



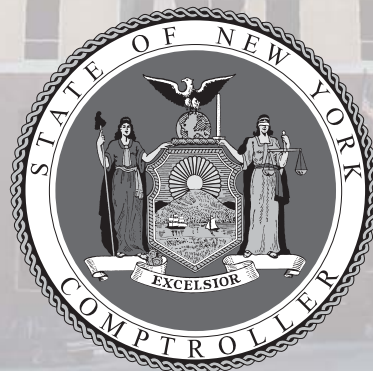
Port Jervis City School District Internal Controls Over Selected Activities

Report of Examination

Period Covered:

July 1, 2008 — June 30, 2009

2010M-3



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

May 2010

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 Port Jervis City School District, entitled Internal Controls Over Selected Activities. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Port Jervis City School District (District) is governed by the Board of Education (Board) which comprises nine 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 four schools in operation within the District, with approximately 3,100 students. The District's budgeted expenditures for the 2008-09 fiscal year were \$58.6 million, which were funded primarily with real property taxes and State aid.

Scope and Objective

The objective of our audit was to evaluate the effectiveness of the controls established over the District's financial operations for the period July 1, 2008 to June 30, 2009. We extended the audit scope period back to June 30, 2007 for analysis of fund balance. Our audit addressed the following related questions:

- Did District officials retain unreserved, unappropriated fund balance within the statutory limit?
- Was there an adequate segregation of duties over payroll?

Audit Results

Our audit found that the Board and District officials need to improve their oversight of the District's fund balance and establish appropriate controls over the payroll function.

Although the District appropriated a portion of its fund balance for the three fiscal years 2006-07 through 2008-09, the amount of unappropriated, unreserved fund balance retained at year-end averaged \$5.5 million during that period. In 2008-09 the District retained approximately \$9 million, or almost 15 percent of the ensuing year's budget – nearly four times the amount allowed by law. The District had also retained more than the statutorily allowed amount in the two previous years, even though the Board appropriated a portion of the unreserved fund balance for the ensuing year's budget in each of those years. By not appropriating more year-end fund balance to finance the budget and reduce the property tax levy, District officials have not complied with the law and did not use these excess funds for purposes that benefit the taxpayers.

District officials also did not adequately segregate duties within the payroll process. The payroll clerk has the ability to create employee records, update employee information, input salary information, set up withholdings and direct deposits, process the payroll, and print and distribute payroll checks. As a result, the payroll clerk can add unauthorized employees to the payroll and/or pay employees more salary than authorized. Although our test of 25 payroll transactions did not disclose any discrepancies or improprieties, the lack of segregation of duties increases the risk of error or fraud occurring and not being detected and corrected.

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 have taken or plan to take corrective action. Appendix B contains our comments on issues raised in the District's response.

Introduction

Background

The Port Jervis City School District (District) is located in the City of Port Jervis, and portions of the Towns of Deerpark and Mount Hope in Orange County and the Towns of Forestburgh and Mamakating in Sullivan County. Additionally, the District educates secondary students from Montague, New Jersey.

The District is governed by the Board of Education (Board) which comprises nine 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 Assistant Superintendent of Business (Assistant Superintendent) is responsible for the fiscal management of the District including preparation of the budget and supervising Business Office personnel.

There are four schools in operation within the District, with approximately 3,100 students. The District's budgeted expenditures for the 2008-09 fiscal year were \$58.6 million, which were funded primarily with real property taxes and State aid.

Objective

The objective of our audit was to evaluate the effectiveness of the controls established over the District's financial operations. Our audit addressed the following related questions:

- Did District officials retain unreserved, unappropriated fund balance within the statutory limit?
- Was there an adequate segregation of duties over payroll functions?

Scope and Methodology

We examined internal controls over selected financial activities of the Port Jervis City School District for the period July 1, 2008 to June 30, 2009. We expanded the audit scope period back to June 30, 2007 for fund balance analysis.

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 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 have taken or plan to take corrective action. Appendix B contains our comments on issues raised in the District's response.

Fund Balance

A school district's financial condition determines its ability to provide public educational services to its students. A primary responsibility of the Board and the Superintendent is to ensure that District budgets are accurate. The Board and District management must make sure that budgets are prepared, adopted, and amended based upon reasonable and accurate assessments of resources that can be used to fund appropriations, as well as an estimate of fund balance at the end of the fiscal year. Accurate estimates prevent the levy of excessive real property taxes.

It is essential that District officials maintain an amount of unreserved, unappropriated fund balance that complies with the legal limit set by law and that supports the District's financial stability. There are two types of fund balance: reserved and unreserved. Reserved fund balance is money the District has set aside and may use only for specific purposes. Unreserved fund balance is uncommitted and therefore available for appropriations to help finance the budget and reduce real property taxes in the next fiscal year. The portion of the unreserved fund balance used to help finance the next year's budget is known as appropriated fund balance. The remaining portion – the unappropriated, unreserved fund balance – can be retained by the District at the end of the fiscal year for cash flow purposes and unanticipated expenditures. Current Real Property Tax Law (Law) limits the unreserved, unappropriated fund balance the District can retain to no more than 4 percent of the next year's budget¹ to help ensure that excessive moneys are not kept idle but used to benefit the taxpayers.

The Superintendent and Assistant Superintendent are responsible for preparing and presenting the District's budget to the Board. The Assistant Superintendent is responsible for estimating what the District will receive in revenue (e.g., State aid) and how much the District will need to fund District programs. The Superintendent and Assistant Superintendent must also estimate how much fund balance will be available at fiscal year-end. The Board can propose to use some or all of the available fund balance to finance the ensuing year's appropriations. District officials have the discretion to reserve, appropriate, or retain (up to the statutory limit) portions of this fund balance in a manner that best serves the interests of District taxpayers.

¹ Prior to the 2007-08 fiscal year, the Law limited the amount of fund balance school districts could retain to no more than 2 percent of the next year's budget. The Law was amended in July 2007 to raise this limit to 3 percent of the 2007-08 fiscal year's budget and to 4 percent of the 2008-09 and 2009-10 fiscal years' budgets.

We found that, although the District appropriated a portion of its fund balance for the three fiscal years 2006-07 through 2008-09, the retained fund balance at year-end continued to increase and averaged \$5.5 million a year during that period.

Fund Balance			
Fiscal Year	2006-07	2007-08	2008-09
Beginning Fund Balance*	\$11,457,274	\$13,829,357	\$16,959,273
Actual Revenues	\$51,841,476	\$54,580,635	\$58,909,964
Actual Expenditures	\$49,469,391	\$51,450,724	\$53,877,044
Operating Surplus	\$2,372,085	\$3,129,911	\$5,032,920
Year-End Fund Balance	\$13,829,359	\$16,959,268	\$21,992,193
Less: Reserved Fund Balance	\$10,662,208	\$11,151,089	\$11,473,218
Less: Appropriated Fund Balance	\$725,000	\$725,000	\$1,540,629
Retained Fund Balance at Year-End	\$2,442,151	\$5,083,179	\$8,978,346
Ensuing Year's Budget	\$54,010,666	\$58,562,024	\$60,941,600
Percentage of the Ensuing Year's Budget Retained as Fund Balance	4.52%	8.68%	14.73%
Statutory Limit for Retained Fund Balance**	\$1,080,213	\$1,756,861	\$2,437,664
Excess Fund Balance	\$1,361,938	\$3,326,318	\$6,540,682
*Including any prior period adjustments			
**Calculated as a percentage of the ensuing year's budget			

The District retained approximately \$9 million, or almost 15 percent of the ensuing year's budget in unappropriated, unreserved fund balance for the 2008-09 fiscal year – nearly four times the amount allowed by the Law. Further, in the previous two fiscal years, the District had also exceeded the statutory limit: retaining over \$2.4 million in 2006-07, equal to 4.5 percent of the ensuing year's budget (more than twice the amount then allowed by the Law), and approximately \$5.1 million in 2007-08, equal to almost 9 percent of the ensuing year's budget (three times the amount then allowed). While the Board appropriated a portion of the unreserved fund balance to fund the ensuing year's budget in each of these years, and to pay down debt and fund capital projects, this was not enough to maintain an unreserved fund balance within the limit allowed by the Law.

District officials stated that they retained excess funds to establish a new capital reserve fund to allow the District to roll unspent budget

allocations at the end of each school year to an interest-bearing account to finance a new school. However, in November 2009, District residents voted against the proposition to establish such a capital reserve fund and, therefore, the District was not authorized to retain funds for that purpose.

The District's practice of repeatedly retaining excess fund balance is not in compliance with the Law and effectively withholds public funds from being used to benefit the taxpayers.

Recommendations

1. The Board and District officials should develop a plan to use the surplus general fund balance identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to:
 - Increasing necessary and properly authorized reserves
 - Paying off debt
 - Financing one-time expenses
 - Reducing District property taxes.
2. District officials should monitor the amount of the District's year-end fund balance and develop plans for addressing any accumulated fund balance that exceeds the statutory limitation.

Segregation of Payroll Duties

Payroll expenditures, salaries and benefits generally represent the most significant operating costs in a school district. District officials must establish an effective system of internal controls, including procedures to prevent and detect errors and irregularities in the District's payroll function. Strong controls include an adequate segregation of duties so that no one individual is responsible for most or all key aspects of payroll transactions. Duties that should be segregated include adding or removing employees from payroll records, approving changes in pay rates, processing payrolls, and signing and distributing paychecks. When it is not practical to segregate all incompatible duties, the Board should establish compensating controls, such as having District officials or other administrative staff periodically review the work in question, rotating duties, making vacations mandatory, or performing periodic payroll audits.

District officials have not established formal policies and procedures to ensure that no single employee handles all phases of payroll transactions, and have not established adequate compensating controls. The payroll clerk has the ability to create employee records, update employee information, input salary information, set up withholdings and direct deposits, process the payroll, and print and distribute payroll checks. As a result of performing these incompatible duties, the payroll clerk can add unauthorized employees to the payroll and/or pay employees more salary than authorized. The District has not implemented adequate compensating controls, such as periodic payroll audits, to help ensure that unauthorized payroll transactions would be detected.

Because of the lack of segregation of duties, we reviewed the District's payroll reports, employment contracts, and Board minutes for the 2008-09 fiscal year to determine the validity of payroll changes made during the audit period. We tested the wages paid to 25 District employees totaling \$1,757,734 and verified the accuracy of payments made to these employees. Although our testing did not identify any unauthorized employees, significant discrepancies, or unusual transactions, there remains some risk that erroneous or inappropriate payroll disbursements may occur and go undetected.

According to District officials, payroll duties were not segregated due to limited staff. However, as of the end of our audit fieldwork in September 2009, District officials were in the process of moving and

restructuring the job duties of several District staff and hiring a new employee to provide for an adequate segregation of duties.

Recommendation

3. District officials should revoke the payroll clerk's authority to enter new employees and make changes to salaries, and delegate these functions to a trained individual outside of the payroll processing function.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



May 14, 2010

Christopher J. Ellis, Chief Examiner
State of New York, Office of the State Comptroller
Newburgh Regional Office
33 Airport Center Drive, Suite 103
New Windsor, New York 12553

Re: Port Jervis City School District
Internal Controls Over Selected Activities
2010 M-3

Dear Mr. Ellis:

The Port Jervis City School District Administration, Board of Education and the Audit Committee reviewed the draft audit report. The concerns of these professionals were echoed to the state auditors on May 10, 2010. Although one or two of the items were corrected, the quality of the report continues to be poor. The report is plagued with misleading statements and errors in basic accounting practices.

Specifically, the chart included in the section of Fund Balance continues to have a year-end balance that does not equal the next year's opening balance. A two dollar and five dollar difference is a rounding error and not a prior period adjustment. When errors of basic accounting are not corrected, even when brought to the attention of the auditor, the integrity of the entire report is under scrutiny.

See
Note 1
Page 16

The Report of Examination reports on the district's fund balance. It is important to note that the state is reporting fund balance and related excesses a year in advance of the annual external report. The district finds it difficult, if not impossible, to spend or plan to spend excess fund balance prior to the end of the year and not knowing what the excess will be.

See
Note 2
Page 16

Additionally, the state reports the excess fund balance as part of the allowed fund balance when it references the amount allowed by law. This presentation, for the average reader, is misleading. For example, the report states that in 2006-2007, the district retained approximately \$2.4 million or two times the amount allowed by law. It would be more appropriate and informative to state that the excess funds were \$1.3 million since \$1.1 million represents the allowed balance.

See
Note 3
Page 16

The Port Jervis City School District Administration and Board of Education is aware of the excess fund balance. A plan has been developed that takes into consideration the most recent actions of the state, i.e. mid-year aid cuts, actual and threatened cuts for 2010-2011 and 2011-2012.

The Administration and the Board are taking prudent and fiscally responsible actions to preserve the educational program and financial health of the district for the 2010-2011 school year and beyond.

For each recommendation included in the audit report, the following is our corrective action(s) taken or proposed. For recommendations, where corrective action has not been taken or proposed, we have included the following explanations:

Audit Recommendation:

1. **The Board and District officials should develop a plan to use the surplus general fund balance identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to:**

- Increasing necessary and properly authorized reserves
- Paying off debt
- Financing one-time expenses
- Reducing District property taxes

Implemented Plan of Action(s):

- Between July 1, 2008 and June 30, 2009, a referendum to approve a Capital Reserve for the purpose of building a new school was presented to the taxpayers. Excess fund balance would have fees allocated to the reserve. The referendum was defeated.
- The Capital Reserve referendum was placed on the ballot, again, in November 2009. The referendum was defeated.
- The 2010-2011 budget allocates fund balance to reduce the levy and for a one-time expense

Implemented Date:

2010-2011 School Year

Person Responsible for Implementation:

Lorelei Case, Assistant Superintendent for Business

2. **District officials should monitor the amount of the District's year-end fund balance and develop plans for addressing any accumulated fund balance that exceeds the statutory limitation.**

Implemented Plan of Action(s):

The Audit Committee and the Board of Education will consider using excess fund balance to reduce the borrowing on the February 2010 Renovation Referendum.

Implemented Date:

A resolution will be presented to the Board in June 2010.

Person Responsible for Implementation:

Lorelei Case, Assistant Superintendent for Business

3. **District officials should revoke the payroll clerk's authority to enter new employees and make changes to salaries, and delegate these functions to a trained individual outside of the payroll processing function.**

Implemented Plan of Action(s):

- Hired additional staff
- Implemented new account software with enhanced segregation abilities.

Implemented Date:

Summer 2009

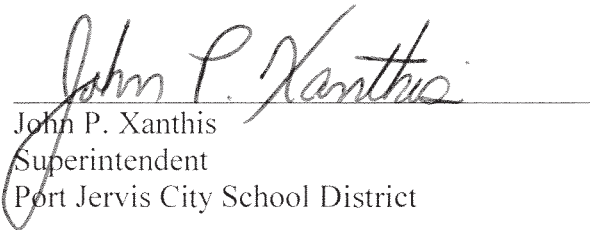
Person Responsible for Implementation:

Lorelei Case, Assistant Superintendent for Business

Sincerely,



William Onofry
President, Board of Education
Port Jervis City School District



John P. Xanthis
Superintendent
Port Jervis City School District

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

As discussed with District officials and noted in the report, the year-end fund balance in our chart does not always equal the next year's opening balance because the beginning fund balance includes prior period adjustments reported by the District on its annual update (ST-3) filing.

Note 2

The District had excess fund balance in each of the prior three years. The reported 2008-09 fund balance reflects the most current information provided by District officials during our audit and is not based on the annual external report. In addition, the calculation in the last two external audit reports was incorrect. Given the District's history of excess fund balance, District officials should better monitor the amount of year-end fund balance.

Note 3

We determined that all of the unappropriated fund balance was retained, and the statutory limit had been exceeded in each of the three years. The amounts retained and exceeding the amounts allowed by law are specifically addressed in the chart that we included in the report to clarify amounts and percentages reported.

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 on the reported objectives and scope by selecting for audit those areas most at risk. We selected fund balance and segregation of payroll duties for further audit testing.

- We reviewed current Board policies relevant to our audit objectives.
- We reviewed monthly Board meeting minutes and Board packets for the period July 2008 to August 2009.
- We calculated the annual operating surplus limitation by taking the following year's approved budget amount from the ST-3 form submitted to the State, multiplied by the appropriate rates of 2, 3 and 4 percent. We calculated the operating surplus for the general fund balance by using the unappropriated, unreserved fund balance from the submitted ST-3, deducting the amount calculated for that year's limitation to obtain the amount of excess fund balance retained.
- We calculated the excess fund balance percentage by taking the excess fund balance retained divided by the total approved budget for the following year. The fund balance as a percentage of the budget was calculated by taking the unappropriated, unreserved fund balance divided by the total approved budget for the following year.
- We interviewed key personnel to determine the duties of the payroll clerk.
- We reviewed the District's earnings reports, employment contracts, and Board minutes for the fiscal year 2008-09 to verify the accuracy of payments made to employees and to determine the validity of payroll changes made during the audit period.

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

APPENDIX D

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