



# Sodus Central School District Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2006 — August 31, 2007

2007M-300



Thomas P. DiNapoli

# Table of Contents

	<b>Page</b>
<b>AUTHORITY LETTER</b>	3
<b>EXECUTIVE SUMMARY</b>	5
<b>INTRODUCTION</b>	7
Background	7
Objective	7
Scope and Methodology	7
Comments of District Officials and Corrective Action	8
<b>SEGREGATION OF DUTIES</b>	9
Recommendation	10
<b>INFORMATION TECHNOLOGY</b>	11
Access Rights	11
Monitoring Reports	11
Disaster Recovery Plan	12
Recommendations	12
<b>APPENDIX A</b> Response From District Officials	14
<b>APPENDIX B</b> Audit Methodology and Standards	16
<b>APPENDIX C</b> How to Obtain Additional Copies of the Report	17
<b>APPENDIX D</b> Local Regional Office Listing	18

# State of New York Office of the State Comptroller

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## **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 Sodus Central School District, entitled Internal Controls Over Selected Financial Activities. 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 Sodus Central School District (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.

### **Scope and Objective**

The objective of our audit was to determine if internal controls over selected financial activities were designed appropriately and operating effectively for the period July 1, 2006 to August 31, 2007. Our audit addressed the following related questions:

- Did the Board segregate the duties of the Treasurer or implement compensating controls?
- Did the Board establish policies and procedures addressing information technology access rights and monitoring reports, and establish plans to protect equipment and data from potential disaster?

### **Audit Results**

We found that District officials did not segregate the duties of the Treasurer nor implement other compensating controls. The Treasurer was responsible for performing the District's financial duties with limited oversight. The Business Administrator reviews the bank reconciliations, but does not review the bank statements or cancelled checks. Therefore, the review is not sufficient to compensate for the overall lack of segregation of duties. The lack of segregation of duties increases the risk that errors and/or irregularities might occur and go undetected and uncorrected.

Additionally, we found that the Board had not established adequate control policies and procedures to safeguard the District's financial computer data. Access to the financial software was not restricted to just those modules required by individual employees' job descriptions and/or official duties. The District does not have policies and procedures in place requiring that monitoring reports be provided and independently reviewed. The District does not have a disaster recovery plan, which is critical for uninterrupted operations if the computer systems or data are compromised or rendered inoperable by unauthorized users or as a result of a disaster. Consequently, the District is at risk of misuse or the loss of computer data and equipment.

### **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 agreed with our recommendations and indicated that they plan to initiate correction action.

# Introduction

## Background

The Sodus Central School District (District) is located in the Towns of Arcadia and Sodus in Wayne 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 1,350 students and 260 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$22 million, which were funded primarily with State aid, sales tax, real property taxes, and grants.

The Business Office is responsible for District's financial recordkeeping. The office includes a District Treasurer (Treasurer), payroll supervisor, and Business Administrator, who also serves as the purchasing agent. The District's information technology (IT) system is used to process financial and non-financial student data.

## Objective

The objective of our audit was to determine if internal controls over selected financial activities were designed appropriately and operating effectively for the period July 1, 2006 to August 31, 2007. Our audit addressed the following related questions:

- Did the Board segregate the duties of the Treasurer or implement compensating controls?
- Did the Board establish policies and procedures addressing IT access rights and monitoring reports, and establish plans to protect equipment and data from potential disaster?

## 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: cash receipts and disbursements, purchasing, 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 Treasurer's duties,

and IT. We therefore examined these areas 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 agreed with our recommendations and indicated that they plan to initiate correction 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*.

## Segregation of Duties

District officials are responsible for designing internal controls that help safeguard the District's resources and ensure that these resources are used economically and efficiently. An adequate system of internal controls includes clear policies and procedures that promote effective operations, the prudent use of resources and the adherence to applicable laws and regulations. Further, an effective system of internal controls provides for the segregation of duties such that no single individual controls all phases of a transaction: authorization, custody and record keeping. When it is not practical to segregate duties because of limited staff resources, District officials should establish compensating controls. Such compensating controls could require other administrative employees to periodically review the work of the staff under their direction, and for the periodic rotation of work duties.

District officials have not adopted comprehensive written policies and procedures to provide guidance and internal controls for cash receipts and disbursements. This lack of guidance has resulted in a lack of segregation of duties and a lack of compensating controls over the duties and responsibilities of the Treasurer.

The Treasurer is the District's chief accounting officer and the custodian of all District moneys. Establishing policies and procedures for the Treasurer provides clear guidelines to follow when performing his duties. One of the District officials' responsibilities is to ensure that the Treasurer properly accounts for all District moneys. One way to accomplish this is to make sure that the duties performed by the Treasurer are properly segregated so that he may not control all phases of a transaction. In general, the transaction approval function, the accounting function and the asset custody function must be separated. For example, one person should not be able to collect revenues, record receipts, make deposits, reconcile bank accounts, perform bank transfers, prepare journal entries, and sign checks. If it is not feasible for officials to adequately segregate the Treasurer's duties, then District officials should ensure that compensating controls are in place to protect District assets. These controls could include having a different staff member review the work performed by the Treasurer. In addition, someone other than the person preparing journal entries and bank transfers should review and approve them.

We found that the District had not adopted written policies governing the Treasurer's duties and responsibilities, adequately segregated the Treasurer's duties or implemented other effective compensating

controls. During our audit period, the District's Treasurer was responsible for performing the District's financial duties, including preparing and approving journal entries, signing all checks, recording all cash deposits (except retiree health insurance), making all bank transfers, maintaining accounting records, and reconciling all bank accounts. Although the Business Administrator reviews the bank reconciliations, such reviews do not include a review of the bank statements or cancelled checks.

Due to the lack of segregation of duties over the Treasurer's operations, we reviewed 65 cash receipts totaling approximately \$2.5 million for January 2007 to ensure that they were properly received, recorded and deposited intact and in a timely manner. We also reviewed January and August 2007 bank reconciliations to ensure they were appropriate and agreed with accounting records.

While our testing did not reveal any material discrepancies, the lack of segregation of duties for the Treasurer significantly increases the risk that errors and/or irregularities might occur and go undetected and uncorrected.

## **Recommendation**

1. District officials should establish written policies and procedures for the cash receipts and disbursements functions that adequately segregate the duties of the Treasurer or provide for effective compensating controls over his duties.

# Information Technology

The District uses IT to initiate, process, record, and report transactions. The pervasive use and complexity of these computerized functions produces internal control risks such as unauthorized access to data, unauthorized changes to master files, and the potential loss of data.

The District can mitigate these risks through a combination of automated and manual controls including policies and procedures adopted by the Board and limiting user access to protect data from loss by intentional or unintentional manipulation. The system of internal controls must include a disaster recovery plan and systematic backup procedures to restore lost or damaged data as quickly and easily as possible. Disasters include sudden, unplanned catastrophic events (e.g., fires, computer viruses, or inadvertent employee actions) that compromise the integrity and data of the IT system.

District officials have not established adequate internal control policies and procedures to limit access to the financial software, monitor computer activity and safeguard the District's financial computer data and systems. As a result, the District is at risk of misuse or the loss of computer data and equipment.

## Access Rights

Access to computer operations must be restricted to only those functions required by individual employees' job description(s) and/or official duties and, when granted, preserve proper segregation of duties. Such access controls prevent users from handling incompatible aspects of financial transactions.

The regional information center that administers the software sets user access rights based on information from the Treasurer. While three employees had appropriate access to the purchasing module, access for other employees was not restricted to just those modules required by their job descriptions and/or official duties. Specifically, the Treasurer and the payroll supervisor had full access to the payroll module and some functions in the human resource module. In both instances, these individuals had the ability to add, delete, or modify employee information. By allowing access beyond that necessary for an individual's assigned duties, the District increases the risk that errors and irregularities could occur and remain undetected and uncorrected.

## Monitoring Reports

A good financial software package provides adequate tools to allow the District to set up a strong system of internal controls by monitoring

computer activity. Exception reports and change reports are two of the basic tools available in most financial software packages. Exception reports are detailed lists of transactions that are exceptions to ordinary transactions. Change reports show changes that are made to certain data records such as vendor information or personnel information.

The Board receives certain documentation for review from the Treasurer, including the Treasurer's monthly cash report, budget status reports and extra-classroom activity fund reports. In addition, the District's financial accounting software has the ability of producing additional monitoring information, such as user-activity reports, permissions, vendor name change, vendor payment above limit and vendor payment limit reports. However, the District does not have policies and procedures in place requiring that such monitoring reports be provided and independently reviewed. The review of these reports could provide a meaningful compensating control for the lack of segregation of duties performed by the Treasurer, as well as the control weaknesses resulting from allowing him to have computer access rights that are not necessary for performing his normal job functions.

## **Disaster Recovery Plan**

Good business practices require establishing a formal disaster recovery plan to address the possible loss of computer equipment and data and establish procedures for recovery in the event of such a loss. The plan should detail the precautions to be taken to minimize the effect of any disaster and enable District officials to either maintain or quickly resume its mission-critical functions. The Board should communicate the plan to all District employees and periodically test it to ensure its effectiveness.

The Board has not adopted a formal disaster recovery plan to protect the District's computer data and systems in the event of a disaster. Consequently, in the event of a disaster, District personnel have no guidelines or plan to follow to help minimize or prevent the loss of equipment and data or guidance on how to implement data recovery procedures. If the computer system fails, the problems that result could range from inconvenient to catastrophic. Even small disruptions in computer systems can require extensive employee and consultant hours to evaluate and repair. District officials will likely face the loss of vital data and other resources if a disaster occurs.

## **Recommendations**

2. District officials should monitor user-access rights to ensure they are based on job functions and responsibilities, and promote proper segregation of duties.

3. District officials should use monitoring reports generated by the financial software to help strengthen internal controls.
4. The Board should adopt a formal disaster recovery plan that details specific guidelines for the protection of essential 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.

The District's response letter refers to an attachment that supports the response letter. Because the District's response letter provides sufficient detail of its actions, we did not include the attachment in Appendix A.



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Transportation Supervisor

March 7, 2008

NYS Office of the Comptroller  
Rochester Regional Office  
16 West Main Street, Suite 522  
Rochester, NY 14614


Dear Sir or Madame,


The Sodus Central School District is in receipt of the drafted "Report of Examination" from the audit conducted by [redacted] and [redacted] for the period July 1, 2006-August 31, 2007. We wish to extend our appreciation to [redacted] and [redacted] for their professionalism and courtesy while working on the audit in our District offices.

Attached to this letter is an action plan that has been drafted as the District's response to the audit report. Please note that a number of the corrective actions recommended by the auditor had already been implemented prior to receipt of the audit report. It is the intent of the Sodus Central School District to implement this action plan in the time frame identified; if the corrective action is not already in place. Please advise us as to any corrective action item that does not meet the intent of the audit recommendation.

Thank you for your collaboration in this matter.

Sincerely,

  
Susan Kay Salvaggio  
Superintendent

  
Brian Mayou  
Board of Education President

Attachment

Cc: Steve Moore, Business Administrator  
Board of Education

*The mission of the Sodus Central School District, powered by the nurturing force of parents, school and a community enriched by human diversity, is to graduate 100% of our students with a joy for life and learning, academic competence, skills and strategies enabling them to be responsible citizens in an ever-changing global society.*

## 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. 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 segregation of duties and IT for further audit testing.

During this audit, we examined the District's processes relating to the cash receipts and disbursements and IT for the period July 1, 2006 to August 31, 2007. To accomplish the objectives of this audit, and to obtain relevant audit evidence, our procedures included the following:

- We conducted interviews with District officers and personnel to gain an understanding of procedures in place and the nature of internal controls.
- We reviewed deposits, cash receipts and cash disbursement records and supporting documentation including bank statements, cancelled checks, warrants and claim vouchers.
- We reviewed all payments to key administrative officials and Board members to ensure that payments were approved for proper District purposes.
- We traced all bank reconciliation book balances to general ledger account balances for January 2007 to ensure they were accurately and properly prepared.

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 C

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**DIVISION OF LOCAL GOVERNMENT**  
**AND SCHOOL ACCOUNTABILITY**

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

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