



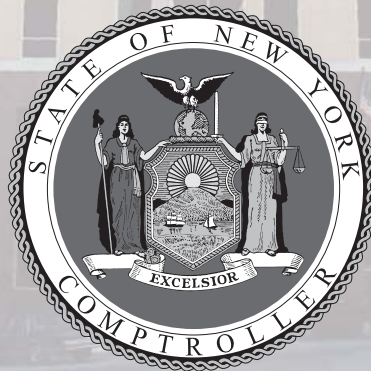
Hammond Central School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2007 — March 31, 2009

2009M-160



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2009

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 Hammond 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*

Introduction

Background

The Hammond Central School District (District) is located in the Town of Hammond, Morristown, Rossie, and Macomb in St. Lawrence County and the Town of Alexandria Bay in Jefferson 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 the High School principal, and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There is one school in operation within the District, with approximately 350 students and 60 employees. The District's budgeted expenditures for the 2008-09 fiscal year were approximately \$5 million, which were funded primarily with State aid, real property taxes, and grants.

The District's Business Office staff consists of one position. This position is a combination of the Business Manager and Treasurer's positions. The Business Manager/Treasurer performs all aspects of cash disbursements and most aspects of the purchasing function. The School Board is responsible for auditing claims because it has not appointed a claims auditor.

Objective

The objective of our audit was to determine if internal controls over selected financial activities were appropriately designed and operating effectively. Our audit addressed the following related question:

- Have adequate internal controls been established over the financial operations of the Business Office to ensure that District assets are properly safeguarded?

Scope and Methodology

We examined the District's internal controls over cash disbursements, reconciliations and claims auditing for the period July 1, 2007 to March 31, 2009.

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 is included in Appendix B of this report.

**Comments of District
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. 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 Operations

District officials are responsible for designing internal controls over financial operations to safeguard the District's resources. Such controls include procedures for claims auditing to ensure that cash is disbursed upon proper authorization and approval, when supported by appropriate documentation, for valid business purposes, and is properly recorded. Proper internal controls also include the segregation of duties so that the work of one employee is independently checked in the course of another employee's regular duties. In small business offices, establishing an optimum separation of duties may not always be possible because of the small number of office staff members. When it is not possible to segregate incompatible duties, District officials can establish compensating controls such as reviewing the work performed by staff members.

The Treasurer is the only Business Office staff person and therefore performs incompatible cash disbursement and bank reconciliation duties. Although compensating controls have been established, they could be enhanced by having someone other than the Treasurer receive bank statements and cancelled checks for review prior to the reconciliations being performed. In addition, the procedures for claims auditing have not been followed, resulting in 47 of the 165 claims tested, totaling \$387,889, not being listed on warrants to indicate they had been audited and approved by the Board. Due to these deficiencies, there is an increased risk that inappropriate transactions could occur and not be detected, and the District cannot be assured that all purchases are for valid and necessary expenditures.

Cash Disbursements and Bank Reconciliations

An effective system of internal controls over cash disbursements requires the proper distribution of duties so that the same individual does not perform incompatible functions. A proper division of responsibility ensures that the work of one employee is independently checked in the course of another employee's regular duties. The reconciliation of bank account balances to general ledger cash balances is an essential control activity. When done effectively, this process provides for the timely identification and documentation of differences between District and bank records. Without accurate and complete bank reconciliations, performed and reviewed by an individual independent of the cash custody and record keeping functions, District officials cannot have a reasonable level of assurance that the accounting records are correct or that monies are accounted for properly. Since the size of this District is small with one staff person handling the business operations, optimal segregation of duties may not always be possible. If the duties of making disbursements,

recordkeeping and reconciling bank accounts cannot be separated, compensating controls should be put in place.

We determined that cash disbursement duties were not segregated and bank reconciliations were not performed by an individual who was independent of the cash custody and recordkeeping functions. Specifically, the Treasurer performed all aspects of the cash disbursement process including recording disbursements within the financial management software, and processing, printing and signing checks. In addition, the Treasurer performed the bank reconciliations and had the duties of collecting cash, making daily deposits, recording receipts within the financial software, transferring funds from District accounts, and preparing, approving, reviewing and printing journal entries.

Furthermore, the Treasurer received the bank statements for the accounts she reconciled, including copies of cancelled checks, and she reconciled the bank accounts with only minimal oversight. The Treasurer provided bank reconciliations to the Board as part of her monthly Treasurer's Reports. Providing a copy of a bank reconciliation alone is not a sufficient compensating control to adequately reduce the District's exposure to the possibility that inappropriate activity could be initiated or hidden. For example, cash disbursements could be made for unauthorized or improper purposes without detection. Although the duties assigned to the Treasurer were incompatible, District officials could enhance compensating controls by having someone other than the Treasurer receive bank statements and cancelled checks for review prior to the reconciliations being performed.

Due to these control weaknesses, we selected and traced all checks that cleared the bank during the test months of December 2008 and March 2009, totaling over \$2 million, back to their corresponding cash disbursement reports (approved warrants) and traced source documents to the amounts listed on issued checks. We did not find any discrepancies. In addition, to verify the adequacy of the bank reconciliations, we reviewed the bank reconciliations for December 2008 and March 2009. We determined that all reconciliations were done in a timely manner and agreed with the general ledger, and that the cash transfer activity appeared to be appropriate and recorded accurately. Although we did not find any exceptions, because the Treasurer can initiate transactions, make accounting entries, and perform bank reconciliations, there is an increased risk that inappropriate activities could be initiated and hidden.

Claims Audit

Conducting a proper audit of claims before they are paid is an integral part of any internal control system. Education Law requires the Board to audit each claim before authorizing payment or to appoint a claims

auditor to perform this function. The Board has not appointed a claims auditor and is therefore responsible for auditing all claims. The Board is responsible for conducting a thorough review of all claims to determine whether the proposed payments represent proper and valid charges against the District. Specifically, the Board should assess whether authorized officials incurred the charges, the claim is sufficiently itemized and mathematically correct, it conforms to District policies and applicable State laws (e.g., bidding), and the District actually received the goods and services. Education Law (Law) authorizes the Board to authorize the payment of certain claims in advance of audit, including public utility services, postage, freight and express charges. However, all such claims must be subsequently presented to the Board for audit and listed on the subsequent month's warrant to indicate that they have been audited and approved for payment.

We selected and traced all checks that cleared the bank during the test months of December 2008 and March 2009 to source documents and identified 165 checks totaling over \$2 million that were supported by vendor claims and therefore subject to Board audit. We reviewed the claims and corresponding warrants to determine if the claims were for legitimate charges and were audited by the Board. Although all claims were for legitimate charges, we found that 18 claims for December (22 percent) totaling \$279,711 and 29 claims for March (35 percent) totaling \$108,178 were not listed on the corresponding warrants to indicate that they had been audited and approved for payment. District officials told us that the Board had subsequently audited these claims. However, none of these claims were included on any subsequent month's warrant to indicate they had been audited. Furthermore, 29 of these claims totaling \$258,757 were of a type that could not be legally paid prior to audit; for example, payments for health insurance premiums, BOCES monthly payments, credit card payments and employee expense reimbursements.

All of the Board members have received the mandated financial training and the District has adopted procedures that provide guidance for auditing claims. However, the Board did not follow these procedures. Without a thorough and documented audit of claims, as required by law, the District cannot be assured that all purchases are for valid District expenditures. In addition, these deficiencies could allow errors or irregularities to occur and not be detected and corrected in a timely manner.

Recommendations

1. District officials should evaluate the financial operations of the Business Office and the Treasurer's duties and responsibilities, specifically in the area of cash disbursements and, where practicable, properly segregate duties or provide compensating

controls. For example, District officials could ensure that the Superintendent, or someone else who is independent of the cash custody and record keeping functions, regularly receives and reviews bank statements and cancelled checks prior to the bank account reconciliations being performed.

2. The Board should review the adopted procedures for claims auditing and ensure that all claims are audited and listed on approved warrants, and only those claims that are permitted by law are paid prior to audit.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

DOUGLAS MCQUEER

Superintendent of Schools

NINA LONSBERY

SHAWN DACK

DEBORAH LEROUX

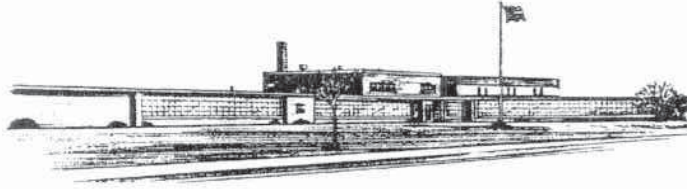
Assistant Principals

TAMMY J. GALLAGHER

Treasurer – Business Manager

TERRI HOLLISTER

Administrative Secretary



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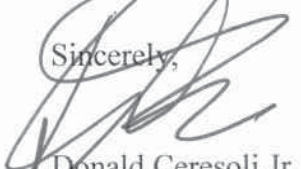
Ann Singer, Chief Examiner
Office of the State Comptroller
Division of Local Government Services
State Office Building, Room 1702
44 Hawley Street
Binghamton, New York 13901-4417

Dear Ms. Singer:

Our district has reviewed the areas of concern from the state audit of our district. We agree that there are areas that need to be improved to safeguard the financial operations of the district. We are now developing a plan of action to alleviate these concerns and are working on a corrective action plan at this time. Some courses of action have already been put into practice at the present.

We appreciate the opportunity to correct the areas of concern, and will do our best to improve our district's financial security. Thank you for bringing these concerns to our attention.

Sincerely,



Donald Ceresoli Jr.
Board President

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided on the reported objective and scope by selecting for audit those areas most at risk. We selected cash disbursements, reconciliations and claims auditing for further audit testing. Our procedures included the following:

- We interviewed the Business Office Manager/Treasurer and the Superintendent concerning financial operations.
- We selected and traced all checks that cleared the bank during December 2008 and March 2009 totaling over \$2 million back to their corresponding cash disbursement reports (approved warrants) and traced source documents to the amounts listed on issued checks.
- We reviewed bank reconciliations for December 2008 and March 2009 to determine if all reconciliations were done in a timely manner and agreed with the general ledger. We also traced cash transfers per the bank statements to the District's records to determine if the cash transfers appeared to be appropriate and recorded accurately.
- We examined warrants for evidence that claims were audited by the Board and examined claims documentation for evidence that the payments were for valid District expenditures.

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.

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