



New Suffolk Common School District Internal Controls Over Payroll

Report of Examination

Period Covered:

July 1, 2005 — May 31, 2007

2007M-263



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	3
EXECUTIVE SUMMARY	5
INTRODUCTION	6
Background	6
Objective	6
Scope and Methodology	6
Comments of District Officials and Corrective Action	6
INTERNAL CONTROLS OVER PAYROLL	8
Segregation of Duties and Oversight	8
Approval of Employee Pay and Benefits	9
Recommendations	10
APPENDIX A Response From District Officials	12
APPENDIX B OSC Comments on the District's Response	18
APPENDIX C Audit Methodology and Standards	19
APPENDIX D How to Obtain Additional Copies of the Report	20
APPENDIX E Local Regional Office Listing	21

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 2008

Dear School District Officials:

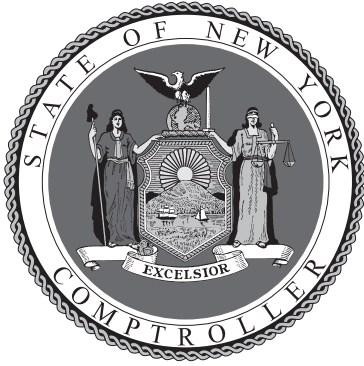
A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, 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 New Suffolk Common School District, entitled Internal Controls Over Payroll. 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

EXECUTIVE SUMMARY

The New Suffolk Common School District is governed by the Board of Trustees (Board) which comprises three 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. Responsibilities relating to the District's finances, accounting records and reports are largely those of the Treasurer.

Scope and Objective

The objective of our audit was to evaluate internal controls over payroll for the period July 1, 2005 through May 31, 2007. Our audit addressed the following related question:

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

Audit Results

Controls over payroll processing are not adequate. The District Treasurer is responsible for all aspects of payroll. Furthermore, payrolls are not reviewed by an individual independent of the payroll process. As a result of these weaknesses, in 2006, the District did not withhold the required withholding and payroll taxes on health insurance buyout payments and extra compensation totaling \$9,327.

There were no Board resolutions, policies or negotiated employment agreements to support the salaries and benefits paid to part-time employees. As a result, employee benefit payments totaling \$19,778 were made to certain part-time employees without any evidence of the Board's approval.

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 agree with our recommendations and indicated they plan to implement corrective action. Appendix B contains our comments on issues raised in the District's response.

Introduction

Background

The New Suffolk Common School District is located in the Town of Southold, Suffolk County. The District is governed by the Board of Trustees (Board) which comprises three 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. Responsibilities relating to the District's finances, accounting records and reports are largely those of the District Treasurer.

There was one school in operation within the District during the 2006-07 year, with nine students attending Kindergarten through Grade 6, and 12 employees. An additional 17 students in Grades 7 -12 attended school at other school districts. The District's budgeted expenditures for the 2006-07 fiscal year were \$772,875, which were funded primarily with real property taxes.

Objective

The objective of our audit was to evaluate internal controls over payroll. Our audit addressed the following related question:

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

Scope and Methodology

We examined payroll internal controls of the New Suffolk Common School District for the period July 1, 2005 to May 31, 2007.

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

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agree with our recommendations and indicated they plan to implement corrective action. Appendix B contains our comments on issues raised in the District's response.

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

Salary and employee benefit costs comprise a significant portion of the District's budget. Therefore, District officials and administrators must ensure that appropriate controls are established to prevent and detect errors and irregularities in the District's payroll procedures and practices. Such controls should ensure that the calculation of pay rates, and compensation for health insurance buyouts is in accordance with employment contracts and District policies. Employment contracts and agreements should address matters such as hours to be worked, rates of compensation to be paid, the amount and method of leave time to be granted, eligibility for health insurance or compensation for employees who opt out of the health insurance plan, and post-employment benefits to be granted.

Internal controls for payroll normally consist of written policies and procedures. Important components of any internal control system include the proper segregation of duties, ensuring that no person controls all phases of a transaction, and effective management oversight procedures.

The District's controls over payroll are not adequate. The District has not adopted a payroll policy and has not segregated the duties relative to preparing and processing payroll. The District has also not established an effective system of controls to adequately oversee the activities of the Treasurer, who was essentially responsible for all aspects of payroll preparation. Therefore, errors occurred and went undetected. The district made payments to some employees that were not in accordance with employment agreements. The Board did not provide employment agreements or pass annual resolutions to authorize compensation and benefits for certain employees.

Segregation of Duties and Oversight

Good internal controls over the payroll process require that no one individual should be responsible for all or substantially all aspects of the operation. This can be accomplished by assigning various payroll functions to multiple employees such as adding new employees to the computer system, updating salary information, and processing the payroll. In smaller districts such as New Suffolk, there are often insufficient resources to allow an optimum segregation of duties. In such cases, alternative control procedures must be developed to help mitigate the heightened control risk that results when, by necessity, an individual is assigned duties that are not compatible. These controls can include having someone independent of the payroll process perform a review of the completed payrolls.

The Treasurer performs all payroll duties including adding new employees into the computerized financial system, updating salary information, processing payroll, signing paychecks along with Board members, distributing paychecks to employees, and receiving and reconciling the payroll bank account statement to the District's books. Furthermore, the Board has authorized the Treasurer to certify completed payrolls. The heightened control risk associated with the Treasurer performing all aspects of payroll is compounded by the fact that the Board has not implemented procedures to ensure that completed payrolls are reviewed or certified by someone independent of the payroll process.

While the District has a limited number of employees between which duties can be segregated, District managers could have mitigated the lack of segregation of duties by assigning an individual separate of payroll processing to add new employees, update salary information, reconcile the payroll bank account. In addition, the Board could have authorized the Superintendent to certify completed payrolls.

The lack of segregation of duties and oversight allowed an error regarding the reporting of certain forms of compensation to occur and go undetected. In calendar year 2006, the District did not report additional compensation on employee's W2s nor did the District withhold the proper Federal and State taxes on compensation totaling \$9,327. These payments included:

- Health insurance buyout payments totaling \$8,978.
- Extra compensation payments totaling \$349.

As a result of this undetected error, the District may be liable for penalties, and interest on the under remittance of taxes to the proper taxing jurisdictions. The failure to provide adequate oversight over payroll duties increases the risk that inappropriate payroll transactions can be committed and concealed, and that errors or irregularities may be undetected.

Approval of Employee Pay and Benefits

Documentation of the Board's authorization of salaries, wages and fringe benefits in writing, by resolution, policy document, or negotiated employee contract is an important control over payroll and fringe benefit expenditures; it communicates the Board's intent and provides a framework for compensating officers and employees that is clearly understood by everyone involved in the process.

The District had 12 employees for the 2005-06 fiscal year. The Board had only three employment agreements, one for the Superintendent and two for the full-time teachers. However, the District did not have an employment agreement with the Superintendent for the 2006-

07 fiscal year. Also, there were no Board resolutions, policies or negotiated employment agreements to support the salaries and benefits paid to the District Treasurer, District Clerk, teacher's aide/secretary, driver, custodian, and part-time and substitute teachers for the audit period. Salaries for these employees were derived from a salary schedule that the Treasurer prepared (using the District's budget for guidance) and the Board President reviewed. However, there is no evidence of formal Board approval. The lack of contractual agreements or resolutions has resulted in the following payments being made without any evidence of the Board's approval:

- Health insurance buyout payments totaling \$11,846 to the teacher's aide and driver.
- Post employment Medicare reimbursement payments totaling \$1,988 to the District's former driver.
- Bonuses and extra compensation for work in addition to regular job responsibilities totaling \$4,937.
- Leave payments to the teacher's aide/secretary totaling \$1,007.

Furthermore, the District paid a stipend of \$3,249 to the head teacher in the 2005-06 fiscal year which was not in accordance with her employment agreement.

The failure to compensate officers and employees in accordance with the terms of authorized contracts and the absence of written employment contracts for certain employees represent significant weaknesses in internal controls over payroll processing and identify the need for the Board to exercise additional oversight over this function. In addition, payments may have been made to District employees in excess of amounts intended by the Board.

Recommendations

1. The District should adopt a comprehensive payroll policy and should develop written procedures to provide guidance regarding payroll processing responsibilities. These procedures should require that payroll registers are certified by someone else independent of the payroll process.
2. Payroll-related duties should be assigned so that the work of one individual independently verifies the others' in the course of their regular duties. At a minimum, the duties of payroll processing should be separate from entering new employee information, deleting employees, and updating salary levels in the computer system.

3. The District should adopt policies and procedures to ensure that payroll and withholding taxes are remitted on health insurance buyout payments, and payments for additional compensation.
4. The Board should formally authorize all compensation and fringe benefits either by employment contracts, District-wide policies, or annual resolutions.
5. The Board should review compensation provided to employees and pursue the repayment of any unauthorized or unintended amounts.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

**NEW SUFFOLK COMMON SCHOOL DISTRICT
7605 NEW SUFFOLK ROAD – PO Box 111
NEW SUFFOLK, NY 11956
631-734-6940**

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ROBERT L. FEGER, SUPERINTENDENT

**New Suffolk Common School District
Internal Controls Over Payroll**

Report of Examination

**Period Covered:
July 1, 2005 – May 31, 2007**

2007M-263

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The Districts official's response to this audit can be found on the following pages.

January 8, 2008

CATEGORY – Internal Controls over Payroll

FINDINGS AND RECOMMENDATIONS -

“The District has not adopted a payroll policy and has not segregated the duties relative to preparing and processing the payroll.”

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN –

1. The District will have a first reading of its Payroll Policy at its regular meeting on December 11, 2007.
2. Segregation of duties relative to preparing and processing the payroll has been implemented. The Superintendent of Schools will review and certify all payrolls prior to distribution effective December 3, 2007. The Board will pass a resolution to that effect at its December 11, 2007 regular meeting.

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CATEGORY – Internal Controls over Payroll

FINDINGS AND RECOMMENDATIONS -

“The Board did not provide employee agreements or pass annual resolution to authorize compensation and benefits for certain employees.”

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN –

1. While the District did not provide separate employment agreements to all District employees, the Board authorized compensation to all employees through the budget development and approval process. Each employee appears as a line item in the budget.
2. The Superintendent will draft salary agreements for all employees citing salary, hourly rate for duties performed outside of regular duties, sick day allowance, vacation day allowance and personal day allowance. Said agreements were presented to the Board for approval at the December 11, 2007 regular board Meeting. The Salary Agreement format was adopted at the December 11th meeting. Individual Salary Agreements will be presented to the Board at the January 8, 2008 meeting for adoption.

See Note 1 Page 18

CATEGORY – Segregation of Duties and Oversight

FINDINGS AND RECOMMENDATIONS -

“...The Board could have authorized the Superintendent to certify completed payrolls.

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN –

At the December 11, 2007 Board of Trustees meeting, the Superintendent was authorized and designated as the individual who will certify completed payrolls.

~ ~ ~ ~ ~

CATEGORY – Segregation of Duties and Oversight

FINDINGS AND RECOMMENDATIONS -

In the calendar year 2006, the district did not report additional compensation on employees' W2s nor did the district withhold the proper Federal and State taxes on compensation totaling \$10,267. These payments included:

1. Health insurance buyout payments totaling \$8,978.
2. Bonuses paid totaling \$550.
3. Extra compensation payments totaling \$739.

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN –

1. Employees are being informed that effective January 1, 2008 all health insurance buyouts will appear on their W2 or 1099. We are awaiting advice on how payments made in 2006 should be handled.
2. Check #s 3069, 3070, and 3071 totaling \$503 were erroneously “memoed” as bonus, but were correctly coded to Account 1621.4 – Capital Improvement/Repairs. They were all reimbursements made for the purchase of materials and supplies used to paint the interior of the school building.
3. Checks #s 2613 and 2929 totaling \$439, payable to Mary Diana Foster were correctly coded under accounts 1240.6 Administrative expenses and 1010 Dues/Print/Postage. Check # 3030 for \$300, payable to Ann Lynch, was correctly coded to Account 8070.4 Census salary.

See Note 2 Page 18

CATEGORY – Approval of Employee Pay and Benefits

FINDINGS AND RECOMMENDATIONS -

“...there were no Board resolutions, policies or negotiated employment agreements to support the salaries and benefits paid to the District Treasurer, District Clerk, teacher’s aide, driver, custodian, and part-time and substitute teachers for the audit period.”

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN –

Salaries and benefits for said employees were negotiated by the Board President and approved by the Board. They all appear as line items in the 2005-06 and 2006-07 budget. Salary agreements for all mentioned employees were drafted by the Superintendent of Schools and presented to the Board for approval at the regular Board Meeting scheduled for January 8, 2008.

See Note 1 Page 18

~ ~ ~ ~ ~

CATEGORY – Approval of Employee Pay and Benefits

FINDINGS AND RECOMMENDATIONS -

“Salaries for these employees were derived from a salary schedule that the Treasurer prepared and the Board President reviewed. However there is no evidence of Board approval.”

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN –

Salaries for these employees were negotiated by the Board President and approved by the Board in the form of line items in the budget. The Treasurer developed a schedule of payment based on the approved salaries.

RECOMMENDATIONS

Recommendation #1 – The District should adopt a comprehensive payroll policy and should develop written procedures to provide guidance regarding payroll processing responsibilities. These procedures should require that payroll registers are certified by someone else independent of the payroll process.

See Note 1 Page 18

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN

To this end, the Board has had a first reading of policies related to financial controls at its December 11, 2007 meeting. Said policies are likely to be adopted at the January 8, 2008 meeting. At its December 11th 2007 meeting, the Board designated the Superintendent as the individual responsible to certify payroll registers.

Recommendation #2 – Payroll related duties should be assigned so that the work of one individual independently verifies the others' in the course of their regular duties. At a minimum the duties of payroll processing should be separate from entering new employee information, deleting employees and updating salary levels in the computer system.

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN

The Superintendent has been assigned the responsibility to certify payrolls before they are issued. In addition, all changes to employee records as mentioned require approval of the Superintendent.

Recommendation #3 – The District should adopt policies and procedures to insure that payroll and withholding taxes are remitted on health insurance buyout payments, and payments for additional compensation.

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN

We are currently in the process of approving such policies and procedures at the Board level.

Recommendation #4 – The Board should formally authorize all compensation and fringe benefit either by employment contracts, district-wide policies or annual resolutions.

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN

The Board has adopted a format for employment contracts. They will be implemented at the January 11, 2008 Board meeting. The Board currently authorizes, through annual budget line resolutions. District-wide policies are currently being put in place on a meeting-by-meeting basis.

Recommendation #5 – The Board should review compensation provided to employees and pursue the repayment of any unauthorized or intended amounts.

SUGGESTIONS FOR CHANGE OR REMEDIATION PLAN

The Board President has completed this process with the Treasurer and it was determined that there were no unintended amounts.

Submitted by: Robert L. Feger, Superintendent

Date: January 9, 2008



APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

A line item in the District's budget is not sufficient to determine an employee's rate of compensation and benefits (including insurance coverage, leave time, etc.). It merely represents the total amount of money the District estimates it will expend during the coming fiscal year for a particular purpose. In addition, the annual compensation for certain employees, such as the District's three part-time teachers, is posted to a single line item in the budget.

Note 2

We have reduced the total amount reported in the finding to \$9,327 to reflect the fact that \$940 that we had originally included represented reimbursements to employees for purchases of materials and supplies. As such, these payments would not have been included in their salary payments and should not be included in W2 statements reported to the Federal and State governments.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

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

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected payroll for further audit testing.

- We interviewed appropriate District officials and employees to gain an understanding of the procedures used to process the District's payroll.
- To determine the proper withholding of payroll and withholding taxes, we traced 2006 earnings from payroll and cash disbursement reports to W2's.
- To determine if the board formally approved salary and benefits, we reviewed payroll and cash disbursement reports, employment agreements, and the districts minutes. .

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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