



Sackets Harbor Central School District Internal Controls Over Claims Processing

Report of Examination

Period Covered:

July 1, 2006 — November 30, 2007

2008M-201



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 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 Sackets Harbor Central School District, entitled Internal Controls Over Claims Processing. 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 Sackets Harbor Central School District (District) is located in the Towns of Adams, Henderson and Hounsfield in Jefferson 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 is one school in operation within the District, with approximately 490 students and 80 employees. The District's budgeted expenditures for the 2007-08 fiscal year were \$7.6 million, funded primarily with State aid, real property taxes and grants.

Objective

The objective of our audit was to determine whether the District had adequate internal controls over claims processing. Our audit addressed the following related question:

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

Scope and Methodology

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. Based on that evaluation, we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We did determine that risk existed in the claims processing area and, therefore, we examined internal controls over claims processing for the period July 1, 2006 to November 30, 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. Except

as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comments on an issue raised in the District's response letter.

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, 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 Processing

An important component of the District's internal controls relates to policies and procedures governing claims processing. In general, the objectives of claims processing are to ensure that claims contain enough supporting documentation to allow District personnel to determine whether the claims comply with District policies, and whether they represent actual and necessary District expenses. To that end, it is imperative that the Board adopt clear and effective policies and procedures to accomplish these objectives.

We identified internal control weaknesses in the District's operations relating to the function of the claims auditor and her duties which could lead to errors or irregularities occurring and not being detected. During the 2006-07 fiscal year, the claims auditor was a Board member and, as such, was ineligible to be the District's claims auditor. She also had no formal training that would allow her to effectively execute her duties as the claims auditor. We also found that the Treasurer paid 30 claims totaling \$230,475 without approval from the claims auditor.

Audit and Approval of Claims

The claims auditor assumes the Board's powers and duties of approving or denying claims against the District. The appointment of a highly ethical, inquisitive claims auditor who has a clear understanding of what is expected can increase the effectiveness of the District's internal control environment. Education Law¹ and the District's policy² prohibit certain persons, including members of the Board, from holding the office of claims auditor.

The Board appointed one of its own members as the District's claims auditor and had not established written procedures for the proper audit of claims. In addition, the appointed Board member did not perform a proper audit of District claims. We found that she reviewed the claims and signed off on the warrants; however, there was no indication that the claim packages were examined to ensure that all necessary documentation and approvals were included. The Board told us that they were not aware of the specific requirements for conducting a proper audit of claims. Furthermore, they indicated that the appointed Board member had no formal training as claims auditor. Therefore, the District's internal controls over claims processing were not appropriately designed and did not comply with statutes during the first 12 months of our 17-month audit period.

¹ Education Law, Section 1709

² Board Policy #1138 adopted August 23, 2006 states that no person shall be eligible for appointment to the office of Internal Claims Auditor who shall be: a. A member of the Board.

The former Business Manager³ told us that the Board and District managers were not aware of the inherent conflict between the duties of a Board member and the claims auditor or the fact that statutes and District policy specifically prohibit a Board member from serving as claims auditor. She also told us that the District's external auditor informed them of the conflict during their audit in July 2007 and the Board took prompt corrective action by appointing the former Business Manager as claims auditor later that month, effective for the 2007-08 fiscal year.

Unauthorized Payment of Claims

Education Law⁴ and the District's policy prohibit the District's Treasurer from paying claims without written authorization from the claims auditor. The authorization is documented by an approved warrant that verifies that the claims have been audited and approved for payment.

The District had inadequate controls in place to ensure that all claims paid were audited prior to payment during the 2006-07 fiscal year. Although the claims auditor certified the general and school lunch fund warrants, we found that she did not certify any warrants for the \$32,705 disbursed from the Special Aid fund or for one of the two capital fund warrants totaling \$197,770. We found that the Business Office did not prepare warrants for any of the 26 claim payments, totaling \$32,705, disbursed from the Special Aid fund during the fiscal year 2006-07. We found no evidence that any of these 30 claims, totaling \$230,475, had been presented to the claims auditor and properly approved for payment. Therefore, the former District Treasurer⁵ paid the claims without the written authorization from the Board or an appointed claims auditor that is required by statutes, District policy, and good standards of internal control. Both failure to conduct a thorough audit of claims and paying claims without written authorization from the claims auditor may result in unnecessary purchases or improper payments for goods and services that were not received.

Based upon the weaknesses found, we examined a sample of 70 claims,⁶ totaling \$280,098 during the audit period, for proper supporting documentation including certifications that the purchased goods or services were received. Our testing did not disclose any improper payments.

³ The Board appointed the retiring Business Manager/Treasurer as claims auditor at its July 12, 2007 reorganization meeting.

⁴ Education Law, Section 1724

⁵ The Board appointed a new Business Manager/Treasurer at its July 12, 2007 reorganization meeting.

⁶ Sixty non-credit card claims and 10 credit card claims

However, our review of the 60 non-credit card claim payments, totaling \$267,366, disclosed that 12 claims, totaling \$25,488, lacked certification that the District had received the purchased goods or services. Some of these exceptions were:

- A payment of \$4,640 for a school lunch software program
- A payment of \$3,123 for sporting dues and assessments
- Two payments totaling \$3,830 to a local contractor for refinishing a gymnasium floor
- A payment of \$1,387 for athletic equipment and supplies
- A payment of \$1,176 for t-shirts.

Also, our review of the 10 credit card claim payments, totaling \$12,732, identified questionable payments of \$901, which included:

- Home internet service charges of \$26 per month were paid by the District for the former Superintendent,⁷ totaling over \$207 for eight months. We found no evidence that the Board had authorized the District to pay for the Superintendent's home internet service.
- A restaurant receipt for 15 entrees, totaling \$693, did not have any supporting documentation to allow a claims auditor to determine whether the charges represented a legitimate and proper District expense under the District's written policy. The claim lacked required documentation as to the purpose of the meal purchase and a list of attendees. The former Superintendent told us that the dinner was a traditional annual event for board members and guests.

When claims processing is not adequate, such as the failure to audit and approve all claims before payment is made, the Board cannot be assured that payments made for goods and services represent legitimate and necessary charges to the District. As a result, District moneys could be misused and not be detected or corrected in a timely manner.

Recommendation

1. The Board should review the internal controls over claims processing and take steps to ensure that all claims are properly audited.

⁷The Board appointed a new Superintendent effective January 14, 2008, subsequent to our audit period.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Frederick E. Hall, Jr.
Superintendent
Jennifer Gaffney
Building Principal
Julie Gayne
Treasurer
Sheri Rose
District Clerk



Board of Education
Mark J. McWilliams DDS, President
Gregg A. Townsend PE, Vice President
Teresa K. Dewey DVM
Stephen L. Swain
Christine M. Allen

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December 3, 2008

Office of the State Comptroller
Syracuse Regional Office
State Office Building, Room 409
333 E. Washington Street
Syracuse, NY 13202

Dear Chief Examiner Eugene A. Camp:

On behalf of the Sackets Harbor Central School District Board of Education and Administration, please accept this letter as both our district's Audit Response letter and our Corrective Action Plan (CAP) of the preliminary draft findings of the Comptroller's audit of the Sackets Harbor Central School District, for the time period of July 1, 2006 to November 30, 2007.

The report was reviewed with the district on November 18, 2008 by the Syracuse Regional Comptroller's Office staff with the following Sackets Harbor representatives: Superintendent of Schools, Building Principal, District Treasurer, Board of Education Audit Committee Members, District Clerk, Business Office Personnel, and Internal Claims Auditor.

The District takes the responsibility of proper internal claims controls seriously. We are pleased that after a thorough review of our financial records no significant discrepancies were found. While no inappropriate use of funds or improprieties were identified, the recommendations for reduction of risks and the safeguarding of district assets are appreciated.

We are in agreement with the recommendations spelled out in your report. We have taken measures to remedy our district procedures and policies to further enhance the internal controls over the district's finances.

The district's reaction and Corrective Action Plan (CAP) is as follows:

Recommendation #1: *The Board should provide sufficient written control policies and procedures, training, and other necessary guidance and support to ensure an effective claims audit function. At a minimum, the Board should clearly communicate the duties and responsibilities of the position, as well as the Board's expectations, to the claims auditor.*

By hiring an Internal Claims Auditor at its July 2007 Board of Education meeting, the Sackets Harbor Central School District Board of Education addressed and rectified this recommendation prior to the start of the Comptroller's audit, but these corrective measures were in effect for only a portion of the audit's time frame. With the hiring of this individual, the district utilized written procedures for this position from the *Claims Auditor Internal Audit Function*, prepared by [REDACTED] Office of Educational Management State Education Department and [REDACTED] CPA under the guidance of the district's external auditing firm, [REDACTED]. The Internal Claim's Auditor duties are defined in Board of Education Policy 1138 of the Sackets Harbor Central School District Board of Education Policy Manual. The Internal Claims Auditor has received and will continue to receive appropriate training and professional development for the effective execution of the job and responsibilities.

See
Note 1
Page 11

Recommendation #2: *The Board should review the internal controls over claims processing and take steps to ensure that all claims are properly audited.*

By hiring an Internal Claims Auditor at its July 2007 Board of Education meeting, the Sackets Harbor Central School District Board of Education addressed and rectified this recommendation prior to the start of the Comptroller's audit, but in effect for only a portion of the audit's time frame. The Internal Claims Auditor audits and approves all claims and presents a written monthly report to the Board of Education at its monthly meetings. The Board of Education reviews this report and the contents become part of the Board of Education's public record.

See
Note 2
Page 11

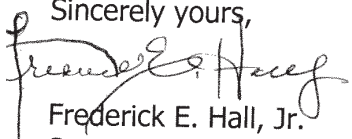
Recommendation #3: *The Treasurer should only pay claims based on written authorization from the appointed claims auditor.*

By hiring an Internal Claims Auditor at its July 2007 Board of Education meeting, the Sackets Harbor Central School District Board of Education addressed and rectified this recommendation prior to the start of the Comptroller's audit, but these corrective measures were in effect for only a portion of the audit's time frame. The payment of claims by the District Treasurer is defined by Board of Education Policy 1138 of the Sackets Harbor Central School District Board of Education Policy Manual. All claims are audited and approved by the Internal Claims Auditor prior to payment by the District Treasurer.

See
Note 3
Page 11

We welcome and appreciate the feedback from your report. The information provided is constructive and will improve the overall effectiveness of our financial operation and internal controls for safeguarding the district's and taxpayers' assets. The entire experience with members of the Comptroller's field team was most positive, professional, collegial, and comprehensive from start to finish.

Sincerely yours,


Frederick E. Hall, Jr.
Superintendent of Schools


Julie Gayne
District Treasurer

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

We have removed the recommendation related to this audit finding from our report. We commend District officials for the corrective actions they have taken to provide guidance and training to the new claims auditor.

Note 2

District officials took significant corrective action to improve controls by appointing a new claims auditor and providing her with appropriate guidance. However, our testing of 35 claims paid after the claims auditor was appointed found that the claims auditor had approved four claims, totaling \$7,379, without certification that the District received the purchased goods or services. The District's response to this recommendation cites the claims auditor's monthly report to the Board. However, we found that the auditor's report is simply a summary of warrant and check numbers and the dollar amounts approved. The auditor's report does not provide necessary information to monitor the effectiveness of the claims audit process. Therefore, we continue to recommend that the Board take additional action to ensure that claims are being properly audited.

Note 3

We have removed the related recommendation directed to the Treasurer from our report. The payment exceptions cited in this report all occurred prior to the appointment of the new Treasurer. During the remaining five months of our audit period, all of the claims paid by the new Treasurer were authorized by the claims auditor.

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.⁸ 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. Based on that evaluation we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected claims processing for further audit testing.

We focused our attention on the procedures for auditing and authorizing the payment of claims during the period July 1, 2006 to November 30, 2007. To determine the effectiveness of internal controls and to evaluate the effect of deficiencies in those controls:

- We reconciled the District's cash disbursement records and warrants to bank statements for the audit period.
- We examined all of the warrants to verify that they had been properly certified as audited and approved for payment for the audit period.
- We examined cancelled checks and supporting claim documentation for a sample of 70 paid claims. The supporting records we reviewed included purchase requisitions, travel authorization forms, employee reimbursement forms, claim forms, purchase orders, written contracts, and vendor invoices.
- We interviewed appropriate District staff and officials to obtain additional information necessary to assess the propriety of transactions.

⁸ The District provided all payroll data; however, due to system limitations the District was unable to provide all cash disbursement data requested for the analysis. The cash disbursement data was limited to the 2007-08 fiscal year.

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.

APPENDIX D

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