cafeteria sales promptly into the point-of-sale cash registers, and that all moneys received were deposited. Daily cafeteria reports indicated that, over the course of one school year, cash register collections exceeded the recorded sales by a net total of approximately \$2,000; however, no one investigated the variances between the recorded sales and the cash counts entered into the point-of-sale system, and the Treasurer did not verify daily deposits against total sales. We found no evidence that the surplus cash was deposited. Additionally, the duties of the cafeteria manager and cashiers were not sufficiently segregated, and they did not use unique identifiers on the point-of-sale system to provide individual accountability for cash register transactions. Without procedures to ensure the proper processing and monitoring of the cafeteria cash receipts, the District is at an increased risk of its cafeteria revenues being mismanaged, lost, or stolen.<sup>1</sup>

<sup>1</sup> During our audit fieldwork, District officials instituted compensating controls including management oversight of the cash-out process, and independent reconciliation of declared cash counts with recorded sales totals. These additional controls resulted in reduced deficiencies.

The Board did not establish internal control policies and procedures to sufficiently safeguard the District's computerized data and other information technology (IT) resources. District officials did not ensure adequate data security through properly managed user accounts and strong passwords; we found that the IT administrator did not deactivate nine user accounts for individuals who had left District service. District officials did not ensure the periodic testing of backup data for integrity, and did not develop a formal disaster recovery plan. As a result, the District could incur serious and costly disruptions to its business operations and is at an increased risk of losing its computerized data without the means to recover it.

Lastly, we noted weaknesses in internal controls over the District's process for classifying workers whom the District enrolls in the Employees Retirement System (ERS). Although we did not find any material exceptions, these weaknesses increase the risk that the District could improperly enroll non-employees (independent contractors) in the ERS.

### **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 Margaretville Central School District (District) is located in the Towns of Andes, Bovina, Middletown, and Roxbury in Delaware County, the Towns of Halcott and Lexington in Greene County, and the Towns of Shandaken and Hardenburgh in Ulster County. The District is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Superintendent also serves as the District's purchasing agent. The District Treasurer (Treasurer) is responsible for recording and reporting financial activities, and performs all aspects of cash receipts and disbursements processing as well as the reconciliation of all District bank accounts. The Board designated a claims auditor to audit and approve all claims prior to payment.

There is one school in operation within the District, with approximately 484 students and 85 employees. The District's budgeted expenditures for the 2006-2007 fiscal year were approximately \$9.6 million, funded primarily with real property taxes, State aid, and grants.

The cafeteria manager is responsible for the daily operation of the cafeteria, including accounting for and depositing all cafeteria cash receipts and overseeing the cafeteria's cashiers and staff. Cafeteria sales were approximately \$84,000 per year during our audit period.

The District uses one networked computer system to process and store financial and non-financial data,<sup>2</sup> supported by seven servers located at the school. Financial data is stored on a dedicated network server. The Information Technology (IT) administrator oversees the network system, and is an employee of the Broome-Tioga Board of Cooperative Educational Services (BOCES).

## Objective

The objective of our audit was to determine if District officials were properly managing District operations to safeguard District assets. Our audit addressed the following related questions:

- Did the Board ensure duties related to cash receipts and disbursements were adequately segregated?

<sup>2</sup> Non-financial data includes student attendance records, grades, and data generated by students and staff.

- Did the Superintendent ensure that District personnel sought competition for the purchase of goods and services as required by the District’s procurement policy?
- Did the claims auditor properly audit and approve all District claims?
- Did the cafeteria manager ensure that cafeteria moneys were properly recorded and deposited in a timely manner?
- Did the Board establish comprehensive policies and procedures to safeguard computerized data and assets?
- Did the District’s process for classifying workers ensure that the persons the District enrolls in the Employees Retirement System (ERS) are valid public employees?

**Scope and Methodology**

We examined cash receipts and disbursements, purchasing, claims processing, cafeteria cash receipts, the safeguarding of computerized data and assets, and the worker classification process of the Margaretville Central School District for the period July 1, 2005 to June 28, 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*.

## Segregation of Duties

An effective system of internal controls over cash receipts and disbursements requires the separation of duties so that no one individual controls most or all phases of a transaction. The work of one employee should be independently verified in the course of another employee's regular duties. Concentration of key financial activities with one individual – for example, receiving and depositing cash, updating the accounting records, initiating and confirming wire transfers, and reconciling bank statements – weakens internal controls and significantly increases the risk that errors or irregularities may occur and go undetected. If complete segregation of duties is not feasible, District officials should implement compensating controls, such as periodic independent review of the accounting records and monthly reconciliations for proper documentation of cash disbursements.

We found that the duties of the Treasurer were not properly segregated, and there were no mitigating controls. The Treasurer performed all aspects of the cash receipt and disbursement processes and was the custodian of all District moneys and financial records. Her duties included collecting and recording receipts, preparing deposit slips and making deposits, recording journal entries, and reconciling all District bank accounts.<sup>3</sup> The Treasurer also prepared purchase orders, performed all wire transfers, recorded disbursements, and signed all District checks. As a result of the lack of segregation in the Treasurer's duties, the District is at an increased risk of errors or irregularities occurring and not being detected and corrected in a timely manner.

To address this risk, we reviewed two months of cash receipts, comprising 133 receipts totaling over \$3.7 million, to ensure that they were properly received, recorded, and deposited in a timely manner and intact. We also reviewed two months of disbursements comprising approximately 400 disbursements, including 44 electronic funds transfers, to ensure they were for legitimate District purposes, properly authorized, and documented. Lastly, we reviewed two months of bank account reconciliations for all funds for accuracy, completeness, and timeliness, and certain journal entries to ensure they were appropriate.

While our testing did not reveal any material discrepancies, concentrating key duties with one individual with little or no

<sup>3</sup> Although the Superintendent told us he reviewed the bank reconciliations, we found no evidence of such review.

compensating controls significantly increases the risk that errors or irregularities might occur and not be detected and corrected in a timely manner.

A similar finding relating to the lack of segregation of the Treasurer's duties was included in the District internal auditor's initial risk assessment report, dated February 18, 2007, addressed to the District Audit Committee and Board. At the time of our audit (four months later) District officials had not taken corrective action, citing the District's small size as being cost-prohibitive to the hiring of a full-time employee. However, they increased the duties of the part-time Business Office account clerk to include observing the cafeteria cash-out process, counting cafeteria cash collections, and reconciling of cafeteria cash collections to recorded sales.

### **Recommendation**

1. The Board should ensure that duties are adequately segregated so that no one person controls all aspects of the cash receipt and disbursements processes. If this is not feasible, the Board should institute sufficient compensating controls.

## Use of Competition

An effective procurement process enables school districts to obtain services, supplies, and equipment of suitable quality and quantity, from the best qualified and lowest-priced source, and in compliance with Board and legal requirements. The use of competition in the procurement process helps the District expend taxpayer dollars efficiently and guards against favoritism, extravagance, and fraud. General Municipal Law (GML) requires that District officials solicit competitive bids for purchases of more than \$10,000 and public works contracts of more than \$20,000. GML also requires school districts to adopt written policies and procedures for the procurement of goods and services that are not subject to the GML competitive bidding requirements. Such policies and procedures establish each method of procurement, the procedures for determining which method to use, and requiring adequate documentation of the actions taken.

The Board adopted a policy establishing requirements for purchases of goods or services that are expected to fall below GML thresholds. The policy requires three verbal quotes for purchases and for public works contracts of \$1,000 to \$4,999; three written quotes for purchases of \$5,000 to \$10,000; three written quotes for public works contracts of \$5,000 to \$9,999; and more than three written quotes for public works contracts of \$10,000 to \$20,000. The policy also requires staff to document and attach supporting documents to the related claims. The Board designated the Superintendent as the District's purchasing agent and authorized him to issue purchase orders without prior approval of the Board when formal bidding procedures are not required by law and budget appropriations are adequate. As purchasing agent, the Superintendent is responsible for establishing and implementing procedures and standard forms for all purchasing-related activities.

Although the District's purchasing policy appeared to be designed properly, there were instances where the controls were not operating effectively. We examined 38 claims totaling approximately \$348,000. Of the 38 claims, 21 claims totaling approximately \$83,000 did not have sufficient documentation to show that District staff sought competition for the purchases, pursuant to the District's purchasing policy.

- Fourteen claims totaling almost \$44,000 did not include any attached documentation indicating that quotes were solicited for the items, nor was the documentation otherwise available. These items included a toolbox (\$5,799), cabinets (\$4,769), calculators (\$4,471), two-way radios (\$2,859), a press

gun (\$2,600), building supplies (\$2,020), and art supplies (\$1,915).

- Seven claims totaling over \$39,000 had documentation attached showing that staff did get an estimate of the purchase price from the vendor from whom they purchased the goods and services, but no documentation to show that they sought three verbal or written quotes as required by the District's policy. These goods and services included tree removal (\$12,000),<sup>4</sup> bus lift repair (\$9,110), a pressure washer (\$3,803), truck repair (\$2,880), and computer software (\$1,310).

These deficiencies occurred because the Superintendent, as purchasing agent, approved the purchases without first soliciting or ensuring that District staff solicited sufficient competition as required by the District's policy. As a result, District officials do not have assurance that the District acquired goods and services of suitable quality at the best price.

## **Recommendation**

2. The District's purchasing agent should comply with and enforce the provisions of the District's purchasing policy requiring that District personnel seek and document sufficient competition for purchases above designated thresholds.

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<sup>4</sup> This public works contract requires more than three written quotes, per District policy.

## Audit of Claims

Generally, Education Law requires school districts to audit and approve each claim against the District before making payment. Such audit must be performed by either the Board or its appointed claims auditor. If the Board appoints a claims auditor, that individual assumes all the powers and duties of the Board to audit each claim to determine whether it is properly authorized and accurate; whether the purchase represents a valid District expense for goods or services; and whether the goods or services were actually received. Audited claims should be included on warrants certified by the claims auditor prior to payment by the District's chief financial executive. The Board has the responsibility to establish controls over the claims audit process and to periodically monitor them to ensure that they are operating properly. Such controls include written policies and procedures detailing the duties and responsibilities of the claims auditor.

The Board appointed a claims auditor to review and approve District claims prior to payment, and established policies and detailed procedures for the claims auditor to follow. According to the Board's adopted policy, the claims auditor is required to provide the Treasurer with evidence that the claims have been audited and are approved for payment by presenting a warrant or order listing the audited vouchers. The warrant or order should specify the number of the voucher, the name of the claimant, the amount allowed, the fund and the appropriation account chargeable, and any other essential information. District policy also requires the claims auditor to track the numerical sequence of the vouchers she reviews and approves, and to prepare and certify a checklist confirming completion of the tasks required for auditing claims. After giving the warrant to the Treasurer, the claims auditor should keep on file a reference copy of the warrant bearing the claims auditor's signed certification. Finally, the claims auditor should report to the Board any deficiencies noted during the audit of claims. It is the Board's responsibility to define the requirements for the deficiency report format and the frequency of the claims auditor's results reporting.<sup>5</sup> In addition to these policy stipulations, District management established other detailed claims audit procedures and expectations, including the use of purchase orders and receiving documentation.

The claims auditor told us that she did not track the numerical sequence of the vouchers that she audited and approved for payment,

<sup>5</sup> The two most common methods for claims auditors to report the results of their work are the certification of the warrant, which lists approved claims, or the certification of each individual voucher packet (claim).

as required by District procedures. She also did not report the results of the claims audits directly to the Board; instead, she kept the results in her records. In addition, the claims auditor did not sign the warrant of approved claims or sign individual claims as evidence that the claims were audited, and did not prepare and certify the checklist of required tasks for claims audited, pursuant to Board policy. Instead, the District used a cash disbursement schedule (listing all disbursements made from every fund) that was printed on a monthly basis, signed by the Clerk and the District's purchasing agent, and forwarded to the Board. According to the notation on the cash disbursement schedule, the Clerk's signature certified that the checks listed were audited and the amount was allowed, and the Treasurer was authorized and directed to pay the amounts claimed.

As a result of these deficiencies, we reviewed 80 claims totaling over \$400,000 which had been approved by the claims auditor, and found 38 claims<sup>6</sup> totaling \$95,865 that were not audited in accordance with District procedures:

- Ten claims did not have a purchase order verifying approval for the purchase. These included claims for software upgrades (\$3,371), dairy products (\$2,004), roof repairs (\$1,120), and tools (\$323).
- Five claims did not have a claim form verifying approval for the purchase. These included payments to the District's internal auditor (\$3,771) and claims for tuition (\$3,001), sewing machine tune-up (\$620), and mail service for tax bills (\$248).
- Three claims had a purchase order dated after the vendor's invoice date. These included claims for building materials (\$6,248), cafeteria food supplies (\$2,514), and a brake meter (\$1,003).
- Ten claims exceeded the amount authorized on their purchase orders by an aggregate of over \$10,000. These included claims for computers and accessories (\$48,711), bus parts including tools (\$2,809), cafeteria food supplies (\$2,514), and textbooks (\$1,595).
- Eight claims did not have sufficient confirmation that the District received the goods and services. These included claims for various supplies (\$2,168) and software updates (\$1,310).

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<sup>6</sup> Some claims had more than one deficiency.

- Five claims did not have a completed claim form attached to the claims package. These included claims for floor repairs (\$1,639), repair of musical instruments (\$535), and lunch (\$172).

These deficiencies occurred because the claims auditor did not properly perform her job duties as outlined in the District's procedures, and the Board failed to monitor the claims auditor's work and enforce the existing claims auditor procedures. As a result, there is an increased risk that District moneys could be spent for inappropriate purposes, and that errors and irregularities could occur and not be detected and corrected in a timely manner.

### **Recommendations**

3. The claims auditor should audit all District claims in accordance with Education Law and District procedures.
4. The claims auditor should prepare a report of all deficiencies noted during the audit of claims and present this information to the Board at regular time intervals as established by the Board.
5. The Board should monitor the work performed by the claims auditor, and enforce the District's claims audit procedures.

## Cafeteria Cash Receipts

A good system of internal controls provides reasonable assurance that all moneys received are properly recorded, accounted for, and deposited intact. District officials are responsible for establishing controls to ensure that the District receives the proper amount of revenue from its cafeteria operations. Effective policies and procedures require cash to be placed in the cash drawer and recorded at time of sale, and cash collections to be deposited fully intact each day. District officials should monitor the financial activities of cafeteria operations and ensure the segregation of key duties or institute compensating controls, such as having individuals independent of cafeteria operations count the daily cash receipts, reconcile the declared cash counts to recorded sales, and investigate and resolve any variances. Lastly, unique log-ins for every employee who operates the register help to account for individual responsibility.

During the audit period, District officials had not developed policies and procedures to ensure that cafeteria moneys were properly recorded, accounted for, and deposited intact. The cafeteria manager did not ensure that all cafeteria sales were promptly recorded in the cash registers, and that all moneys received were deposited. Further, the Treasurer did not provide sufficient oversight of cafeteria cash collections, and the duties of the cafeteria staff were not segregated. Because of these control weaknesses, District officials do not have assurance that the District receives and deposits the correct amount of revenues from its cafeteria operations.

Collection, Recording, Counting, and Deposit of Cash—The cafeteria had two computerized cash registers, one used during the breakfast period and both used during lunch. Two cashiers, and occasionally the cafeteria manager, recorded (rang up) moneys for food sales and student account deposits for prepaid meals. At the end of each meal period, the cashier counted the cash collected, entered this “declared” amount into the register system, and prepared a deposit slip. The Daily Summary Report<sup>7</sup> showed if the register was “over” (when declared ending cash exceeded recorded sales) or “short” (when the declared ending cash was less than recorded sales).

The cafeteria manager deposited the money each day and gave the bank deposit slip with the Daily Summary Report to the Treasurer for recording in the District’s financial software. However, the cafeteria

<sup>7</sup> The Daily Summary Report, which the cashier printed each day from the computerized cash register system, showed recorded sales entered on the cash registers and the ending cash reported as collected (counted) by the cashiers.

manager did not follow up on variances between total recorded sales and declared cash collections, and the Treasurer did not verify the deposit amounts against total sales. Further, no one observed the cash counts at each meal session. All the key cash management duties – collecting, recording, and counting the cash; preparing the deposit slip; and maintaining custody of the cash and making the actual deposit— were performed by the cashiers with no independent oversight. Additionally, the cafeteria manager did not ensure that all cafeteria transactions were recorded promptly and accurately in the registers, and allowed other tasks performed by the cashiers to take priority over cash register operations.

We reviewed 168 Daily Summary Reports covering a complete school year and found that the total cash counts (moneys in the drawer) for 93 days were over recorded sales by an aggregate of approximately \$4,000. For the remaining 75 days, cash counts were short of recorded sales by approximately \$2,000. However, the cashiers did not deposit all moneys received (counted), but based the deposit amounts on recorded sales. The cafeteria manager told us she retained the surplus cash in an envelope and sometimes used it to supplement cash collections when they were short.<sup>8</sup> Based on the Daily Summary Reports, we anticipated the envelope would contain approximately \$2,000 in cash (the net register surplus). However, the cafeteria manager produced an envelope containing only \$30. Because there was no independent review and reconciliation of variances between recorded sales and cash in the register drawer,<sup>9</sup> District officials do not have adequate assurance that the District receives and deposits the proper amount of revenue from its cafeteria operations.

User Accountability — The cashiers did not sign in with a unique user name and password, but all used the same log-in. Further, the cafeteria manager sometimes allowed an assigned cashier to operate the register under the manager’s active log-in. Accordingly, user reports from the cash register system did not distinguish between users, and District officials cannot establish responsibility for cafeteria register transactions.

As a result of our audit, the Superintendent and Treasurer implemented certain compensating controls after the audit period. The cafeteria manager has been removed from operating the cash register; the

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<sup>8</sup> The Treasurer told us she was unaware of the envelope, and that she had directed the cafeteria manager to base the deposit amounts on the total sales from the Daily Summary Report.

<sup>9</sup> The cafeteria manager and Treasurer attributed the variances to a system “processing error” and said the vendor had been contacted several times about the problem, but they could not provide documentation of those attempts.

Business Office account clerk and/or the Treasurer observes the cash register daily cash-out process; the Business Office account clerk and/or Treasurer recounts the cash (after the cashier's count) before the Treasurer prepares the deposit ticket; the cashier signs the cash count sheet acknowledging the cash has been counted and is correctly stated (declared); and the Business Office account clerk reconciles the declared cash amounts to the total cash on the Daily Summary report.

We observed limited cafeteria operations for three days after these procedures were implemented and, based on this brief observation period, we noted that there were only minimal discrepancies in the cafeteria collections process. District officials are responsible for ongoing review of such compensating controls, and improvement as needed, to reduce the risk of errors or irregularities in the management of cafeteria cash receipts.

## **Recommendation**

6. District officials should monitor the new procedures to ensure that controls are operating effectively, and strengthen them as needed. At a minimum, these controls should include the following:
  - After the cashiers count the cash, someone independent of cafeteria cash collections should verify the declared cash collections and reconcile them to the recorded sales, as shown on the Daily Summary Report. Any variances should be investigated and resolved.
  - The Treasurer should ensure that the actual cash deposited and entered into the District's financial software is based on total sales (collections).
  - District officials should ensure that the cashiers are properly trained to deposit the cash collections in their entirety (without retaining surplus cash), and to record cash receipts promptly into the register system as they are remitted.

## Computerized Data Safeguards

An effective system of internal controls to safeguard computerized data includes policies and procedures adopted by the Board to minimize the loss or corruption of essential data. Computer data is a valuable resource that District officials rely on for processing financial transactions, maintaining student information, providing computer-based education, communicating via e-mail, accessing the Internet, and reporting to State and Federal agencies as well as the public. If the computer on which this data is stored fails or the data is lost or altered either intentionally or unintentionally, the results could range from inconvenient to severe. Even small disruptions in electronic data systems can require extensive time and effort to evaluate and repair. For this reason, access to computer data systems should be controlled and monitored to reduce the risk of misuse and/or alteration of data resulting in potential financial loss to the District. Additionally, computer data should be backed up, and a formal disaster plan should be established to provide guidance on the prevention of the loss of computer data as well as the recovery of computer data in the event of a disaster.

The Board did not adequately assess the IT risks and did not adequately safeguard the District's computerized data and assets by establishing and implementing appropriate controls. The District had no comprehensive policies and procedures addressing user accounts on the District's computer system, such as requiring unique user names and complex passwords; limiting log-in attempts; and ensuring that employee access is promptly disabled upon termination of employment. Further, District officials did not develop a formal disaster recovery plan to guide District personnel in recovering lost data and resuming business operations in the event of a disaster. As a result, the District is at an increased risk of its sensitive information being modified, lost, or improperly disclosed through accidental events or unauthorized use.

### User Accounts

Sound internal controls over computerized data include policies and procedures to limit employees' access to only those areas of the computer system needed for their particular job duties. To control electronic access, a system or application must identify and differentiate among users. User accounts identify users and establish relationships between a user and a network, computer, or application. Typically, the system administrator creates these accounts, which contain information about the users such as their passwords and access rights to files, applications, directories, and other computer resources.

To help prevent unauthorized access to District data, user accounts should be disabled when an employee leaves District service.

Passwords — Passwords are a basic control that can mitigate the risk of unauthorized users obtaining access to the District’s computer systems. The more complex a password, the more effectively it prevents unauthorized users from accessing the system. Strong passwords contain combinations of uppercase and lowercase letters and numbers, have a significant number of characters, and are not simple words or easily guessed names. To help reduce the risk of guessing passwords and the opportunities to do so, the system administrator can limit the number of unsuccessful log-in attempts allowed.

The IT Administrator told us that District officials have not configured the system to require password complexity or to lock the user out of the session after multiple failed log-in attempts, because there was no written policy. For example, the payroll clerk’s password was only four characters long and all lowercase, and the cafeteria manager’s and the cashiers’ passwords were only two characters long. In addition, the cafeteria manager and cashiers were all using the same default user name and password even though they had been assigned unique user names and passwords. Lastly, the Treasurer entered an incorrect password 15 times before successful log-in.

Deactivation of User Accounts — Network user accounts were not immediately removed when the employees left District service. Seven former District employees, including the former IT administrator, still had active user accounts even though they had left District service from four days to two years earlier. Additionally, there were two active user accounts for a County social worker and a volunteer who had both not worked in the District in at least one year. The IT administrator could not provide us with a network user log-in report to show whether these accounts had any actual activity, but removed the accounts as soon as we notified her of them.

These control weaknesses in password requirements and the proper maintenance of user accounts places the District at an increased risk of losing important financial data or incurring serious disruption of District operations – causing, for example, an inability to process checks to pay vendors or employees. In addition, accountability over individual financial transactions is lost by sharing user accounts (see “Cafeteria Cash Receipts,” above). Further, without restrictions on the number of log-in attempts, an unauthorized user is allowed unlimited opportunities to access the system or application, with an increased potential for errors and irregularities to occur and go undetected.

## **Data Backup and Disaster Recovery**

Effective controls over the safeguarding of the District's computerized information include policies and procedures to minimize the loss of essential data and to maintain or quickly resume critical operations. Such procedures require data to be backed up (i.e., a copy made) on a routine basis, and the copy to be stored at an environmentally and physically secure off-site location for retrieval in case of an emergency. The periodic restoration of the backup data is an important test to verify the integrity of the backup data for contingency use. Additionally, a formal disaster recovery plan provides District employees with specific guidance in restoring District systems and data in the event of a disaster, and contingency procedures to resume business operations as efficiently and quickly as possible.

Data Backup — Although the District's financial data was backed up on the dedicated server located in the server room and then backed up to a tape drive daily, the tapes were placed on top of the servers instead of being stored in a separate location. Further, the IT Administrator stated that the backup tapes had never been fully tested to determine if the District's system could be restored in the event of a disaster, because there was no written policy requiring it. However, the Superintendent told us that backup tapes had been used to restore certain files for some District employees.

Because of the significant control weaknesses in the District's data backup and testing procedures, the District is at an increased risk of losing its computerized data if the system were to become compromised and properly tested backup tapes were not available.

Disaster Recovery Plan — An effective disaster recovery plan addresses the possible loss of computer equipment and data and establishes procedures for recovery. Such a plan details the precautions to minimize the effects of any disaster and to enable the District to either maintain or quickly resume its mission-critical functions. Typically, disaster recovery planning requires an analysis of business processes and continuity needs and may include a focus on disaster prevention.

Board members said that they did not establish a formal disaster recovery plan because they were unaware that one was required. Although not required, the development and periodic testing of a disaster recovery plan is good business practice, essential for the protection of the District's computerized data and for the recovery of its business operations in the event of a disaster. Without a formal disaster recovery plan, District personnel have no guidelines to help minimize or prevent the loss of equipment and data, and no contingency procedures for implementing data recovery and resuming business operations as quickly as possible. As a result, the District is

at a significant risk of costly disruption to its business operations, and the potential loss of its essential financial data.

**Recommendation**

7. The Board should adopt policies to safeguard the District's computerized data, and District officials should develop specific procedures to:
  - Strengthen data security through properly structured user accounts and the immediate disabling of active user accounts when employees leave the District
  - Provide for a data backup process that includes secure off-site storage and the periodic test restoration of backup data to verify its integrity
  - Develop a formal disaster recovery plan to guide District personnel in the efficient recovery of data and restoration of business operations in the event of a disaster.

## Classification of Employees

Local governments and school districts obtain services from both public employees and independent contractors and consultants. The Office of the State Comptroller's *Financial Management Guide for Local Governments*<sup>10</sup> provides information to help distinguish between independent contractors and employees. The New York State and Local Retirement System (NYSLRS), which operates the Employees Retirement System (ERS), provides its own checklist of indicators<sup>11</sup> that can help localities and school districts make this determination correctly. In addition, as of April 3, 2008, enhanced regulations are available that more clearly define how local governments and school districts should classify professional service providers as employees or independent contractors. These regulations are posted on the Office of the State Comptroller (OSC) website.

For the period July 1, 2005 through June 28, 2007, we audited the status of persons the District enrolled in ERS to determine whether these individuals met the criteria for employee classification as established by the *Financial Management Guide for Local Governments* and ERS indicators. Although we did not find any material exceptions, the District had no formal procedures for staff to follow in distinguishing employees from independent contractors (for example, checking criteria related to the worker's supervision, reporting structure, work hours, benefits, and so forth), but based such classification on general knowledge of the individual worker. This weakness in internal controls over the District's classification process increases the risk that the District could improperly enroll non-employees in ERS.

### Recommendation

8. District officials should strengthen controls over the employee classification process to help ensure that they correctly determine the status of individuals who work for the District in compliance with the Guide and the enhanced regulations posted on the OSC website.

<sup>10</sup> *Financial Management Guide for Local Governments*, Subsection 8.4020, page 1, issued December 1992

<sup>11</sup> The NYSLRS Checklist: Distinguishing Between an Employee and an Independent Contractor (available from the NYSLRS)

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# MARGARETVILLE CENTRAL SCHOOL

415 MAIN STREET, P.O. BOX 319  
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Building Principal  
Linda J. Taylor

JOHN P. RIEDL, SUPERINTENDENT

Treasurer  
Karen H. Dietrich

Telephone 845-586-2647  
FAX 845-586-2949

May 7, 2008

[REDACTED]  
Office of the State Comptroller  
State Office Building, Room 1702  
44 Hawley Street  
Binghamton, NY 13901-4417


Dear [REDACTED]:

This letter is in response to the draft report that was reviewed with us on April 30 at 3:00PM.

Although we had some discussions around items in each of the major findings, we accept the findings as accurate and as they existed at the time of the Audit.

We appreciated the opportunity to discuss these items with you, and we have corrected the areas of major weakness in every case. It is our intent to have a corrective action plan to you within the ninety-day timeline.

Sincerely,

  
John P. Riedl  
Superintendent

JPR:tkg

## APPENDIX B

### AUDIT METHODOLOGY AND STANDARDS

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

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objective and scope by selecting for audit those areas most at risk. We selected cash receipts and disbursements, purchasing, claims processing, cafeteria cash receipts, safeguards over computerized data and assets, and employee classification for further audit testing. Certain observations and lesser findings related to the use of fuel credit cards were discussed with District officials to help them strengthen internal controls in that area.

In order to accomplish the objective of this audit and obtain valid audit evidences, we interviewed pertinent District officials and performed the following procedures:

#### Segregation of Duties in Cash Receipts and Disbursements:

- We examined two months of cancelled check images to determine if the vendor name and amount was consistent with the vendor name and amount on the District's cash disbursement schedule.
- We tested two months of wire transfers, journal entries, and cash receipts from all funds to determine if they were appropriate and supported by adequate documentation.
- We reviewed two months of bank account reconciliations for accuracy, completeness, timeliness, and approval by the Superintendent.
- We reviewed the check sequence integrity for all funds for the audit period to verify that the checks, both used and unused, were properly accounted for.
- We reviewed a sample of utility bills to ensure they pertained to District facilities.

- We scanned bank statements for the audit period looking for unusual withdrawals or other debits.

#### Procurement Policy:

- We reviewed a judgmentally selected sample of claims packages to ensure that purchases were made in compliance with the District purchasing policy and regulations.
- We reviewed a sample of purchase transactions from vendors that appear frequently to ensure that items purchased were legitimate, reasonable, and proper.

#### Claims Processing:

- We tested 80 claims (two months) to determine if the claims were properly audited prior to payment, if they were reasonable, and if supporting documentation was adequate.
- We traced and examined 416 cancelled checks (two months) to the cash disbursement schedule and to the claims packages to determine if the claims were listed on the warrant and approved by the claims auditor prior to payment.
- We reviewed pertinent documents including cancelled checks, bank statements, purchase requisitions, purchase orders, claim packets, and warrants to determine if purchases were properly initiated, supported, approved, and recorded.

#### Cafeteria Cash Receipts:

- We reviewed pertinent documents including deposit slips and bank statements, cafeteria daily summary reports, and various other cafeteria accounting records and reports to determine their accuracy, completeness, and propriety.
- We observed one of the two cashiers during the cash-out process, and we counted cafeteria cash and compared these amounts to the cash register sales to establish accountability.
- We reviewed the daily cafeteria summary reports for 168 days for the two registers, to document the overage and shortage of the cash registers.
- We verified that selected receipts were recorded accurately and were deposited in a timely manner.
- We scanned the cafeteria register cash log to review for unusual transactions.

#### Fuel Credit Card Purchases:

- We reviewed information on the fuel log sheets (odometer reading, date, gallons purchased, and vehicle) to ensure that mileage per gallon appeared reasonable, and then verified the odometer reading to the actual vehicle for two District vehicles.

- We reviewed gallons purchased per the fuel credit card bills for our audit period and compared this to the vehicle gas capacity to determine if gallons purchased were in excess of the tank capacity.
- We reviewed documentation relating to a previous credit card fraud and related prosecution.
- We reviewed fuel credit card bills for the audit period to determine the percentage of the fuel purchased by the transportation department head versus the total fuel credit card purchases.

#### Computerized Data Safeguards:

- We reviewed current procedures relating to computer access rights, passwords, data backup, and a formal disaster recovery plan, including data recovery.
- We observed District employees' log-in procedures to view passwords, incorrect log-in attempts, and account lockouts after periods of inactivity.
- We inspected computer-related storage areas and the server room.

#### Classification of Employees:

- We reviewed the District's process for classifying workers to ensure that the persons the District enrolls in the Employees Retirement System (ERS) are valid public employees rather than independent contractors or consultants.

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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**DIVISION OF LOCAL GOVERNMENT**  
**AND SCHOOL ACCOUNTABILITY**

Steven J. Hancox, Deputy Comptroller  
John C. Traylor, Assistant Comptroller

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