



# Poland Central School District Internal Controls Over Cash Disbursements

Report of Examination

Period Covered:

July 1, 2006 — August 31, 2007

2008M-88



Thomas P. DiNapoli

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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 Poland Central School District, entitled Internal Controls Over Cash Disbursements. 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 Poland Central School District (District) is located in the Towns of Newport, Norway, Ohio, Russia, Salisbury and Webb in Herkimer County; the Town of Deerfield in Oneida County and the Town of Morehouse in Hamilton County. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are two schools in operation within the District, with approximately 750 students and 150 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$10,882,010, which were funded primarily with State aid, real property taxes and grants.

The Business Office staff consists of the Business Manager, the Treasurer/accounts payable clerk (Treasurer) and a Deputy Treasurer/payroll clerk (Deputy Treasurer). They are responsible for maintaining the District's financial accounting records and reports, and processing the District's cash receipts and disbursements, purchasing, accounts payable and payroll. The Madison-Oneida Board of Cooperative Educational Services (BOCES) personnel print District payroll checks and apply the Deputy Treasurer's computerized signature to checks at BOCES. The Board appoints the claims auditor on an annual basis.

## Objective

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

- Are internal controls over cash disbursements appropriately designed and operating effectively to adequately safeguard District assets?

## Scope and Methodology

We examined internal controls over cash disbursements of the Poland Central School District for the period July 1, 2006 to August 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 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*.

## Cash Disbursements

District management is responsible for implementing the Board's control directives by designing and documenting appropriate operating policies, practices and procedures, and properly delineating employee responsibilities to ensure that cash is disbursed only upon proper authorization. Duties must be segregated so that no single individual controls all phases of a transaction. When internal controls are not designed appropriately or operating effectively, it increases the risk that errors and irregularities such as unauthorized payments may occur and not be detected and corrected.

Our review disclosed that the District did not appropriately segregate the duties of the Treasurer and the Deputy Treasurer, nor did they establish sufficient compensating controls. Both the Treasurer and the Deputy Treasurer had access rights to all accounting functions in the computerized accounting system. This exposed the District to the risk that improper payments could be made and records could be altered to prevent detection. In addition, the Treasurer does not maintain adequate control over her signature. BOCES personnel apply the Treasurer's computerized signature to payroll checks when payroll is processed at BOCES without her direct supervision. This increases the risk that signed checks are not produced for only legitimate District purposes. The District's recordkeeping is inadequate to protect District assets. The District receives check images from the bank, but these images only show the front side of the checks for many District bank accounts. Although our review did not reveal significant discrepancies, the lack of adequate internal controls exposes the District to the risk that error or abuse will occur and not be detected and addressed in a timely manner.

### **Segregation of Duties**

An effective system of internal controls provides for the segregation of duties so that no single individual controls all or most phases of a transaction. Concentrating key duties with one individual with little or no oversight weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected. When it is not practical to segregate duties because of limited staff resources, it is important for District officials to establish compensating controls. Such compensating controls could include the requirement that District officials or other administrative staff periodically review the work in question, that duties be rotated among appropriate staff members, and that staff take mandatory vacations.

District officials did not effectively address the duties and responsibilities of the Treasurer or the Deputy Treasurer to ensure that the duties were properly segregated, nor did they establish sufficient compensating controls, such as having staff independent of the cash receipts and disbursements perform bank reconciliations. Both the Treasurer and Deputy Treasurer have access rights to perform all accounting functions in the computerized accounting system. The Treasurer enters disbursement information and processes checks for the general and capital funds. The Deputy Treasurer enters disbursement information and processes checks for payroll, the school lunch fund and federal aid fund. In addition, the Treasurer and Deputy Treasurer make journal entries and act as back up for each other. Although the Business Manager does review and approve the journal entries made by the Treasurer and Deputy Treasurer, this does not adequately mitigate the risks associated with the incompatible duties because the Deputy Treasurer also receives and opens all bank statements, and reconciles all bank accounts. Although each Board member receives a copy of the bank reconciliations, we found no indication that any District official verified the completeness and accuracy of bank reconciliations. As a result, internal controls are weakened and there could be improper payments made and records could be altered or manipulated to prevent detection.

### **Treasurer's Signature**

Effective control over the disbursement of cash is vital to prevent unauthorized payments and the misuse of District funds. As the District official responsible for signing checks, the Treasurer plays a critical role in the cash disbursement process. The Treasurer must ensure that her signature is not used to make payments that have not been approved. Education Law requires the Treasurer's actual or facsimile signature be affixed to District checks by the Treasurer or affixed under the Treasurer's direct supervision. We found that the Treasurer did not maintain adequate control over her signature. Payroll and accounts payable checks are computer generated with the Treasurer's signature imprinted on them.

The Madison-Oneida Board of Cooperative Educational Services (BOCES) is responsible for physically printing the computer-generated checks for payroll with the Treasurer's signature imprinted on them. While the Deputy Treasurer is responsible for input, she is not responsible for the check printing. The Deputy Treasurer first enters all payroll information in the computerized payroll system at the District. Then, she prints a report of her entries to check for any entry errors, which she keeps in the Business Office. At this point, the BOCES personnel access the payroll information, print checks and apply the Treasurer's computerized signature at BOCES. The Treasurer does not directly supervise this signature process or verify the accuracy of the payroll checks before they are distributed. In

addition, the Treasurer does not review the accounts payable checks that relate to the funds maintained by the Deputy Treasurer nor directly supervise the signature process over accounts payable checks before they are mailed. Because checks containing the Treasurer's signature are produced without the Treasurer's oversight, the District is at increased risk that signed checks are not produced for only legitimate District purposes and in the correct amount.

### **Check Processing Software**

The software that the District uses to print checks allows for the production of signed checks that are duplicates of the original checks except for the check numbers that are pre-printed on the checks. These reprinted checks are not recorded in the District's computerized accounting system. The ability to produce signed checks that are not recorded in the accounting system is a serious weakness since it provides an opportunity for unauthorized payments to be made, which may not be detected promptly.

### **Post-Payment Review**

Reviewing payment documents after payments are processed by the banks is an essential procedure for documenting the District's cash disbursement activity because it allows District officials to verify that payments are made only to authorized payees. If the bank does not provide cancelled checks, the District must obtain alternative documentation in the form of check images. General Municipal Law provides that check images showing both sides are considered the equivalent of original cancelled checks for purposes of record keeping and auditing requirements. The District receives check images from the bank, but these images only show the front side of the check for many of the District's bank accounts.<sup>1</sup> If the District cannot access images of both sides of the check, important information such as the identity of the final endorser of the check is not available for review. The absence of such payment information demonstrates that such a routine review has not occurred at the District and would not allow internal and external auditors to perform appropriate auditing procedures.

Based on the above weaknesses, we performed tests of disbursements to ensure that they were properly authorized. We examined 100 cash disbursements from the District's bank statements (50 payroll checks totaling \$34,229 and 50 non-payroll checks totaling \$60,293). We obtained both front and back copies of these checks from the District's bank. We performed tests to identify unrecorded disbursements. Our testing did not reveal any significant discrepancies.

### **Recommendations**

1. District officials should assign financial-related duties so that the work of one individual independently verifies another's in

<sup>1</sup>General fund, federal fund, trust & agency and payroll checking accounts

the course of their regular duties. Bank reconciliations should be performed by someone independent of the cash receipt and disbursement functions. If this is not practical, the completeness and accuracy of bank reconciliations should be regularly verified by someone independent of those functions.

2. The Treasurer should control her electronic signature at all times. The Treasurer should review printed checks and compare them to the warrant for vendor checks or a payroll register for payroll checks prior to distributing them to verify that checks are being produced only for legitimate District purposes.
3. District officials should request the accounting system software vendor to make the necessary program changes to prevent the creation of checks that are not recorded in the accounting records, or develop alternative controls to compensate for this weakness.
4. The District should request that images of both sides of the checks be returned from the bank with the monthly bank statements. District personnel should include a review of these check images as part of the bank reconciliation process.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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



# Poland Central School

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Laura M. Dutton  
Superintendent of Schools  
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826-0205

June 19, 2008

Syracuse Regional Office  
NYS Office of the State Comptroller  
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This letter is in response to the draft audit report regarding internal controls over cash disbursements that you presented to the district on June 10, 2008.

The district is pleased that after a thorough review of our financial records no significant discrepancies were found. We would like to thank your office and in particular the examiners involved in our audit for the professionalism and straight-forwardness that was exhibited during the review.

We are in agreement with the recommendations listed in your report. And, feel that by implementing your recommendations, we will be able to further enhance the internal controls over the district's finances.

### Corrective Action Plan

Following you will find the district's corrective action plan which is based on the recommendations in your report:

**Recommendation #1:** *District officials should assign finance-related duties so that the work of one individual independently verifies another's in the course of their regular duties. Bank reconciliations should be performed by someone independent of the cash receipt and disbursement functions. If this is not practical, the completeness and accuracy of bank reconciliations should be regularly verified by someone independent of those functions.*

The district will work this summer with our independent and internal control auditors to develop increased segregation of duties. Starting

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immediately the School Business Manager will provide an independent verification of the bank reconciliation process on a monthly basis.

**Recommendation #2:** *The Treasurer should control her electronic signature at all times. The Treasurer should review printed checks and compare them to the warrant for vendor checks or a payroll register for payroll checks prior to distributing them to verify that checks are being produced for only legitimate District purposes.*

Effective immediately the Treasurer will conduct a review of all checks printed and maintain a log of all checks reviewed.


**Recommendation #3:** *District officials should request the accounting system software vendor to make the necessary program changes to prevent the creation of checks that are not recorded in the accounting records, or develop alternative controls to compensate for this weakness.*


The district has sent a written request to the software vendor to make the necessary changes. As an additional control the School Business Manager will monitor the check log and the accounting records against the pre-printed check supply on a regular basis.

**Recommendation #4:** *The District should request that images of both sides of the checks be returned from the bank with the monthly bank statements. District personnel should include a review of these check images as part of the bank reconciliation process.*

Since the recent merger of our primary bank all of our bank statements now include front and back images. The review of these images is now included as part of the bank reconciliation process.

Again, we would like to thank you for assisting us in improving our internal control systems. We feel that the Poland Central School and the taxpayers of our district have been well served by this audit process.

Sincerely,  
  
Laura M. Dutton  
Superintendent of Schools

  
Chad S. Hess  
School Business Manager

Copy: Poland CSD Board of Education  
Poland CSD Business Office Personnel

## 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.

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 cash disbursements for further audit testing.

To accomplish the objective of this audit, our procedures included the following:

We examined the following records to determine the effectiveness of internal controls pertaining to the cash disbursements function and to identify any associated effect of deficiencies found in those controls:

- Bank statements
- Cancelled checks
- General ledger accounts
- Claim packets
- Warrants
- Payroll registers.

We also used ACL (an audit testing program) to verify check sequence integrity, look for duplicate check numbers or payments, examine non-payroll checks to employees, and test for certain other check transactions.

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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**AND SCHOOL ACCOUNTABILITY**

Steven J. Hancox, Deputy Comptroller  
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