



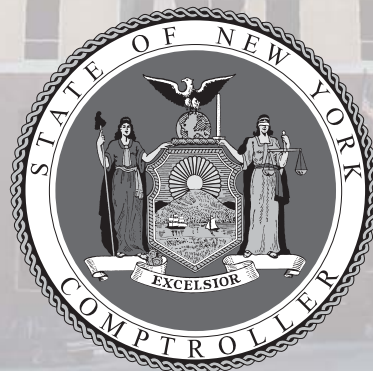
Westhampton Beach Union Free School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — November 30, 2007

2008M-193



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 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 Westhampton Beach 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 Westhampton Beach Union Free 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.

There are three schools in operation within the District, with approximately 1,800 students and 360 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$41 million, which are funded primarily with real property taxes, tuition, State aid, and grants.

Scope and Objective

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

- Have District officials designed and implemented effective internal controls over reserve funds?
- Has the District developed and implemented adequate internal control policies and procedures over changes to capital projects?
- Has the District provided adequate segregation of duties in the Treasurer's Office with regard to payroll processing?
- Have District officials established adequate controls, policies and procedures to safeguard the District's information technology equipment and data?

Audit Results

The Board and District officials did not establish policies and procedures to ensure appropriate internal controls were in place over reserve funds, the safeguarding of the District's financial assets and information technology. The Treasurer did not maintain custody of her signature disk, and the District's information technology equipment and data are at risk. In addition, competitive bids were not solicited for supplementary work related to the high school construction project and, as a result, the cost of the work may have been higher than necessary.

District officials did not properly account for the employee benefit accrued liability reserve (EBALR) and put more money than necessary into the reserve. The District established an EBALR in 2004 by transferring funds from the compensated absences payable account. At June 30, 2007 the balance in the reserve was \$5,285,118. The District's audited financial statements showed that the total liability for compensated absences was only \$4,125,656 at June 30, 2007. Therefore, at June 30, 2007, the excess in the EBALR totaled \$1,159,462. District officials also combined reserve fund moneys with general fund moneys for investment purposes but they did not allocate a pro rata share of the interest earned to the EBALR fund. As a result, reserve funds have been improperly added to the general fund where their use is not properly restricted to the purpose for which the reserve fund was established.

District officials also did not have adequate controls over changes made to capital projects. As a result, changes to the general construction contract for the high school project, in the amount of \$114,502, which were not within the scope of the original contract, were awarded without the solicitation of competitive proposals. In addition, work on three change orders totaling \$213,618 was started before the Board had authorized the changes. Therefore, there is an increased risk that the cost of the work may have been higher than necessary, and the work may not have met the District's design expectations.

District officials did not provide for an adequate segregation of duties in the Treasurer's Office. During our audit period, the payroll clerk was responsible for preparing the District's bi-weekly payrolls, adding and deleting employees from the payroll system and altering employees' pay rates and payroll deductions. She also used the Treasurer's signature disk to sign employee paychecks. The lack of control over the signature disk could have resulted in the misuse of District funds. As of July 1, 2007, the District instituted new procedures to resolve these issues.

Finally, District officials did not establish adequate controls over information technology. The District's acceptable-use policy was not comprehensive and agreements were not in place with external parties to control remote access. In addition, access controls over authorizations, passwords and connections were weak, all data was not backed up in a secure off-site location, and the District did not have a disaster recovery plan in place. As a result, the District is at risk of unauthorized access to its computer resources, loss or misuse of electronic information, and the disruption of its computer operations.

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. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they had already initiated or planned to initiate, corrective action. Appendix B includes our comments on the issues raised in the District's response letter.

Introduction

Background

The Westhampton Beach Union Free School District (District) is located in the Town of Southampton, Suffolk 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. Responsibilities relating to the District's finances, accounting records and reports are largely those of the Business Official and the Treasurer.

There are three schools in operation within the District, with approximately 1,800 students and 360 employees. The District's budgeted expenditures for the 2006-07 fiscal year were \$41 million, which are funded primarily with real property taxes, tuition, State aid, and grants.

The District has a technology network of more than 2,000 computers. The network includes firewall components, servers, switches, printers, wiring panels, and software packages. The network is used throughout the three school buildings and the administration building, in offices, classrooms, libraries, and computer labs.

Objective

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

- Have District officials designed and implemented effective internal controls over reserve funds?
- Has the District developed and implemented adequate internal control policies and procedures over changes to capital projects?
- Has the District provided adequate segregation of duties in the Treasurer's Office with regard to payroll processing?
- Have District officials established adequate controls, policies and procedures to safeguard the District's information technology equipment and data?

**Scope and
Methodology**

We examined the District’s internal controls over reserve funds, capital projects, Treasury office operations and information technology for the period July 1, 2006 to November 30, 2007. Our audit disclosed areas in need of improvement concerning information technology controls. Because of the sensitivity of this information, certain specific vulnerabilities are not discussed in this report but have been communicated to District officials so they could take corrective action.

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 had already initiated or planned to initiate, corrective action. Appendix B includes our comments on the issues raised in the District’s response letter.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the GML, 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.

Employee Benefit Accrued Liability Reserve

General Municipal Law authorizes school districts to create an employee benefit accrued liability reserve (EBALR) to make cash payments for the value of accrued benefits (compensated absences) due to employees upon separation. If District officials determine that the reserve fund is no longer needed, moneys in excess of the amounts necessary to satisfy all liabilities incurred or accrued against the fund may be transferred to other reserve funds as authorized by law. The District is not required to establish a separate bank account for this reserve. However, moneys in the reserve must be accounted for separately from other District moneys and interest earned on moneys in the reserve must be allocated to the reserve fund.

The funds that school districts may accumulate in an EBALR must pertain only to employees' compensated absences and not to any other salary-related payments (non-permissible costs, such as FICA, Medicare taxes, and contributions to a retirement system). Although school districts must measure and report the total liabilities on their financial statements, they cannot legally accumulate funds in an EBALR for non-permissible payroll-related costs.

In October 2003, the Board adopted a resolution authorizing the creation of an EBALR, to use the funds for its liability for compensated absences. On January 1, 2004 the District transferred \$5,464,205 from the compensated absences payable account to establish the reserve. At June 30, 2004 the balance in the reserve was reduced by \$179,087. The journal entry indicated the reduction would bring the reserve balance into agreement with the District's total compensated absences. As a result, at June 30, 2007 the balance in the reserve amounted to \$5,285,118.

The District's audited financial statements at June 30, 2007 showed that the total liability for compensated absences was only \$4,125,656. Therefore, at the close of the 2006-07 fiscal year, the excess in the reserve totaled \$1,159,462. If the entire balance in this reserve is not needed to fund compensated absences, the unneeded amount may only be transferred to another reserve in compliance with statutory restrictions.

Finally, District officials combined reserve fund moneys with general fund moneys for investment purposes. However, they did not allocate a pro rata share of the interest earned to the EBALR fund. As a result, interest earnings on the reserve fund moneys have been improperly

added to the general fund where their use is not restricted to the purpose for which the reserve fund was established.

Recommendations

1. District officials should analyze the balance in the EBALR and transfer moneys in excess of the amounts necessary to satisfy liabilities incurred or accrued against the EBALR fund to other reserve funds as authorized by law.
2. District officials should credit the pro rata share of interest earned on invested funds to the EBALR.

Change Orders

All prospective bidders must have an equal opportunity to bid on significant changes to capital projects that are not within the scope of the original contract. It is recognized that, as work goes forward, it is sometimes necessary to make some changes from the initial plan. If problems arise during the construction process for any reason, or if District officials change their mind about what they want done, a change order form must be completed to define the change in contract price.

A change order authorizes a contractor to add or delete work because of unanticipated field conditions or changes in design or project specifications. However, no important general change may be made which so varies from the original plan, is of such importance or so alters the essential identity or main purpose of the contract as to constitute a new undertaking. If the change is not related to the scope of the original contract, it must be performed through a new contract that is competitively awarded. Change orders should be kept to a minimum because the prices for change order work are usually determined through negotiated agreements with contractors rather than competitive bidding. Consequently, there is a significant risk that work performed through a change order will be more costly than if it had been competitively bid.

Competitive bidding provisions give all responsible vendors equal opportunity in furnishing supplies, equipment and services to the District. Furthermore, it prevents the favoring of one vendor over another and helps to prevent fraud. General Municipal Law and the District's policy require competitive bidding on all purchase contracts involving an expenditure of more than \$10,000 annually for items of materials, supplies and equipment and expenditures of more than \$20,000 for public work contracts.

Change orders should also be reviewed promptly to ensure that they are approved before the work is performed and the work is completed according to contract requirements. Because the Board authorizes the District's general construction contracts, the Board must also authorize changes relating to those contracts prior to the commencement of work.

During 2005, the Board approved three construction contracts totaling \$18.7 million for additions and alterations to the high school. The original contracts were properly awarded after public advertisement for competitive bid proposals. Between November 2005 and August

31, 2007, 24 change orders totaling \$617,074 increased the contracts' total to \$19.3 million. Our test of five of these changes, totaling \$296,764, disclosed that District officials awarded one contractor additional work, totaling \$114,502, which was outside the scope of the corresponding contract by authorizing change orders instead of bidding the additional work competitively. We also found that the additional work associated with three of the five change orders began before the Board approved them.

Competitive Bidding — The initial general construction contract for \$14.1 million was awarded by the Board on September 27, 2005. Eight change orders totaling \$183,410 were made to this contract. We tested two of these change orders totaling \$114,502 and found that the additional work consisted of new undertakings which should have been publicly advertised for competitive bids.

- On February 20, 2007, the construction manager prepared a change order to the general construction contract to provide landscaping work to the courtyard behind the high school auditorium in order to complement sculptures created by the Art Department. This change cost the District an additional \$37,502. District officials acknowledged that this change was not part of the original contract and should have been bid out separately.
- On April 6, 2007, the construction manager prepared a change order to the general construction contract for the removal and replacement of 771 linear feet of concrete curb and 6,986 square feet of concrete sidewalks, including asphalt repair, as requested by the District, for an additional cost of \$77,000. District officials stated that the sidewalk was damaged during the construction project and it created a safety issue to students. District officials never declared this an emergency purchase, which would have exempted it from competitive bidding requirements, and instead relied on the construction manager to insure a reasonable cost.

Because this additional work was not awarded after the solicitation of competitive bids, there was an increased risk that the cost of the work may have been higher than necessary.

Approval of Change Orders — For three of the five change orders we tested, totaling \$213,618, work was already completed or near completion before the Board approved the change orders. For example, work related to the curb and sidewalk change order prepared on April 6, 2007 was completed by April 16, 2007. However, this change order was not approved by the Board until May 7, 2007. The District

paid the contractor \$77,000 for this additional work. When change order work is commenced before the change order is reviewed and approved by the Board, there is a risk that the resulting work will not meet the District's cost or design expectations.

Recommendations

3. District officials should solicit competitive bids for all significant changes to construction contracts outside the scope of the original contract.
4. The Board should take steps to ensure that all change orders for additional work are properly authorized and approved by the Board before the corresponding work has begun.

Treasurer's Operations

The Treasurer is the custodian of all District moneys and performs duties that include printing and signing checks. As the District official responsible for signing checks, the Treasurer must ensure that her signature is not used to make payments that have not been approved. Education Law requires the actual or facsimile of the Treasurer's signature to be applied to District checks either by the Treasurer or under the Treasurer's direct supervision.

To help prevent the misuse of District funds and to help ensure the accuracy of employee payrolls, it is important to segregate the duties of payroll processing. It is essential that the individual responsible for processing payrolls and adding employees to the payroll system not also have the ability to print and sign employee paychecks.

Prior to July 2007, the District used a computerized signature disk with the Treasurer's signature to sign all District checks. During the fiscal year ended June 30, 2007, the Treasurer did not properly safeguard her signature disk. The signature disk was kept locked in a safe. However, the payroll clerk, in addition to the Treasurer and the Deputy Treasurer, had the combination to the safe and regularly signed payroll checks in the absence of the Treasurer. The Treasurer was fully aware that the payroll clerk was signing payroll checks.

During the 2006-07 fiscal year, in addition to signing payroll checks, the payroll clerk prepared the District's bi-weekly payrolls. She also had the ability to add and delete employees from the payroll system and alter employees' pay rates and payroll deductions. Due to this poor segregation of duties, we reviewed payroll disbursements made to three District employees.¹ Although our review disclosed no exceptions, the lack of control over the signature disk could have resulted in the misuse of District funds.

As of July 1, 2007, the District instituted new procedures to resolve the poor segregation of duties. Officials implemented a new software program which stores the Treasurer's and the Deputy Treasurer's signatures electronically. When payroll checks are processed the software requests that a password be entered to affix the signature. The Treasurer or Deputy Treasurer must be present to enter their password into the system and have their signature affixed to the checks. The payroll clerk does not have access to this password.

¹ Two payroll department employees and the School Business Official

Furthermore, the payroll clerk no longer has the ability to add and delete employees from the payroll system and alter pay rates and payroll deductions.

Recommendation

5. The Treasurer and Deputy Treasurer should be the only individuals signing employee paychecks. To ensure that this is the case, each of their electronic signature access passwords should be known only to them.

Information Technology

The use of computer data affects the fundamental manner in which District officials initiate, record, process and report transactions. The extent to which District officials and staff process significant accounting transactions electronically, as well as the complexity of the data processing system, determines the specific risks that computer data poses. These risks include unauthorized access to data, unauthorized changes to data in master files and 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. It is important that the system of internal controls include a disaster recovery plan and systematic backup procedures. 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. Backup procedures should include provisions to store backups off site so that in the event of loss of computerized data, system data can be restored with a minimal amount of inconvenience, as quickly as possible.

The District uses information technology (IT) to initiate, process, record, and report transactions. District officials rely upon computer data for making financial decisions and for reporting to State and Federal agencies. During our audit period, the District had a technology network of more than 2,000 computers, accessible to administrators, teachers, staff members, and students. More than 200 of these computers are laptops that are given to teachers for use in the classroom. The network included firewall components, servers, switches, printers, wiring panels, and software packages. The network was used throughout three school buildings and the administration building in offices, classrooms, libraries, and computer labs.

District officials did not establish adequate controls for information technology. The District's acceptable-use policy is not comprehensive and agreements are not in place with external parties to control remote access. In addition, network access controls over authorizations, passwords and connections are weak, and the District does not have a disaster recovery plan. As a result, the District is at risk of unauthorized access to its computer resources, loss or misuse of electronic information, and the disruption of its computer operations.

Acceptable Use

An acceptable-use policy defines the District's goals for the acceptable use of equipment and computing systems, and the security measures to protect the District's resources and confidential information. District officials are responsible for establishing a comprehensive acceptable-use policy to establish the rules of behavior for all system users and provide for enforcement in the event of violations. Such policies need to be reviewed and updated periodically. While the Board did adopt an acceptable-use policy, District officials did not have adequate controls in place to ensure that the policy was enforced.

In 1996, the Board established a policy for District faculty and staff which defined acceptable educational computer use. This policy was reviewed in 2001 and readopted each year thereafter, although no changes were made to the policy. Continuous advances in information technology demand that District officials be proactive in reviewing and updating policies and procedures. During the audit, District officials were receptive to suggestions made by field examiners and, in March 2008, the Board adopted a revised faculty and staff computer use policy, a financial software policy and an information security policy.

The District's policy states that District administration reserves the right to supervise the use of all computers, networks, and to inspect the information and content that they contain. However, District officials have not implemented procedures to monitor usage of laptops assigned to employees. As a result, provisions of the acceptable-use policy have been circumvented by District employees. In February 2008, we tested 10 laptop computers assigned to District teachers and found that certain teachers used District computers to access unauthorized websites and to install unauthorized software. In addition, the virus protection program installed on a District computer used by one teacher was not updated for four months because the teacher accessed the Internet from home, rather than from school.

Unauthorized Websites — Although the District has content filters on its network servers to block Internet access to unauthorized websites and chat rooms, the filters only work when teachers access the Internet through the District's network. The filters do not work when the Internet is accessed in any other manner, such as when a teacher uses a laptop to access the Internet from his or her home. Of the 10 laptop computers we examined, two computers, assigned to elementary school teachers, were used to access unauthorized websites. The websites were various shopping, vacation, automotive and auction sites.

Unauthorized Software — The District's acceptable-use policy states that the installation of software is allowed only by the District's

administration, and should not be undertaken by any other user unless authorized. However, one of the 10 laptop computers we examined had a software program installed by the computer user that was not authorized by the District. The software program was an advanced security tool allowing the user to completely remove data from the hard drive. In addition, this program allowed the user to change the computer's operating system. Only those District officials with administrative rights must have the ability to change a computer's operating system.

Virus Protection — Anti-virus programs protect computers from viruses that can damage not only the computer initially infected, but other computers in the District's network. Anti-virus programs need to be updated periodically because, over time, computer viruses become ever more sophisticated. Virus protection programs on District computers are automatically updated on a regular basis when users connect to the District's network. However, we found the anti-virus program on one of the 10 laptops we examined had not been updated in four months. This computer was being used at home and was not being used in the classroom as intended. As a result, there was an increased risk that not only this one computer could be infected by a virus, but that other computers connected to the District's network could be infected as well, once this computer was connected to the network.

The District's failure to implement procedures to supervise laptop use and the ability of laptop computer users to avoid the District's content filters and updates to District's virus protection software allowed a number of the District's laptops to be used inappropriately. As a result, although officials stated that they have not experienced any damage from computer viruses, District computers were at greater risk of damage from computer viruses.

Network Access

Access controls provide reasonable assurance that computer resources are protected from unauthorized modifications. To control electronic access, a computer system or application must identify and differentiate among users. User accounts identify users and establish relationships between a user and a network, computer, or application. The system administrator creates accounts that contain information about the users, such as rights to files, applications, directories and other computer resources. It is important that the system administrator creates user accounts based upon management's written authority.

To access a network, computer, or application, users must enter their user name and authentication. The computer compares this information with its database of user accounts and, if a match is found, gives the user access to those resources stipulated in their user account.

Fingerprints or smart cards can authenticate users, but passwords are the most common way. It is essential to establish and safeguard system passwords to prevent unauthorized users from gaining access to and misusing system data.

Passwords can be used effectively to mitigate the risk of unauthorized access to the District's computer resources. The more complex a password, the better the chances are that intruders and unauthorized users will be prevented from obtaining access to the system. Strong passwords meet a level of complexity that makes them difficult to guess. For example, strong passwords generally are not a word in any language, do not contain personal information, and contain a combination of uppercase and lowercase characters, symbols, and numbers. Passwords should be changed every 30 to 90 days to protect confidentiality. Doing so significantly increases protection against unauthorized access to District information. Access to the system should be denied after a specific number of failed log-in attempts to further prevent unauthorized users from guessing passwords. A password must also be required to access the system after a period of inactivity to discourage unauthorized access from unattended workstations.

District officials have not established policies and procedures for accessing the District's computer network. We identified weaknesses in the District's controls relating to accessing the District's network. Due to the sensitive nature of these issues, we have communicated these concerns in a separate, confidential memo.

Remote Access

Remote access is the ability to log-on to a network from off-site locations. Generally, this involves a computer, a modem or Internet access, and remote access software. Remote access can cause security risks for an otherwise secure network because remote computers, even if physically secure, may be vulnerable to attacks from other systems. Policy directives, education, and due diligence are all key to secure remote access.

District officials have not established and implemented policies and procedures governing remote access, ensured that remote access systems were secure, nor verified that all parties capable of remote access were authorized users. Currently, employees of the software company the District uses for its financial data have remote access to the server where District data is stored. In addition, the District contracted with a third-party provider to provide technical support for the District's computer network. This agreement includes the services of a consultant, with full administrative rights, to work on-site one day a week. This individual's administrative rights allow him unlimited access to the District's information technology resources, including remote access. These users can remotely access the District's

system without first asking for permission and their activities within the system are generally not monitored by the District. Without an acceptable use policy or a remote access agreement with third party vendors, there is a greater risk that the District's IT resources could be compromised and/or inappropriate transactions could be initiated and not detected by the District.

Backup Data Storage

Data needs to be backed up (i.e., a copy made) on a routine basis and the backup copy stored at an environmentally and physically secure off-site location. The District's procedure has been to back up data and store the data in the basement of the same building where the data was produced. The practice of storing backup data in close proximity to the original data exposes the backup data to the same risks as the District's system and may impede the District's ability to recover and restore its computer operations in the event of a disaster.

Disaster Recovery

A system of strong internal controls should also include a disaster recovery plan to prevent loss of computer equipment and data, and procedures for recovery in the event of a loss. The plan must include precautions to be taken to minimize the effects of a disaster so the organization will be able to either maintain or quickly resume its mission-critical functions. The plan should also include a significant focus on disaster prevention.

District officials have not established a disaster recovery plan to ensure that the computer data used in daily business operations is protected from loss. In the event of a disaster, District personnel have no guidelines or plan to follow to minimize the loss of equipment and data, or guidance on how to appropriately recover data.

Recommendations

6. The Board and District officials should continue to periodically review and revise the comprehensive acceptable-use policy to address personal use of the District's computer resources.
7. District officials should implement procedures to prohibit users from loading unauthorized software on District computers.
8. District officials should ensure that remote access agreements are in place with all external parties that have remote access to the District's IT system and data. In addition, the activities of all external parties that have remote access should be monitored.
9. District officials should ensure that backup data is stored in a secure off-site location and periodically test the data to verify that it can be used, if necessary.
10. District officials should develop a written disaster recovery plan.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



WESTHAMPTON BEACH UNION FREE SCHOOL DISTRICT

OFFICE OF THE SUPERINTENDENT

MILL ROAD, WESTHAMPTON BEACH, NEW YORK 11978-2045

(631) 288-3800 FAX (631) 288-8351

Lynn Schwartz
Superintendent of Schools

November 25, 2008

Office of the State Comptroller
Division of Local Government and School Accountability
New York State Office Building/Room 3A10
250 Veterans Memorial Highway
Hauppauge, NY 11788-5533

Dear Sir:

This audit response is in reference to the Office of the State Comptroller's Report of Examination number 2008M-193 Westhampton Beach Union Free School District - Internal Controls Over Selected Financial Operations - Period Covered: July 1, 2006 – November 30, 2007. The Westhampton Beach School District strives to provide a high quality education for all its students while maintaining the lowest possible tax impact on residents. The Board of Education takes seriously their responsibilities and continues to uphold their fiscal accountability to taxpayers, while maintaining a challenging, competitive, and consistent educational program for students.

Due to prudent financial planning and continuous efforts to work with external and internal auditors to improve operations and efficiencies, the District is prepared to meet the challenging economic crisis facing school districts in New York State. The Office of the State Comptroller's overall goal to assess the adequacy of the internal controls put in place by officials to safeguard the Westhampton Beach School District's assets is appreciated. Public trust and confidence are essential to achieving the missions, goals and objectives of the Westhampton Beach School District. The District's educational leaders maintain the highest standards of ethical conduct and continuously review internal controls, so that improvements may be made to assure that school resources are being spent appropriately.

It should be brought to the forefront of the Report of Examination that the State auditing team, in their initial assessment, evaluated a number of areas that are crucial to determining the fiscal integrity and strength of the Westhampton Beach School District. Those areas included: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and other business office related functions. In many of the aforementioned areas, the District's protocols were found to be sound and our practices acceptable. The District takes seriously its charge to reduce any potential risk of fraud, theft and/or professional misconduct (of which, none was found) and has already

addressed a number of the recommendations provided by the Office of the State Comptroller.

Employee Benefit Accrued Liability Reserve

The District would like to clarify its initial intent in the establishment, funding and anticipated utilization of the EBALR. In an effort to be “proactive” and fiscally prudent, we established the fund to offset the future liability of “other post-employment benefits” (OPEB), as set forth in GASB45. Lacking any recent guidance from the state and following the advice of our auditors, we thought this strategy to be fiscally sound. While we understand that it is the position of the Comptroller that your audits are based upon actions and law, not a district’s objectives; the exclusion of our motives in the Comptroller’s report, implies ill-intent by district officials which is simply not the case.

School districts strive to shore up reserves for purposes of future prudent financial planning. Planned funding of the EBALR reserve was based on the following:

- advice of our external auditors: public accounting firms who were aware of and approved the establishment and funding of the EBALR;
- reliance on Governmental Accounting Standards Board Statement No. 16, July 1994, and Office of the State Comptroller documents, also from July of 1994 (again, see attached) indicating liabilities must be calculated for expenditures associated with compensated absences, including FICA, Medicare, retirement system contributions, and other employee benefits;
- reliance on State Education Department documents indicating General Municipal Law 6-p reserve funds can be used to save for “the payment of any accrued employee benefit due an employee upon termination of the employee’s service.” (see attached);and,
- upon learning of Office of the State Comptroller’s alternative interpretation of General Municipal Law 6-p, did not use our EBALR to continue to fund “Other Post Employment Benefits” liabilities (OPEB) (Office of State Comptroller Opinion 2006-8).

See
Note 1
Page 25

See
Note 2
Page 25

Public accountants and the State Education Department had, for years, advised districts that General Municipal Law Section 6-p authorizes a reserve fund for payment of benefits due upon termination of employment and that this reserve is financially prudent. Recommendations to prepare for and/or fund this future liability were commonplace prior to the Comptroller’s 2006 Opinion

Change Orders

The Westhampton Beach Community has supported capital additions and enhancements at all three school buildings over the past several years. The District has completed close to fifty million taxpayer dollars worth of construction in an effort to provide students and faculty with a safe, healthy and technologically advanced learning environment.

Proper planning and analysis prior to the on-set of any capital project is essential to reducing the number and frequency of change orders. It should be noted that the total change order dollar amount for our capital projects were well below industry standards. The District acknowledges the two change orders in questions were not part of the original contracts, however, the District fully believes it acted in the best interest of the taxpayer. Too often bureaucratic red tape ties up work and escalates costs. By the time a bid would have been put together and proposals submitted, a month's time, at least, would have transpired and work, which may have been completed in a week's time, would still not have been completed. The District believed it was prudent to rely on the advice of its architect and construction manager who strongly indicated that the price per unit cost provided by the on-site contractor was very competitive and a lower price was not likely.

The change order involving the concrete curb side at the high school was treated as a health and safety issue. While it was not officially declared an emergency at a public Board of Education meeting, the Board of Education was very much aware of the risk and sought to protect the health & safety of students and faculty by quickly having the curb and walk way, which were damaged by the construction, replaced and repaired prior to the opening of school in September. In the future, all emergency procedures will be declared and documented at public Board of Education meetings.

The Comptroller's report inaccurately states that a contractor was paid \$77,000 on May 4, 2007 for additional work which was not approved by the Board of Education until May 7, 2007. The District has all checks approved by an internal claims auditor prior to release. Preparation for this weekly approval process takes time. After the Board of Education approved the change order, the check went through the routine approval process of the purchasing agent, the internal claims auditor and finally, the Board President signed it. While the payment was prepared on May 4, 2007, it was not mailed until May 11, 2007. This was acknowledged by the State auditing team at the exit conference on November 5, 2008.

See
Note 3
Page 25

Treasurer's Operations

The comptroller's report states that the payroll clerk had access to the Treasurer's signature disk and regularly signed checks in the Treasurers absence. It should be noted that all payrolls were reviewed by the Business Official and certified by the Superintendent prior to the printing of checks. On the rare occasion, that the Treasurer was absent, the Business Official (the Deputy Treasurer) was present to oversee the printing of checks.

See
Note 4
Page 25

See
Note 5
Page 25

In response to the comment regarding payroll protocols, the District understands that the internal controls of a school district are the checks and balances that exist within any business operation. Segregation of duties is a key element in any internal control system. This concept ensures that an individual cannot execute a transaction without at least one other individual checking his/her work. Due to the relatively small size of the Westhampton Beach School District's Business Office staff, segregation of duties is often

not feasible. However, compensating controls were employed by the District to address this challenge. Prior to the State’s audit, in an effort to address the issue of segregation of duties, District officials carefully analyzed the payroll procedure and implemented a new software program to mitigate the ability of the payroll clerk to change employee information. This compensating control provides the personnel office staff with the ability to update and change employee information. The business office staff, in turn, reviews and verifies the information as it pertains to payroll.

Information Technology

Through on going community support, the Westhampton Beach School District provides students with an environment that supports technology-rich instructional experiences not found in a typical public school setting. In fact, the District prides itself on being the only public school district in the state of New York to have a one-to-one laptop initiative for all students in grades four through twelve. The District is a pioneer and understands the challenges this initiative presents. An environment that provides support and encourages exploration is crucial for employees and students to be successful in this rapidly changing global universe.

Determining the optimal balance between control and access is essential to the success of a one-to-one laptop initiative. District administration is sensitive to this challenge and has allocated significant resources to assure that all information is protected and secure. At no time did any user have unauthorized access to the District’s computer resources, nor was there loss or misuse of electronic information, nor was there ever a disruption of its computer operations.

Every teacher and student laptop, as well as every desktop computer, has individual virus protection software installed which is automatically updated when the computer is attached to the Westhampton Beach network. In addition every server in the district has anti-virus protection including the network storage server. Furthermore, the email server is filtered twice, both internally and externally for anti-virus and spam.

See
Note 6
Page 26

In addition to the Student Computer Use policy that was already in place, the Board of Education has adopted a policy which addresses employee computer use. A user security agreement is reviewed and agreed to each time a user logs on to a Westhampton Beach School District computer.

Securing and protecting the integrity of the District’s information as it pertains to the financial operations, as well as, the management of student information within the District is taken quite seriously. The issue of disaster recovery for District data was being addressed by District officials prior to the State Comptroller’s audit. A comprehensive, formal written Disaster Recovery Plan, which sets forth the protocols and procedures to be followed should a disaster occur, has been adopted by the Westhampton Beach Board of Education. Financial and student information systems are backed up locally each night as well as at a remote site off of Long Island.

See
Note 7
Page 26

See
Note 8
Page 26

The Westhampton Beach School District has incorporated many of the Comptroller's recommendations into the District's operations. The administration will continue to assess and evaluate the ever changing environment that surrounds the district and reflect on practices to ensure that the District remains fiscally prudent.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Lynn Schwartz", with a long, sweeping horizontal stroke extending to the right.

Lynn Schwartz
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Employee Benefit Accrued Liability Reserves (EBALRs) are governed by General Municipal Law (GML) 6-p. The Law was adopted in 1996 and thus superseded previous pronouncements. EBALRs can only be used to make payments to employees upon separation of service for accrued leave time due. Governmental Accounting Standards Board (GASB) Statement No. 16 covers more liabilities than are allowed by GML 6-p. The Statement does not apply specifically to EBALRs.

District officials appear not to understand the difference between the financial statement reporting requirements of GASB Statement 16, "Accounting for Compensated Absences," and the GML-established EBALR. In July 1994, OSC issued guidance for the implementation of GASB Statement 16. This guidance specifies what should be included in the liability and offers suggestions for calculating it. However, it also clearly states that funding of the liability is not required. There is a distinct difference between what should be included in the liability and what is permitted to be funded by the EBALR. According to the GML 6-p, "employee benefits" means the value of accrued and unliquidated time earned by municipal and school district employees and payable to those employees upon termination of service. This clearly does not include salary-related payments or OPEB costs.

Note 2

The District's statement that the State Comptroller's Office offered an "alternative" interpretation of General Municipal Law 6-p is incorrect. The State Comptroller's interpretation of the law and the wording of the law are the same; there are no provisions that allow EBALR funds to be used to pay other post employment benefits.

Note 3

Regardless of whether the contractor was paid on May 4 or May 11, 2007, the fact remains that the work was completed by the contractor before the change order was approved by the Board. The Board must authorize changes related to capital project contracts prior to the commencement of work to ensure that the work is completed according to contract requirements.

Note 4

During our audit we were unable to verify that payrolls were certified prior to the printing of payroll checks because the Superintendent's signature on bi-weekly payrolls was not dated.

Note 5

Neither the payroll clerk nor the deputy Treasurer should be using the Treasurer's signature disk in his or her absence.

Note 6

As noted in our report, certain users did not connect to the District network for as long as four months at a time. Their computers were at the greatest risk because their virus protection had not been updated.

Note 7

Although District officials indicate that a disaster recovery plan was being addressed prior to our audit, the Board did not adopt a disaster recovery plan during the time of our fieldwork. Such plan may have been adopted after the completion of our field work.

Note 8

The remote site back up of financial and student information is a recent change in District procedure. During our audit period, such information was not backed up.

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. 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 financial condition, interest in contracts, purchasing and information technology for further audit testing.

Our examination included the following:

- We examined recent annual audit reports prepared by the District's public accounting firms.
- We analyzed changes in fund balance.
- We reviewed documentation to support reserve fund and short- and long-term liability calculations.
- We reviewed interest earned on the reserve funds.
- We reviewed the minutes of the Board of Education meetings and the Board policy manual.
- We interviewed District employees about capital projects and reviewed documentation to determine if change orders were new undertakings.
- We examined claims paid to District officers, employees and employee relatives. We determined the nature of the payments and whether they were prohibited or required disclosure.
- We reviewed all computer use and information technology policies.

- We interviewed the Director of Technology and other District officials regarding computer use policies and procedures relating to: user accounts, acceptable use, remote access to the network by third party vendors, user access authorizations, network passwords, network connections, data backups, and disaster recovery plans.
- We tested 10 staff laptops for improper use and unauthorized software.

We conducted our performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX D

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