



Piseco Common School District Internal Controls Over Payroll

Report of Examination

Period Covered:

July 1, 2005 — May 31, 2007

2007M-280



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

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

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

Respectfully submitted,

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

Introduction

Background

The Piseco Common School District (District) is located in the Towns of Arietta and Morehouse in Hamilton County. The District is governed by the Board of Education (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.

There is one school in operation within the District, with approximately 30 students, eight full-time employees and 17 other employees including part-time, summer help and substitutes. The District's actual expenditures for the 2006-07 fiscal year were \$901,422, which were funded primarily with State aid, real property taxes, and grants. The District's major expenditures include employee salaries and related fringe benefits, which were \$582,767 for the 2005-06 fiscal year and \$548,917 for the 2006-07 fiscal year.

The District Treasurer (Treasurer) is responsible for the day-to-day functions related to the District's finances and accounting records. The Treasurer, who works at a satellite location 20 miles from the District, controls the majority of the payroll process.

The District also employs a Secretary to the Superintendent (Secretary) who works at the District office. She collects the timesheets and forwards them to the Treasurer for processing. The Secretary also maintains the leave records for District employees.

Objective

The objective of our audit was to determine whether the Board established appropriate policies and procedures and internal controls over payroll processing. Specifically, our audit addressed the following related question:

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

Scope and Methodology

During this audit we examined internal controls over payroll for the 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 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 that they have initiated 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*.

Payroll

An effective system of internal controls over payroll processing should ensure that employees are properly paid the wages and salaries and provided the benefits to which they are duly entitled. Internal controls over payroll consist of written policies and procedures that describe employee responsibilities in preparing and disbursing payroll, as well as written Board authorization for salaries, wages and fringe benefits. Two essential components of any internal control system are proper segregation of duties to ensure that no one person controls all phases of a transaction, and management oversight.

Payroll is the District's most significant operating cost and represents 61 percent of the total expenditures for the 2006-07 fiscal year. As such, it is essential that management designs and implements effective controls over the payroll process.

The District did not have written payroll policies and procedures in place, which resulted in the Treasurer and Secretary developing their own informal procedures. As a result, we found instances where employee pay and leave accruals were not accounted for properly. In addition, there was a general lack of management oversight and segregation of duties in the Business Office that allowed for errors and irregularities to occur and go undetected.

Policies and Procedures

Written payroll policies and procedures combined with job descriptions help ensure that payroll is processed consistently and accurately, and provide a framework for employees to understand the Board's objectives and each individual's role in the process. Written policies are particularly important when a separation of duties is needed to provide an adequate level of internal controls.

The District had not established any written policies and procedures to describe employee responsibilities in processing and distributing bi-weekly payrolls or maintaining leave records. In the absence of a written policy, the Treasurer and Secretary developed informal systems for processing payroll and accounting for leave accruals. As a result, during the fiscal year ended June 30, 2007, the Treasurer was solely responsible for processing approximately \$549,000 in payroll and related fringe benefits for eight employees with limited oversight by anyone independent of the process. Similarly, the Secretary was directly responsible for maintaining the leave accruals for all employees in the District with no oversight by anyone independent of the process.

The Board's failure to provide specific guidance through well-developed policies and procedures could lead to the neglect of key internal control activities and the occurrence of errors or irregularities.

Separation of Duties

An important principal of internal control requires that one person not have uncontrolled access to an entire processing cycle. It is important that the Board establish a system of checks and balances over payroll so that one person does not exercise control over all or most of the process. Management should not allow one person to perform the three key payroll duties of authorization (entering employee records, and changing hourly and annual salary amounts), recordkeeping (inputting time worked, posting of payroll to the accounting records), and asset custody (distributing checks).

If the District's limited staff size precludes establishing an adequate segregate duties, the Board, at a minimum, should consider mitigating this internal control weakness by having someone independent of the preparation process perform a review of the completed payrolls and accrual records. The review should include random checks to verify that payrolls are based on actual hours or days worked and/or the use of authorized leave time, verification that the hourly rates or annual salaries used were properly authorized by the Board, a comparison of net payrolls to payroll journals, and an overall assessment of the payroll for reasonableness.

The Treasurer was directly responsible for the following payroll duties: adding and deleting employees, entering payroll changes, entering hours worked and salaries paid, and maintaining custody of the payroll checks. We verified that seven employees receiving compensation were not fictitious by reviewing the Detailed Payroll Check Register Reports, and appointments and resignations noted in the Board minutes and the 941 Forms (Employer's Quarterly Federal Tax Return). We scanned the payroll records for the 2005-06 fiscal year and the 2006-07 fiscal year and found no indication that anyone independent of the payroll process reviewed and certified payrolls prior to payment. The only oversight included in the District's payroll system occurred when the Board President signed payroll checks. However, there was no indication the Board President compared the checks to the payroll journal or performed any other procedures to verify the accuracy of the payroll.

The Board is responsible for establishing a system of checks and balances so that one person does not exercise control over all or most of the payroll process. Not having someone independent of the payroll process review the completed bi-weekly payrolls increases the risk that errors and/or irregularities could occur and go undetected.

Leave Accrual and Usage Records

Paid leave time is an employee benefit granted to District employees pursuant to collective bargaining agreements or employment contracts. Because Districts often provide cash payments to employees for all or a portion of their accrued leave time when they leave service, it is especially important to maintain accurate leave accrual and usage records. The District does not have written policies and procedures relating to the verification, approval and monitoring of unused leave time. In the absence of written policies and procedures, the Secretary developed her own informal method to account for leave accruals. This consists of recording absences on a manual record for each employee and posting these once a year to a leave record form.

We selected seven employees and traced 24 instances of personal, vacation and sick leave used during the period July 2005 to March 2007 to determine if the District had adequate procedures in place to monitor District officials and employees leave accruals and to verify that leave usage was properly approved, recorded and available. Although we only noted three instances where leave request forms were not submitted, leave was not approved and leave usage could not be traced to attendance/time records. The failure to maintain complete and up-to-date leave accrual and usage records increases the risk that payments for leave time may be made to District employees to which they are not entitled.

Attendance Records

Properly designed and maintained time records are an important element of good internal controls over payroll. Employees maintaining daily records of their hours worked and/or absences are an important component of these controls. Therefore, time records should contain the information necessary to account for an employee's entire workday, including starting and ending times, leave charges and meal periods. All time cards, time sheets and time summaries should be reviewed and signed by the employee and their respective department supervisor.

Employees maintaining timesheets are required to submit them to the Secretary before the timesheets are forwarded to the Treasurer for payroll processing. If a timesheet is not completed, the Secretary forwards a timesheet to the Treasurer using estimates of the hours worked. Timesheets are not compared to leave requests or reviewed by supervisors prior to being submitted to the Treasurer for processing.

For 11 employees, we tested 39 time records submitted for six payroll periods totaling \$44,100 to verify that payments were made for actual services rendered, were properly recorded and were at approved pay rates. Gross payroll costs for the District average \$15,400 every two weeks. Although all employees tested were paid at their approved

rates, there were five instances when the hours worked recorded on the timesheets were inaccurate because the time was estimated and submitted by the Secretary and not the actual employee. However, we were able to confirm that appropriate adjustments for these inaccuracies were made in the subsequent pay period.

We also tested 30 additional timesheets submitted by District employees to determine if they contained required employee signatures and evidence of supervisory approval. None of the 30 timesheets tested were reviewed and approved by the appropriate department supervisor and 13 lacked the employee's signature.

The failure to maintain appropriate time and leave records makes it difficult to confirm that employees worked the hours for which they are paid. The absence of appropriate supervisory approvals on time and leave records compounds the risk of errors or irregularities.

Recommendations

1. The Board should develop and adopt a comprehensive payroll policy. District officials should develop written procedures to guide those involved with payroll processing responsibilities. These procedures should require that:
 - Duties be segregated to the extent possible so that no one person controls all aspects of the payroll process
 - An independent verification of payroll calculations is routinely performed
 - Payroll registers are certified by a Board-authorized official.
2. The Board should ensure that District personnel accurately record charges to leave accruals for all officers and employees entitled to leave benefits. Leave request forms should be used to record leave approvals and usage.
3. The Board and District officials should require that all timesheets are prepared and signed by employees and approved by their supervisors.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

PISECO COMMON SCHOOL DISTRICT
P.O. Box 7, Route 8
Piseco, N.Y. 12139
(518) 548-7555 phone (518) 548-5310 fax

February 25, 2008

[REDACTED]
Office of the State Comptroller
One Broad Street Plaza
Glens Falls, N.Y. 12801

[REDACTED],

This letter is in response to your correspondence of January 28, 2008, regarding the preliminary draft findings contained therein regarding your examination of the Piseco Common School District – Internal Controls Over Payroll. As was discussed at the exit discussion held on January 31, 2008, the Piseco Common School District is in agreement with your findings and we have already taken corrective action to address your concerns.

We appreciated the opportunity to work with you and your staff on this important project. If you need any further information regarding this matter, please feel free to contact me at your earliest convenience.

Regards,



Peter J. Hallock
Superintendent

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. 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 and personnel services for further audit testing.

During the audit, we examined the payroll records and reports for the period July 1, 2005 to May 31, 2007. To accomplish the objectives of the audit and obtain valid audit evidence, our procedures included the following steps:

- Interviewed and observed appropriate District officials and employees to learn about procedures used to process payrolls
- Reviewed all collective bargaining agreements and individual employee contracts for our audit period to ensure salary payments were properly authorized and in accordance with the agreements
- Reviewed and tested seven employees' leave time records for accuracy
- Reviewed and tested 11 employees' 2005-06 and 2006-07 salaries to ensure all payments were legitimate and calculated correctly
- Reviewed and tested five employees' timesheets to verify timesheets were reviewed and approved by the appropriate department supervisor
- Verified that employees receiving compensation were not fictitious by reviewing the Detailed Payroll Check Register Reports, and appointments and resignations noted in the Board minutes and the 941 Forms (Employer's Quarterly Federal Tax Return) for seven employees.

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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