



Springs Union Free School District

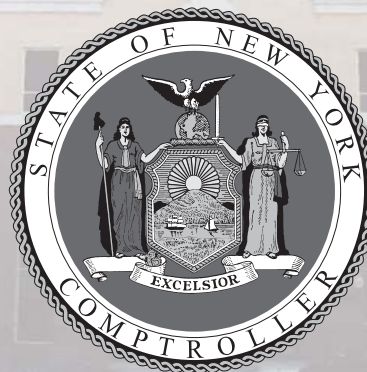
Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — September 30, 2007

2008M-22



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

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 is mandated to oversee 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 Springs Union Free 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

EXECUTIVE SUMMARY

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.

The District Business Official, who acts as the Treasurer, plays a key role in the daily administration of the Business Office and has one full-time employee to assist him with these functions. The Board has also appointed a claims auditor to review all claims presented for payment. All accounting transactions are processed on a computerized financial system designed specifically for school districts. For the fiscal year ending June 30, 2007, cash disbursements totaled approximately \$10 million and payroll disbursements totaled approximately \$7.2 million.

Scope and Objective

The objective of our audit was to examine the District's internal controls over selected financial operations for the period July 1, 2006 to September 30, 2007. Our audit addressed the following related questions:

- Are internal controls over cash disbursements appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the access to the computerized financial system appropriately designed to safeguard District assets?
- Are internal controls over payroll appropriately designed and operating effectively to adequately safeguard District assets?

Audit Results

We found instances where District officials had not established internal controls or the controls they had established were not implemented and operating effectively. As a result, the District is vulnerable to the possibility of errors and/or irregularities occurring and not being detected in a timely manner.

The claims auditor does not conduct a thorough and deliberate audit of all claims, does not review and

certify warrants, and failed to report directly to the Board. We reviewed 100 claims and found the Business Official independently paid 16 claims totaling \$42,655 without a purchase order or review/approval from the claims auditor. The Business Official controlled all aspects of these purchases, bypassing all internal controls established by the District. In addition, we found the claims auditor approved 21 claims totaling \$92,520 that showed no authorization from the purchasing agent. As a result, there is an increased risk that payments may be made for improper purposes.

Furthermore, the District's Business Official, who also acts as the Treasurer, has administrative access rights to the computerized financial system. This access designation, if uncorrected, increases the risk that errors, fraud, abuse, or professional misconduct could occur and remain undetected.

Finally, we found a lack of segregation of duties over payroll, relating to the payroll clerk. We did not note any material exceptions.

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.

Introduction

Background

The Springs Union Free School District (District) is located in the East Hampton Township in Suffolk 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 in the District, with approximately 600 students and 100 employees. The District's budgeted expenditures for the 2007-08 fiscal year were approximately \$20 million funded primarily with State Aid, real property taxes and grants. For the year ending June 30, 2007, cash disbursements totaled approximately \$10 million and payroll disbursements totaled approximately \$7.2 million.

The District Business Official, who acts as the Treasurer, plays a key role in the daily administration of the Business Office and has one full-time employee to assist him with these functions. The Board has also appointed a claims auditor to review all claims presented for payment. All accounting transactions are processed on a computerized financial system designed specifically for school districts.

Objective

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

- Are internal controls over cash disbursements appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the access to the computerized financial system appropriately designed to safeguard District assets?
- Are internal controls over payroll appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

We examined payroll, cash disbursements, the computerized financial system and payroll of the Springs School District for the period July 1, 2006 to September 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 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 may occur and not be detected and corrected. The possible errors and irregularities that could result from these internal control weaknesses include unauthorized payments for non-District purposes.

We found weaknesses in the claims audit function and the use of blanket purchase orders.

Claims Auditor

An important aspect of the District's internal controls over cash disbursements rests with the claims auditor. The claims auditor assumes the powers and duties of the Board for approving or denying claims against the District. The person holding this position should have a clear understanding of his or her responsibilities and specific Board expectations. The claims auditor must not be involved in any other business or accounting functions within the District and should report directly to the Board and not to any other District staff or management. Further, the State Education Department (SED) has issued guidance interpreting the regulations regarding claims auditing services.

Typically, the claims auditor documents the approval of claims by certifying a warrant (a list of claims) that authorizes and directs the Treasurer to pay the claims listed. 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. The District's claims audit guidance states: "The internal claims auditor is required to provide the Board of Education with evidence that claims have been audited and are eligible for payment. This evidence is provided through a warrant or order on which the audited vouchers have been listed. The warrant or order is directed to the Board of Education and is certified by the internal claims auditor". Further, "After conveying the warrant to the Board of Education, the internal claims auditor should keep on file for reference a copy of the warrant bearing his signed certification."

The Board did not appoint a claims auditor in accordance with SED guidelines. The Board appointed a part-time claims auditor that reports directly to the Business Official.

Furthermore, the claims auditor does not adequately audit the claims. We noted that the claims auditor does not compare actual audited claims to the warrants of audited and approved claims. Further, he does not certify the warrant, directing the Business Official/Treasurer to pay the related claims, per the District's claims policy. The claims auditor reviews and signs a "pre-warrant" which lists the claims for payment with voucher numbers, as opposed to check numbers. After this review, the checks are printed, and a final warrant with the check numbers is given to the Board for approval. The claims auditor does not review the warrant that is presented to the Board. When the Board receives the warrant, they approve it, but do not examine the support for each claim. This deficiency in controls over the audit, approval, and payment of claims increases the risk that improper or erroneous payments could occur and not be detected.

Based on this weakness, we judgmentally selected 100 claims for payment totaling \$234,298 to assess whether the District's claim documentation provides sufficient evidence that transactions are processed in accordance with Board purchasing policies and internal control standards; included in the 100 claims selected were all personal reimbursements to the Business Official and other Business Office staff.

The claims auditor approved only 84 of the 100 vouchers tested. Sixteen claims totaling \$42,655 paid by the Business Official did not contain evidence of the claims auditor's review and approval. The purchasing agent also did not approve seven of the 16 claims, totaling \$24,388, which means that the Business Official (who has computer access to input a claim) was the only person approving the purchases and claims for payment, thus bypassing internal controls.

Additionally, the claims auditor did not follow District policy when auditing all of the 84 claims. We found the following weaknesses:

- Twenty-three of the claims did not include the proper authorization form (i.e. purchase order or travel reimbursement form) with the invoice. The purchasing agent approved only eight of these 23 claims, which leaves 15 not signed by the purchasing agent.
- The purchasing agent did not sign six other claims where the authorization form was used.

- Nine instances in which the claims auditor approved a claim that had either no support or the support given did not satisfy the legitimacy of the purchase. For example, two claims totaling \$509 for paint supplies (one payment was reimbursed to the Business Official (\$39), the other was a payment to a store (\$470)) lacked proper authorization and support to enable us to make a determination if the payments were appropriate District expenses.

Deficient claims auditing increases the risk that the District may pay claims that are not actual and necessary.

Blanket Purchase Orders

An appropriately designed purchase order system helps the District to monitor expenditures while ensuring that appropriations are not over-expended. The District issues open or blanket purchase orders to various vendors for the purchase of items considered to be of immediate need, or for the purpose of consolidated (bulk) purchases. The District's purchasing agent, who is the District Clerk, approves the amount of the blanket purchase order. Purchases should not exceed the maximum amount remaining on the purchase order, unless the purchasing agent amends the purchase order. In addition, the District's claims audit policy states it is the claims auditor's responsibility to review claims to ensure the appropriation has not been exceeded.

The District's internal control system over blanket purchase orders is weak. The computerized financial system has the capacity to alert the accounts payable clerk if a claim against a blanket purchase order will exceed the limit of the purchase order. However, this feature was never activated and as a result, the system allowed the District to approve purchase orders that exceeded the approved amount of blanket purchase orders throughout our scope period. In addition, when the claims auditor reviews claims, the blanket purchase order that is signed by the purchasing agent is not provided with the claim packet given to the claims auditor for review; therefore, he is unable to see if the claim is authorized and within the limit set forth by the purchasing agent.

We tested 25 blanket purchase orders totaling \$1,120,745 for the 2006-07 fiscal year and found that 10 exceeded the approved limits by \$88,631. In four cases, the accounts payable clerk charged the purchase to the original blanket purchase order. Because the computerized control feature was not activated, the system never flagged the payments as exceeding the blanket purchase orders. The other six purchase orders were exceeded because some claims against the purchase order were not charged to the blanket purchase order.

number; in fact, the purchase order number was left blank in the computerized financial system.

Recommendations

1. The appointed claims auditor should report directly to the Board.
2. District officials should only pay claims that have been properly audited and approved by the claims auditor.
3. The claims auditor should ensure that every claim contains adequate itemization and documentation to support that it is a proper District charge, and that it was authorized by appropriate District officials.
4. District officials should design controls to ensure that blanket purchase orders are monitored and expenditures do not exceed original authorized amounts without approval. The System Administrator should turn on the feature in the computerized financial system that alerts the accounting department when a blanket purchase order has exceeded its limit.
5. District officials should ensure that a copy of the blanket purchase order is given to the claims auditor.
6. In the event that a purchase order threshold becomes insufficient, the purchasing agent should not approve new purchase requests without verifying that sufficient budget appropriation exists, and then either amending the existing blanket purchase order or issuing a new blanket purchase order to cover the requested purchase.
7. District officials should ensure all claims made against a blanket purchase order are encumbered against the purchase order when the claim is entered into the computerized financial system.

Access Controls

The use of information technology affects the fundamental manner in which the District initiates, processes, records and reports transactions. The extent to which the District uses computer processing in significant accounting applications, as well as the complexity of that processing, determines the specific risks that information technology poses to the District's internal controls. The District's widespread use of information technology presents internal control risks that must be addressed. These risks include unauthorized access to data, changes to data in master files, and potential loss of data.

Good businesses practices dictate that a computerized financial system allow users only those access levels they need based on their job descriptions and responsibilities. Having access controls in place prevents users from being involved in multiple aspects of financial transactions. A system administrator has the ability to add new users as well as change users' rights. With this ability, administrators are able to control and use all aspects of the software. A good system of controls segregates the duties of administering access to the computerized financial system and the Business Office function to reduce the risk that District financial information or resources could be misused.

We found that the District's Business Official has administrative access rights to the computerized financial system. This individual is involved in day-to-day Business Office operations and is significantly involved in financial transactions. With these broad financial responsibilities, he should not have the ability to control access to the system and determine how the system works. The Business Official should have only the rights he needs to perform his job duties. We reviewed all personal reimbursements and payroll payments made to the Business Official and did not note any exceptions.

The Business Official told us that no one reviews reports showing user application privileges and the District does not generate change/edit reports. As a result, there is an increased risk that errors, fraud, abuse, or professional misconduct could occur and remain undetected.

Recommendations

8. District officials should designate an employee who is independent of daily Business Office operations to be the administrator of the computerized financial system.
9. District officials should regularly monitor the computerized financial system user access rights to ensure that employees only have access to functions in the system that are consistent with their job duties.

Payroll

A good system of internal controls provides checks and balances so that no one person exercises control over all or most of the payroll process. Proper segregation of duties over payroll processing ensures that incompatible payroll duties relating to personnel (hiring, firing, pay rate setting and benefits), timekeeping and supervision, payroll processing and check distribution are not performed by the same person. There should also be controls to ensure that employees are paid wages and salaries and provided benefits to which they are duly entitled.

If it is not feasible for District officials to adequately segregate duties, at a minimum, District officials should consider implementing certain mitigating controls such as having someone independent of the preparation process perform a review of the completed payrolls and accrual records. At a minimum, the review should include random checks to verify that payrolls are based on actual hours or days worked or authorized leave time; verify that the Board authorized the hourly rates or annual salaries used; compare net payrolls to payroll journals; and assess the payroll for reasonableness.

There is a lack of segregation of duties within the payroll process. The Business Official is directly responsible for creating manual and computerized employee records, adding and deleting employees from the payroll software, entering all payroll data changes, collecting time sheets, entering hours worked and salaries paid, entering leave records and employee absences, preparing and filing employment reports with both State and Federal agencies, preparing paychecks on his computer, signing paychecks as Treasurer and maintaining employee personnel files.

Based on the lack of segregation of duties over the payroll process, we reviewed 25 employees (including the Business Official) to determine the accuracy of accounting for wages, benefits, withholdings, extra pay in accordance with approved employment contracts and the legitimacy of these employees. Our testing did not identify any material exceptions.

Without action to segregate payroll duties, or establish a compensating control function, there remains an increased risk that errors and/or irregularities might occur and go undetected and uncorrected in a timely manner.

Recommendation

10. District officials should segregate payroll related duties to the extent possible or implement mitigating controls, such as having an employee not involved with the payroll process add new employees to the system and update all salary information.

APPENDIX A
RESPONSE FROM DISTRICT OFFICIALS

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

Springs Public School

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KENNETH HAMILTON, DISTRICT TREASURER
FRANCES E. SILIPO, DISTRICT CLERK

Attn: [REDACTED]
Binghamton Regional Office
Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton, New York 13901-4417

April 10, 2008

Re: Draft Audit Report Response

Mr. [REDACTED]

This letter is in response to the draft audit report reviewed during our school district's exit interview on March 19, 2008. Each response item corresponds to the section headings that are used in the draft report, as amended by the phone call from you to Mr. Thomas Quinn on March 20, 2008.

CASH DISBURSEMENTS

Claims Auditor

Paragraph 4: The paragraph addresses a misinterpretation the District had from our external auditors who favored the approach of the District not generating the checks until the claims auditor reviewed the warrant. Using this approach, the claims auditor would then revisit the warrant after the checks were printed to assure everything was identical. The District did not have the claims auditor do the second step. This procedure has been changed so that the purchasing agent and the claims auditor reviews a final warrant after the checks have been printed.

Paragraph 6: "The claims auditor approved only 84 of the 100 vouchers tested." Initially, the new claims auditor was only signing the warrant itself, not each individual invoice. Upon being made aware of this by our external auditors, the claims auditor was instructed to individually sign-off on each invoice.

"The purchasing agent did not approve seven of the 16 claims, totaling \$24,388." This finding relates to the issue in paragraph #4 whereby the purchasing agent is signing a voucher warrant and not the warrant with the actual printed checks. As stated above, this situation has been corrected.

Paragraph 7: Bullets

Bullet #1: ...“The purchasing agent approved only eight of these 23 claims, which leaves 15 not signed by the purchasing agent.” This finding relates again to paragraph #4 and has been corrected.

Bullet #2: “The purchasing agent did not sign six other claims where the authorization form was used.” This finding relates again to paragraph #4 and has been corrected.

Bullet #3: “Nine instances in which the claims auditor approved a claim that had either no support or the support given did not satisfy the legitimacy of the purchase.” The two examples cited were 1: \$38 for a bucket, brush, and soap for the bus drivers to wash the new busses (This was reimbursed to the Business Official) and 2: \$471 to Riverhead Building Supply for epoxy when the custodians ran out in the middle of refinishing the gym floor. The findings are legitimate and reinforce the need to follow procedures in all cases.

Recommendations

1. “The appointed claims auditor should report directly to the Board”. The claims auditor will attend monthly board meetings and present the Claims Auditor Report and the warrants to the Board.
2. “District officials should only pay claims that have been properly audited and approved by the claims auditor.” This recommendation primarily refers to the issue of the claims auditor reviewing warrants prior to the checks being printed. This procedure was changed before the start of the '07-'08 fiscal year on July 1st, 2007.
3. “The claims auditor should insure that every claim contains adequate itemization and documentation to support that it is a proper District charge, and that it was authorized by appropriate District officials.” District officials will review all district purchasing procedures with the claims auditor. The claims auditor will be sent for additional training in his overall responsibilities.
4. “District officials should design controls to insure that blanket purchase orders are monitored and expenditures do not exceed original authorized amounts without approval. The system administrator should turn on the feature in the computerized financial system that alerts the accounting department when a blanket purchase order has exceeded its limit.” The new feature in the financial system that warns of over-expenditures was enabled in 2007.
5. “District officials should insure that a copy of the blanket purchase order is given to the claims auditor.” A binder of blanket purchase orders was created in 2007 and is updated as required. This binder is provided to the claims auditor when a warrant is reviewed.
6. “In the event that a purchase order threshold becomes insufficient, the purchasing agent should not approve new purchase requests without verifying that sufficient budget appropriation exists, and then either amending the existing blanket purchase order or issuing a new blanket purchase order to cover the requested purchase.” The purchasing agent will be given read access to the financial system to view blanket purchase order status. An open purchase order report will also be provided to the purchasing agent for the warrant review.

7. "District officials should insure all claims made against a blanket purchase order are encumbered against the purchase order when the claim is entered into the computerized financial system." This is a basic check that should be made on each invoice. The business office had staffing issues for a major part of the year and various part-time personnel were being used to keep the operation going. This resulted in the daily processing being constantly interrupted and certain cross checks were not always completed. New business office personnel have been hired to address this issue.

ACCESS CONTROL

Recommendations

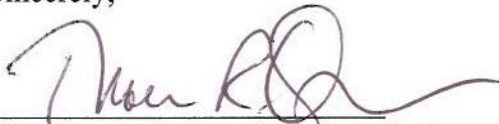
8. "District officials should designate an employee who is independent of daily Business Office operations to be the administrator of the computerized financial system." The computer system administrator will become the administrator of the computerized financial system. He will maintain a printout of each user and the access rights that they have. Any changes to the user rights will require the proper approvals. The system will generate a report showing all user rights changes.
9. "District officials should regularly monitor the computerized financial system user access rights to insure that employees only have access to functions in the system that are consistent with their job duties." The internal auditor will regularly review the user access rights to insure proper access is being maintained.

PAYROLL

Recommendation

10. "District officials should segregate payroll related duties to the extent possible or implement mitigating controls, such as having an employee not involved with the payroll process add new employees to the system and update all salary information." The district has made some changes already to improve the segregation of duties issue. The entering of employee leaves and absences, as well as the maintenance of employee personnel files was transferred to the District Clerk's office. The personnel files are now located in the superintendents office. The internal auditor was tasked with reviewing the segregation issue and reporting to the audit committee on a plan to further segregate duties in the business office.

Sincerely,



Mr. Thomas Quinn, Superintendent

Cc.: Board of Education

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 cash disbursements, the computerized financial system user rights and payroll for further audit testing.

In order to accomplish the objectives of this audit, our audit procedures included the following:

Cash Disbursements – We judgmentally selected and reviewed 100 claims for payment to determine if they were for legitimate District expenditures, were supported and that the information included on check stubs agreed with related supporting documentation. We compared the 25 judgmentally selected blanket purchase orders to what was spent per the financial system to see if they exceeded the respective blanket purchase order limit and why this occurred. We viewed all meals and refreshments expenditures and their supporting documentation to see if they were adhering to their policy.

Computerized Financial System – We reviewed user access rights into the financial system to see if duties were appropriately assigned to users.

Payroll — We also reviewed payrolls for 25 judgmentally selected employees by viewing their year-to-date employee earnings records, payroll registers for October 25, 2006 and May 25, 2007, employee contracts and timecards. We also followed up on the hand drawn checks that replaced lost checks of employees from prior school years by looking at bank statements and the coinciding payroll registers for the pay period in which the check was lost. We also tested to see if there were any ghost employees by randomly selecting 25 employees from the May 11, 2007 payroll register and traced the name on the paycheck to their employee file and either the staff directory or the substitute listing.

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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