



# Oxford Academy and Central School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — January 22, 2008

2008M-116



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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

September 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 Oxford Academy and Central School District, entitled *Internal Controls Over Selected Financial Operations*. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's Authority as set forth in Article 3 of the General Municipal Law.

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

Respectfully submitted,

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



## State of New York Office of the State Comptroller

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### EXECUTIVE SUMMARY

The Oxford Academy and 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 Board and District officials are responsible for establishing policies and implementing procedures to ensure that District assets, including computerized data, are safeguarded from unauthorized use or disposition and are accounted for properly. The Board must ensure that the District does not pay claims unless they have been audited and approved for payment by the Board or by a Board-appointed claims auditor who is appointed in compliance with the State Education Department's (SED) regulations. The Board must also appoint a Treasurer to manage District moneys and establish policies to properly segregate the Treasurer's duties. In addition, the Board must establish policies and District officials must implement procedures to adequately protect the District's information technology system. The Superintendent and the District's Business Official are responsible for ensuring that these policies and procedures are communicated to staff members and enforced.

#### **Scope and Objective**

The objective of our audit was to determine if internal controls over selected financial operations and information technology were appropriately designed and operating effectively to adequately safeguard district assets for the period of July 1, 2006 to January 22, 2008. Our audit addressed the following related questions:

- Did the Board appoint a claims auditor in accordance with State Education Department regulations and ensure that claims were audited prior to payment?
- Did District officials ensure that internal controls over cash disbursements were appropriately designed and operating effectively?
- Did the Board and District officials establish policies and implement procedures to adequately protect the District's information technology system?

#### **Audit Results**

The Board did not appoint a claims auditor in accordance with SED regulations. The Board appointed the Delaware-Chenango-Madison-Otsego Board of Cooperative Educational Services (DCMO

BOCES) to act as their claims auditor, which was a direct violation of SED regulations. However, we found that the audit of claims by DCMO BOCES was proper and complete in nature.

District officials did not ensure that internal controls over cash disbursements were appropriately designed and operating effectively. District officials failed to segregate the Treasurer's duties or implement compensating controls until her retirement in November 2007, when the Board appointed a new Treasurer. In addition, the new Treasurer did not supervise and control the use of his facsimile signature or compare signed checks to certified warrants for accuracy and consistency before allowing checks to be distributed. Although our review of canceled checks and wire transfers totaling \$1,533,272 did not disclose material discrepancies, the District's lack of internal controls over cash disbursements increases the risk that errors or irregularities could occur and remain undetected and uncorrected.

The Board and District officials have not established comprehensive policies and procedures to adequately protect the District's information technology system. Specifically, the Board and District officials did not establish policies or implement procedures to develop strong passwords<sup>1</sup> or create a formal disaster recovery plan. These weaknesses significantly increase the risk that sensitive or mission-critical data and hardware may be lost, compromised or damaged, and the District's computer data system could be disrupted.

### **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.

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<sup>1</sup> Strong passwords contain a combination of upper- and lower-case letters and at least eight characters.

# Introduction

## Background

The Oxford Academy and Central School District (District) is located in the towns of Oxford, Coventry, McDonough, Norwich, Pharsalia, Preston, and Smithville in Chenango 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.

There are two schools in operation within the District, with approximately 950 students and 240 employees. The District's expenditures for the 2006-07 fiscal year were \$15.7 million, which were funded primarily with State aid, real property taxes, and grants. The District uses the Delaware-Chenango-Madison-Otsego Board of Cooperative Educational Services (DCMO BOCES) for educational and administrative services. During the 2006-07 fiscal year, the District paid DCMO BOCES \$4.5 million for these services.

In January 2007, the Board appointed DCMO BOCES to be the District's claims auditor. An employee from DCMO BOCES audited all of the District's claims, including claims from DCMO BOCES, until September 2007.

Annually, the Board appoints a Treasurer. The Treasurer, under the supervision of the Superintendent, is responsible for the custody, receipt and disbursement of District moneys. When the Treasurer retired in November 2007, the Board appointed the District's Business Official as the new Treasurer.

The Board is also responsible for adopting policies, and District officials must implement procedures and develop safeguards to protect computerized data. The District employs an information technology staff person, who, along with District officials, oversees the District's computer system. The District uses one networked computerized system, which is supported by Broome-Tioga BOCES Regional Information Center.

## Objective

The objective of our audit was to examine the District's internal controls over selected financial operations and information technology. Our audit addressed the following related questions:

- Did the Board appoint a claims auditor in accordance with State Education Department regulations and ensure that claims were audited prior to payment?
- Did District officials ensure that internal controls over cash disbursements were appropriately designed and operating effectively?
- Did the Board and District officials establish policies and implement procedures to adequately protect the District's information technology system?

**Scope and Methodology**

We examined the District's internal controls over claims processing, cash disbursements and information technology for the period July 1, 2006 to January 22, 2008. Because of the sensitivity of some of the information technology findings, certain specific vulnerabilities are not discussed in this report but have been communicated separately to District officials so they could take corrective action.

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 GML, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

## Claims Auditing

Conducting a proper audit of claims before the District pays them is an integral part of any internal control system. Education Law requires the Board to audit each claim voucher before authorizing payment. Education Law further authorizes the Board to adopt a resolution to appoint a claims auditor to perform this important function. The claims auditor assumes the Board's powers and duties for approving and disapproving claims against the District. If the Board chooses to appoint a claims auditor, the claims auditor must not perform any other business function in the District, have an interest in any contracts, or provide any other goods and services to the school district to help ensure an independent review of claims. Education Law does not permit the Board to appoint more than one claims auditor; therefore, the claims auditor must audit all claims against the District.<sup>2</sup>

State Education Department (SED) guidance on interpreting regulations<sup>3</sup> states that it may not be appropriate for a Board of Cooperative Education Services (BOCES) to provide claims auditing services to its component districts because most of these districts would have material and significant contract payments<sup>4</sup> to that BOCES.

Prior to our audit period, the Board appointed a District business teacher to act as the District's claims auditor. In September 2006, the teacher was promoted to Principal and could no longer hold the claims auditor position. At that time, District officials conducted a search for a qualified claims auditor to replace her. In December 2006, the Board appointed DCMO BOCES as the District's claims auditor, and DCMO BOCES assigned one of their employees to audit all District claims. According to the Business Official, after three months of searching, District officials regarded the appointment of DCMO BOCES as the District's claims auditor as the only competent option. However, because the District made significant purchases from DCMO BOCES, this entity did not meet SED independence standards for providing District claims audit services.

<sup>2</sup> See questions 7, 12 and 13 of the SED document entitled *School District Accountability Question and Answers*, dated August 25, 2006.

<sup>3</sup> Amendment of the Regulations of the Commissioner of Education

<sup>4</sup> Contract payments include all payments paid to a BOCES for goods and services provided to the District, which, if significant or material, may impair the claims auditor's independence and result in a conflict of interest.

Beginning in January 2007, DCMO BOCES audited and approved all District claims, including over \$3 million in claims payable to DCMO BOCES. In September 2007, the Board recognized DCMO BOCES' independence impairment when auditing claims that were payable to themselves. The Board instructed the Business Official to audit all future claims payable to DCMO BOCES and recommend whether the District should pay or reject them. The Business Official now audits all claims payable to DCMO BOCES. However, there is no legal authority for anyone other than the appointed claims auditor to audit and approve District claims, and no one involved in the District's business functions should audit District claims.

Because the DCMO BOCES did not meet SED independence standards for claims audit services, we examined 94 claims that were audited by DCMO BOCES. We found that DCMO BOCES did an effective job of auditing claims and reporting their findings to business officials and the Board. In addition, we reviewed two claims payable to DCMO BOCES that were audited by the Business Official and determined that he did conduct a complete audit of these claims.

Although our review revealed no discrepancies, the District's failure to appoint a claims auditor in compliance with SED regulations increases the risk that District monies could be misused and discrepancies could occur and not be corrected in a timely manner.

## **Recommendation**

1. The Board should appoint a claims auditor who meets the requirements, including the independence standard, established by SED regulations.

## Cash Disbursements

District officials must establish an internal control system that ensures that no individual exercises control over all or most of the aspects of the cash disbursement process. Key duties of the Treasurer's office (i.e., authorization, recordkeeping, custody, and disbursement) should be segregated so that the work of one employee is routinely verified by another. If it is not feasible to segregate incompatible duties because of limited staffing, the Board should implement compensating controls that include appropriate oversight by an individual who is not involved in the function that is being reviewed. As the official responsible for signing checks, the Treasurer plays a critical role in the cash disbursement process. If a facsimile signature is used, the Treasurer must supervise and control his/her signature to ensure that checks are for correct amounts and appropriate purposes.

District officials did not appropriately design internal controls over cash disbursements. The former Treasurer performed duties that controlled most of the aspects of the cash disbursement process. We also found that the Business Official/Treasurer did not adequately control his facsimile signature. Because the Board did not appropriately design internal controls over cash disbursements, there is an increased risk that errors or irregularities could occur and remain undetected and uncorrected.

### Segregation of Duties

The same individual must not prepare and disburse checks, perform electronic banking transactions, record transactions and perform bank reconciliations. If proper segregation of duties is not feasible, at a minimum, the Board should implement compensating controls. Compensating controls include appointing someone independent of the process to review the accounting records to ensure that they are up-to-date, complete, and accurate; and/or review the bank statements and reconciliations on a monthly basis to ensure that cash disbursements are accounted for properly.

We found that the District did not properly segregate cash disbursement duties or implement compensating controls. The former Treasurer was responsible for preparing and signing checks, preparing and recording journal entries, performing electronic banking transactions, and preparing monthly bank reconciliations with little or no oversight. District officials assigned all cash disbursement duties to the Treasurer because the Board had instituted a policy that stated that the Treasurer was responsible for all aspects of the cash disbursement process. When the Treasurer retired in November 2007, District officials appointed the Business Official as Treasurer. All of the former Treasurer's cash

disbursement duties were assigned to a senior account clerk. The District did not segregate the senior account clerk's cash disbursement duties, and the Business Official/Treasurer did not review the senior account clerk's work.

As a result of the District's lack of segregation of duties over cash disbursements, we reviewed 82 canceled checks totaling \$398,789 that were prepared and disbursed by the former Treasurer and 43 canceled checks totaling \$790,595 that were prepared and disbursed by the senior account clerk to ensure that the canceled checks agreed with supporting documentation. We also reviewed electronic transfers and wire transfers totaling \$343,888 that were prepared and disbursed by the former Treasurer to ensure that the transfers/wires agreed with supporting documentation. Although our review did not disclose any discrepancies, concentrating duties with one individual with little or no oversight increases the risk that errors or irregularities could occur and go undetected.

### **Facsimile Signature**

The Treasurer has the authority to sign the District's checks and, if authorized by the Board, may sign checks with a facsimile signature. The Treasurer must directly supervise and control the use of his/her facsimile signature to prevent the improper use of District moneys.

The District uses a computer program to print checks that affixes the Business Official/Treasurer's facsimile signature. Historically, the District has assigned the check printing process to the person who completes accounts payable. Because the former Treasurer completed accounts payable, she was responsible for the check printing process. The former Treasurer maintained control over her facsimile signature because she oversaw the check-printing process. When she retired, the Treasurer's accounts payable duties were reassigned to a senior account clerk. After his appointment, the Business Official/Treasurer did not maintain control over his facsimile signature. When asked why he did not control his facsimile signature, the Business Official/Treasurer explained that District officials did not think to reassign oversight of the check-printing process from accounts payable to the Business Official/Treasurer when the former Treasurer retired. We did note that he took steps to restrict the access to his facsimile signature only to himself when we informed him that he should maintain control of his facsimile signature.

As mentioned above, we reviewed 43 canceled checks totaling \$790,595 that were prepared and disbursed by the senior account clerk and contained the Business Official/Treasurer's facsimile signature and found no discrepancies. Once the Business Official/Treasurer obtains control over his facsimile signature, he should maintain it to reduce the chance that errors could occur and go undetected and uncorrected.

## **Recommendations**

2. District officials should institute controls to segregate duties over cash disbursements. If it is not feasible to segregate incompatible duties, District officials should establish supervisory review procedures and other compensating controls to mitigate specific risks.
3. The Business Official/Treasurer should directly supervise and control the use of his facsimile signature.

## Information Technology

District officials rely on information technology (IT) to generate computerized data to make financial decisions and report to state and federal agencies. The potential consequences of a system failure can range from inconvenient to severe; even small disruptions in processing can require extensive time and effort to evaluate and repair. The Board must ensure that access to the District's computerized system is controlled and monitored, and it is imperative that the Board establish a formal disaster recovery plan.

The Board is responsible for adopting policies and District officials are responsible for implementing procedures to safeguard computerized data and assets. In addition, the Superintendent and the IT staff person are responsible for ensuring that District officials and employees adhere to adopted policies and procedures. The Board has not effectively addressed the safeguarding of computerized data and assets by establishing and monitoring policies and procedures. Specifically, the District did not establish strong password<sup>5</sup> requirements and did not establish a disaster recovery plan.

### Passwords

To protect computerized data, the Board must adopt policies and District officials must implement procedures that require the use of strong passwords to gain access to computer networks and applications. Policies and procedures must require passwords to be complex in nature, changed every 30 to 90 days, limit the number of failed attempts to access the system to three or four times, and provide for a network time-out<sup>6</sup> after a reasonable period of inactivity.

We found that the Board and District officials have not adopted comprehensive policies or implemented procedures to address the use of strong passwords or the timing-out of computers after a reasonable period of inactivity. Individual users select their passwords with no complexity requirements, and, once established, passwords never need to be changed. Further, the District's computers are not set up to time-out after a set period of inactivity.

If a password system is not strong, the risk is increased that unauthorized users could obtain and use passwords to gain access to the District's computer system and applications. Additionally, when terminals do not time-out, unauthorized users could easily use an

<sup>5</sup> Strong passwords contain a combination of upper- and lower-case letters, punctuation and at least eight characters.

<sup>6</sup> A network time out requires employees to re-enter their user names and passwords to gain access to the system after a set period of inactivity.

unattended terminal to gain access to any application that is open and running on the terminal. Once unauthorized users gain access, they may have the ability to obtain sensitive and confidential data that they could change or delete.

## **Disaster Recovery Plan and Backup**

The District's IT system is a critical resource that must be adequately protected against loss, damage, or misuse. An effective internal control system for IT requires a formal disaster recovery plan to prevent the potential loss of computer resources, and to outline procedures for the recovery of data in the event of a disaster. A disaster<sup>7</sup> recovery plan (DRP), sometimes referred to as a business continuity plan or business process contingency plan, describes how an organization must deal with potential disasters. It describes the precautions that must be taken to minimize the effects of a disaster and enable the organization to restore data and either maintain or quickly resume its mission-critical functions. Typically, disaster recovery planning involves an analysis of business processes and continuity needs, and may also include a significant focus on disaster prevention.

We interviewed the District's IT staff person and found that the Board and District officials have not established a DRP or implemented adequate procedures to ensure that computer data backups are protected from loss. Because the school is located on a flood plain, there is greater risk that a natural disaster could occur, which necessitates the need for the Board and District officials to establish and implement a strong DRP. We did note that the District experienced a flood in June 2006, and no interruption of District operations occurred because staff members moved the servers to higher shelves, which saved them from loss. In addition, although the IT staff person completes daily backups of computer files, these backups are stored on-site. If a disaster caused computer-failure and rendered the school site inaccessible, back-up copies stored on-site would also be inaccessible, which could cause irreplaceable data to be lost. Loss of data could lead to serious interruptions of District operations, such as the inability to process checks to pay vendors or employees. The IT staff person told us that the District plans to obtain an off-site storage location for computer file backups.

Without a disaster recovery plan, District employees do not have a clear understanding of the procedures and processes that they must follow in the event of a disaster. As a result, the District could lose irreplaceable data, which could seriously interrupt the District's operations.

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<sup>7</sup> A disaster is defined as a sudden, unplanned catastrophic event that compromises the integrity and data of the IT systems. This could include a fire, computer virus, or inadvertent employee action.

## Recommendations

4. The Board and District officials should adopt policies and implement procedures regarding passwords that require:
  - a. Users to create strong passwords that are at least eight characters, and contain upper- and lower-case letters
  - b. Employees to change their passwords every 30 to 90 days
  - c. That all computers time-out after a set period of inactivity.
5. The Board and District officials should adopt and implement a comprehensive disaster recovery plan that details specific guidelines for the protection of computerized data against damage, loss, or destruction.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# Oxford Academy and Central School



P.O. Box 192 • Oxford, New York 13830 • 607-843-2025  
www.oxac.org

## District Office

Superintendent: ext. 4041  
Randall Squier  
Clerk: ext. 4040  
Michele Rice  
Business Office: ext. 4046  
Harold Covey  
Student Learning: ext. 4045  
Janet Laytham  
Fax 843-3241

## High School

Principal: ext. 1305  
Christine Pierce  
Nurse: ext. 3302  
Counselor: ext. 1130  
Virginia Pluta  
Fax: 843-3231

## Middle School

Principal: ext. 2521  
Kathleen Hansen  
Nurse: ext. 2523  
Counselor: ext. 2518  
Susan Franco  
Fax: 843-3211

## Primary School

Principal: ext. 3118  
Timothy McDonald  
Nurse: ext. 3105  
Counselor: ext. 3200  
Cheryl Polhamus  
Fax: 843-7030

## Special Programs

Office: ext. 2501  
Dawn Hover  
Fax: 843-3241

## Food Service

Office: ext. 3102

## Transportation

Office: ext. 2508

## Buildings & Grounds

Office: ext. 1156

## Athletics

Office: ext. 1148

August 29, 2008

[REDACTED]  
Office of the State Comptroller  
Division of Local Government and School Accountability  
State Office Building, Room 1702  
44 Hawley Street  
Binghamton, New York 13901

Dear [REDACTED]:

The Oxford Academy and Central School received the draft findings of the report of the audit conducted by the State of New York, Office of the State Comptroller on August 8<sup>th</sup>, 2008 and met with representatives on August 14<sup>th</sup>. Our response is as follows:

**Claims Auditing:** The district understands the position of the report and will continue to work with the State Education Department to bring clarity to the guidance it issues interpreting the regulations regarding the claims auditor.


**Cash Disbursements:** The district agrees with the audit report findings and has put in place additional segregation of duties and safeguards regarding control of facsimile signatures.

**Information Technology:** The district agrees with the audit report findings and has re-established procedures to safeguard passwords and computer access and has created a disaster recovery plan that reflects established and current practices.

We appreciate the time spent and information we received in this report and thank the local auditors for their professionalism and due diligence in drafting this audit report.

  
Robin DeBrita  
President, Board of Education

9/3/08  
Date

  
Randall W. Squier  
Superintendent of Schools

9/3/08  
Date

## 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 systems.

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 claims auditing, cash disbursements and information technology for further audit testing.

To accomplish the objective of the audit and obtain valid audit evidence, our procedures included the following:

- We obtained an understanding of the claims auditing, cash disbursements and information technology systems by interviewing staff members and reviewing adopted policies and procedures.
- We reviewed the warrants for 94 claims totaling \$961,309 to ensure that the District conducted a proper audit of claims. Our review included determining that the claims auditor ensured that all of the required documentation was included and that purchases were for legitimate District expenses prior to approving the claim for payment.
- We reviewed three bank wires totaling \$101,228 by tracing wires from bank statements to supporting documentation to ensure that the bank wires were proper and supported.
- We reviewed three bank transfers totaling \$242,660 by tracing transfers from bank statements to supporting documentation to ensure that the bank transfers were proper and supported.
- We reviewed 125 canceled checks totaling \$1,189,384 by tracing from check copies, then to vouchers, then to warrants to ensure that canceled checks agreed with supporting documentation. We did not note any hand-drawn checks. The former Treasurer disbursed 82

of these checks totaling \$398,789, and the senior account clerk disbursed 43 of these checks totaling \$790,595.

- We traced book balances that were reported on six bank reconciliations to general ledger balances and reviewed checks listed as outstanding on those reconciliations to ensure that they were not reported as cleared on bank statements and that the bank reconciliations were performed timely and accurately.
- We verified check sequence integrity by reviewing cleared checks as reported on bank statements and noted and investigated any gaps in check numbers.
- We conducted interviews with District staff members to determine if the controls regarding computer access passwords were strong.
- We conducted interviews with District staff members and inspected terminals to determine if computers timed-out after a set time period.

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.

## APPENDIX C

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

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