



# Whitesville Central School District

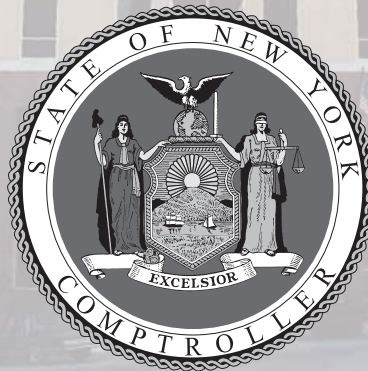
## Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — April 25, 2008

2008M-137



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

December 2008

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Whitesville Central 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

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# EXECUTIVE SUMMARY

The Whitesville Central School District (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 employs a Junior Accountant who serves as the Business Manager and information technology coordinator.

### **Scope and Objective**

The objective of our audit was to determine if the District's internal controls over selected financial operations were appropriately designed and operating effectively for the period July 1, 2006 to April 25, 2008. We expanded our scope for certain budgetary practices back to July 1, 2002. Our audit addressed the following related questions:

- Has the District taken adequate action to address the excessive unappropriated, unreserved fund balance in the general fund and adopt realistic budgets?
- Have the Board and District officials adequately segregated incompatible duties in the Business Office?
- Are internal controls over information technology appropriately designed and operating effectively?
- Has the District appropriately established the internal audit function?

### **Audit Results**

The Board and District officials did not address the excessive balance in the general fund, adopt realistic budgets, ensure that duties were properly segregated and technology controls were appropriate, or properly establish the internal audit function. As a result, the taxes that have been levied have been an unnecessary burden to District taxpayers, the Superintendent was paid more than authorized by his contract, and the District Clerk/Secretary received time off without the formal approval of the Board. Further, the District's information technology equipment and data are at risk, and the internal audit function is not independent, as required.

The District has not taken adequate action to address the excessive general fund balance, even though their external auditors have brought this matter to their attention for the last three fiscal years. Further,

two reserve funds were used to lower the excessive general fund balance at the recommendation of the District's external auditors. We question the propriety of \$305,000 of these reserve funds. Had the District reported in its general fund the reserve fund amounts that we question (\$305,554) and the \$300,000 of unreserved fund balance that was appropriated but was never actually used to fund operations, the District would have exceeded the amount it was legally allowed to retain by more than \$900,000 as of June 30, 2007. Had these moneys been reported as general fund unreserved balance and if the Board had complied with the statutory limits for the amount of unreserved fund balance that may be retained at year-end, we estimate that real property tax increases from 2002-03 to 2006-07, totaling \$331,100, would have been unnecessary.

The Board and District officials have not properly segregated incompatible duties in the Business Office. Although the Superintendent certified each payroll, the District Clerk/Secretary maintained leave time records, including her own, without oversight, and the Treasurer was responsible for all other aspects of the payroll process. In addition, the Treasurer was responsible for cash receipts, wire transfers, preparing and approving journal entries, check signing, maintaining accounting records, reconciling bank accounts and the majority of activity related to cash disbursements. As a result, there was an increased risk that errors or irregularities could occur and remain undetected and uncorrected. For example, the Treasurer paid the Superintendent \$4,500 in salary that was not provided for in his contract. In addition, the District Clerk/Secretary received 18 compensatory days off, each year, valued at \$6,770 over the last four years, pursuant to an undated agreement with the former Superintendent, that the Board had not formally approved and Board members we spoke with could not recall discussing.

Internal controls over information technology (IT) assets are not appropriately designed or operating effectively. There are no requirements to change passwords or complexity requirements for passwords. In addition, three individuals have the ability to change accounting data and the access rights of others without oversight. This weakness allowed the Junior Accountant to change his direct deposit payroll deductions without the knowledge of the Treasurer. Further, most of the computers in the District have administrative rights to make it easier for teachers to install software. However, this allows users to change security settings, or add and delete programs, without the knowledge of the IT coordinator. We also found that four network and five email accounts were not deleted for individuals that are no longer employed by the District and that there is no formal disaster recovery plan. As a result, there is an increased risk that authorized or unauthorized users may gain access to applications and make unauthorized changes to data that are not detected, and that critical information systems or data will not be available for District financial operations in the event of a disaster.

The BOCES employee serving as the internal auditor is not independent in performing the internal audit function. This current arrangement is likely to put the BOCES employee in the position of evaluating significant District services or programs that are provided to the District by the BOCES, the individual's employer.

### **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 that they either have or plan to initiate corrective action. Appendix B contains our comment on one issue raised in the District's response.

# Introduction

## Background

The Whitesville Central School District (District) is located in the Towns of Independence and Willing in Allegany County, and the Town of West Union in Steuben 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.

The Junior Accountant serves as the unofficial Business Manager and information technology coordinator. He is responsible for preparing the annual budget (together with the Board and Superintendent), addressing the District's information technology security, repair and acquisition needs. He is also responsible for accounting duties including adjusting journal entries and year-end reporting. The Treasurer is responsible for payroll, cash receipts and cash disbursement accounting, among other duties. The District Clerk/Secretary is responsible for the daily activities of the District office, preparing minutes of District meetings, and maintaining employee leave time records.

There is one school in operation within the District, with approximately 295 students and 36 full-time employees. The District's budgeted expenditures for the 2007-08 fiscal year were approximately \$5 million which were funded primarily with State aid, real property taxes, and grants.

## Objective

The objective of our audit was to determine if the District's internal controls over selected financial operations are appropriately designed and operating effectively. Our audit addressed the following related questions:

- Has the District taken adequate action to address the excessive unappropriated, unreserved fund balance in the general fund and to monitor revenues and expenditures?
- Have the Board and District officials adequately segregated incompatible duties in the Business Office?
- Are internal controls over information technology appropriately designed and operating effectively?

- Has the District appropriately established the internal audit function?

**Scope and Methodology**

We examined the District’s internal controls over financial condition, segregation of duties, information technology, and the internal audit function, for the period July 1, 2006 to April 25, 2008. We expanded our scope for certain budgetary practices back to July 1, 2002.

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. District officials generally agreed with our recommendations and indicated that they either have or plan to initiate corrective action. Appendix B contains our comment on one issue raised in the District’s response.

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.

## Financial Condition

A school district's financial condition determines its ability to fund public educational services for students within the District. The responsibility for accurate and effective financial planning rests with the Board, the Superintendent and the Junior Accountant. Fund balance represents the resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing fiscal year. A District may retain a portion of fund balance, referred to as unreserved, unappropriated fund balance, but must do so within the legal limits established by Real Property Tax Law.<sup>1</sup> The Board and District officials are responsible for adopting annual budgets that contain realistic estimates of revenues and expenditures, and appropriating a sufficient amount of fund balance to ensure that available resources are used to responsibly lower the tax burden for District residents and that the fund balance does not exceed the amount allowed by law.

The Board and District officials did not adopt realistic budget estimates or appropriate a sufficient amount of fund balance. Consequently, as of June 30, 2007, the District had an unreserved, unappropriated general fund balance of \$490,037. This amount was 9 percent of the ensuing year's appropriations and therefore exceeded the statutory limits by more than \$328,000. This occurred over the past five years generally because the District has consistently overstated its budgeted expenditures. In addition, the District underestimated revenues in two particular years which has also contributed to the excess fund balance.

The District budgets for State aid based on estimates provided by the State Education Department at various points during the State's budget process. In 2002-03, 2003-04 and 2005-06 the District used those estimates to accurately budget for their expected revenue. However, in 2004-05 and 2006-07 they significantly underestimated the State aid they would receive. The State aid received in these two years that was greater than the amount estimated by the District has added over \$450,000 to the District's surpluses.

<sup>1</sup> Previously, unreserved, unappropriated fund balance could not exceed 2 percent of the ensuing year's appropriations. As of June 30, 2007, the limit was 3 percent of 2007-08 appropriations, and as of June 30, 2008, the limit increased to 4 percent of 2008-09 appropriations and continues at 4 percent thereafter.

<b>Underestimated Revenues</b>			
<b>Fiscal Year</b>	<b>Budgeted Revenue</b>	<b>Actual Revenue</b>	<b>Difference</b>
2004-05	\$4,182,859	\$4,485,324	\$302,465
2006-07	\$4,756,472	\$4,906,565	\$150,093

We found that expenditures were consistently overestimated over the five-year period. These overestimates occur throughout the District's budget. For example, overestimates in the budget for 2006-07 included instructional salaries for kindergarten through sixth grade (\$153,159), medical insurance (\$84,140), social security (\$40,200), and contractual expenditures for transportation equipment (\$41,158). District officials indicated that they overestimated expenditures to provide a cushion in the budget to address unforeseen financial hardships such as lowered State aid. However, the purpose for retaining fund balance is to provide a cushion in the budget. We found that the budgeted expenditures have been overstated by a total of over \$1.8 million over the last five years.

<b>Overestimated Expenditures</b>			
<b>Fiscal Year</b>	<b>Budgeted Expenditures</b>	<b>Actual Expenditures</b>	<b>Difference</b>
2002-03	\$4,288,673	\$3,737,337	\$551,336
2003-04	4,351,226	4,064,093	287,133
2004-05	4,482,859	4,269,977	212,882
2005-06	4,793,246	4,420,588	372,658
2006-07	5,056,471	4,677,472	378,999
<b>Totals</b>	<b>\$22,972,475</b>	<b>\$21,169,467</b>	<b>\$1,803,008</b>

The District has appropriated \$300,000 of unreserved fund balance each year to reduce the ensuing year's tax levy. However, this practice was not enough to offset the overstated appropriations built into the budget each year. Therefore, the District experienced operating surpluses; in some years exceeding \$200,000 and aggregating \$818,146 over the five year period ending June 30, 2007. As a result, the general fund balance<sup>2</sup> has substantially increased, which at June 30, 2007 is three times the amount allowed by law.

<sup>2</sup> Adjustments to fund balance occurred in 2002-03, 2003-04, and 2004-05

<b>Fiscal Year</b>	<b>Actual Revenues</b>	<b>Actual Expenditures</b>	<b>Operating Surplus</b>	<b>Unreserved, Unappropriated Fund Balance as of June 30</b>
2002-03	\$4,018,938	(\$3,737,337)	\$281,601	\$90,460
2003-04	\$4,090,153	(\$4,064,093)	\$26,060	\$116,937
2004-05	\$4,485,324	(\$4,269,977)	\$215,347	\$194,899
2005-06	\$4,486,633	(\$4,420,588)	\$66,045	\$260,944
2006-07	\$4,906,565	(\$4,677,472)	\$229,093	\$490,037

The Board, as well as the prior and current administration, were aware of the excessive fund balance, but failed to reduce it to the legal limit, even though their external auditors had brought this matter to their attention for the last three fiscal years.

District actions to reduce fund balance would have included adopting more accurate budgets and appropriating fund balance to reduce real property taxes. In addition, the Board continued to increase the real property tax levy<sup>3</sup> by approximately \$200,000, or 21 percent, over the last five years. The Board continued this approach by increasing the tax levy yet again for the 2007-08 fiscal year by approximately 3 percent.<sup>4</sup>

Further, the excessive fund balance reported above does not include reserve funds. School districts may establish reserve funds to retain a portion of fund balance for specific purposes, but must do so in compliance with statutory directives. It is the Board's responsibility to monitor the need for all reserves to ensure that the best interests of the taxpayers are being met. The School District reported reserve funds totaling \$431,700 as of June 30, 2007. We question the propriety of \$305,554 of these balances.

- Employee Benefit and Accrued Liability Reserve (EBALR) — This type of reserve may be established by Board resolution without voter approval. An EBALR is to be used only for the cash payment of accrued and unused sick, vacation and certain other leave time due employees upon separation from service, and for the expenses related to the administration of the reserve. The EBALR must be accounted for separately from other moneys of the District and the interest earned on moneys in the EBALR becomes part of the reserve fund.

The District reported an EBALR balance of \$353,090 as of June 30, 2007. The reserve was initially funded in 2003

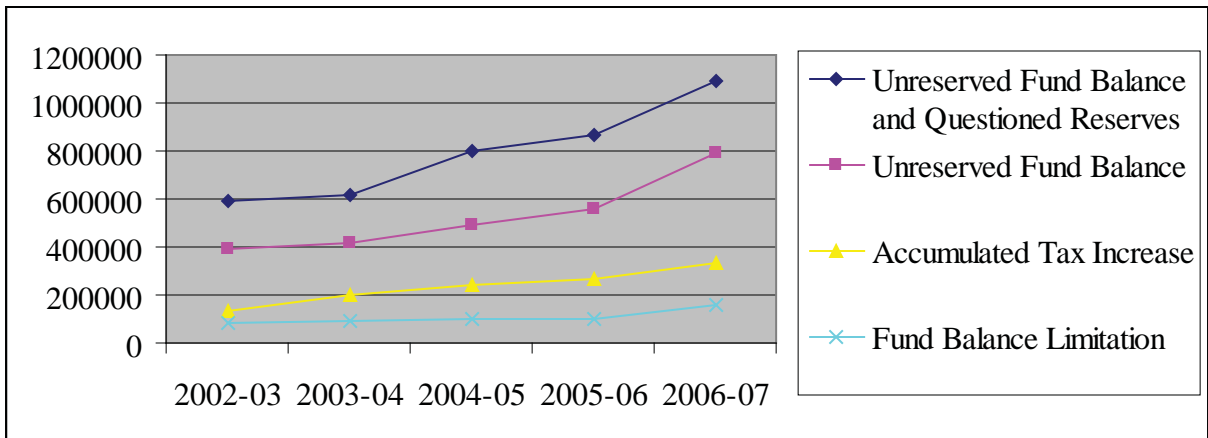
<sup>3</sup> Per Board minutes

<sup>4</sup> Per Board minutes

without a Board resolution, and therefore was not established in compliance with statute. The District provided a schedule that showed only \$126,146 was related to compensated absences. The remaining amount on the schedule was related to retirement incentives and salary enhancements, which were not based on leave time, and therefore not allowable expenditures from the reserve. If the Board determines that the additional \$226,944 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. We also found that EBALR moneys were invested along with general fund moneys; however, District officials incorrectly recorded all interest in the general fund, rather than crediting a pro rata share of the interest earned to the reserve fund.

- Tax Certiorari Reserve — This type of reserve may be established without voter approval to pay judgments and claims in tax certiorari proceedings. The total amount in the reserve may not exceed the amount reasonably necessary to meet anticipated tax certiorari judgments and claims. Funds reserved that go unused must be returned to the general fund on or before the first day of the fourth fiscal year following the deposit of such moneys to the reserve fund. The District has consistently reported a balance in this reserve of \$78,610 since 2002. The Junior Accountant indicated that he was unaware of the requirements for this reserve and simply continued to report the same balance.

The Junior Accountant, who served as the unofficial Business Manager, indicated that the two reserve funds were being used to lower the amount of excessive fund balance as suggested by the District's external auditors. Had the District reported in its general fund the reserve fund amounts that we question (\$305,554) and the \$300,000 of unreserved fund balance that was appropriated but was never actually used to fund operations, the District would have exceeded the amount it was legally allowed to retain by more than \$900,000 as of June 30, 2007.



Had these moneys been reported as general fund unreserved balance and if the Board had complied with the statutory limits for the amount of unreserved fund balance that may be retained at year-end, we estimate that real property tax increases from 2002-03 to 2006-07, totaling \$331,100, would have been unnecessary.

The graph above shows that as fund balance increased, the Board of Education continued to raise taxes that were used to accumulate fund balance and unneeded reserve funds. When we asked about the growing fund balance the past Board president stated that he knew the fund balance was excessive but disagreed with the statutory limit for school districts, and therefore felt that no action should be taken to address it. However, the Board does not have the authority to decide what statutory requirements it will comply with.

## Recommendations

1. The Board and District officials should develop revenue and expenditure estimates for the annual budget that are realistic to ensure that the amount of fund balance appropriated in the budget to reduce the tax levy is actually used.
2. The Board should comply with statutory limits for year-end fund balance by using any unreserved fund balance that remains for productive purposes, such as paying off debt or financing non-recurring District expenses, or appropriate these funds to help finance the ensuing year's budget.
3. The Board should review all reserves and determine if the establishment and the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent they are not, transfers should be made to unreserved fund balance, where allowed by law, or to other reserves, established and maintained in compliance with statutory directives.

## Segregation of Duties

The Board and District officials are responsible for adopting policies and procedures to provide for a proper segregation of duties in the Business Office, so that no one person controls all aspects of a particular function such as custody, authorization and record keeping. When it is not practical to segregate duties, the Board may design compensating controls such as supervisory approval of transactions, rotating job assignments or mandatory vacations to provide reasonable assurance that District assets are being properly safeguarded and that accounting entries are properly authorized and entered correctly.

The Board and District officials did not adopt policies or procedures to adequately segregate duties in the Business Office or establish adequate compensating controls. Although the Superintendent certified each payroll, the District Clerk/Secretary maintained leave time records, including her own, without oversight, and the Treasurer was responsible for all other aspects of the payroll process. In addition, the Treasurer was responsible for cash receipts, wire transfers, preparing and approving journal entries, check signing, maintaining accounting records, reconciling bank accounts and the majority of activity related to cash disbursements. As a result, there was an increased risk that errors or irregularities could occur and remain undetected and uncorrected.

We therefore tested payroll for all Business Office staff members and five other employees, and separation payments to five former employees to determine if payments agreed with contractual provisions. We also tested the validity of newly hired employees, cash receipts collected and recorded for a two month period (including retiree health insurance payments), and wire transfers completed during our audit period. We noted the following:

- The Treasurer paid the Superintendent an additional \$4,500 during the 2006-07 fiscal year that was not provided for in his contract. Although the Board members interviewed stated that the raise was discussed and agreed upon during a Board meeting, there was no contract addendum or evidence in the Board minutes to indicate that this was authorized.
- The District Clerk/Secretary received 18 additional compensatory days off, each year pursuant to an undated signed agreement between the District Clerk/Secretary and the former Superintendent, for performing the District Clerk's duties starting July 12, 2004. According to the prior

Superintendent, this was discussed and agreed upon by the Board; however, no formal approval by the Board was evidenced in the District minutes. Payroll records indicated that since July 2004 she received a Board authorized raise of 13.5 percent, as well as the additional 18 days per year. Two Board members, including the past Board President, stated they had no knowledge of this agreement and would not have approved it while two others could not recall discussing it. We estimate the value of the unauthorized leave time to be approximately \$6,770 over the last four years.

- The Treasurer was allowed to make wire transfers totaling over \$470,000 without the knowledge or approval of any other District official. We found that the wire transfers we reviewed were for legitimate and appropriate District purposes; however, this is a significant internal control weakness.

## **Recommendations**

4. The Board and District officials should adopt policies and procedures to provide for the adequate segregation of duties or implement compensating controls.
5. The Treasurer should ensure that pay rates are in agreement with employment agreements and authorized by formal Board action.
6. The Board should determine if the additional compensatory time granted to the District Clerk was appropriate and, if not, seek to recover the value of the unauthorized compensatory time from the District Clerk/Secretary or former superintendent that authorized the payments.
7. The Board and District officials should adopt policies and procedures to adequately safeguard wire transfer activity, including the requirement for the approval of another District official.

## Information Technology

The use of information technology (IT) has become essential in the operation of most school districts, including almost every function in the Business Office. IT is used for processing payroll, attendance, purchasing and cash receipts. The Board is responsible for adopting policies that set the tone for safeguarding IT assets, while District officials are responsible for designing and implementing control procedures and evaluating potential risks to provide a secure computing environment. Without proper internal controls over IT assets, improper use and disasters have the potential to shut down the entire system and cause significant disruptions, which may result in the need to commit time and resources to address such disruptions. The Board and District officials must ensure that strong password controls are in place, user access is restricted based on job function, and that controls that are in place for the addition and timely deletion of access rights of departing employees. The Board must also adopt a formal disaster recovery plan to prevent the loss of data and provide for the recovery of information in the event of a disaster.

Internal controls over IT assets are not appropriately designed or operating effectively. There are no requirements to change passwords or complexity requirements for passwords. In addition, access rights are not established based on job function. Consequently, three individuals have the ability to change the access rights of others and accounting data, without oversight. This weakness allowed the Junior Accountant to change his direct deposit payroll deductions without the knowledge of the Treasurer. Further, most of the computers in the District have administrative rights to make it easier for teachers to install software. However, this allows users to change security settings, or add and delete programs, without the knowledge of the IT coordinator. We also found that four network and five email accounts were not deleted for individuals that are no longer employed by the District and that there is no formal disaster recovery plan in place. As a result, there is an increased risk that authorized or unauthorized users may gain access to applications and make unauthorized changes to data that are not detected, and that critical information systems or data will not be available for District financial operations in the event of a disaster.

### Access Controls

The Board and District officials are responsible for establishing access controls including passwords, user permissions terminal administrative rights and user accounts to safeguard the District's IT assets and data. We identified the following deficiencies in the District's access controls:

- Passwords — District procedures should require a stringent user access screening system, including passwords, to prevent unauthorized access to computers and the network. Passwords should be changed at least every 30 to 60 days, contain complexities such as upper case and lower case characters, digits and punctuation, and not be based on personal information. We found the District relies solely on the IT coordinator’s discretion for password requirements and that District personnel are not required to change their passwords at anytime. In addition, no requirements for password complexities have been adopted. As a result, there is an increased risk that unauthorized users could gain access to the system, resulting in the corruption of data or the disclosure of confidential records.
- User Permissions — Good internal controls require that users have access to only those functions within the financial accounting software for which they have a specific need to perform their job duties. When users have access to functions for which they do not have direct responsibility, the risk of fraudulent or harmful activity is increased. The District has no policies or procedures in place to restrict user access based on job function. As a result, three of the four authorized users of the financial accounting package have administrator access rights and access to software modules that they do not need based on their job descriptions. This gives them the ability to change the access rights of other users, as well as change accounting data, without oversight. Due to this control weakness, we reviewed the audit logs for the three users with administrator access. We found that the Junior Accountant, who had no payroll responsibilities,<sup>5</sup> accessed and changed his own direct deposit payroll deduction amounts on two separate occasions without the knowledge of the Treasurer, who was the person responsible for payroll.
- Terminal Administrative Rights — Administrative rights for individual computer terminals allow users to change system security settings or add and delete programs without the knowledge of any other District official or employee. Such rights should be limited and established based on comprehensive policies. We found that the District has no policies or procedures to establish when and to whom administrative rights should be granted. In addition, the IT coordinator stated that the majority of the District’s computers

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<sup>5</sup> According to the Superintendent and Treasurer

have administrative rights to make it easier for teachers to install software. However, this allows users to change security settings, or add and delete programs, without the knowledge of the IT coordinator, increasing the potential for corruption of the system network by viruses, hackers or unintentional user actions.

- User Accounts — Policies and procedures must be adopted to ensure that only authorized users have access to the system. We found that the District has no policies or procedures for the addition and timely deletion of access rights of departing employees. Instead, the District relied solely on the IT coordinator to add and delete employees. Due to this control weakness, we obtained a list of all current network and email user accounts from IT coordinator on April 11, 2008, which indicated that the District had 80 established network accounts and 101 established email accounts. Most of the individuals were currently employed by the District. However, we found that the network accounts for four individuals and the email accounts for five individuals that no longer worked for the District were not deleted. The failure to ensure that only authorized users have access to the system increases the risk that the network or email server could be compromised.

## **Disaster Recovery Plan**

A formal plan should be adopted to ensure that the data stored on the system can be restored in the event of a disaster. The system servers are in a climate-controlled room with access limited to only those with master keys. However, the District has not established formal policies or procedures to address potential disasters, and no precautions have been taken to protect against water damage or other types of disasters including viruses or hacker attacks. When there is no plan in place to help prevent these types of disasters, or to provide guidance for personnel to re-establish mission critical systems as quickly as possible, a significant delay can occur, potentially resulting in substantial costs to the District.

## **Recommendations**

8. The Board and District officials should establish policies and procedures for access controls to:
  - Require passwords to be changed at least every 30 to 60 days
  - Require the use of complex passwords
  - Restrict user's access to only those functions that are necessary for their job duties
  - Ensure the addition and timely deletion of user accounts

9. The IT coordinator should remove access rights at the time individuals separate from District employment.
10. The IT coordinator should assist the Board in developing a formal disaster recovery plan to address threats to computerized data. The plan should be distributed to all responsible parties, periodically tested and updated.

## Internal Audit Function

By law, school districts are required to have an internal audit function that includes, at a minimum, the development of a risk assessment of district operations. The risk assessment should include a review of financial policies, procedures and practices; an annual review and update of the risk assessment; and annual testing and evaluation of one or more areas of the District's internal controls. At least annually, or more frequently as the Board may direct, the internal auditor is required to prepare reports that analyze significant risk assessment findings, recommend changes for strengthening controls and reduce identified risks, and specify timeframes for implementing recommendations.

A school district may use its own employees, inter-municipal cooperative agreements, shared services to the extent authorized by Education Law, or independent contractors to fulfill the internal audit function. The internal auditor must have professional auditing qualifications, be independent of other district functions, and have no other responsibilities related to the district's business operations. The internal auditor cannot be a family member of an employee, officer, or contractor providing significant or material services to the district, nor have a significant or material interest in any contracts with the district.

The District entered into an inter-municipal agreement with 17 other school districts and the Cattaraugus-Allegany Board of Cooperative Educational Services (BOCES) to provide for the internal audit function beginning December 18, 2006. The agreement stipulates that "the jointly employed internal auditor shall be considered an employee of BOCES for purposes of payroll administration and benefits."

For 2007-08, the District will spend approximately \$1 million on services provided by the BOCES. Based on the material nature of these payments by the District to the BOCES, the BOCES employee serving as the internal auditor is not independent in performing the District's internal audit function. This current arrangement is likely to put this individual, as a BOCES employee, in the position of evaluating significant District services or programs that are provided to the District by BOCES, the individual's employer. The individual may also be required to audit the system of documentation for the District's payments to BOCES, the individual's employer.

**Recommendation**

11. The Board should terminate the internal audit relationship with the Cattaraugus-Allegany BOCES and replace this position with an internal auditor who meets the independence requirements in Education Law and State Education Department guidelines.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# Whitesville Central School

**Superintendent of Schools**  
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**Board of Education**  
Judy Linza, President  
Scott Garis, Vice-President  
Charles Cutler  
Robyn Lynch  
Michael Van Vlack

**Principal/Curriculum Coordinator**  
Tina A. Wilson

**Guidance Counselor**  
Douglas VanSkiver

November 18, 2008

Office of the State Comptroller  
Attn: Robert E. Meller  
Buffalo Regional Office  
295 Main Street, Room 1032  
Buffalo, New York 14203-2510

Dear Mr. Meller:

On behalf of the Whitesville Central School District and the Board of Education, we feel the Audit Report of the Internal Controls over Selected Financial Operations, during the period of July 1, 2006 and April 25, 2008, was conducted in a manner such that we may adjust our policies and procedures to adequately protect the investments our taxpayers have made to provide the exceptional educational and extracurricular programs to the students of the Whitesville Central School District. We would also like to commend the professionalism of our auditor, [REDACTED]. The manner in which he conducted the audit allowed us to view this as a learning experience rather than an inquisition. As a result, we have already begun implementing several of the recommendations contained in this audit.

We would like to comment on the delivery of the draft audit report. We found it unacceptable that the draft audit report was released to the public prior to our exit conference and giving us an opportunity to respond. The draft report was sent to a former Board of Education member who had not sought re-election. In addition, the draft report was not sent to the community member elected to fill that vacant seat. In the future, we hope the Office of the State Comptroller will examine the current membership of the Board before disseminating draft reports.

Secondly, we would like to comment on the tone of the audit report. The Board of Education, current and past administration have conducted business in a manner keeping the best interest of the children and taxpayers of the school district in the forefront. Our responsibility to the taxpayers is to provide a sound fiscally responsible plan to ensure a quality, comprehensive, and appropriate educational program for the students of the Whitesville Central School District. We feel we have done so by providing reasonable undesignated, unreserved fund balance much like that of other municipalities. The advice we have received from our external auditors as well our predecessors has been taken into consideration when developing our budgets. Given the present financial crisis of our state and our nation, it was prudent to allocate these additional funds so that our educational programs do not suffer for our students and our taxpayers do not incur a significant increase in taxes in any given year.

See  
Note 1  
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# Whitesville Central School

**Superintendent of Schools**

Douglas H. Wyant, Jr.

**Principal/Curriculum Coordinator**

Tina A. Wilson

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**Board of Education**

Judy Linza, President  
Scott Garis, Vice-President  
Charles Cutler  
Robyn Lynch  
Michael Van Vlack

With that being said, we will be adjusting our budget development process to reduce the amount of undesignated fund balance, appropriate monies into established reserves, reducing the amount allocated to the Employee Benefit and Accrued Liability Reserve and the Tax Certiorari Reserve and monitor and adjust spending to better reflect actual expenditures over the past years.

In terms of issues related to the segregation of duties, we are a very small district with a limited amount of office staff. The office consists of our District Treasurer, our Junior Accountant, our District Clerk and the Superintendent of Schools. As stated in the report, the District Treasurer is allowed to make wire transfers without written approval by another District Official. The wire transfers made are for Capital Debt Payment only according to the Debt Service Schedule provided by Fiscal Advisors and Marketing, Inc. The District Treasurer makes one wire transfer per year for each outstanding Capital Project. All wire transfers are instituted by the Depository Trust that designate the Depository Trust account to which the principle payments are to be made. In the future, all wire transfers will be signed by the Junior Accountant.

The oversights that have occurred in the areas of the unauthorized superintendent's pay raise and the compensation time received by the District Clerk have been resolved. In both cases the Board was aware of the compensations and approved of the compensations, but did not have a Board resolution confirming their approval. In each case, there is now a Board resolution confirming approval.

In response to the third category, Information Technology, we appreciate the feedback provided by the office of the State Comptroller. We agree that policies and procedures for access controls to require passwords to be changed frequently; require the use of a complex password; restrict user's access based on job function; administrative rights for individual computer terminals; and the addition and timely deletion of user accounts are absent. These policies and procedures will be put into place during the 2008-2009 school year.

It must be stated, however, that no improprieties were found during the audit with respect to the ability of the Junior Accountant to change direct deposit payroll deduction amounts. The Junior Accountant was responsible for primary payroll functions until 2004 and subsequently responsible for payroll in the absence of the District Treasurer. With access to payroll, the Junior Accountant only changed distribution between banks of his direct deposit amount. No change in the overall deposit amount was made. Since the completion of the audit, user permissions have been restricted to job function and appropriate policies and procedures will be developed to reflect these changes.

The District currently does not have a Disaster Recovery Plan, but will be developing a formal disaster recovery plan coordinated with Erie 1 BOCES.

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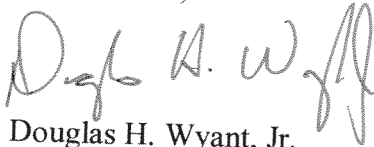
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Finally, Whitesville Central School District has entered into a cooperative agreement with other component School Districts within our BOCES to hire an internal auditor as required by Education Law. We are currently reassessing the inter-municipal agreement to determine the most cost efficient alternative within established regulation.

As required a board approved action plan will be formulated and sent to the State Comptroller's office within the specified time limits.

In Education,



Douglas H. Wyant, Jr.  
Superintendent

## **APPENDIX B**

### **OSC COMMENTS ON THE DISTRICT'S RESPONSE**

#### Note 1

The former Board of Education member was on the Board during our audit period and until the end of our audit field work, and continues to live in the community. However, we acknowledge that we should have also sent a copy of the draft audit report to the person who was elected to fill the former Board member's seat.

## 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, 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 objective and scope by selecting for audit those areas most at risk. We selected financial condition, segregation of duties, information technology and the internal audit function for further audit testing.

- We examined the financial condition of the District for the period July 1, 2002 to April 25, 2008. We compared budgeted amounts to actual results of operation and the amount of fund balance appropriated for fiscal years ending in 2003 through 2007. We also interviewed District officials about the excessive fund balance and referenced external audit reports citing this concern.
- We interviewed District officials and reviewed the segregation of duties in the Business Office. We tested payroll for all Business Office staff members and five other employees, and separation payments to five former employees to determine if payments agreed with contracted amounts. We also tested the validity of employees hired since July 2006, cash receipts collected and recorded for March 2007 and 2008 (including retiree health insurance payments), and all wire transfers completed during our audit period.
- We interviewed the IT coordinator to determine if policies and procedures were established for system password protection, user permissions and administrator access rights, individual terminal administrative rights, and the addition and deletion of user accounts for the financial accounting software. We also obtained a list of all current network accounts and email accounts and tested for the timely deletion of former employees.
- We interviewed District officials to determine the rationale for contracting with BOCES for the internal audit function and reviewed contracts between the District and BOCES.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

## APPENDIX D

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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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